Corporate Snippet

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Interim results beat expectations — China Telecom equipment

DBA Telecom (3335 HK, HK$1.19) — BUY (unchanged)

Target price: HK$2.3 (+93%)

1H FY12/06 results slight better than expected. DBA announced its interim results yesterday. Net profit came in at RMB84m (up 23.8% YoY) on a revenue growth of 22.6% to RMB311m. Revenue growth was mainly driven by the increasing shipments of smart-card vending machines, which jumped to RMB103m in 1H FY12/06 (cf. RMB63.4m in 1H FY12/05). Since smart-card vending machines carried slightly higher gross margin compared with other products, the company managed to maintain its gross margin at 41.1% in 1H FY12/06 (cf. 41.5% in 1H FY12/05). Meanwhile, operating expenses to sales ratio was kept at 9.6% (cf. 10.1% in 1H FY12/05) with effective cost controls. DBA booked around RMB3m for the IPO expenses. Effective tax rate was at 15% and is expected to remain at this level going forward. Last but not least, the company proposed to pay an interim dividend of HK$0.01 (payout of around 13%) for 1H FY12/06, which was a pleasant surprise to us. Management expects no less than 30% of profit will be paid for the full year.

Table 1: Interim results

(RMBm)	1H FY12/06	1H FY12/05	*YoY (%)*
Revenue	311	254	*22.6*
Gross profit	128	105	*21.3*
Operating profit	99	80	*23.6*
Pre-tax profit	99	80	*23.5*
Net profit	84	68	*23.8*
Gross margin (%)	*41.1*	*41.5*	
Operating margin (%)	*31.9*	*31.6*	
Net margin (%)	*26.9*	*26.6*	

Source: Company data and SBI E2-Capital

Smart-card vending machines as growth driver. Sales of smart-card vending machines (33% of revenue in 1H FY12/06) posted the greatest revenue growth during the period and reached RMB103m (up 61.9% YoY). As for the traditional products (such as public phone booths, public telephones and wireless business phones), this segment showed a steady revenue growth of 7.7% YoY to around RMB180m. For the communication transmission connection products segment (e.g. optical distribution frames and optical passive devices), the company posted a 22% YoY revenue growth to RMB28m in 1H FY12/06.

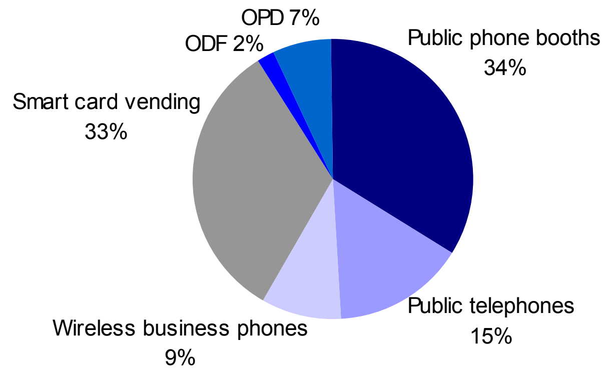
Health financial position. DBA had around RMB400m net cash on hand as at June 2006 (cf. RMB150m at the end of Dec 2005). The company paid down RMB6m bank borrowings during the period. AR days were lowered

Table 2: Financial summary

Year to Dec	Net profit RMBm	EPS HK$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
04A	110.8	0.104	49.4	11.5	6.4	12.4	NA	63.5	61.8	Cash
05A	147.0	0.138	32.6	8.7	4.7	9.1	NA	54.3	63.6	Cash
06F	175.1	0.164	19.2	7.3	1.9	6.9	4.1	32.4	37.7	Cash
07F	218.1	0.204	24.5	5.8	1.5	7.2	5.1	25.2	29.5	Cash
08F	252.6	0.236	15.8	5.0	1.3	6.7	6.0	23.8	27.9	Cash

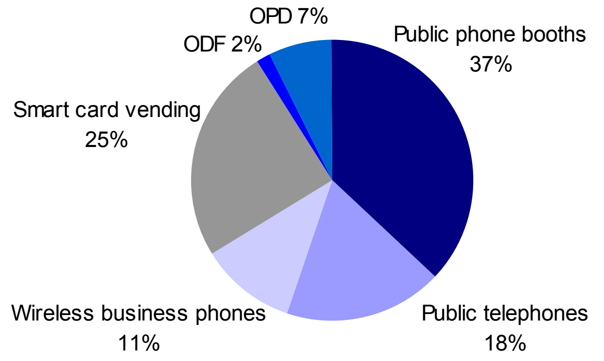
to 81 days at the end of June (cf. 84 days at the end of 2005). Meanwhile, both inventory and AP turnover were maintained at around 11 days.

Chart 1: Revenue breakdown in 1H FY12/06A



Source: Company data

Chart 2: Revenue breakdown in 1H FY12/05A



Source: Company data

On track to meeting our full-year forecast. DBA had already achieved 48% of our full-year earnings forecast of RMB175m in 1H FY12/06. Revenue split between 1H:2H is expected to be 45:55. Orders on hand have reached RMB650m for the full year of 2006 (up from RMB600m recorded in 2Q06). Management claims the progress of new plant construction is on schedule with new capacity to be ramped up in 2H FY12/06. The company is undergoing research to set up additional representative offices in major cities in China to expand its sales and marketing network. In additional, with the plan of expanding into the South East Asia market, the company is performing feasibility study in certain South East Asia countries.

Table 3: Current and new capacity

(k units)	2005	Current utilization	Total capacity by 2H07	% of new additon
Public telephone booths	75	84%	200	167%
Public telephones & wireless business telephone	125	92%	450	260%
Smart card vending machine	13	34%	79	532%
Optical distribution frame	18	75%	59	237%
Optical passive devices	483	84%	1,150	138%

Source: Company data and SBI E2-Capital

Attractive valuations. Our sum-of-the-parts and DCF valuation model suggest a fair value of HK$2.3 (an implied 11.3x FY12/07F P/E) per share. The stock currently only trades at an undemanding 7.3x FY12/06F P/E and 5.8x FY12/07F P/E. The current price weakness should offer a good entry point for value investors. We maintain our BUY rating for the counter and keep our target price of HK$2.3 unchanged, representing a 93% upside from the current share price.

Table 4: Sum-of-the-parts valuation

	EBIT contribution in 2007 (%)	Valuation method	HK$m	HK$/share
Public telephone booths	35	DCF	732.5	0.71
Public telephones	11	DCF	223.5	0.22
Wireless business telephones	14	DCF	284.3	0.27
Smart card vending machine	32	6x 2007F P/EBIT	500.6	0.48
Optical distribution frame	1	5x 2007F P/EBIT	13.4	0.01
Optical passive devices	7	5x 2007F P/EBIT	93.9	0.09
Net cash / (debt)		2007 Year-end	539.7	0.52
Total	100		**2,388**	**2.30**

Source: SBI E2-Capital

Disclosure of interests: SBI E2-Capital Securities Ltd. acted as one of the Joint Bookrunners, Joint Lead Managers and underwriters for the DBA Telecom IPO (283m shares at HK$1.26) on May 11, 2006.