Corporate Snippet

Wed, 11 Oct 2006

Kennedy Tsang, Benny Lo,CFA
(852) 2533 3713, (852)2533 3721
kennedytsang@softbank.com.hk, bennylo@softbank.com.hk

Potential in vending machine operations — China telecom equipment

DBA (3335 HK, HK$0.96) — BUY (unchanged)

Target price: HK$2.30 (+140%)

We recently conducted a operations update with DBA. The key takeaways are as follows:

Smart card vending machine operation trials to commence. DBA is in the process of deploying 200 smart card vending machines across the Fuzhou region to conduct a trial to determine the viability of operating the sales of telephone cards in China. The company has set up a new wholly-owned subsidiary for this new segment, which will come with the "2+3" preferential tax treatment. Total investment for this trial will amount to RMB12m, with each machine costing around RMB60k inclusive of working capital. Operating trials will commence during 4Q FY12/06 and will continue to the end of 1Q FY12/07. If the trials are considered successful, DBA will broaden its operating coverage to the whole of Fuzhou and then proceed to roll out this service across prominent cities in China.

Enhancing first mover advantage. In our view, the potential move into downstream operations will enhance DBA's first mover advantage in the area of smart card vending machines by further integrating itself into the telephone card distribution value chain and in the process, strengthen its market leader status in the industry. Note that management estimated that it had a 33% market share in sales of smart card vending machines at the end of FY12/05. For 1H FY12/06, sales of smart card vending machines surged 61.9% YoY to RMB102.7m, representing the largest growth across DBA's operations during the period. CCID estimated that approximately 630m smart cards were sold in China in 2005 and we believe traction in this market will provide DBA with further growth impetus going forward.

Win-win situation for both DBA and operators. We believe that the new distribution model will provide a win-win situation for both the operator and DBA. From the operator's perspective, the advantages of distributing telephone cards through DBA includes: 1) lower commissions, 2) reduced risk of "fake" card distribution, 3) provision of 24 hour access for customers and 4) enables operator to redirect capital resources to other areas. For DBA, the downstream distribution service allows it to: 1) capture untapped revenue opportunities in telephone card distribution and advertising, 2) infuse the company with another growth driver and 3) sustain gross margins.

Sensitivity analysis. We have conducted a sensitivity analysis to reflect the potential of this new business. We estimate that each vending machine can generate sales of around 450 cards per month initially, at a conservative ASP of RMB80. Assuming a distribution of 55% mobile phone cards / 45% fixed line phone cards, we project the company to yield a commission revenue equivalent to 6.5% of total card sales. After subtracting operating costs (depreciation, utilities, labour, space rental), we expect the net profit margin of this business to be around 60%. Upside potential to our sensitivity analysis will come from additional revenue from

Table 1: 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	9.3	6.4	12.4	NA	63.5	61.8	Cash
05A	147.0	0.138	32.6	7.0	4.7	9.1	NA	54.3	63.6	Cash
06F	175.1	0.164	19.2	5.9	1.9	6.9	5.1	32.4	37.7	Cash
07F	218.1	0.204	24.5	4.7	1.5	7.2	6.4	25.2	29.5	Cash
08F	252.6	0.236	15.8	4.0	1.3	6.7	7.4	23.8	27.9	Cash

advertising on the vending machines.

Reiterating BUY call, target price HK$2.30. We continue to favour DBA for its attractive valuation and sustainable growth prospects. The company's net profit of RMB83.6m and orders on hand amounting to RMB650m in 1H FY12/06 suggests that it can achieve our unchanged FY12/06F profit forecast of RMB175.1m. We maintain our target price of HK$2.30 (11.3x FY12/07F P/E), based on our sum-of-the-parts and DCF valuation model. The stock currently trades at an undemanding valuation of 5.9x FY12/06F P/E and 4.7x FY12/07F P/E.

Table 2: Vending machine operations sensitivity analysis

Year to Dec	4Q06F~1Q07F	2Q07F~4Q07F	08F
Number of vending machines (unit)	200	1,000	10,000
Average costs per machine (RMB)	45,000	45,000	45,000
Working capital per machine (RMB)	15,000	18,000	20,000
Total costs (RMB)	12,000,000	63,000,000	650,000,000
Number of cards sold per machine per month (units)	450	570	630
Revenue per machine per month (RMB)	36,000	45,600	50,400
Commission rate (%)	6.5%	6.50%	6.50%
Total revenue booked by DBA per machine (RMB)	**2,340**	**2,964**	**3,276**
Rental per machine per month (RMB)	150	150	200
Monthly electricity per machine per month (RMB)	15	15	15
Maintenance fee per machine per month (RMB)	20	10	8
Depreciation per machine per month (RMB)	536	536	536
Labour costs per machine per month (RMB)	143	68	62
Total costs per machine per month (RMB)	**863**	**778**	**820**
Profit per machine per month	1,477	2,186	2,456
Attributable profit per machine per month to DBA (after tax)	**1,477**	**2,186**	**2,456**
Net margin (%)	*63%*	*74%*	*75%*

Source: SBI E2-Capital

Table 3: 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.