

Conference call takeaways

China Telecom Equipment

DBA (3335 HK, HK\$0.93)

BUY (unchanged)

Target price: HK\$2.30 (+147%)

Management conducted a conference call to address investors after the share price plunge on 14 Nov 2006. Key takeaways are as follows:

- The lockup period for Kenwell, DBA's founding investor and second largest shareholder with 249.6m shares or 24.06% stake in the company ended on 13 Nov.
- Kenwell disposed of a block of 45m shares to an independent third party on 13 Nov, who proceeded to dump the shares on the open market on the 14 Nov.
- Subsequent to the sell-off, Chairman Yu increased his stake in the company by 5.75m shares and now holds 49.13% stake in DBA. During the conference call, management indicated that the Chairman would be careful in accumulating additional shares as it may trigger off takeover clauses.
- Management has reaffirmed that business is on track, with no changes to company fundamentals. Orders on hand increased slightly from RMB650m previously to RMB700m. Around 40% of the orders on hand is for smart card vending machines with another 45% for phone booths and telephones combined.
- In a bid to increase transparency, the company will begin to announce quarterly results commencing from FY12/07 onwards.
- Trial for the 200 smart card vending machine operations in Fuzhou is scheduled to commence in Dec 2006. The operating trial is planned for a duration of 6 months, after which the company will decide whether to deploy an additional 1,000 smart card vending machines in the Fuzhou area for a subsequent trial period of 9 months. If these trials are successful, the company plans a roll out of this service to other parts of China.
- We maintain our forecasts for the company as we see our projected FY12/06F net profit of RMB175.1m (EPS: HK\$0.164) as being achievable. Potential adjustments to our FY12/07F estimate of RMB218.1m (EPS: HK\$0.204) will be dependent on orders on hand, as well as the results of smart card vending machine operations trial.
- We maintain our target price of HK\$2.30, based on our sum-of-the-parts and DCF valuation model. On a fundamental level, the stock is attractive, trading at an undemanding valuation of 5.7x FY12/06F and 4.6x FY12/07F P/E. However, we note that the market is concerned about DBA's corporate governance after the surprising share disposal by the company's second largest shareholder. We see a substantial valuation discount factored into the current stock price. In our view, this overhang may continue to affect the stock's share price performance until the management builds up a sound track record. Going forward, our assessment of DBA's corporate governance will be a key determinant factor in our continuing coverage of

Table 1: Financial summary

Year to Dec	Net profit HK\$m	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	9.0	6.4	12.4	NA	63.5	61.8	Cash
05A	147.0	0.138	32.6	6.8	4.7	9.1	NA	54.3	63.6	Cash
06F	175.1	0.164	19.2	5.7	1.9	6.9	5.3	32.4	37.7	Cash
07F	218.1	0.204	24.5	4.6	1.5	7.2	6.6	25.2	29.5	Cash
08F	252.6	0.236	15.8	3.9	1.3	6.7	7.6	23.8	27.9	Cash

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbie2capital.com, thomsononeanalytics.com, factset.com and multex.com

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other primary businesses with the companies in this report.

Analyst certification: the views expressed in this report accurately reflects the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer: the information and opinions in this report were prepared by SBI E2-Capital Securities Limited. SBI E2-Capital Securities Limited does not undertake to advise you of changes in its opinion or information. SBI E2-Capital Securities Limited and others associated with it may have positions in and effect transactions in securities of companies mentioned and may also perform or seek to perform investment banking services for those companies. This memorandum is based on information available to the public. No representation is made that it is accurate or complete. This memorandum is not an offer to buy or sell the securities mentioned.

the company.

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.