

Good interim results expected

China Telecom Equipment

DBA Telecom (3335 HK, HK\$1.34)

BUY (unchanged)

Target price: HK\$2.3 (+72%)

1H FY12/06 results preview. DBA is due to announce its results on August 15. We estimate net profit to be around HK\$82m (up 21% YoY). Revenue is expected to increase 20% YoY to HK\$305m on the back of increasing shipments of smart-card vending machines. We expect smart-card vending machine to have contributed around 34% of revenue for 1H FY12/06 (cf. 25% in 1H FY12/05). Gross margin is expected to be quite stable at 41% in 1H FY12/06. Meanwhile, operating expenses to sales ratio is likely to remain steady at around 10%. The company may not pay any interim dividend for 1H FY12/06 due to the brief listing period in 1H06, but we expect no less than 30% of profit will be paid as final dividend.

Table 1: Interim results preview

(RMB m)	1H FY12/06F	1H FY12/05	YoY (%)
Revenue	305	254	20.2
Gross profit	125	105	18.6
Operating profit	97	80	20.9
Pre-tax profit	97	80	21.0
Net profit	82	68	21.4
Gross margin (%)	41.0	41.5	
Operating margin (%)	31.8	31.6	
Net margin (%)	26.9	26.6	

Source: Company data and SBI E2-Capital

Smart-card vending machines lead the pack. We expect smart-card vending machine (an estimated 34% of revenue in 1H FY12/06) to post the greatest revenue growth during the period. We believe this business segment to show 59% YoY and 23% HoH growth to around RMB100m in 1H FY12/06. As for the traditional products (such as public phone booths, public telephones and wireless business phones), we expect to show a steady revenue growth of 7% YoY to around RMB180m. For the communication transmission connection products segment (e.g. optical distribution frames and optical passive devices), we expect to post over a 20% revenue growth to RMB25m in 1H FY12/06.

Table 2: Financial summary

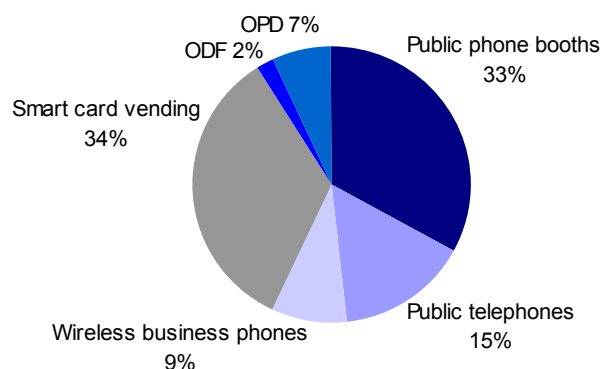
Year to Dec	Net profit RMBm	EPS HK\$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
04A	110.8	0.104	49.4	12.9	6.4	12.4	NA	63.5	61.8	Cash
05A	147.0	0.138	32.6	9.7	4.7	9.1	NA	54.3	63.6	Cash
06F	175.1	0.164	19.2	8.2	1.9	6.9	3.7	32.4	37.7	Cash
07F	218.1	0.204	24.5	6.6	1.5	7.2	4.6	25.2	29.5	Cash
08F	252.6	0.236	15.8	5.7	1.3	6.7	5.3	23.8	27.9	Cash

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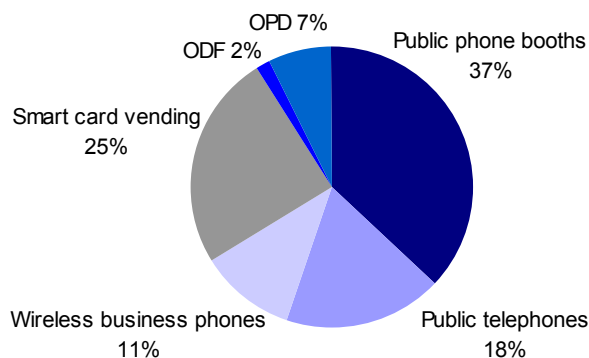
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Chart 1: Revenue breakdown in 1H FY12/06F

Source: SBI E2-Capital

Chart 2: Revenue breakdown in 1H FY12/05

Source: Company data

On track to meeting our full-year forecast. Based on our estimate, DBA will achieve 47% 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.

Attractive valuation. Our sum-of-the-parts and DCF valuation model suggest a fair value of HK\$2.3 per share. The stock currently only trades at an undemanding 8.2x FY12/06F P/E and 6.6x FY12/07F P/E. As a result, we maintain our BUY rating for the counter and keep our target price of HK\$2.3 (unchanged), representing a 72% upside from the current share price.

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.