CHINA MOBILE
LIMITED (00941.HK)

中国移动通信
CHINA MOBILE

Global Investment Research Challenge 2008

BUY with Target Price HK$136.6

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Overview of China Telecom Industry

- China Population: 1.3 billion
- Mobile Penetration: 41.6%
- Rural Penetration: 19%
- Market Share:
  - China Mobile: 69%
  - China Unicom: 29%
Elephant Runs Faster than Expected

1. EBITDA margin remains high
   - Rural Opportunity
   - The increase of VAS usage
2. Market is overly pessimistic about the industry restructuring
3. 3G has minimal impact
Rural Opportunity
Rural Opportunity

- Rising affordability
- Lower Sales and Administrative Expenses
- Stable EBITDA Margin

Source: National Bureau of Statistics of China
Nong Xin Tong

- Agricultural information service
- Accurate information
- Current Users: 26.4 Million (up 48.3%)
- Rural Population: 737 Million
- Increase in productivity of users
The increase of VAS usage
The increase of VAS (Data Service) usage

Value-added Service Revenue

- SMS, Color Ring, WAP, MMS, Instant Message, Web
- High profit margin of value-added services
- Tailor-made Services:
  - Campus Information System
  - Financial Information Express
  - Trade & Business Express etc.

Source: Company data and HKBU Research Team
Estimated Growth of VAS

- SK Telecom: 31%
- 2011: 33%
- Verizon: 21%

Value-added Service Revenue to Total Revenue

Source: Company data and HKBU Research Team
Future Uncertainties

Restructuring &

3G Licensing
Restructuring – Purpose

- **Current Situation**
  - Mobile and fixed line are operated by different operators

- **Future**
  - Quadruple players
    - Mobile, Fixed line, Broadband, IPTV (integrated service)
  - Not to reduce the competitive advantage of China Mobile
Restructuring – 2008 rumor plan

Our valuation is based on this situation:

- **China Mobile + TieTong**
  - GSM + TD-SCDMA
  - + Fixed Line

- **China Unicom + China Netcom**
  - GSM + WCDMA
  - + Fixed Line

- **China Telecom**
  - CDMA + CDMA 2000
  - + Fixed Line

*It creates weak competition because:*

1. China Mobile has a very strong backbone
2. Competitors require time to coordinate the internal operation
Restructuring – Worst Case Scenario

China Mobile
GSM + TD-SCDMA

China Unicom + China Netcom + China Telecom
Fixed line (South) + Fixed line (North) + GSM + CDMA + WCDMA

The combined company is unlikely to threaten China Mobile because:

1. Proactive approaches (e.g. CAPEX, Rural market)
2. China Mobile’s EBITDA was larger than the sum of rivals’ EBITDA in 2007
3. Competitors are in a weaker capital position
The Worst Case

- First mover advantages
- Difficult to compete with China Mobile
- Estimated Price = $110.9

Source: Company data

![Graph showing Worst Case Comparison](source: Company data)
License will most likely be granted to China Mobile because:

- Parent company is the major operator of TD-SCDMA’s trial.

- China Mobile is the sole mobile telecommunication service partner for Beijing Olympics as Chinese Government promised to offer 3G.
Limited Downside Risk of 3G

- China Mobile will most likely lease the 3G network from its parent company

- The 3G business will not be injected into China Mobile until it is profitable
Valuation
1. Discounted Cash Flow Valuation

Why DCF?
- Cash Cow
- Higher visibility of future free cash flows

-> Conservative Estimates <-

Key Forecasts for 2008-2011
- Impact of Industry Restructuring

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2011</th>
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<tbody>
<tr>
<td>Market Share</td>
<td>71%</td>
<td>68%</td>
</tr>
<tr>
<td>ARPU (RMB)</td>
<td>88</td>
<td>83</td>
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</table>

DCF Model Assumptions
- Uncertain outlook of global economy
- Higher risk aversion

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<thead>
<tr>
<th></th>
<th>Normal</th>
<th>Conservative</th>
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<tbody>
<tr>
<td>MRP</td>
<td>6.6%</td>
<td>7.6%</td>
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<tr>
<td>WACC</td>
<td>11.3%</td>
<td>12.4%</td>
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</tbody>
</table>

(Average revenue per user)

(Weighted Average Cost of Capital)

中国移动通信
CHINA MOBILE
1. Discounted Cash Flow Valuation

-> One Year Forward DCF <-

Target Price: HK$136.6
Implied FY08 PER: 21.4 x
Implied FY08 PBR: 6.8 x

Current price HK$112.5 (25 Mar 2008)
Up→ Upside 21.4%
Down↓ Downside 1.5%

Sensitivity Analysis:

<table>
<thead>
<tr>
<th>Terminal Growth Rate</th>
<th>WACC 10%</th>
<th>WACC 11%</th>
<th>WACC 12%</th>
<th>WACC 13%</th>
<th>WACC 14%</th>
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</thead>
<tbody>
<tr>
<td>2.0%</td>
<td>173.1</td>
<td>152.8</td>
<td>136.7</td>
<td>123.6</td>
<td>112.8</td>
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<tr>
<td>2.5%</td>
<td>178.5</td>
<td>156.5</td>
<td>139.4</td>
<td>125.6</td>
<td>114.4</td>
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<tr>
<td>3.0%</td>
<td>184.5</td>
<td>160.8</td>
<td>142.4</td>
<td>127.8</td>
<td>116.0</td>
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<tr>
<td>3.5%</td>
<td>191.6</td>
<td>165.5</td>
<td>145.8</td>
<td>130.3</td>
<td>117.8</td>
</tr>
<tr>
<td>4.0%</td>
<td>199.8</td>
<td>171.0</td>
<td>149.6</td>
<td>133.0</td>
<td>119.9</td>
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2. P/E & EV/EBITDA Valuation

In the past few years
- Traded at a **premium** in terms of P/E & EV/EBITDA

Current
- Trading at a **discount** in terms of P/E & EV/EBITDA

<table>
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<tr>
<th>Discount of China mobile to industry average from 2008 to 2010</th>
</tr>
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<tbody>
<tr>
<td></td>
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<tr>
<td>------------------</td>
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<tr>
<td>Average</td>
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<tr>
<td>Average ex-CM</td>
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- Consolidate our BUY recommendation
Quality Stock in Turbulent Times

- Solid Balance Sheet
- Cash Holding = $10/share
- Minimal impact from subprime crisis
- Steady RMB appreciation
Conclusion

- Conservative assumptions in our model
- Attractive valuation
- Recommendation: BUY
Thank you