

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 Mobile

GSM

China Unicom

GSM+CDMA

China Telecom

Fixed Line

China Netcom

Fixed Line

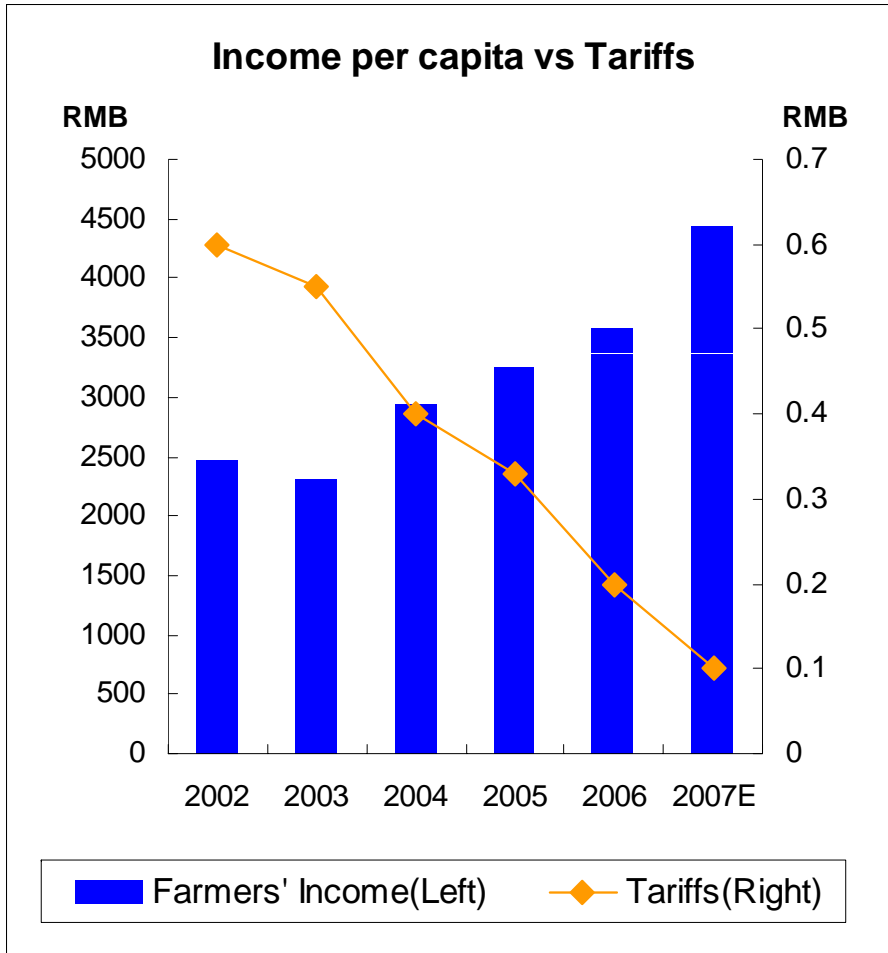
- China Population: 1.3 billion
- Mobile Penetration: 41.6%
- Rural Penetration: 19%
- Market Share:
 - China Mobile: 69%
 - China Unicom: 29%

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

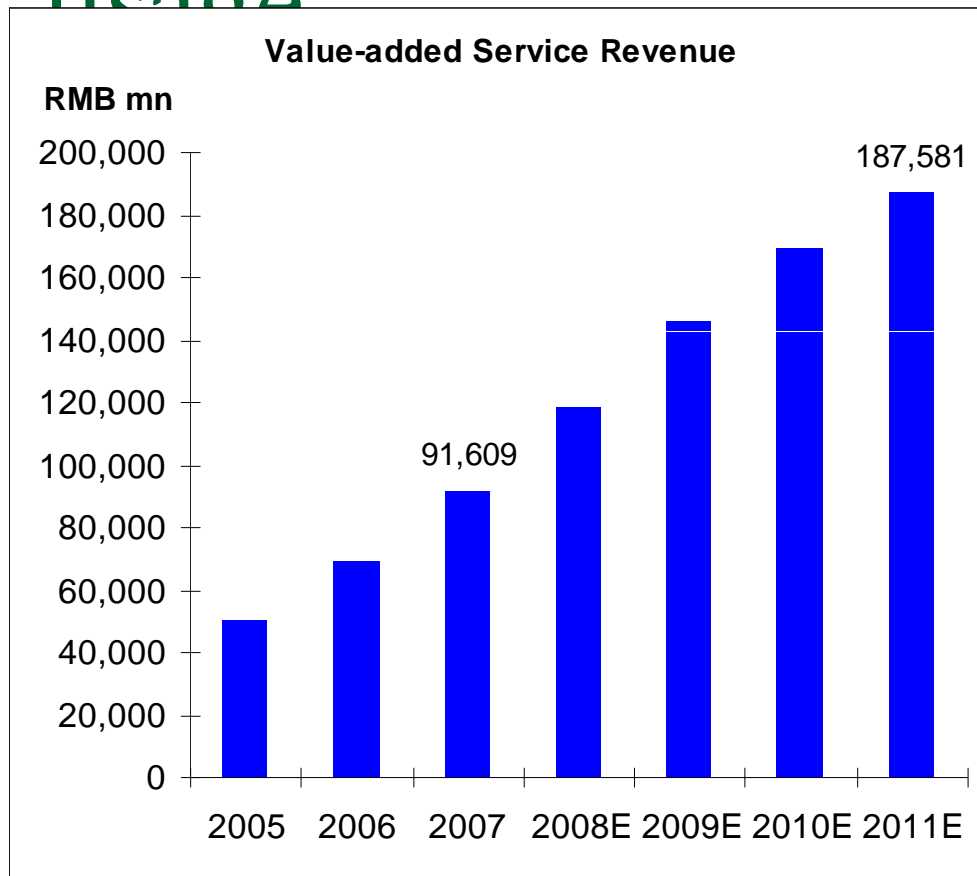
Nong Xin Tong

- 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

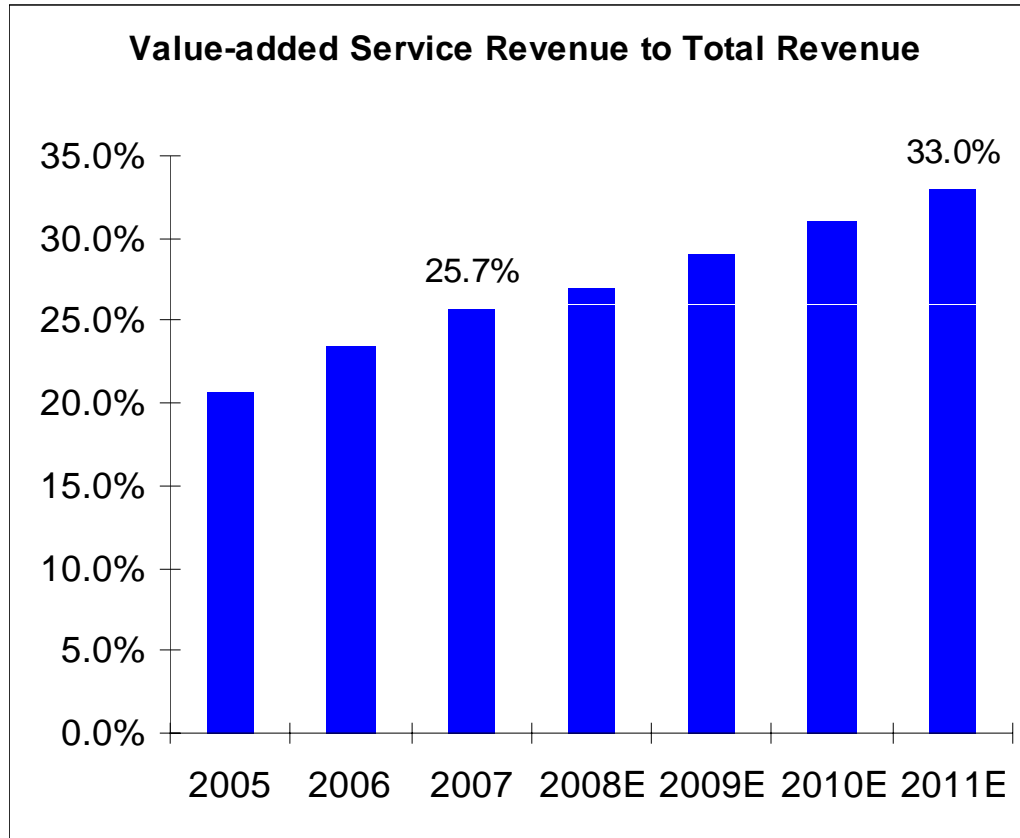
The increase of VAS (Data Service)



Source: Company data and HKBU Research Team

- 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.

Estimated Growth of VAS



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

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:



*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

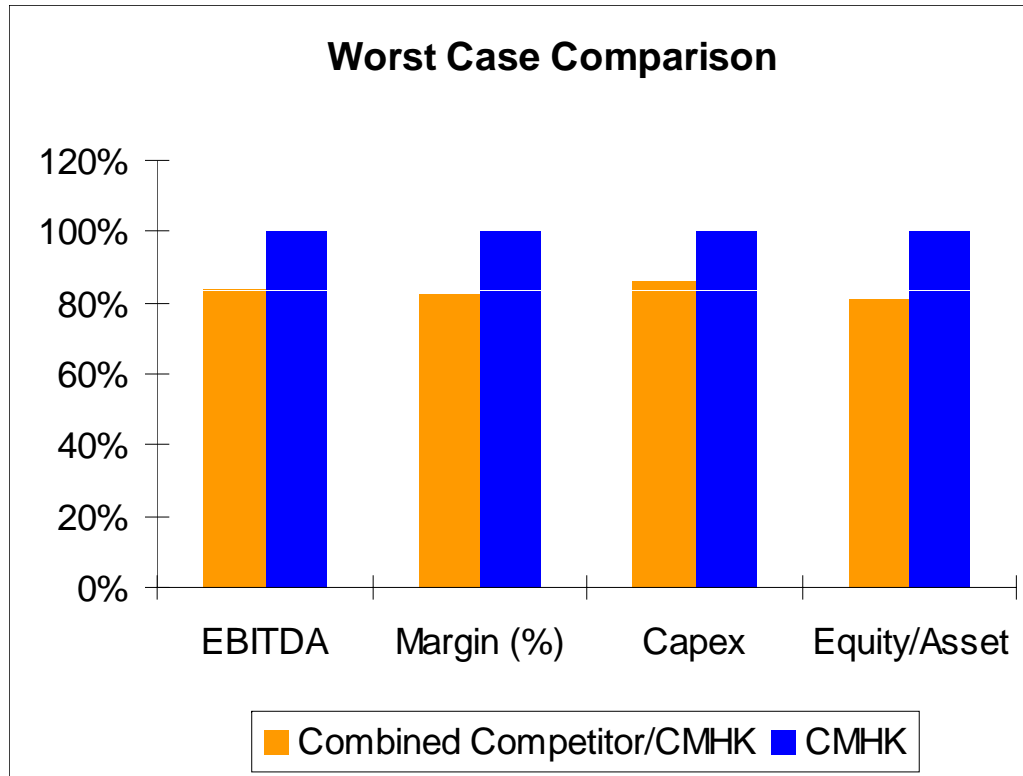
China Mobile
GSM + TD-SCDMA

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



Source: Company data

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

3G Licensing – TD-SCDMA

- 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

	2008		2011	
Market Share	71%	→	68%	↓
ARPU (RMB)	88	→	83	↓
<small>(Average revenue per user)</small>				

DCF Model Assumptions

- Uncertain outlook of global economy
- Higher risk aversion

	Normal		Conservative	
MRP	6.6%	→	7.6%	↑
WACC	11.3%	→	12.4%	↑
<small>(Market Risk Premium)</small>				
<small>(Weighted Average Cost of Capital)</small>				

1. Discounted Cash Flow Valuation

-> **One Year Forward DCF** <-

Target Price: **HK\$136.6**

Current price HK\$112.5 (25 Mar 2008)

Implied FY08 PER: 21.4 x

↑ Upside 21.4%

Implied FY08 PBR: 6.8 x

↓ Downside 1.5%

Sensitivity Analysis:

		WACC				
		10%	11%	12%	13%	14%
Terminal Growth Rate	2.0%	173.1	152.8	136.7	123.6	112.8
	2.5%	178.5	156.5	139.4	125.6	114.4
	3.0%	184.5	160.8	142.4	127.8	116.0
	3.5%	191.6	165.5	145.8	130.3	117.8
	4.0%	199.8	171.0	149.6	133.0	119.9

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

Discount of China mobile to industry average from 2008 to 2010								
	P/E			PE/CAGR	EV/EBITDA			EV/EBITDA/CAGR
	2008	2009	2010	2008-2010	2008	2009	2010	2008-2010
Average	3%	2%	-1%	9%	4%	2%	-1%	16%
Average ex-CM	7%	4%	-3%	21%	10%	5%	-3%	34%

- 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