

## China Mobile

941 HK

Target (HKD): 113.50 → 130.00

Upside: 29.9%

19 Mar price (HKD): 100.10

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell

# 4G leadership remains key

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- 4Q14 results were mixed
- Capex appears to have peaked
- Reaffirm Buy (1) rating and raise target price to HKD130

#### ■ What's new

China Mobile's 4Q14 results were mixed: while net profit was slightly ahead of our forecast (by 1.6%) due to higher-than-expected interest income, service revenue fell well short of our expectation (by 7.3%).

#### ■ What's the impact

The sharp 16% YoY fall in 4Q14 average revenue per user (ARPU) was perhaps the key surprise. While the trend was similar that of its rivals, China Mobile reported the steepest decline. As a result, the company saw its mobile revenue market share erode by 0.7pp QoQ.

On closer inspection, it appears to us that tariff discounts, and not competitive pressures, may have been the key driver of the ARPU decline. For example, voice and SMS usage levels had remained at relatively steady levels in the past three quarters, suggesting there was no accelerated shift to over-the-top or alternative technology platforms. Further, we think competitive pressures within the industry were broadly stable during the quarter, as

evidenced by the industry-wide reduction in marketing expenses in 4Q14 and also by the stable churn rates seen at China Mobile (2014: 3.13%; 2013: 3.15%).

A key question, however, remains to what extent ARPU will recover in 2015-16. Clearly, while tariff discounts have been larger than what we had been expecting, this should be mitigated to a large extent by the company's announcement that it intends to cut selling and subsidy costs by 20% YoY in 2015.

In addition, consistent with its peers, China Mobile also said that the ARPU of 4G users (2014: CNY104) is much higher than its blended ARPU (2014: CNY61). As we expect 4G penetration levels to rise sharply in coming years (2014: 11%; 2015E: 32%; 2017E: 64%), and because value-added-taxes charged for data services (11% rate) are lesser than voice (6% rate), we continue to think that ARPUs should begin recovering YoY, starting from 2H15.

The results also confirm that capital expenditure (2015E: CNY199.7bn; 2014: CNY213.5bn) appear to have peaked. Further, statistics for Feb-15 – China Mobile added 85% of market net additions in 3G/4G – suggest that the company's leadership position in 4G continues to strengthen, which we regard as a re-rating catalyst.

For 2015-16, we are cutting our forecasts for mobile ARPU (by 4.8-5.3%) and also marketing and subsidy expenses (by 25% each). In aggregate, we are making minor (0.2-1.1%) changes to EPS forecasts.

#### ■ What we recommend

Driven by our EPS forecast changes, slightly lower-than-forecasted 2014

net debt and after incorporating a lower discount rate (9.5% versus 10.25% previously, driven by a 1pp decrease in 10-year bond yields over the past year), we raise our DCF-based 12-month target price to HKD130 (previously HKD113.50). We reiterate our Buy (1) rating. An increase in competition is a key risk.

#### ■ How we differ

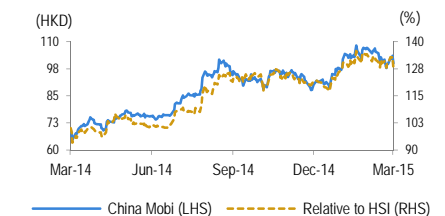
Unlike some in the market, we view China Mobile as a key beneficiary of the move to 4G services as the transition will likely stem the erosion in its revenue market share.

#### Forecast revisions (%)

Year to 31 Dec	15E	16E	17E
Revenue change	(3.0)	(2.4)	n.a.
Net-profit change	1.3	0.1	n.a.
Core EPS (FD) change	1.0	(0.2)	n.a.

Source: Daiwa forecasts

#### Share price performance



12-month range	64.50-108.30
Market cap (USDbn)	259.36
3m avg daily turnover (USDm)	227.39
Shares outstanding (m)	20,101
Major shareholder	CM Comm Corp (CMCC) (74.1%)

#### Financial summary (CNY)

Year to 31 Dec	15E	16E	17E
Revenue (m)	657,809	704,190	745,675
Operating profit (m)	122,585	133,051	147,330
Net profit (m)	112,712	122,367	135,885
Core EPS (fully-diluted)	5.523	5.996	6.658
EPS change (%)	1.6	8.6	11.0
Daiwa vs Cons. EPS (%)	0.2	3.3	7.7
PER (x)	14.6	13.4	12.1
Dividend yield (%)	3.0	3.2	3.6
DPS	2.384	2.588	2.874
PBR (x)	1.8	1.6	1.5
EV/EBITDA (x)	4.9	4.3	3.6
ROE (%)	12.7	12.8	13.1

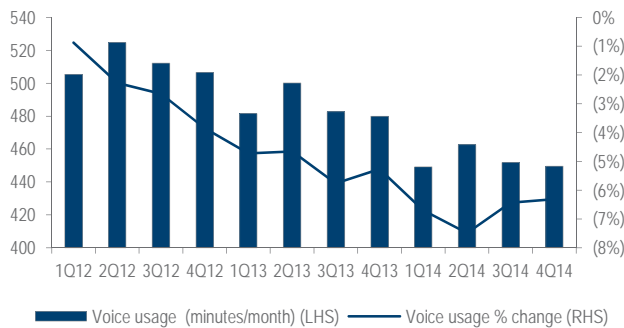
Source: FactSet, Daiwa forecasts

■ **China Mobile: 4Q14 results summary**

CNY billion	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	% YoY	4Q14E	Var (%)
Service revenue	134.7	150.0	150.6	155.6	144.0	153.9	146.1	137.8	(11.4)	148.6	(7.3)
Revenue	143.6	159.5	159.9	167.2	154.8	169.9	156.6	160.2	(4.2)	159.9	0.2
EBITDA	61.2	62.5	62.0	54.8	57.6	60.7	58.1	58.9	7.6	59.7	(1.2)
Service EBITDA margin	45.4%	41.7%	41.2%	35.2%	40.0%	39.4%	39.7%	42.8%	7.6p.p	40.1%	
Net profit	27.9	35.2	28.4	30.2	25.2	32.5	24.9	26.7	(11.7)	26.3	1.6
<b>Key operating data</b>											
Adjusted Blended ARPU	62.5	68.2	67.1	68.1	62.0	65.3	61.3	57.2	(16.0)	61.7	(7.3)
Mobile customer additions (m)	16.0	13.8	15.0	12.0	13.9	9.5	8.5	7.5	(37.5)	7.1	5.1
Proportion of 3G/4G customers	15.7%	18.6%	22.4%	25.0%	29.2%	31.9%	35.7%	41.6%		40.9%	

Source: Company, Daiwa forecasts

■ **China Mobile: voice usage trends**



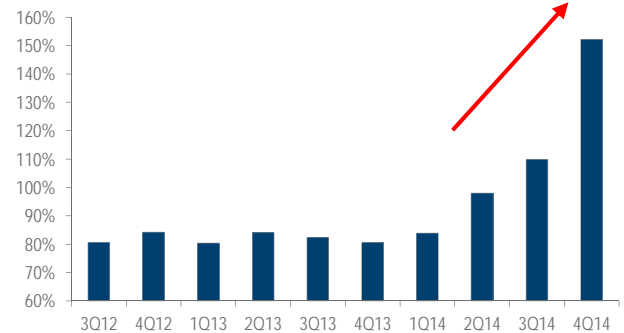
Source: Company

■ **China Mobile: Key changes to forecasts**

%	2015	2016
Service revenue	(5.2)	(4.7)
EBITDA	(1.6)	(2.1)
Service EBITDA margin	1.5 p.p	1.1 p.p
Net profit	1.3	0.1
<b>Change in assumptions (%)</b>		
Subscribers	0.1	0.1
Blended ARPU	(5.3)	(4.8)
Capex	(0.2)	0.0

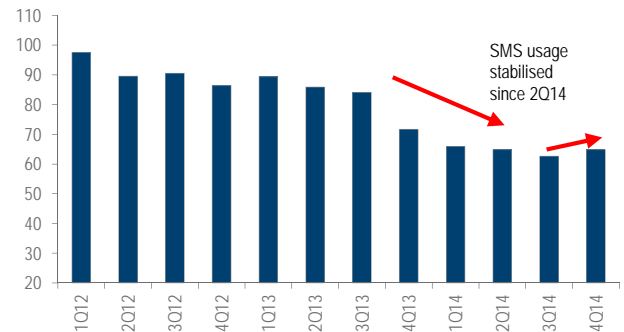
Source: Daiwa forecasts

■ **China Mobile: data traffic per subscriber YoY growth trends**



Source: Company

■ **China Mobile: SMS Usage per subscriber trends**



Source: Company

**Financial summary**
**■ Key assumptions**

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Subscribers 'million	584.0	649.6	710.3	767.2	806.6	844.9	883.1	921.4
2G Subscribers	563.3	598.4	622.4	575.6	470.8	352.3	264.3	176.3
3G Subscribers	20.7	51.2	87.9	191.6	245.8	219.0	180.7	154.0
Blended Average revenue per user per month (CNY)	73.1	71.3	68.7	66.6	61.6	59.8	61.0	61.9

**■ Profit and loss (CNYm)**

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Mobile Service	485,231	527,999	560,413	590,811	581,817	592,215	632,037	669,914
Mobile non service	0	0	0	39,366	59,631	65,594	72,154	75,761
Other Revenue	0	0	0	0	0	0	0	0
<b>Total Revenue</b>	<b>485,231</b>	<b>527,999</b>	<b>560,413</b>	<b>630,177</b>	<b>641,448</b>	<b>657,809</b>	<b>704,190</b>	<b>745,675</b>
Other income	0	0	0	0	0	0	0	0
COGS	0	0	0	0	0	0	0	0
SG&A	(248,247)	(279,587)	(309,043)	(389,829)	(407,889)	(411,204)	(434,567)	(453,483)
Other op.expenses	(83,832)	(94,500)	(98,572)	(104,621)	(114,525)	(124,020)	(136,572)	(144,862)
<b>Operating profit</b>	<b>153,152</b>	<b>153,912</b>	<b>152,798</b>	<b>135,727</b>	<b>119,034</b>	<b>122,585</b>	<b>133,051</b>	<b>147,330</b>
Net-interest inc./(exp.)	4,756	7,848	12,271	14,958	15,921	15,689	16,503	19,434
Assoc/forex/extraord./others	1,225	4,876	6,299	7,972	9,337	10,196	11,621	12,198
<b>Pre-tax profit</b>	<b>159,133</b>	<b>166,636</b>	<b>171,368</b>	<b>158,657</b>	<b>144,292</b>	<b>148,471</b>	<b>161,175</b>	<b>178,962</b>
Tax	(39,047)	(40,603)	(41,919)	(36,776)	(33,187)	(35,633)	(38,682)	(42,951)
Min. int./pref. div./others	(384)	(109)	(107)	(111)	(126)	(126)	(126)	(126)
<b>Net profit (reported)</b>	<b>119,702</b>	<b>125,924</b>	<b>129,342</b>	<b>121,770</b>	<b>110,979</b>	<b>112,712</b>	<b>122,367</b>	<b>135,885</b>
<b>Net profit (adjusted)</b>	<b>119,702</b>	<b>125,924</b>	<b>129,342</b>	<b>121,770</b>	<b>110,979</b>	<b>112,712</b>	<b>122,367</b>	<b>135,885</b>
EPS (reported)(CNY)	5.966	6.275	6.438	6.058	5.469	5.554	6.030	6.696
EPS (adjusted)(CNY)	5.966	6.275	6.438	6.058	5.469	5.554	6.030	6.696
EPS (adjusted fully-diluted)(CNY)	5.890	6.198	6.359	5.986	5.438	5.523	5.996	6.658
DPS (CNY)	2.595	2.730	2.773	2.621	2.311	2.384	2.588	2.874
EBIT	153,152	153,912	152,798	135,727	119,034	122,585	133,051	147,330
EBITDA	239,382	251,025	253,646	240,426	235,259	246,606	269,623	292,192

**■ Cash flow (CNYm)**

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Profit before tax	159,133	166,636	171,368	158,657	144,292	148,471	161,175	178,962
Depreciation and amortisation	86,230	97,113	100,848	104,699	116,225	124,020	136,572	144,862
Tax paid	(38,868)	(40,078)	(44,583)	(43,222)	(33,187)	(35,633)	(38,682)	(42,951)
Change in working capital	23,056	5,426	13,077	19,204	57,645	9,177	14,610	13,068
Other operational CF items	1,828	(2,341)	(10,001)	(14,353)	(89,874)	(25,885)	(28,124)	(31,631)
<b>Cash flow from operations</b>	<b>231,379</b>	<b>226,756</b>	<b>230,709</b>	<b>224,985</b>	<b>195,101</b>	<b>220,150</b>	<b>245,551</b>	<b>262,309</b>
Capex	(113,365)	(123,416)	(123,406)	(139,352)	(213,500)	(199,700)	(160,000)	(130,000)
Net (acquisitions)/disposals	(39,637)	123	6	44	0	0	0	0
Other investing CF items	(23,158)	(53,656)	(77,235)	(44,559)	0	0	0	0
<b>Cash flow from investing</b>	<b>(176,160)</b>	<b>(176,949)</b>	<b>(200,635)</b>	<b>(183,867)</b>	<b>(213,500)</b>	<b>(199,700)</b>	<b>(160,000)</b>	<b>(130,000)</b>
Change in debt	0	(5,330)	0	(23,633)	3	0	0	0
Net share issues/(repurchases)	93	136	531	43	0	0	0	0
Dividends paid	(50,201)	(52,575)	(55,425)	(55,491)	(50,524)	(47,170)	(48,645)	(52,813)
Other financing CF items	3,645	6,942	9,456	12,042	15,921	15,689	16,503	19,434
<b>Cash flow from financing</b>	<b>(46,463)</b>	<b>(50,827)</b>	<b>(45,438)</b>	<b>(67,039)</b>	<b>(34,600)</b>	<b>(31,481)</b>	<b>(32,142)</b>	<b>(33,379)</b>
Forex effect/others	19,083	41,652	85,289	42,926	51,953	0	0	0
<b>Change in cash</b>	<b>27,839</b>	<b>40,632</b>	<b>69,925</b>	<b>17,005</b>	<b>(1,046)</b>	<b>(11,031)</b>	<b>53,409</b>	<b>98,930</b>
Free cash flow	118,014	103,340	107,303	85,633	(18,399)	20,450	85,551	132,309

Source: FactSet, Daiwa forecasts

*Financial summary continued ...*

■ **Balance sheet (CNYm)**

As at 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Cash & short-term investment	292,346	332,978	402,903	419,908	418,862	407,831	461,239	560,169
Inventory	4,249	7,944	7,195	9,152	9,130	6,578	7,042	7,457
Accounts receivable	15,001	28,818	20,429	25,650	30,850	30,955	32,115	33,152
Other current assets	10,286	12,945	16,066	12,479	18,741	19,704	20,667	21,630
<b>Total current assets</b>	<b>321,882</b>	<b>382,685</b>	<b>446,593</b>	<b>467,189</b>	<b>477,583</b>	<b>465,068</b>	<b>521,063</b>	<b>622,408</b>
Fixed assets	440,164	464,400	486,016	564,227	658,136	734,582	758,010	743,148
Goodwill & intangibles	37,707	37,712	37,818	37,957	36,066	35,300	35,300	35,300
Other non-current assets	62,182	67,761	81,682	98,019	124,664	133,771	144,303	155,412
<b>Total assets</b>	<b>861,935</b>	<b>952,558</b>	<b>1,052,109</b>	<b>1,167,392</b>	<b>1,296,449</b>	<b>1,368,721</b>	<b>1,458,676</b>	<b>1,556,268</b>
Short-term debt	5,049	68	68	68	68	68	68	68
Accounts payable	197,914	210,562	228,884	300,350	363,173	369,903	386,137	400,656
Other current liabilities	52,667	62,614	68,844	70,495	68,635	68,635	68,635	68,635
<b>Total current liabilities</b>	<b>255,630</b>	<b>273,244</b>	<b>297,796</b>	<b>370,913</b>	<b>431,876</b>	<b>438,606</b>	<b>454,840</b>	<b>469,359</b>
Long-term debt	28,615	28,617	28,619	4,989	4,992	4,992	4,992	4,992
Other non-current liabilities	287	278	385	766	938	938	938	938
<b>Total liabilities</b>	<b>284,532</b>	<b>302,139</b>	<b>326,800</b>	<b>376,668</b>	<b>437,806</b>	<b>444,536</b>	<b>460,770</b>	<b>475,289</b>
Share capital	2,139	2,140	2,142	2,142	400,737	400,737	400,737	400,737
Reserves/R.E./others	574,018	646,924	721,305	786,631	455,839	521,381	595,102	678,175
<b>Shareholders' equity</b>	<b>576,157</b>	<b>649,064</b>	<b>723,447</b>	<b>788,773</b>	<b>856,576</b>	<b>922,118</b>	<b>995,839</b>	<b>1,078,912</b>
Minority interests	1,246	1,355	1,862	1,951	2,067	2,067	2,067	2,067
<b>Total equity &amp; liabilities</b>	<b>861,935</b>	<b>952,558</b>	<b>1,052,109</b>	<b>1,167,392</b>	<b>1,296,449</b>	<b>1,368,721</b>	<b>1,458,676</b>	<b>1,556,268</b>
EV	1,358,213	1,312,711	1,243,295	1,202,749	1,203,914	1,214,945	1,161,536	1,062,606
Net debt/(cash)	(258,682)	(304,293)	(374,216)	(414,851)	(413,802)	(402,771)	(456,179)	(555,109)
BVPS (CNY)	28.714	32.337	35.992	39.240	42.613	45.874	49.541	53.674

■ **Key ratios (%)**

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales (YoY)	7.3	8.8	6.1	12.4	1.8	2.6	7.1	5.9
EBITDA (YoY)	4.5	4.9	1.0	(5.2)	(2.1)	4.8	9.3	8.4
Operating profit (YoY)	2.9	0.5	(0.7)	(11.2)	(12.3)	3.0	8.5	10.7
Net profit (YoY)	3.9	5.2	2.7	(5.9)	(8.9)	1.6	8.6	11.0
Core EPS (fully-diluted) (YoY)	3.8	5.2	2.6	(5.9)	(9.2)	1.6	8.6	11.0
Gross-profit margin	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
EBITDA margin	49.3	47.5	45.3	38.2	36.7	37.5	38.3	39.2
Operating-profit margin	31.6	29.2	27.3	21.5	18.6	18.6	18.9	19.8
Net profit margin	24.7	23.8	23.1	19.3	17.3	17.1	17.4	18.2
ROAE	22.1	20.6	18.8	16.1	13.5	12.7	12.8	13.1
ROAA	14.8	13.9	12.9	11.0	9.0	8.5	8.7	9.0
ROCE	26.6	23.9	21.3	17.5	14.3	13.7	13.8	14.1
ROIC	38.8	35.0	33.1	28.7	22.3	19.3	19.0	21.0
Net debt to equity	net cash	net cash	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	24.5	24.4	24.5	23.2	23.0	24.0	24.0	24.0
Accounts receivable (days)	9.4	15.1	16.0	13.3	16.1	17.1	16.3	16.0
Current ratio (x)	1.3	1.4	1.5	1.3	1.1	1.1	1.1	1.3
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	43.5	43.5	43.1	43.3	42.3	42.9	42.9	42.9
Free cash flow yield	7.3	6.4	6.6	5.3	n.a.	1.3	5.3	8.2

Source: FactSet, Daiwa forecasts

■ **Company profile**

China Mobile is a leading mobile services provider with operations in Mainland China and Hong Kong. In China, it provides cellular services based on the 2G GSM, 3G TD-SCDMA and 4G TD-LTE technology platforms, and the company has the distinction of possessing the world's largest customer base. At the end of 2013, it had 767m customers. The stock was listed on the New York Stock Exchange and The Stock Exchange of Hong Kong on 22 October 1997 and 23 October 1997, respectively.

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