

China Mobile (941 HK)

Underweight

Target price (HKD)	80.00
Share price (HKD)	100.10
Potential return (%)	-20.1

Note: Potential return equals the percentage difference between the current share price and the target price

Dec	2014 a	2015 e	2016 e
HSBC EPS	5.44	5.23	5.21
HSBC PE	14.8	15.4	15.4
Performance	1M	3M	12M
Absolute (%)	-6.4	10.9	44.0
Relative ^A (%)	-5.7	5.5	12.5

Note: (V) = volatile (please see disclosure appendix)

19 March 2015

Neale Anderson*

Analyst

The Hong Kong & Shanghai Banking Corporation Limited

+852 2996 6716

neale.anderson@hsbc.com.hk

Jia Wen*

Associate

The Hong Kong & Shanghai Banking Corporation Limited

+852 2822 4686

Jia.wen@hsbc.com.hk

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Issuer of report: The Hong Kong & Shanghai Banking Corporation Limited

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UW: focus is on 4G users, not profits

- **4Q14 sales and EBITDA missed on heavy discounting of data: this is expected to continue in 2015, limiting 4G upside**
- **No clarity on benefits from 4G or tower sharing, CM seeks 'slightly better' sales growth in 2015e than the 1.8% recorded in 2014**
- **UW: DCF-derived HKD80 target price unchanged**

4Q14 results missed consensus slightly, on higher 4G discounting. 4Q14 sales missed consensus estimates by 2%, while EBITDA missed by 5%, due to the discounting of mobile data. Net income was 1% ahead of consensus estimates on higher contribution from associates. In 2014 total revenues grew 1.8%, service revenues declined 1.5%, EBITDA declined by 2.1%, and net income declined by 10.2%.

4G and tower sharing benefits uncertain; costs likely to continue to grow.

Management expects revenue growth to be slightly better in 2015, but indicated that its priority is to move as many customers as possible to 4G, rather than use 4G to focus on high-spending users and boost revenue. The company offered no clarity on tower sharing developments or timing. On the cost side, while the company plans to cut a further RMB20bn from the sales and marketing budget (from RMB23.5bn in 2014), this will likely be offset by higher growth in network costs and depreciation.

Trim estimates, offset by lower capex than previously forecast: DCF derived target price unchanged. We trim our 2015e and 2016e sales estimates by 1% and 0.4% respectively, and EBITDA by 0.3% and 5% respectively, on higher network costs. We are 3% below consensus 2015e EBITDA estimates, and 8% below 2016e. These cuts are offset in our DCF by lower capex than previously forecast, and by rolling forward our start year to 2015. China Mobile stock trades at 15x 2015e EPS and 4.8x 2015e EBITDA.

User growth to remain strong, but profit turnaround in doubt. We have argued that China Mobile is doing 'national service' with its 4G network rollout, and the results briefing reinforced this view. Capex and opex on the 4G network is likely to remain high, while revenue benefits are limited due to heavy discounting, and a focus on migrating as many users as possible to the new network. We believe this represents a great outcome for the Chinese economy, but a less good outcome for telco investors. A catalyst to change our view is evidence of higher margins from 4G at the first half results, as well as an acceleration in the rollout of the tower company.

Index ^A	HSCEI
Index level	11,982
RIC	0941.HK
Bloomberg	941 HK

Source: HSBC

Enterprise value (CNYm)	1151078
Free float (%)	78
Market cap (USDm)	264,211
Market cap (HKDm)	2,049,497

Source: HSBC

Financials & valuation

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (CNYm)				
Revenue	641,765	662,623	691,837	720,105
EBITDA	233,876	247,804	245,957	251,869
Depreciation & amortisation	-116,225	-134,650	-133,789	-139,656
Operating profit/EBIT	117,651	113,154	112,168	112,213
Net interest	15,921	13,868	13,738	14,025
PBT	142,909	137,024	136,548	137,878
HSBC PBT	141,820	136,169	136,048	137,378
Taxation	-33,241	-31,641	-31,620	-31,846
Net profit	109,542	105,149	104,694	105,798
HSBC net profit	117,585	112,786	112,686	113,790

Cash flow summary (CNYm)

Cash flow from operations	228,068	238,391	228,702	234,767
Capex	-213,500	-199,700	-175,840	-172,634
Cash flow from investment	-213,500	-199,700	-175,840	-172,634
Dividends	-52,685	-46,990	-45,214	-45,019
Change in net debt	4,603	8,299	-7,648	-17,114
FCF equity	4,611	29,344	52,383	61,407

Balance sheet summary (CNYm)

Intangible fixed assets	36,066	36,066	36,066	36,066
Tangible fixed assets	658,136	723,186	765,236	798,215
Current assets	477,583	475,021	487,052	508,406
Cash & others	419,557	416,266	423,914	441,028
Total assets	1,296,449	1,368,084	1,432,307	1,497,780
Operating liabilities	427,537	388,781	393,095	398,028
Gross debt	9,331	14,339	14,339	14,339
Net debt	-410,226	-401,927	-409,575	-426,689
Shareholders funds	856,576	961,725	1,021,401	1,081,705
Invested capital	324,691	429,226	471,345	503,630

Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Y-o-y % change				
Revenue	1.8	3.3	4.4	4.1
EBITDA	-2.7	6.0	-0.7	2.4
Operating profit	-13.3	-3.8	-0.9	0.0
PBT	-9.9	-4.1	-0.3	1.0
HSBC EPS	-10.2	-3.8	-0.4	1.1

Ratios (%)

Revenue/IC (x)	2.1	1.8	1.5	1.5
ROIC	32.4	24.9	20.7	19.1
ROE	14.3	12.4	11.4	10.8
ROA	8.9	7.9	7.5	7.3
EBITDA margin	36.4	37.4	35.6	35.0
Operating profit margin	18.3	17.1	16.2	15.6
EBITDA/net interest (x)				
Net debt/equity	-47.8	-41.7	-40.0	-39.3
Net debt/EBITDA (x)	-1.8	-1.6	-1.7	-1.7
CF from operations/net debt				

Per share data (CNY)

EPS reported (fully diluted)	5.44	5.23	5.21	5.26
HSBC EPS (fully diluted)	5.44	5.23	5.21	5.26
DPS	2.33	2.25	2.24	2.26
Book value	42.52	47.85	50.81	53.81

Valuation data

Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	1.8	1.7	1.7	1.6
EV/EBITDA	4.9	4.6	4.7	4.5
EV/IC	3.5	2.7	2.4	2.2
PE*	14.8	15.4	15.4	15.3
P/Book value	1.9	1.7	1.6	1.5
FCF yield (%)	0.3	1.9	3.4	3.9
Dividend yield (%)	2.9	2.8	2.8	2.8

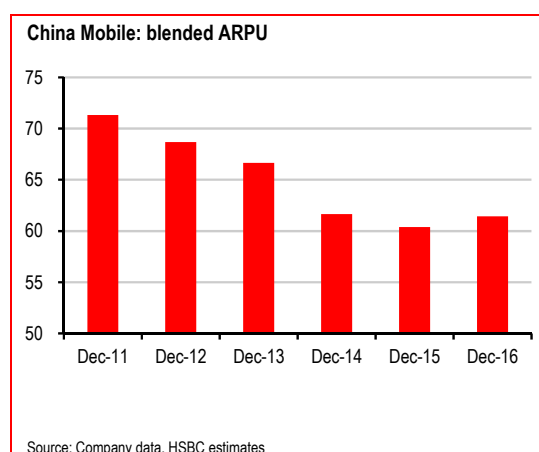
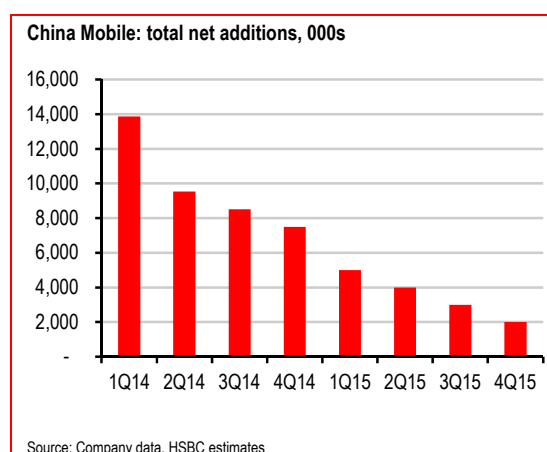
Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 19 Mar 2015

Valuation, rating, risks

- ▶ Focus on 4G *subscriber* growth, not *revenue* growth
- ▶ Continued cuts in sales and marketing costs offset by higher network costs and depreciation
- ▶ Underweight: DCF-derived target price unchanged at HKD80



Wireless business: limited near-term positives

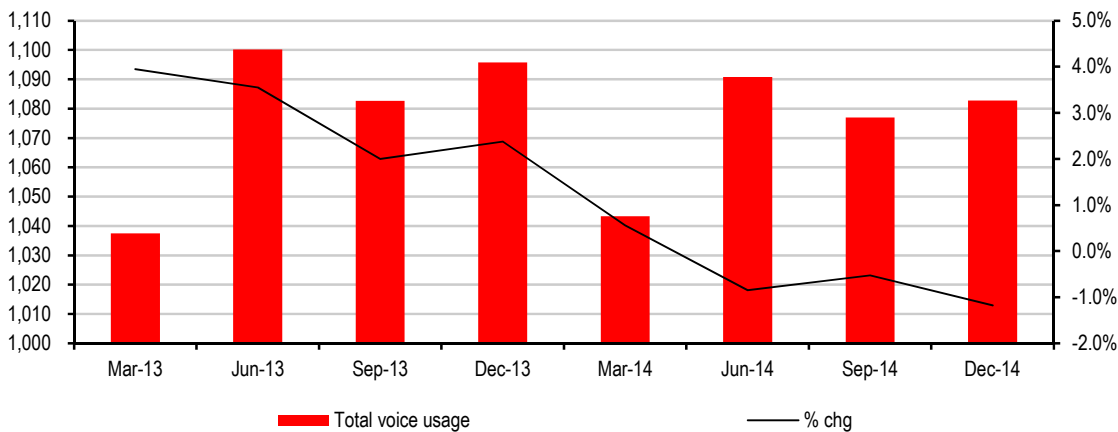
Revenues: 4G impact diluted by lower-value users, data price discounting

The key focus at the results was the impact of 4G, with China Mobile reaching 90m by end 2014. Here management was unforthcoming: while 4G ARPU is cRMB105 (1.7x blended ARPU) relative to blended ARPU of RMB61, we expect 4G ARPU to decline fast. Management's priority is to move as many customers as possible 4G, rather than focusing on growing revenue from high-spending users. This fits our view that the key priority for the government is to make 4G services available to as many people as possible, in as many parts of the country as possible:

- ▶ **Subscriber growth: high 4G growth, lower overall growth.** The company targets 250m 4G users by end 2015. Given continued declines in 4G smartphone costs, we expect this to be easily reachable. However, given saturation in the overall market, we expect net addition momentum to slow (chart above left).
- ▶ **Voice revenue: continuing to decline.** Total voice usage declined YoY for the first time in 2014, with the decline in 4Q14 reaching 1.2% YoY (chart on next page). We expect further voice substitution by messaging, driving a voice revenue decline in 2015 of 13%, similar to that in 2014.

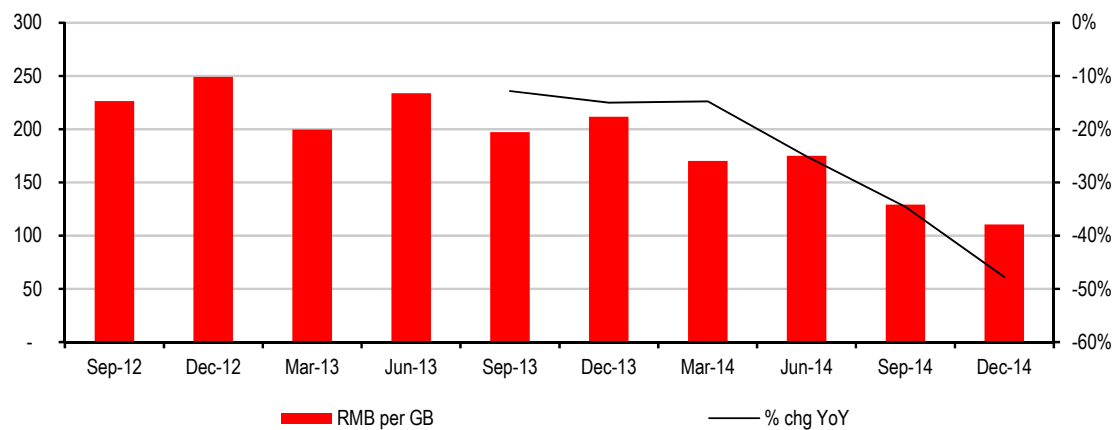
China Mobile: key indicators

China Mobile: voice (bn minutes), % chg YoY



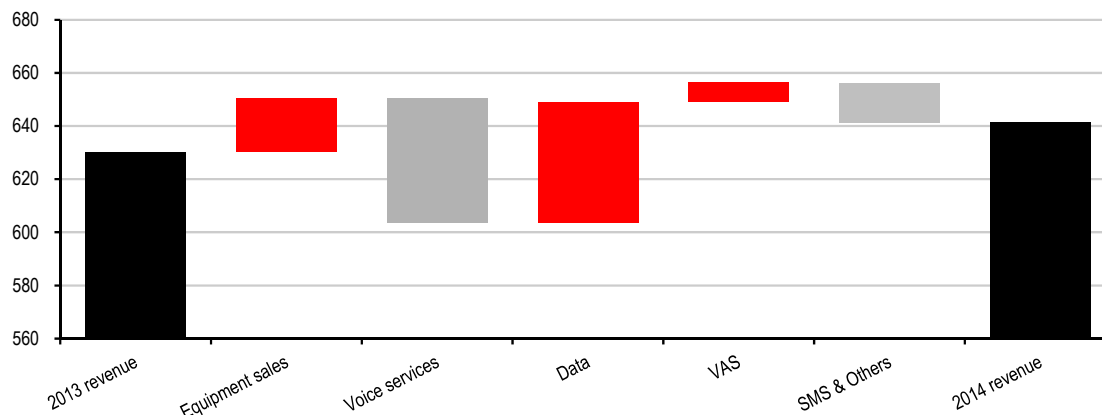
Source: Company data

China Mobile: revenue per GB, % chg YoY



Source: Company data

2014 revenue drivers: we expect voice declines to cancel out data growth in 2015 as well



Source: Company data

- **Data trends: price per unit declining dramatically.** A necessary corollary of pushing 4G to the mass market is lower pricing for data, and China Mobile's revenue per MB/GB declined 48% YoY in 4Q14, from c35% in 3Q, and c25% in 2Q14 (chart on previous page).

With voice and text declines continuing, and data revenue growth slower because of tariff cuts, we expect blended ARPU to decline in 2015 to RMB60, growing slightly to RMB61 in 2016e.

Costs: sales and marketing to decline, network and depreciation costs to rise

The company guided for further strong cost control in sales and marketing, targeting an RMB20bn reduction in 2015e. However, it noted that depreciation growth would be higher than the 11% recorded in 2014, with network related expenditure also expected to rise.

This is due to the continued investment in the 4G network, with China Mobile targeting 1m 4G base stations by end 2015 (from 720k at end 2014). Its focus in 2015 is broadening the coverage to create a seamless 4G network, as well as improving capacity and in-building coverage. This suggests ongoing expenditure, and we continue to believe capex will remain relatively high as a result. The company gave no guidance on progress at the tower sharing company.

Valuation and risks

China Mobile shares trade at 15x 2015e EPS relative to a three-year average of 11.4x forward earnings. We continue to use a sum-of-the-parts valuation methodology to capture the value of China Mobile's stakes in Shanghai Pudong Development Bank (600000 CH – RMB15.64; OW(V), TP RMB20.10) and True Corporation PCL (not rated).

China Mobile purchased 20% of Shanghai Pudong Development Bank (SPDB) holdings through a non-public offering at RMB39.8bn and became the largest shareholder in March 2010. On 9 June 2014, China Mobile purchased an 18% stake in True Corp via a private placement of 4.4bn common shares at THB6.45, representing a 13% discount. The total investment is roughly USD882m.

In our DCF valuation, we apply an equity beta of 0.8, a risk-free rate of 3.5%, an equity risk premium of 7.5% and a country risk premium of 2% to derive a cost of equity of 11.5%. Our cost of debt of 5% and our debt-to-capital ratio of 0% assumptions result in a WACC of 11.5%. We apply a terminal growth rate of 1.5%. This results in an EV for the telecoms assets of RMB635bn.

We value the 20% stake in SPDB by applying a 15% holding company discount to the three-month average stock price. This discount is at the low end of the 15-40% used by HSBC's conglomerates research team, reflecting the minimal synergies of SPDB with the overall business. This results in a fair value of the SPDB stake of RMB23bn, which compares with a purchase cost of RMB39.8bn, and the current market value of RMB35bn. The SPDB stake contributes HKD2 to our overall fair value.

We value the 18% stake in True Corp by applying a 15% holding company discount to the three-month average stock price. This discount is at the low end of the 15-40% range used by HSBC's conglomerates research team, reflecting the low contribution from True Corp to the overall business. This results in a fair value of the True stake of RMB8bn, compared with a purchase cost of RMB5.4bn, and the current market value of RMB11bn. The True Corp stake contributes HKD0.60 to our overall fair value.

We add RMB23bn and RMB8bn for the investments in SPDB and True, respectively, as well as RMB60bn for unlisted associates. We then deduct minorities of RMB2bn while adding net cash of RMB402bn. This results in a valuation of RMB1,126bn for China Mobile's equity, implying a one-year forward sum-of-the-parts fair value of HKD80 per share, unchanged.

Under our research model, the Neutral band for non-volatile stocks runs from 5ppt below to 5ppt above the hurdle rate set by our Global Equity Strategy team (9% for China). Our target price implies a potential return of -20.1%, which is below the Neutral band; we therefore reiterate our Underweight rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Risks to our view

The key upside risks are:

- ▶ Faster revenue growth due to strong 4G adoption, elasticity of data demand and tiered data tariffs
- ▶ Lower-than-expected opex growth due to VAT rebates, and strong cost control
- ▶ A positive financial impact of SoE reform and a change in the capital return policy

Estimates versus consensus

China Mobile: HSBCe vs Consensus, prior estimates

RMBm	2013a	2014e	2015e	2016e	13-16e CAGR
Consensus					
Revenues	630,177	646,289	680,692	728,610	5.0%
% chg YoY		2.6%	5.3%	7.0%	
Operating Expense	(347,929)	(408,233)	(426,276)	(460,422)	9.8%
% chg YoY		17.3%	4.4%	8.0%	
EBITDA	242,882	238,056	254,417	268,188	3.4%
% chg YoY		-2.0%	6.9%	5.4%	
% margin	41.1%	36.8%	37.4%	36.8%	
Operating Profit	137,720	118,183	119,672	129,831	-1.9%
% chg YoY		-14.2%	1.3%	8.5%	
% margin	23.3%	18.3%	17.6%	17.8%	
Net Income	121,692	109,362	113,153	117,468	-1.2%
% chg YoY		-10.1%	3.5%	3.8%	
EPS	6.05	5.37	5.51	5.81	-1.4%
HSBC					
Revenues	630,177	641,765	662,623	691,837	3.2%
% chg YoY		1.8%	3.3%	4.4%	
Operating Expense	(389,829)	(408,206)	(414,819)	(445,880)	
% chg YoY		4.7%	1.6%	7.5%	
EBITDA	240,348	233,559	247,804	245,957	0.8%
% chg YoY		-2.8%	6.1%	-0.7%	
% margin	38.1%	36.4%	37.4%	35.6%	
Operating Profit	135,649	117,334	113,154	112,168	-6.1%
% chg YoY		-13.5%	-3.6%	-0.9%	
% margin	21.5%	18.3%	17.1%	16.2%	
Net Income	121,692	109,279	105,149	104,694	-4.9%
% chg YoY		-10.2%	-3.8%	-0.4%	
EPS	6.05	5.42	5.23	5.21	-4.9%
HSBC vs. Consensus					
	2013a	2014e	2015e	2016e	
Sales		-0.7%	-2.7%	-5.0%	
EBITDA		-1.9%	-2.6%	-8.3%	
OP		-0.7%	-5.4%	-13.6%	
Net Income		-0.1%	-7.1%	-10.9%	
EPS		1.0%	-5.1%	-10.3%	
HSBC Nov-14 estimates					
	2013a	2014e	2015e	2016e	
Sales	630,177	649,466	668,696	694,304	
EBITDA	240,348	236,187	248,615	259,238	
OP	135,649	116,289	103,544	109,021	
Net Income	121,692	107,358	98,434	103,587	
EPS	6.05	5.28	4.71	4.95	
HSBC vs. previous					
	2013a	2014e	2015e	2016e	
Sales		-1.2%	-0.9%	-0.4%	
EBITDA		-1.1%	-0.3%	-5.1%	
OP		0.9%	9.3%	2.9%	
Net Income		1.8%	6.8%	1.1%	
EPS		2.7%	11.1%	5.2%	

Source: Company data, HSBC estimates, Bloomberg

Changes to our estimates are outlined in the table below. We trim our sales estimates, and cut 2016e EBITDA on higher network operating costs than previously forecast. We raise our OP forecasts as our previous depreciation forecasts were too high.

Disclosure appendix

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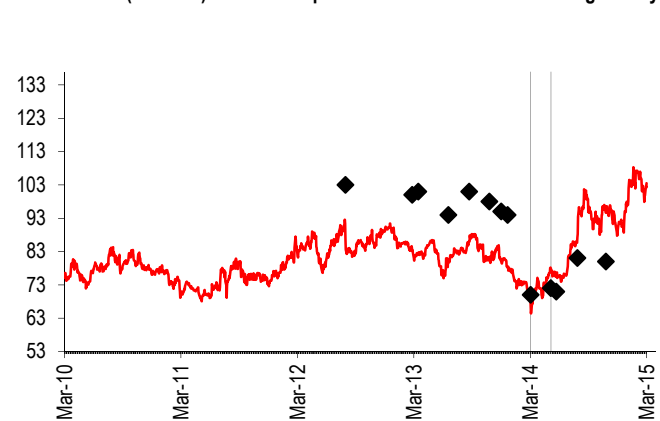
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As of 19 March 2015, the distribution of all ratings published is as follows:

Overweight (Buy)	41%	(30% of these provided with Investment Banking Services)
Neutral (Hold)	39%	(28% of these provided with Investment Banking Services)
Underweight (Sell)	20%	(20% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

China Mobile (0941.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight	Neutral	20 March 2014
Neutral	Underweight	22 May 2014
Target Price	Value	Date
Price 1	103.00	16 August 2012
Price 2	100.00	14 March 2013
Price 3	101.00	02 April 2013
Price 4	94.00	05 July 2013
Price 5	101.00	09 September 2013
Price 6	98.00	11 November 2013
Price 7	95.00	18 December 2013
Price 8	94.00	07 January 2014
Price 9	70.00	20 March 2014
Price 10	72.00	22 May 2014
Price 11	71.00	09 June 2014
Price 12	81.00	14 August 2014
Price 13	80.00	11 November 2014

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
CHINA MOBILE	0941.HK	103.50	18-Mar-2015	6, 11

Source: HSBC

- 1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.
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Issuer of report

The Hongkong and Shanghai Banking Corporation Limited

Level 19, 1 Queen's Road Central
Hong Kong SAR

Telephone: +852 2843 9111

Fax: +852 2596 0200

Website: www.research.hsbc.com

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Global Telecoms, Media & Technology Research Team

Global

Stephen Howard
Analyst, Global Sector Head
+44 20 7991 6820 stephen.howard@hsbcib.com

Europe

Nicolas Cote-Colisson
Analyst
+44 20 7991 6826 nicolas.cote-colisson@hsbcib.com

Antonin Baudry
Analyst
+33 1 56 52 43 25 antonin.baudry@hsbc.com

Christopher Johnen
Analyst
+49 211 910 2852 christopher.johnen@hsbc.de

Dominik Klarmann, CFA
Analyst
+49 211 910 2769 dominik.klarmann@hsbc.de

Christian Rath
+49 211 910 3049 christian.rath@hsbc.de

Luigi Minerva
Analyst
+44 20 7991 6928 luigi.minerva@hsbcib.com

Olivier Moral
Analyst
+33 1 5652 4322 olivier.moral@hsbc.com

Adam Fox-Rumley
Analyst
+44 20 7991 6819 adam.fox-rumley@hsbcib.com

Dhiraj Saraf, CFA
Analyst
+91 80 3001 3773 dhirajsaraf@hsbc.co.in

Americas

Christopher A Recouso
Analyst
+1 212 525 2279 christopher.a.recouso@us.hsbc.com

Sunil Rajgopal
Analyst
+1 212 525 0267 sunilrajgopal@us.hsbc.com

Global Emerging Markets (GEMs)

Hervé Drouet
Analyst
+44 20 7991 6827 herve.drouet@hsbcib.com

Emerging Europe, Middle East & Africa (EMEA)
Franca Di Silvestro
Head of Research, SA
+27 11 676 4223 franca.disilvestro@za.hsbc.com

Bülent Yurdağul
Analyst
+90 212 376 46 12 bulentyurdagul@hsbc.com.tr

Asia

Yogesh Aggarwal
Analyst
+91 22 2268 1246 yogeshaggarwal@hsbc.co.in

Neale Anderson
Analyst
+852 2996 6716 neale.anderson@hsbc.com.hk

Joyce Chen
Analyst
+8862 6631 2862 joycechen@hsbc.com.tw

Luis Hilado
Analyst
+65 6658 0607 luishilado@hsbc.com.sg

Jenny Lai
Head of Research, Taiwan
+8862 6631 2860 jennylai@hsbc.com.tw

Lionel Lin
Analyst
+65 6658 0624 lionelylin@hsbc.com.sg

Carrie Liu
Analyst
+8862 6631 2864 carriecfliu@hsbc.com.tw

Steven C Pelayo
Analyst
+852 2822 4391 stevenpelayo@hsbc.com.hk

Ricky Seo
Analyst
+822 37068777 rickyjuilseo@kr.hsbc.com

Rajiv Sharma
Analyst
+91 22 2268 1239 rajivsharma@hsbc.co.in

Jerry Tsai
Analyst
+8862 6631 2863 jerrytsyai@hsbc.com.tw

Chi Tsang
Analyst
+852 2822 2590 chitsang@hsbc.com.hk

Rajesh Raman
Analyst
+65 6658 0608 rajeshraman@hsbc.com.sg

Yolanda Wang
Analyst
+8862 6631 2867 yolandayywang@hsbc.com.tw

Tse-yong Yao
Analyst
+8862 6631 2861 tse-yongyao@hsbc.com.tw

Jena Han
Analyst
+822 3706 8772 jenahan@kr.hsbc.com

Will Cho
Analyst
+822 3706 8765 will.cho@kr.hsbc.com

Alice Cai
Associate
+852 2996 6584 alice.y.cai@hsbc.com.hk

Jia Wen
Associate
+852 2822 4686 jia.wen@hsbc.com.hk

Kenneth Shim
Associate
+822 3706 8779 kennyshim@kr.hsbc.com

David Huang
Associate
+886 2 66312865 david.s.huang@hsbc.com.tw

Specialist Sales

Gareth Hollis
+44 20 7991 5124 gareth.hollis@hsbcib.com

Kubilay Yalcin
+49 211 9104880 kubilay.yalcin@hsbc.de

Myles McMahon
+852 2822 4676 mylesmacmahon@hsbc.com.hk