Deutsche Bank
Markets Research

Rating
Buy

Asia
China

Technology
Software & Services

Company
China Comm Services Alert

Reuters	Bloomberg	Exchange	Ticker
0552.HK	552 HK	HKG	0552

ADR Ticker	ISIN
CUCSY	US1689221026

Date
25 March 2015

Forecast Change

Price at 25 Mar 2015 (HKD)	3.34
Price target - 12mth (HKD)	3.85
52-week range (HKD)	3.93 - 3.33
HANG SENG INDEX	24,400

2H14 miss; looking for better top-line recovery

Vivian Hao
Research Analyst
(+852) 2203 6241
vivian.hao@db.com

Alan Hellawell III
Research Analyst
(+852) 2203 6240
alan.hellawell@db.com

2H14 miss; challenges remain in FY15

China CommService delivered 2H14 revenue of RMB39.4b (+9% YoY/-17% HoH), 6%/3% lower than DBe/consensus mainly due to slowed spending by domestic telcos (2.8% short of budget in FY14) and service charge reduction. GPM was 0.4ppts lower than DBe but 0.4ppts higher than consensus. EBITDA was RMB1.5b (-5% YoY/-16% HoH), 21%/9% behind DBe/consensus, partly due to labor cost increase. NP to equity holders was RMB913m (-8% YoY/-26% HoH), 23%/18% lower than DBe/consensus. Domestic telco infrastructure service rev growth re-accelerated in 2H14 due to 4G licensing to CT and CU. We believe telcos' contracts would remain the major growth driver in FY15 given expedited 4G expansion plan. Margin pressure however should remain.

Expecting top-line growth from telcos' capex hike and tower.co initiatives

China Telecom, one of CCS's key client (44% of revs in 2014) has lifted its 2015 capex budget substantially (+40%YoY) to pursue a more aggressive expansion in 4G network given a recent award of FDD-LTE commercial license. We envision incremental but not drastic growth catalyst to CCS in FY15, given that 4G technology requires less construction compared to 3G. We are positive to CCS's preferential agreement with the tower company, which makes it easier to bid the tender. Telecom infrastructure service revenue should continue to be the main revenue driver in 2015, while the company seeks potential growth outlets such as project outsourcing, oversea non-operators and virtual operator big project. However, margin wise headwinds in service charge reduction, VAT and labor cost rise should continue in 2015.

Efforts in improving free cash flows

The company successfully reversed the negative free cash flow situation at 2014-end via WC management. Given that over 70% of the account receivables coming from the three telcos operators, the intense telcos competition and network expansion in FY15 may continue to lead CCS's free cash flow under pressure. The company therefore targets at stable account receivable turnover ratio in FY15, and aiming for positive FCF with tighter AR control mechanism.

Reducing TP by 13% to HK$3.85; Maintaining Buy

We cut rev and NP forecasts for FY15/16E by 2%/1% and 15%/12% respectively, to reflect a mix of telcos' capex hike, service charge reduction and labor cost increase, and launch 2017 forecast. We believe the current share price largely reflects the downside risks given it has dipped a lot (underperform HSI by 7.4%/9% for YTD/past 3 months). We maintain a Buy rating on the low valuation. Our TP is based on DCF (assumptions unchanged), which utilizes a WACC of 8.8% (9.3% DB CoE, 0.97 beta, 0% terminal growth, 10% gearing ratio). Risks: slower spending in 4G capex from telco operators; margin contraction.

Key changes

Price target	4.40 to 3.85	↓	-12.5%
Sales (FYE)	87,635 to 86,228	↓	-1.6%
Op prof margin (FYE)	4.1 to 3.6	↓	-11.4%
Net profit (FYE)	2,954.1 to 2,522.3	↓	-14.6%

Source: Deutsche Bank

Stock data

Market cap (HKDm)	19,277
Market cap (USDm)	2,486
Shares outstanding (m)	6,926.0
Major shareholders	China Telecommunications Corp (50.71%)
Free float (%)	25
Avg daily value traded (USDm)	3.1

Source: Deutsche Bank

Key data

FYE 12/31	2014A	2015E	2016E
Sales (CNYm)	73,176	86,228	95,974
Net Profit (CNYm)	2,150.3	2,522.3	2,929.7
DB EPS (CNY)	0.31	0.36	0.42
PER (x)	9.7	7.3	6.3
Yield (net) (%)	3.1	4.1	4.7

Source: Deutsche Bank