HKBN

(1310.HK)

Rating	NEUTRAL* [V]
Price (HK$)	9.00
Target price (HK$)	10.10[1]
Market cap. (HK$mn)	—
Yr avg. mthly trading (HK$mn)	—
Last month's trading (HK$mn)	—
Projected return:	
Capital gain (%)	12.2
Dividend yield (net %)	3.7
Total return (%)	15.9
52-week price range	-

** Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.
[V] = Stock considered volatile (see Disclosure Appendix).

Research Analysts

Chate Benchavitvilai
65 6212 3241
chate.benchavitvilai@credit-suisse.com

INITIATION

Attractive cash flow growth, priced in

- **Initiate coverage with NEUTRAL.** We initiate coverage on HKBN with a NEUTRAL rating and a DCF-based target price of HK$10.10 (a 7.3% WACC, 0.3% terminal growth from FY8/22E), implying 12% potential upside.
- **A growing company in a growing industry.** Against the conventional belief that it is mature and boring, the HK broadband market is attractive, in our view. While broadband household penetration reached 83%, higher speed fibre penetration is still less than 60%. We expect multiple supply push and demand pull factors to continue to drive take-up of higher-speed products while the sector's focus on profitability should allow this opportunity to be monetised. We believe HKBN is still in a position to gradually gain market share while customers upgrade to higher speed and price gaps particularly for voice/broadband bundled service give room for ARPU upside. We expect HKBN to deliver a 9% service revenue CAGR over FY8/14-17E.
- **22% 3Y FCF (and dividend) CAGR.** Importantly, we expect HKBN's cash operating expenses to grow at a slower rate than services revenue, allowing EBITDA margin to expand 43.5% in FY8/17E (from 41.2% in FY8/14A). While we expect absolute capex to remain broadly stable, growing revenue means capex-to-sales should also decline from 16.8% in FY8/14A to 13.5% in FY8/17E. A combination of growing revenues, EBITDA margin expansion, lower capex-to-sales and interest saving from recent re-financing could drive the 22% adjusted free cash flow CAGR (and dividend) over the next three years.
- **Question is valuation.** HKBN offers FY8/15E (annualised) dividend yield of 4.0%, rising to 5.2-6.2% in FY8/16-17E. While this is attractive particularly when growth is taken into account, upside to DCF only warrants NEUTRAL rating relative to market. Risks to our forecasts/valuations include, among others, a more aggressive competitive environment and interest rate risk.

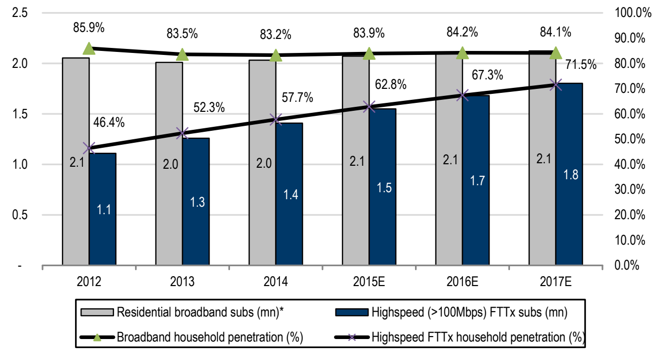
Financial and valuation metrics

Year	08/14A	08/15E	08/16E	08/17E
Revenue (HK$mn)	2,131.6	2,323.3	2,516.0	2,707.6
EBITDA (HK$mn)	845.3	938.1	1,044.4	1,151.6
EBIT (HK$mn)	292.9	481.2	577.0	677.9
Net income (HK$mn)	286.0	324.0	481.0	565.2
EPS (CS adj.) (c)	28.43	32.22	47.83	56.20
Change from previous EPS (%)	n.a.	—	—	—
Consensus EPS (c)	n.a.	—	—	—
EPS growth (%)	26.3	13.3	48.5	17.5
P/E (x)	31.7	27.9	18.8	16.0
Dividend (c)	—	17.13	47.07	55.98
Dividend yield (%)	—	1.9	5.2	6.2
P/B (x)	5.5	5.4	5.7	6.1
Net debt/EBITDA (x)	3.03	2.58	2.32	2.10

Source: Company data, Credit Suisse estimates

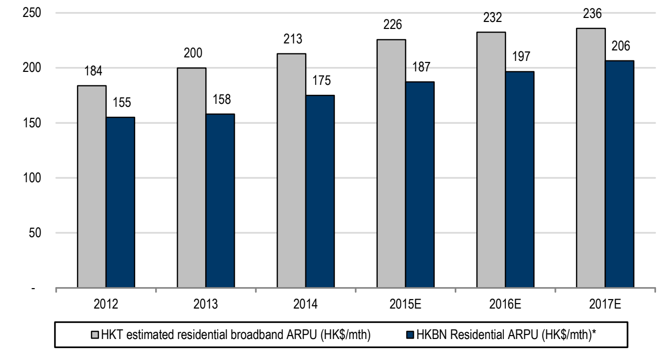
Focus charts and tables

Figure 1: We expect penetration of higher-speed fibre broadband to continue to rise…



Source: OFCA, Company data, Credit Suisse estimates

Figure 2: …while the competitive environment / focus on profitability should allow further ARPU uplift



**For HKBN, use FY8/12 for 2012, residential ARPU include revenues form bundled voice, IPTV and other entertainment services*
Source: Company data, CS estimates

Figure 3: HKBN—adjusted free cash flow forecast

HK$ mn	FY8/13A	FY8/14A	FY8/15E	FY8/16E	FY8/17E
Residential subscribers (000s)	**660**	**692**	**742**	**782**	**814**
YoY growth (%)	5.4%	4.8%	7.2%	5.4%	4.1%
Residential ARPU (HK$)	**158**	**175**	**187**	**197**	**206**
YoY growth (%)	1.9%	10.8%	7.0%	5.0%	5.0%
Residential broadband & bundled revenues	**1,219**	**1,420**	**1,611**	**1,798**	**1,977**
YoY growth (%)	n/m	16.4%	13.5%	11.6%	10.0%
Enterprise broadband & bundled revenues	**319**	**376**	**426**	**469**	**510**
Other service revenues	323	258	216	186	164
Total service revenues	**1,861**	**2,053**	**2,254**	**2,453**	**2,650**
YoY growth (%)	n/m	10.4%	9.7%	8.9%	8.0%
EBITDA	**741**	**845**	**938**	**1,044**	**1,152**
YoY growth (%)	n/a	14.1%	11.0%	11.3%	10.3%
EBITDA margin (%)	39.8%	41.2%	41.6%	42.6%	43.5%
Capex	**(324)**	**(346)**	**(352)**	**(356)**	**(357)**
Capex to sales (%)	17.4%	16.8%	15.6%	14.5%	13.5%
Net interest paid	(146)	(165)	(141)	(111)	(111)
Adjusted free cash flow	**227**	**311**	**366**	**473**	**563**
YoY growth (%)	n/a	37.2%	17.6%	29.5%	18.9%

Source: Company data, Credit Suisse estimates

Figure 4: Hong Kong telecoms sector—comparative multiples

	Current Price (HK$)	Target Price (HK$)	Upside (%)	Rating	P/E (x)		EV/EBITDA (x)		FCF yield (%)		Div yield (%)		
					FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY17E
HKBN	**9.00**	**10.1**	**12.2**	**N**	**27.9**	**18.8**	**12.2**	**11.0**	**4.0**	**5.2**	**4.0**	**5.2**	**6.2**
HKT Trust	10.08	11.00	9.1	N	18.3	15.6	11.9	10.9	5.7	6.6	5.7	6.6	7.1
HTHK	3.76	4.10	9.0	O	23.6	19.4	10.4	9.4	4.5	5.5	3.6	4.0	5.1
SmarTone	14.80	15.30	3.4	O	22.5	19.5	9.5	8.5	3.7	5.3	3.3	3.8	4.1
PCCW	4.80	5.70	18.8	N	15.2	12.9	8.8	7.9	6.9	8.3	5.4	6.3	6.8
Asia ex Japan Integrated					**17.7**	**19.2**	**7.4**	**7.0**	**2.0**	**5.6**	**3.9**	**4.4**	
Asia ex Japan Wireless					**17.3**	**16.6**	**7.1**	**6.5**	**3.3**	**6.4**	**3.1**	**3.2**	

Note: Prices as of 9 March 2015.
Source: Company data, Credit Suisse estimates

Attractive cash flow growth

HK broadband market is attractive…

Against the conventional belief that it is mature and boring, we believe that the HK broadband market remains attractive. While broadband household penetration reached 83% at end-2014 (112% using bottom-up reported subscriber numbers), higher speed fibre broadband penetration (i.e., speed <100Mbps) remains <60%. We expect multiple supply pushes (extensive FTTx coverage, focus on upgrading subscribers) and demand pulls (richer content, digitalisation of businesses, multiple smart wireless devices, expectation of instant access) to continue to drive take-up, and higher-speed fibre broadband penetration to reach 72% by FY17E. Importantly, we believe that the competitive environment would remain relatively benign, as we believe operators' key focus will remain on managing profitability and expect further improvement in the sector's ARPU, albeit at a slower pace.

…and HKBN is well positioned to capture growth

With our expectation for HKT to keep focusing on overall growth/profitability rather than market share while the threat from smaller operators could remain limited, HKBN, in our view, is in a position to gradually gain market share from 32.6% at end-2014 to 36.7% by end-2017E. While room for further direct tariff increases could now be more limited and HKBN's target for subscriber growth could mean some trade-off on ARPU improvement, we still see room for HKBN to improve its residential broadband ARPU from penetrating more into the medium-income segment and/or upselling higher-speed products. The price gap against HKT, particularly in voice-bundled plans (38-49% discount), also means some legroom for HKBN to adjust price and/or balance subscriber and revenue growth. We also see opportunities for HKBN to grow into the enterprise segment where it has only a ~12% market share, as demand for access from small and medium enterprises continues to grow. Our base case expects HKBN to deliver a 9% service revenue CAGR over FY8/14-17E, driven by a combination of both subscriber and ARPU growth.

We expect a 22% 3Y FCF (and dividend) CAGR

Importantly, we expect HKBN's cash operating expenses to grow at a slower rate than services revenue, allowing EBITDA margin to expand 43.5% in FY8/17E (from 41.2% in FY8/14A). While we expect absolute capex to remain broadly stable, growing revenue means capex-to-sales should also decline from 16.8% in FY8/14A to 13.5% in FY8/17E. A combination of growing revenues, EBITDA margin expansion, lower capex-to-sales and interest saving from the recent re-financing could drive the 22% adjusted free cash flow CAGR (and dividend) over the next three years.

Valuation and risks

We initiate coverage on HKBN with a NEUTRAL rating and a DCF-based target price of HK$10.10 (a 7.3% WACC, 0.3% terminal growth), implying 12% potential upside. At the current level, HKBN offers FY8/15E (annualised) dividend yield of 4.0%, and we expect this to increase to 5.2-6.2% in FY8/16-17E. While this is attractive particularly when growth is taken into account, it does not stand out relative to other high yield stocks, e.g., HKT while upside to DCF in our view only warrants NEUTRAL rating relative to market.

Risks to our forecasts/valuation include (1) a more or less aggressive broadband pricing environment, (2) a lack of ability to bundle mobile data services compared to peers, (3) higher or lower capex requirement for network, (4) a faster or slower decline in IDD services, and (5) higher or lower interest costs due to higher or lower interest rates.

HKBN 1310.HK / 1310 HK

Price (09 Mar 15): **HK$9.00**, Rating**: NEUTRAL [V]**, Target Price: **HK$10.10**

Per share data	8/14A	8/15E	8/16E	8/17E
No. of shares (EOP)	1,005.67	1,005.67	1,005.67	1,005.67
EPS (Credit Suisse) (HK$cents)	28.43	32.22	47.83	56.20
DPS (HK$)	—	0.17	0.47	0.56
Dividend payout ratio	—	53.16	98.42	99.60
Operating cash flow per share	0.66	0.66	0.82	0.91

Income statement (HK$ mn)	8/14A	8/15E	8/16E	8/17E
Total revenue	**2,140.8**	**2,332.3**	**2,525.1**	**2,716.6**
Cost of goods sold	1,295.5	1,394.2	1,480.7	1,565.0
SG&A (excluding R&D)	—	—	—	—
R&D costs	—	—	—	—
Other operating inc/(exp.)	(9.2)	(9.0)	(9.0)	(9.0)
EBITDA	**845**	**938**	**1,044**	**1,152**
Depr & amort (excl. goodwill)	327.1	346.7	357.2	363.5
Goodwill impairment	225.3	110.2	110.2	110.2
EBIT	**293**	**481**	**577**	**678**
Net interest expense/(inc.)	179.2	141.3	111.0	111.0
Net non operating inc (exp)	(8.6)	(55.9)	—	—
Share of associates/JVs' equity	—	—	—	—
Exceptionals/extraordinaries	—	—	—	—
Recurring PBT	**105.0**	**284.0**	**466.0**	**566.9**
Taxes	51.5	70.2	95.2	111.9
Profit after tax	53.6	213.8	370.8	455.0
Other after tax income	—	—	—	—
Minority interests	—	—	—	—
Preferred dividends	—	—	—	—
Reported net income	**54**	**214**	**371**	**455**
Analyst after tax adjustment	232.4	110.2	110.2	110.2
Adjusted net income	**286**	**324**	**481**	**565**

Cash flow (HK$ mn)	8/14A	8/15E	8/16E	8/17E
EBITDA	845.3	938.1	1,044.4	1,151.6
Cash taxes paid	(42.8)	(70.2)	(95.2)	(111.9)
Change in working capital	24.8	(64.9)	(9.0)	(9.0)
Other cash & non-cash items	387.3	315.6	356.3	362.7
Cash flow from operations	**662.1**	**661.7**	**829.1**	**919.7**
Capex	(345.6)	(352.1)	(355.8)	(356.8)
Disposals of PPE	—	—	—	—
Free cash flow to the firm	**269.0**	**374.5**	**482.4**	**572.0**
Acquisitions	—	—	—	—
Divestments	0.66	—	—	—
Other investment/(outflows)	—	—	—	—
Cash flow from investment	**(344.9)**	**(352.1)**	**(355.8)**	**(356.8)**
Net share issue/(repurchase)	—	—	—	—
Dividends paid	—	(172.2)	(473.4)	(562.9)
Change in debt	(236.6)	—	—	—
Other financing inflows/outflows	—	—	—	—
Cash flow from financing activities	(236.6)	(172.2)	(473.4)	(562.9)
Effect of exchange rates	—	—	—	—
Movements in cash/equivalents	80.6	137.4	—	—

Balance sheet (HK$ mn)	8/14A	8/15E	8/16E	8/17E
Assets				
Cash and cash equivalents	435.6	573.0	573.0	573.0
Accounts receivable	80.0	80.0	80.0	80.0
Inventory	—	—	—	—
Other current assets	202.8	202.8	202.8	202.8
Total current assets	718.4	855.8	855.8	855.8
Total fixed assets	1,957.0	1,962.3	1,960.9	1,954.2
Intangible assets and goodwill	1,440.7	1,330.5	1,220.3	1,110.2
Investment securities	4.7	4.7	4.7	4.7
Other assets	4.6	4.6	4.6	4.6
Total assets	**5,719.4**	**5,752.0**	**5,640.4**	**5,523.5**
Accounts payable	11.6	11.6	11.6	11.6
Short-term debt	—	—	—	—
Other short term liabilities	540.7	540.7	540.7	540.7
Total current liabilities	552.3	552.3	552.3	552.3
Long-term debt	2,994.1	2,994.1	2,994.1	2,994.1
Other non-current liab.	530.2	521.2	512.1	503.1
Total liabilities	4,076.6	4,067.6	4,058.5	4,049.5
Shareholders' equity	1,642.8	1,684.4	1,581.9	1,474.0
Minority interest	—	—	—	—
Total equity & liabilities	5,719.4	5,752.0	5,640.4	5,523.5

Key ratios and valuation	8/14A	8/15E	8/16E	8/17E
Growth(%)				
Sales	9.3	9.0	8.3	7.6
EBIT	53.6	64.3	19.9	17.5
Net profit	26.3	13.3	48.5	17.5
EPS	4.4	(15.1)	36.2	14.2
Margins (%)				
EBITDA margin	39.7	40.4	41.5	42.5
EBIT margin	13.7	20.7	22.9	25.0
Pretax margin	4.9	12.2	18.5	20.9
Net margin	13.4	13.9	19.1	20.9
Valuation metrics (x)				
EV/sales	1.2	1.0	1.0	0.9
EV/EBITDA	—	—	—	—
EV/EBIT	8.7	5.0	4.2	3.6
P/E	17.7	20.8	15.3	13.4
P/B	5.51	5.37	5.72	6.14
ROE analysis (%)				
ROE (%)	17.7	19.5	29.5	37.0
ROIC	3.4	8.7	11.3	13.8
Asset turnover (x)	0.37	0.40	0.45	0.49
Interest burden (x)	0.36	0.59	0.81	0.84
Tax burden (x)	0.51	0.75	0.80	0.80
Financial leverage (x)	3.48	3.41	3.57	3.75
Credit ratios				
Net debt/equity (%)	155.7	143.7	153.1	164.3
Net debt / EBITDA (x)	3.0	2.6	2.3	—
Interest cover (x)	1.63	3.41	5.20	6.11
Dividend payout ratio (%)	—	—	—	—

Quarterly data	8/14A	8/15E	8/16E	8/17E
EPS for Q1	—	—	—	—
EPS for Q2	—	—	—	—
EPS for Q3	—	—	—	—
EPS for Q4	—	—	—	—

*Source: Company data, ASX, Credit Suisse estimates, * Adj. for goodwill, notional interest and unusual items. Relative P/E against ASX/S&P200 based on pre GW in AUD. Company PE calculation is based on displayed EPS Currency.*

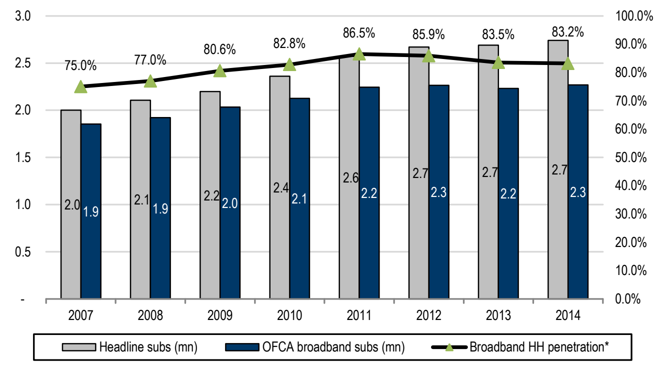
HK broadband market is attractive

Is this a matured and boring market?

On the surface, HK broadband might be perceived as a mature and boring market given its relatively high penetration rate (106% household penetration, 83% if adjusted for multiple lines), number of players (four with their own networks) and relatively low tariffs (~US$25/month for 100Mbps broadband compared with ~US$30/month in Singapore or ~US$33/month in Korea).

These are the results of early liberalisation of the sector (starting in 1995; introducing competition earlier), relatively high population density (lower cost per home-pass; easier to cover), relatively high income (affordability not a barrier for a large portion of consumers), new entrants' decision to invest in fibre networks (fibre broadband coverage now >80% of households) and intense competition in both price and speed, particularly during 2009-12.

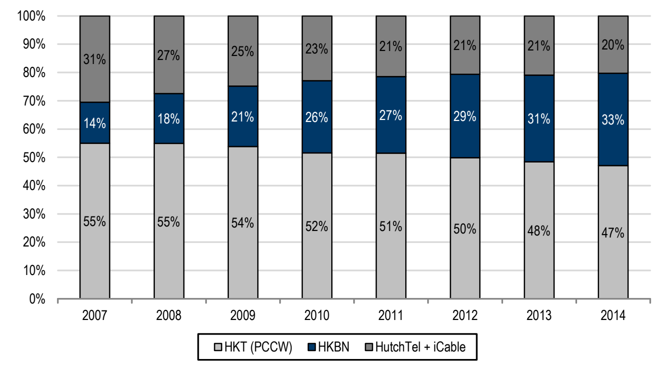
Figure 5: **Hong Kong broadband market—subscribers**



**Residential broadband penetration based on OFCA statistics*

Source: Company data, Credit Suisse estimates

Figure 6: **Hong Kong broadband market—market share**



**HKT (PCCW)'s broadband subscribers derived using OFCA reported broadband subscriber base – other telcos' reported subscribers*

Source: Company data, Credit Suisse estimates

This four-player residential broadband market comprising **HKT** (PCCW, xDSL + FTTx), **HKBN** (FTTx), **HutchTel** (FTTx) and **i-Cable** (DOCSIS 3.0) went through a period of intense price competition during 2009-11, driven by HKBN's effort to gain market share using aggressive acquisition schemes (e.g., HK$99 (US$13)/month for 100Mbps broadband), higher speed products (fibre with 100Mbps and above speed) and targeted more dense/price-sensitive areas such as public housing.

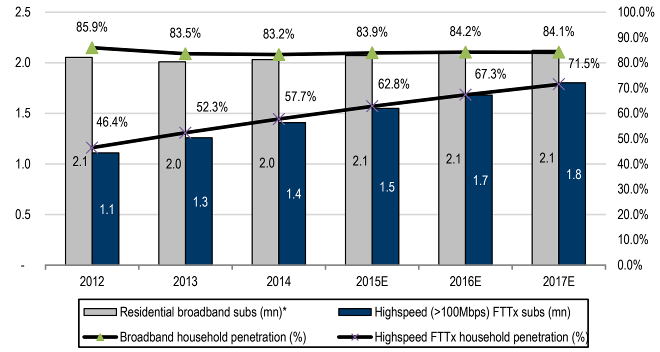
Those efforts allowed HKBN to almost double its market share from ~13% in 2007 (~14% using OFCA number) to 25% in 2012 (29% using OFCA number), mainly at the expense of i-Cable and HutchTel which lost ~8% and ~3% market shares, respectively, over the period. HKT Trust (PCCW) has been able to maintain its subscriber market share well at 57-58% despite intense competition, driven by extensive coverage for lower speed xDSL products (98% of home), new entrants' difficulty in getting into some areas/buildings, HKT's strong triple-play proposition with voice and nowTV services while its strong execution on pricing (different pricings in key competitive areas) also helped.

We do not think so! Penetration of 'high speed' broadband suggests clear room for growth…

However, we argue that the HK broadband market is in fact attractive, and is offering room for growth both in terms of subscribers (~27,000-28,000 new households per year, migration of subscribers from xDSL and Cable to higher speed fibre broadband) and ARPU increase driven by the monetisation of higher-speed products.

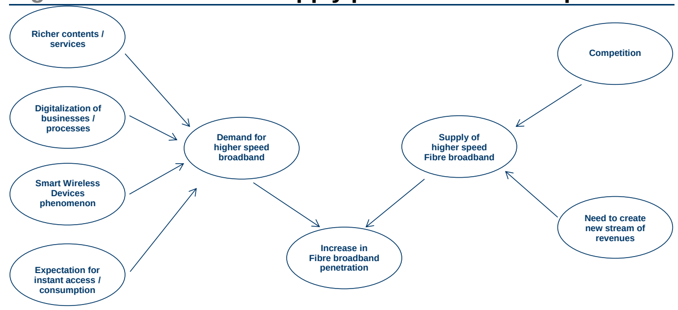
While the headline residential broadband penetration rate might look relatively high at 106% (83% if adjusted for multiple lines), we note that the penetration rate of higher-speed fibre broadband products (100Mbps and above) remains quite low at only 58% of households (55% of headline broadband subscriber base).

Figure 7: Fibre broadband as a percentage of household



Source: OFCA, Company data, Credit Suisse estimates

Figure 8: Fibre is both supply push and demand pull



Source: Credit Suisse estimates

We estimate that higher speed fibre broadband (>100Mbps) penetration in Hong Kong has been rising quickly, from only ~37% as at December 2011 to 58% of household currently. While we acknowledge that this was partly driven by competition, as market challengers such as HKBN and HutchTel offer only fibre broadband (hence naturally drive up fibre penetration as they gain market share), we believe the key driver for this has also been real demand for higher-speed services.

This, in our view, has been driven by **(1) the development and availability of richer content** (e.g. both commercially and self-produced videos, multiplayer on-line game, HD movies, IPTV), **(2) digitalisation of businesses/processes** which in turn lead to the creation of new platforms/ways businesses interact with consumers and vice versa, e.g. proliferation of e-commerce, processes like signing up for services (e.g., subscribing for broadband services, registering interests for new products, ticket booking, restaurant reservation etc.), **(3) smart wireless phenomenon** (shifts in consumers' behaviour, e.g. individual members at home using multiple devices to consume different content/services simultaneously), and **(4) perhaps, most importantly, expectation of instant access** as we believe the availability, convenience of access and good mobile data services in Hong Kong have created consumers' expectations that they can access content or services that they want anytime, particularly at home.

We note that the recent increase in mobile tariffs in Hong Kong could also contribute to future demand for bandwidth at home, as some consumers might alter their behaviour to consume/pre-load richer content more at home instead of on the go.

Figure 9: Hong Kong fibre broadband coverage

	Stated coverage	Proportion of high-speed subscribers	Subscription / installation time
HKT	Home coverage: 98% xDSL 86.9% FTTB ready / 79.9% FTTH ready	462k FTTH customers (~30% of broadband subscriber base) as at end of Jul-14.	FTTB-ready = FTTH service can be available within 29 days of receiving a service order, building management access permitting. FTTH-ready means FTTH service can be available within 4 days of receiving a service order
HKBN	2.1 mn residential home passed (79% of HK residential unit)	All subscribers on 100Mbps and above	Symmetric 100Mbps and above, typically within 48 hours.
HTHK	More than 70% of home	Most subscribers on 100Mbps and above	n/a

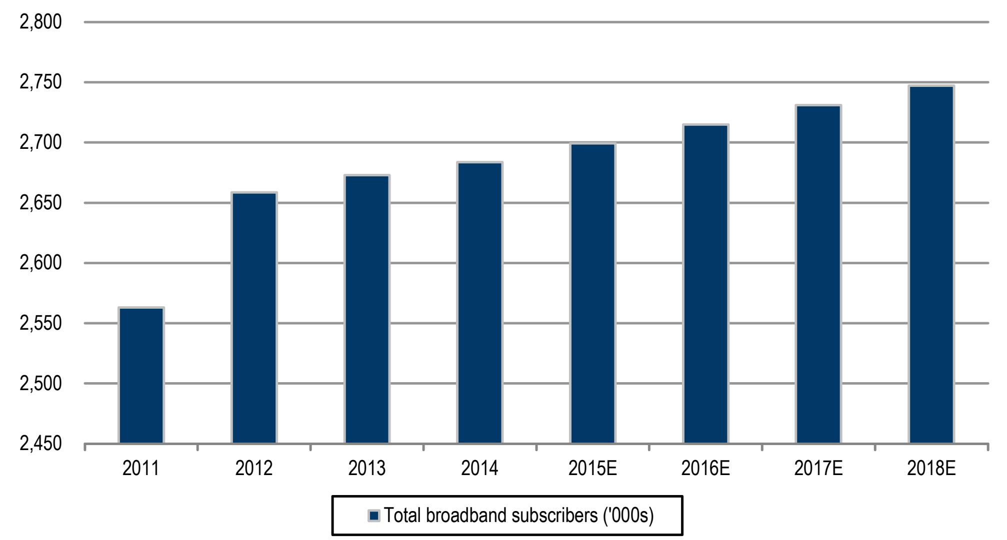
Source: Company data, Credit Suisse estimates

On the operators' side, given the combination of (1) competition (early liberalisation of the industry, HKBN's decision to focus on fibre for the residential market), (2) the need to find new revenue streams, e.g. data and internet to replace the decline in traditional usages, and (3) fixed-line infrastructure to support both demand for fixed broadband and fibre backhaul for mobile as mobile data usage rises, fibre network coverage in Hong Kong is also high and continues to grow.

We acknowledge that not every household would subscribe to fibre broadband services (some limiting factors, e.g. affordability, a genuine lack of demand for some subscribers, and a lack of coverage), but we see both demand and supply factors that would continue to push up fibre broadband penetration in HK as discussed above.

Overall our base case expects higher speed residential fibre broadband (>100Mbps) subscribers to grow at FY14-17E CAGR of 7.5%, driven mainly by HKT's 13.4% CAGR over the period followed by HKBN's 5.4% CAGR, implying 63% fibre broadband penetration of household by the end of 2015E, 72% by 2017E and 82% by 2020E.

Figure 10: **Hong Kong broadband market—subscribers projection**



Source: Company data, Credit Suisse estimates

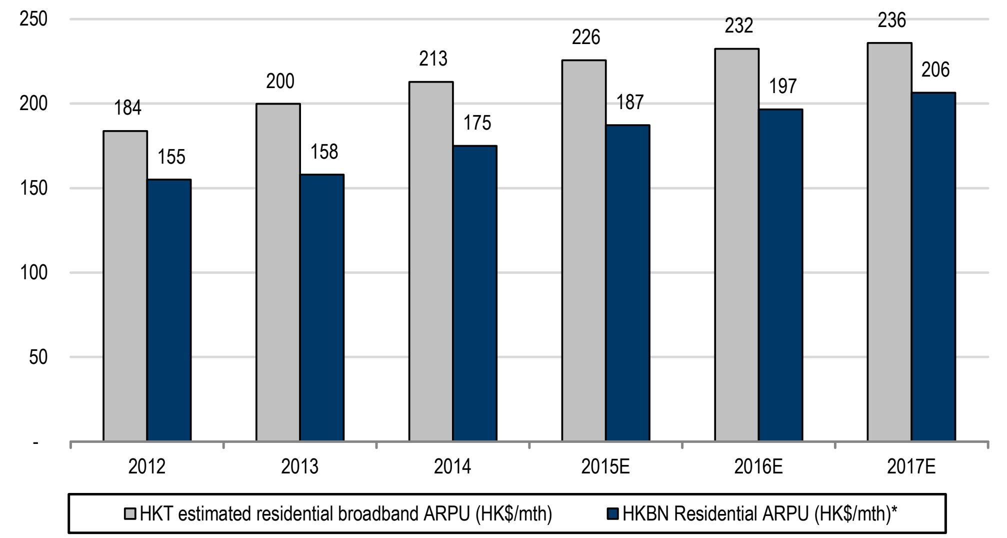
…and a (relatively) benign competitive environment should allow monetisation to come through

The much more important element for growth, though, in our view, is the monetisation of higher-speed broadband as subscribers migrate to fibre broadband or upgrade their subscription, i.e., subscribers should contribute higher ARPU as the speed increases.

The key determinant of monetisation, in our view, are (1) the competitive environment and (2) operators' trade-off between subscriber growth and ARPU (e.g., free fibre broadband would increase the subscriber base substantially but not revenues).

Importantly, while the HK broadband market continues to have four players and it went through a period of intense price competition in 2009-11, the sector went through a significant change in 2012, with both HKT and HKBN shifting their focus away from market share gain (for HKBN) or protection (for HKT) to more towards profitability. This "industry repair" included more rational competition, cessation of very aggressive promotions, imposition of installation fees (previously waived) and generally re-contracting subscribers at a higher speed and a higher ARPU.

Figure 11: **HKT and HKBN—residential broadband ARPU progression**



**For HKBN, use FY8/12 for 2012, residential ARPU include revenues form bundled voice, IPTV and other entertainment services. Source: Company data, Credit Suisse estimates*

We believe these positive changes were driven by (1) HKBN's reaching scale, (2) PCCW's HKT Trust spin-off and its focus on "adjusted fund flow", (3) HTHK (which was focusing mainly on the corporate side) turning aggressive in 2H11, though elasticity was negative (FY11 residential revenues declined 12% YoY) and thus it reversed this strategy in FY12 while i-Cable's broadband service is not competitive even after the upgrade (DOCSIS3.0 can offer theoretical speed of 130Mbps, but incumbents' FTTx are 100Mbps and above).

Therefore, while headline subscriber growth has seen a slowdown (only 4.0% YoY in FY12A and 0.8% YoY in FY13A), the sector delivered 7.4% YoY growth in broadband revenues in FY12A and FY13A, driven largely by the 5% recovery in blended ARPU to ~HK$218/mth in FY13A as subscribers came out of their previous contracts (generally 24-month) and re-contracted at a higher price.

We believe the sector's main focus remains on improving ARPU…

We believe the focus for the HK broadband sector remains on improving ARPU (re-contracting and/or migrating subscribers to higher-speed and higher ARPU products) and profitability for four reasons.

- **First,** HKT's key focus is on profitability (which drives growth in adjusted fund flow – the basis for its dividend) rather than subscriber market share. Its solid broadband revenue growth (8.0% FY11-14A CAGR) has been driven primarily by ARPU growth (tariff increase, monetisation of higher-speed broadband) while its subscriber has been flat (and hence a gradual decline in market share) over the past two years. In fact, HKT noted during its FY14A result briefing that it did not react to HKBN's recent price activities as it remained focused on overall profitability rather than defending its subscriber market share. We believe HKT could react if its market share loss is substantial (and hence affect its overall revenue) but would be able to tolerate gradual market share loss as long as there's room for ARPU to continue to improve as it upgrades its subscribers to higher-speed FTTx.

- **Second,** while HKBN is in our view setting quite a high residential broadband subscriber growth target (~40,000-60,000 per year), higher than 32,000-46,000 it delivered over the past three years, and turned more active in the market in 2H14 (HKBN pointed out it added only 2,000 subs in 1H14 compared with 30,000 in 2H14), we still believe that its main goal would still be (1) to deliver revenue and profitability growth, and (2) not to provoke HKT into responding aggressively on pricing. We believe this has been managed well so far and expect HKBN to increase its market share gradually.

Figure 12: Hong Kong broadband market—tariffs comparison

HKT				HKBN		HTHK		i-Cable	
Speed	**Listed price**	**Speed**	**Surveyed price***	**Speed**	**Survey price**	**Speed**	**Survey price**	**Speed**	**Price**
<100M "Basic"	598	<100M "Basic"						50M	134
100M	498	100M	208	100M	188	100M	128(30mth)	130M	158
300M	498	300M	231			300M	148(36mth)		
500M	598	500M	276	500M	208	500M	158(36mth)		
1000M	698	1000M	362	1000M	228	1G	188		

*Source: Company data, Credit Suisse estimates, *average of 4 locations or where available, tariff based on 24-mth plan*

- **Third,** we believe that the elasticity to aggressive tariff cut/promos at the current level could be negative. Apart from the low fixed-line churn rate (which means subscribers could move quite slowly), we believe that market conditions have changed materially since HKBN broke into the market. We believe both HKT and HKBN are now experienced operators which would react quickly to aggressive cuts. For example, HutchTel's effort to break into the market in FY11A led to a 12.0% YoY decline in its residential fixed-line revenues with limited traction in terms of subscribe market share. We believe there would still be competition and discounts particularly on an area-by-area basis, but it is unlikely for smaller operators to cut tariffs aggressively.

- **Fourth**, we expect HutchTel and i-Cable to remain smaller in the market. For i-Cable, while it has upgraded its network to DOCSIS3.0 and thus is capable of offering 130Mbps theoretical speed, this in our view is not competitive against HKT, HKBN or HutchTel FTTx's offers (100Mbps and above) and it does not make sense for it to re-invest in a new technology even if available (very unlikely to generate returns greater than cost of capital). For HutchTel, while it claimed 70% homepass (FTTB) and in our view could post some threat if it turns aggressive again, (1) we expect HutchTel to still mainly focus its resources on its mobile business which still remains under pressure despite the recent improvement in industry's pricing, and (2) we believe building access could still be a key limitation for HutchTel, particularly for it to roll out FTTH services.

...there will always be competition, but more so on an area-by-area basis

This, however, does not mean that there is no competition among operators. As highlighted above, we believe HKBN's residential broadband subscriber growth target is quite high (~40,000-60,000 per year), an acceleration from 32,000-46,000 it delivered over the past three years and higher than market growth (i.e., thus market share gains from other operators).

We believe though that it is important to note that residential broadband competition and broadband tariffs in HK could be very different from headline tariffs and could vary materially among different locations depending on coverage areas (e.g., whether all operators have access) and affordability (e.g., discounts/promos for public housing estates). The competition could also include discounts, freebies, and partial waiver of installation fees (e.g. HKBN). The table below shows HKT's headline pricing versus its quoted pricing in different locations.

Figure 13: Tariffs comparison—HKT vs. HKBN

	Headline (24 mths)	May Sun, Kennedy Town	J Residence, Wan Chai	Haywood, Causeway bay	Imperial court, Mid- level	Wah Fu Estate, Pok Fu Lam	Fu On Court, Chai Wan	Harbour Green, Tai Kok Tsui
HKT								
100M			208				208	
200M	498					168		
300M	498	208		208	298			208
500M	598	246		246	398	246		246
1000M	698	338		338	498	298		338
HKBN								
100M	268	188	188	188	220	158	173	188
200M								
300M								
500M	318	208	208	208	288	178	193	208
1000M	368	228	228	228	308	198	213	228

Source: Company data, Credit Suisse estimates

What this means is that instead of a major price cut, we expect competition/pricing activities to be more on an area-by-area basis. Such competition would affect new/re-contracting subscribers in the area, but the impact would be less on the overall base while such activities could be adjusted/pulled out relatively quickly (low "menu costs").

We do note though that the ARPU increase could now be at a slower pace

Given higher fibre penetration (33% of HKT broadband base are now on FTTx and substantially all subscribers for HBKN and HutchTel), we do recognise though that a further direct broadband tariff increase could be more difficult as fibre continues to penetrate into the medium-end (and thus more price-sensitive) segment. We note that this could be more the case for HKT rather than HKBN as the latter focused more on the lower-end (e.g. public housing) segment when it started.

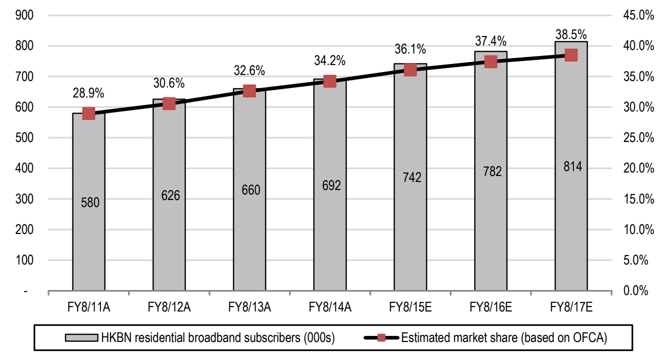
This in our view could make it more challenging for HKT to increase and execute the migration of subscribers to these higher tariff plans. However, on a bigger picture, we believe that the competition in the HK residential broadband market remains quite rational and we expect to see further improvement in broadband ARPU, albeit at a slower pace than before.

HKBN is well positioned to capture growth

We expect HKBN to continue to gain market share, albeit at a more gradual pace…

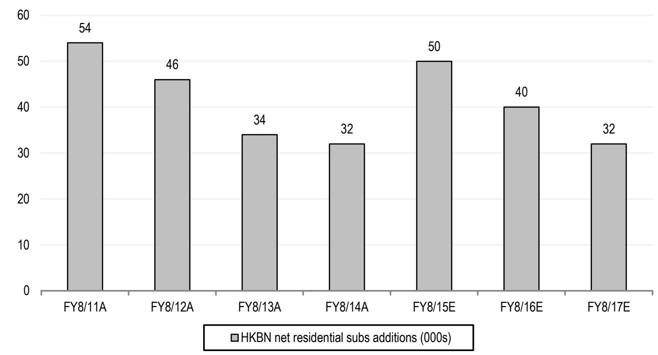
With (1) our expectation for fibre broadband penetration in HK to continue to rise driven by both supply push and demand pull factors, (2) HKT's focus on managing overall profitability rather than just market share (thus we do not expect HKT to react aggressively as long as HKBN did not make the tariff gap too wide), (3) HKBN's tariff discount relative to HKT, and (4) our expectation that competitive threat from smaller operators such as HutchTel and i-Cable would remain limited as discussed in the previous section, we still see room for HKBN to continue to grow its broadband subscribers faster than the market, and hence continue to gain market share within the Hong King broadband sector.

Figure 14: **HKBN—residential subscriber forecasts**



Source: Company data, Credit Suisse estimates

Figure 15: **HKBN—residential subs additions assumption**



Source: Company data, Credit Suisse estimates

We do note though that HKBN's key strong presence so far has been in the lower/lower-middle income segment, e.g. public housing estates. To continue to grow the subscriber base further and gain market share from here, we believe HKBN would also need to try to break further into the medium- and higher-income segment.

This segment could be less price sensitive, more reluctant to switch (i.e., go through cancellation and re-installation process), could require higher service levels while HKT could also try to protect this group of subscribers better given their higher ARPU. Given these challenges, our base case assumes HKBN's speed of subscriber market share gain to gradually slow from its peak in FY8/15E.

Would SMT's broadband services (reseller of HKBN) change the dynamics?

SmarTone on 30 July 2014 announced the launch of fixed fibre broadband service, 'ST Fibre Broadband' by becoming a reseller of HKBN's fibre broadband. This move could benefit both SMT and HKBN. From HKBN's perspective, while it has made good progress in the residential broadband segment, it has made little progress in penetrating corporate and medium/higher-end residential segments, which are dominated by HKT. SMT's relationship with corporate customers and higher-end mobile subscribers could help HKBN (indirectly) penetrating more into these segments.

The question, of course, is whether this would change the sector's competitive dynamics. While this does increase competitive risk for the sector (if SMT managed to break into the market currently dominated by HKT meaningfully), we note that (1) SMT is not pricing its broadband services at a very deep discount, with tariffs broadly in line with HKBN even after mobile bundling discounts, and (2) we believe the reseller's cost structure would prevent SMT from turning irrationally competitive against the incumbents. We expect SMT to be able to gain some market share (built in as part of HKBN's lines here) but do not expect its launch to lead to aggressive price competition like in the case of 2009.

Figure 1: **Hong Kong broadband tariff comparison**

HKT		HKBN		SMT	
Speed	**Price (HK$)***	**Speed**	**Price (HK$)**	**Speed**	**Price (HK$)**
100M	208	100M	188		
300M	231				
500M	276	500M	208	500M	168**/208
1000M	362	1000M	228	1000M	198**/248

*Source: Company data, Credit Suisse estimates, *Based on average surveyed price, **bundled price with SuperCare smartphone plan both handset bundled and SIM only starting at $195*

…and there's room for further ARPU increase

Positive tariff environment and upselling have allowed ARPU to increase…

Apart from subscriber growth, another clear key driver behind HKBN's 10.4% YoY service revenue growth in FY8/14A was the 10.8% YoY improvement in blended residential ARPU (including broadband, voice and some Pay TV), reaching HK$175/month in FY8/14A compared with HK$155-158/month in FY8/12-13A.

This ARPU improvement was mainly driven by the impact of selective tariff increases over the previous few years along with HKT's tariff increases as well as up-selling effort for higher-speed, higher ARPU products (tariff increases and upselling only affect new and re-contracting subscribers, and hence takes time to come through).

…and we believe there's room for this to still continue

Importantly, apart from continued impact from previous tariff increases and upselling effort as existing subscribers continue to re-contract at a higher price (which allowed HKBN's residential ARPU in three months to Nov-14 to improve further to HK$183/month, +7.6% YoY), we believe there's room for HKBN's residential ARPU to continue to expand from here.

- **First,** HKBN's current residential ARPU of HK$183/month is only closer to its mid-end product pricing for public housing (HK$178/month 500Mbps broadband) and only around starting 100Mbps level for middle-class residence (HK$173-188/month). This means there could be room for further ARPU uplift even without further tariff increase, particularly if HKBN manages to penetrate more into the middle-class residences and/or better upsell its 500Mbps-1Gbps services to re-contracting subscribers.

- **Second,** HKT is charging voice services at a substantially higher price than HKBN for bundled plans. For example, even for public housing, HKT's 300Mbps fibre with voice bundled is HK$318/month compared with HK$208/month for broadband only (i.e., HKT is charging HK$110/month for voice). This compared to HKBN's only ~HK$10/month price difference. We note that while fixed-line voice is perceived to be a declining business, HKT has been quite successful in maintaining the number of voice lines and able to selectively raise voice tariffs recently which in turn allowed them to report 2.7% YoY growth in local telephony revenues in 2H14A. We believe this price gap could give HKBN some room to increase prices of its voice bundled broadband offerings.

Figure 16: **Sample prices of residential broadband only packages in Hong Kong**

	Speed (Mbps)	Public housing	Middle-class residence	Upscale residence
		Solo	Solo	Solo
	< 100 (xDSL)	*	298	*
	100 (Fibre)	168	*	*
HKT	200 (Fibre)	168-208	208	*
	300 (Fibre)	208	208	298-398
	500 (Fibre)	206-246	246	398-498
	1000 (Fibre)	298-338	338	498-598
	100 (Fibre)	158	173-188	188-298
HKBN	500 (Fibre)	178	193-208	208-318
	1000 (Fibre)	198	213-228	228-338
	< 100 (xDSL)	150	*	*
	100 (Fibre)	150-154	150	*
HGC	300 (Fibre)	*	148[a]	148[a]
	500 (Fibre)	*	158[a]	158[a]
	1000 (Fibre)	*	188	188
	10 (HFC)	*	93	*
i-Cable	50 (HFC)	134-169	113-169	134-169
	130 (HFC)	158-199	158-199	158-199
	200 (HFC)	166-199	166-199	166-199

*Source: MPA, HKBN prospectus.*Not available in the residences sampled; [a]Based on a 36-month contract for broadband only package*

Figure 17: **Sample prices of residential internet broadband and voice bundle packages in Hong Kong**

	Speed (Mbps)	Public housing	Middle-class residence	Upscale residence
		Bundled	Bundled	Bundled
	< 100 (xDSL)	*	408[a]	*
	100 (Fibre)	296	*	*
HKT	200 (Fibre)	241-318[a]	318[a]	*
	300 (Fibre)	318[a]	281-336[a]	536-666
	500 (Fibre)	279-356[b]	319-374[a]	636-766
	1000 (Fibre)	371-448[b]	411-466[a]	736-866
	100 (Fibre)	168[#]	183[#]-208[#]	218[#]-338[#]
HKBN	500 (Fibre)	188[#]	203[#]-228[#]	238[#]-358[#]
	1000 (Fibre)	208[#]	223[#]-248[#]	258[#]-378[#]
	< 100 (xDSL)	185[#]	*	*
	100 (Fibre)	185[#]-189[#]	185[#]	*
HGC	300 (Fibre)	*	183[b][#]	183[b][#]
	500 (Fibre)	*	193[b][#]	193[b][#]
	1000 (Fibre)	*	223[b][#]	223[b][#]
	10 (HFC)	*	175	*
i-Cable	50 (HFC)	216-251	195-251	216-251
	130 (HFC)	240-281	240-281	240-281
	200 (HFC)	181[#]-281	181[#]-281	181[#]-281

*Source: MPA, HKBN prospectus. *Not available in the residences sampled; [a]Based on an 18-month contract for voice only package; [b]Based on a 36-month contract for broadband only package; (#) Represents a discounted price as a bundled offering as compared to subscribing for broadband and voice on a standalone basis.*

- **Third,** looking at the overall price gap between HKT and HKBN, HKBN's broadband pricing for broadband-only product is still at a ~6-21% discount to HKT for 100-500Mbps broadband for the public housing segment and a ~13-19% discount to HKT for middle-class residences. The gap would be even wider for 1Gbps services (35-38%) and voice bundled-broadband as discussed above. We believe there could be room for HKBN to narrow this gap. We note though that this opportunity could be more for the longer term as HKBN shifts its focus away from market share gain to maintaining share and improving profitability.

As discussed in the previous section, there will always be competition in the marketplace and we expect occasional promotions or tariff discounts for new and/or re-contracting subscribers particularly as HKBN still wants to grow its subscriber market share. We, however, expect this to remain more on an area-by-area basis and to still allow some improvements in blended residential ARPU from the current level.

Our base case assumes HKBN's blended residential ARPU to increase at FY8/14-17 CAGR of 5.7%, reaching HK$206/month in FY8/17E from ~HK$183/month currently.

Figure 18: **HKBN—residential revenues projection**

HK$ mn	FY8/13A	FY8/14A	FY8/15E	FY8/16E	FY8/17E
Residential subscribers ('000s)	**660**	**692**	**742**	**782**	**814**
YoY growth (%)	5.4%	4.8%	7.2%	5.4%	4.1%
Residential ARPU (HK$)	**158**	**175**	**187**	**197**	**206**
YoY growth (%)	1.9%	10.8%	7.0%	5.0%	5.0%
Residential broadband & bundled revenues	**1,219**	**1,420**	**1,611**	**1,798**	**1,977**
YoY growth (%)	n/a	16.4%	13.5%	11.6%	10.0%
Other residential revenues	271	211	169	139	116
YoY growth (%)	n/a	-22.1%	-19.9%	-17.9%	-16.1%
Total residential service revenues	**1,490**	**1,630**	**1,780**	**1,936**	**2,093**
YoY growth (%)	6.7%	9.4%	9.2%	8.8%	8.1%

Source: Company data, Credit Suisse estimates

Corporate represents additional revenue opportunities, though more challenging

The corporate segment represents another area of growth potential for HKBN. The segment currently contributes ~21% of HKBN's group service revenues and delivered 14.1% YoY growth in FY8/14A and 12.5% YoY in three months to Nov-14.

We note that growing the enterprise segment is challenging. **First,** the segment consists of more competitors relative to the residential segment including HKT, HutchTel (HGC), Wharf T&T and New World. **Second,** given that enterprise customers tend to have higher ARPU (HKBN's FY8/14A enterprise ARPU was HK$1,026/month, compared with HK$175 on the residential side), and hence incumbents could be more protective of market share. **Third,** enterprise customers are more complex than residential subscribers with more focus on other aspects of services than price. **Fourth,** given the difference in requirements and service level expectations, enterprise customers also require separate teams both in terms of sales and customer services. **Fifth,** enterprise customers particularly larger corporates are in our view stickier and hence more difficult for new entrant/smaller player to break into the market.

HKBN has a c12% market share in the enterprise segment. While breaking into the market could be challenging, we see a market opportunity for HKBN in the small and medium enterprise segment. Customers in this segment would still have more requirement/expect higher service level than residential, but in our view could still behave closer to residential subscribers than in the case of larger enterprises. With the growing digitisation of business and demand for access, we expect demand for broadband connectivity for small and medium enterprises to also increase steadily.

In our current base case, HKBN would be able to add 3,000 enterprise broadband subscribers each year (a 7.6% 3Y CAGR, albeit from a low base) while ARPU would see FY14-17 CAGR of 2.4% to HK$1,101 in FY8/17E from HK$1,026 in FY8/14A.

Figure 19: HKBN—enterprise revenue forecasts

HK$ mn	FY8/13A	FY8/14A	FY8/15E	FY8/16E	FY8/17E
Enterprise subscribers ('000s)	**29**	**32**	**35**	**37**	**40**
YoY growth (%)	7.4%	10.3%	7.8%	8.0%	7.0%
Enterprise ARPU (HK$)	**948**	**1,026**	**1,068**	**1,090**	**1,101**
YoY growth (%)	4.2%	8.2%	4.1%	2.1%	1.0%
Enterprise broadband & bundled revenues	**319**	**376**	**426**	**469**	**510**
YoY growth (%)	n/a	17.9%	13.5%	10.1%	8.6%
Other Enterprise revenues	52	47	47	47	47
YoY growth (%)	n/a	-9.1%	0.0%	0.0%	0.0%
Total Enterprise service revenues	**371**	**423**	**474**	**517**	**557**
YoY growth (%)	4.9%	14.1%	12.0%	9.1%	7.8%

Source: Company data, Credit Suisse estimates

We expect a 22% 3Y FCF (and dividend) CAGR

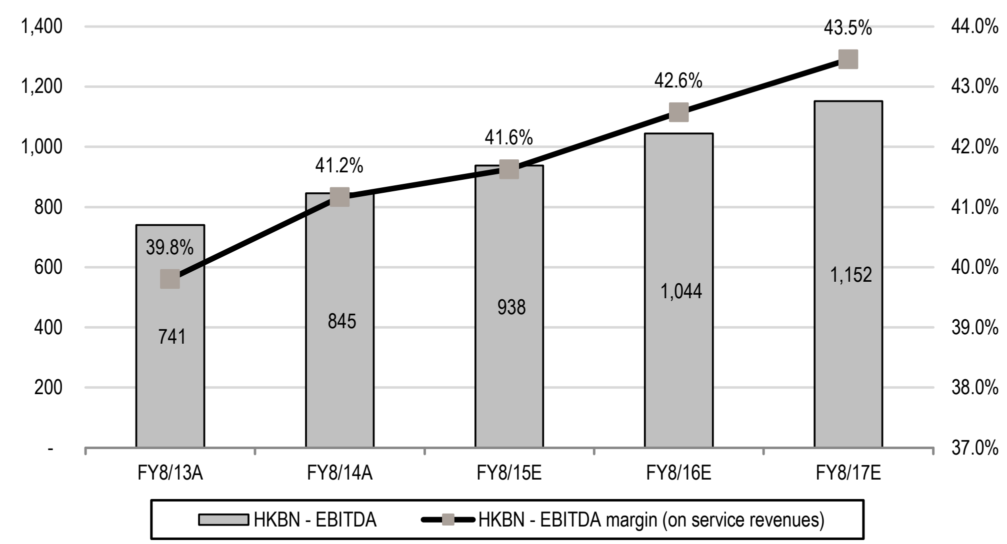
Operational leverage means EBITDA margin should improve…

Putting together our residential and enterprise revenue projections as set out in the previous section, our base case forecasts HKBN can deliver 8.9% FY14-17E service revenue CAGR, driven by a combination of subscriber growth and ARPU increases in both residential and enterprise markets.

More importantly, we expect HKBN's cash operating expenses to grow at a slower rate than its revenue. While we expect its talent (employee-related) expenses and advertising and marketing expenses to witness FY8/14-17E CAGRs of 9.9% and 6.0%, respectively, other cash operating expenses such as network costs should grow at a much slower rate, and thus overall cash operating expenses should see FY8/14-17E CAGR of 6.5%.

This operational leverage, we believe, should allow HKBN's EBITDA margin (on service revenues) to improve further, from 41.2% in FY8/14A to reach 43.5% in FY8/17E, allowing 8.9% FY14-17E service revenue CAGR to feed through to EBITDA CAGR of 10.9%.

Figure 20: **HKBN—EBITDA and EBITDA margin forecasts**



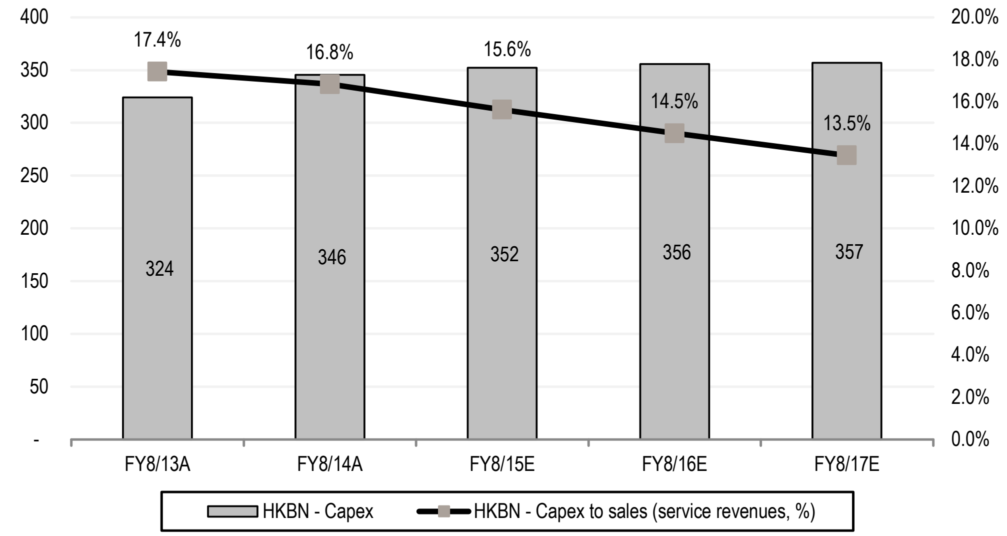
Source: Company data, Credit Suisse estimates

…while capex-to-sales would decline as revenue grows…

On the capex side, while HKBN's fibre coverage has ~2.1 mn residential home-passed, or 79% coverage, we expect HKBN to continue to expand its coverage particular to support its growth plan into medium-end residences and the corporate segment. Our base case assumes its absolute capex amount will remain broadly stable at ~HK$352-357 mn over the next three years.

Given the growing revenue base, however, this means HKBN's capex-to-sales could decline, from 16.8% in FY8/14A to 15.6% in FY8/15E and 13.5% in FY8/17E despite a broadly stable absolute capex amount.

Figure 21: **HKBN—capex and capex-to-sales forecasts**



Source: Company data, Credit Suisse estimates

….resulting in strong cash flow growth

A combination of service revenue growth, EBITDA margin expansion and the decline in capex-to-sales could result in very strong operating cash flow growth for HKBN over the next three years, at a 16.7% CAGR.

Figure 22: **HKBN—adjusted free cash flow forecasts**

HK$ mn	FY8/13A	FY8/14A	FY8/15E	FY8/16E	FY8/17E
EBITDA	**741**	**845**	**938**	**1,044**	**1,152**
YoY growth (%)	n/a	14.1%	11.0%	11.3%	10.3%
EBITDA margin (%)	39.8%	41.2%	41.6%	42.6%	43.5%
Capex	**(324)**	**(346)**	**(352)**	**(356)**	**(357)**
Capex to sales (%)	17.4%	16.8%	15.6%	14.5%	13.5%
Net interest paid	(146)	(165)	(141)	(111)	(111)
Other non-recurring items	-	4	-	-	-
Other non-cash items	(9)	(9)	(9)	(9)	(9)
Income tax paid	(4)	(43)	(70)	(95)	(112)
Changes in working capital	(30)	24	-	-	-
Adjusted free cash flow	**227**	**311**	**366**	**473**	**563**
YoY growth (%)	n/a	37.2%	17.6%	29.5%	18.9%

Source: Company data, Credit Suisse estimates

Following recent re-financing activities (bond redemption funded by five-year loan at a base cost of H+206, we are assuming ~HK$66 mn net interest cost savings), we expect HKBN to be able to deliver FY8/14-17E adjusted free cash flow CAGR of 21.8%, to HK$562 mn in FY8/17E from HK$311 mn generated in FY8/14A.

Cash flow to be paid out as dividend

Importantly, given its dividend policy of "not less than 90% of adjusted free cash flow with an intent to pay 100% of adjusted free cash flow in respect of the relevant year/period, after adjusting for potential debt repayment, if required", we expect HKBN's strong growth in cash flow to be passed on to shareholders. Our base case assumes 100% payout of adjusted free cash flow, implying FY8/15-16E dividend yield of 4.0 (annualised) -5.2%, rising to 6.2% in FY8/17E.

Initiate with NEUTRAL, 12% potential upside

We value HKBN using a discounted cash flow valuation based on cash flow projection as discussed in the previous section built out to FY8/22E, a 7.3% weight average cost of capital (a 9.1% cost of equity, 4.6% longer term cost of debt) and a 0.3% terminal growth rate from FY8/22E; this supports our HK$10.1 bn target equity value for HKBN, or HK$10.10/share.

With 12% potential upside to our DCF-based target price, we initiate coverage on HKBN with a NEUTRAL rating. At our target price, HKBN would offer only a 3.6% (annualised) dividend yield for FY8/15E, increasing to 4.7-5.5% in FY8/16-17E .

Figure 23: **HKBN—DCF valuation**

	FY8/15E	FY8/16E	FY8/17E	FY8/18E	FY8/19E	FY8/20E	FY8/21E	FY8/22E
Revenue	2,323	2,516	2,708	2,877	3,034	3,164	3,259	3,335
EBITDA	938	1,044	1,152	1,239	1,307	1,364	1,406	1,436
Growth	11.0%	11.3%	10.3%	7.6%	5.5%	4.3%	3.1%	2.2%
Less: depreciation & Amortisation	(457)	(467)	(474)	(472)	(469)	(464)	(463)	(473)
EBIT for DCF	481	577	678	767	838	900	942	963
Change in working capital	(65)	(9)	(9)	(9)	(9)	(9)	(9)	(9)
Less: capital expenditure	(352)	(356)	(357)	(353)	(346)	(362)	(373)	(382)
less: notional tax	(79)	(95)	(112)	(127)	(138)	(148)	(155)	(159)
Enterprise free cash flow	442	584	674	750	813	845	868	886
YoY growth (%)	-7.2%	32.3%	15.3%	11.3%	8.4%	3.8%	2.8%	2.1%
Discount rate (WACC %)	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%
Discount factor	1.00	0.93	0.87	0.81	0.76	0.70	0.66	0.61
Discounted cash flow	**442**	**545**	**586**	**608**	**614**	**594**	**570**	**542**
Cumulative DCF	**4,500**							
Discounted terminal value	7,734							
Enterprise value (HK$ mn)	12,234							
Enterprise value (HK$ mn) - 12mth	12,694							
Net Cash/(Debt)	(2,558)							
Equity value (HK$ mn)	**10,136**							
Equity value per share (HK$/shr)	**10.1**							
CS target price	**10.1**							

Source: Company data, Credit Suisse estimates

Relative to domestic peers, HKBN is trading at a premium on EV/EBITDA though offers stronger FCF growth and thus a higher dividend yield than wireless operators into FY16-17E. We note though that HKBN's FY15-16E dividend yield of 4.0% (annualised) and 5.2% do not standout against HKT's 5.7-6.6% yield or only comparable to other high yield telcos in the region while upside to DCF only warrant NEUTRAL rating relative to market.

Figure 24: **Hong Kong telecoms sector—comparative multiples**

	Current	Target	Upside	Rating	P/E (x)		EV/EBITDA (x)		FCF yield (%)		Div yield (%)		
	Price (HK$)	Price (HK$)	(%)		FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY17E
HKBN	**9.00**	**10.1**	**12.2**	**N**	**27.9**	**18.8**	**12.2**	**11.0**	**4.0**	**5.2**	**4.0**	**5.2**	**6.2**
HKT Trust	10.08	11.00	9.1	N	18.3	15.6	11.9	10.9	5.7	6.6	5.7	6.6	7.1
HTHK	3.76	4.10	9.0	O	23.6	19.4	10.4	9.4	4.5	5.5	3.6	4.0	5.1
SmarTone	14.80	15.30	3.4	O	22.5	19.5	9.5	8.5	3.7	5.3	3.3	3.8	4.1
PCCW	4.80	5.70	18.8	N	15.2	12.9	8.8	7.9	6.9	8.3	5.4	6.3	6.8
Asia ex Japan Integrated					**17.7**	**19.2**	**7.4**	**7.0**	**2.0**	**5.6**	**3.9**	**4.4**	
Asia ex Japan Wireless					**17.3**	**16.6**	**7.1**	**6.5**	**3.3**	**6.4**	**3.1**	**3.2**	

Note: Prices as of 9 March 2015 for HKT Trust, HTHK, SmarTone and PCCW. Source: Company data, Credit Suisse estimates

Risks

- **A more or less aggressive broadband pricing environment.** Our forecasts / valuations are based on assumptions that HKBN can gradually gain subscriber market share and that HKT would continue to focus on its profitability and cash flow generation. The key risk would be that if HKBN's subscriber growth and/or its promotion triggered HKT to respond / shift its focus more toward market share protection. An aggressive response from HKT could hurt HKBN both in terms of subscriber growth projection and ARPU uplift assumption.

- **A lack of ability to bundle mobile data services compared to peers.** HKBN is largely a fixed-line only operator while its main competitors HKT and HutchTel are both integrated operators with an ability to bundle mobile and fixed-line services. In the case that HKT and/or HutchTel chooses to pursue bundled offers more aggressively (e.g., offer material mobile and fixed-line bundling discount), HKBN could not match these and hence maintain its competitiveness directly.

- **Higher or lower capex requirement for network.** Our current assumptions for broadly similar capex in absolute terms (and hence declining capex to sales) do not include any significant upgrade / re-investment in the network. In the case that there is material shift in technology or further requirement to upgrade / re-invest, higher-than-expected capex could affect cash flow and dividend.

- **A faster or slower decline in IDD services.** IDD revenues still contribute ~10% of HKBN revenues and ~15% of EBITDA given that it has higher margins than broadband business. IDD, in our view, is structurally on a declining trend, and we have built in 18% CAGR decline in IDD revenues over the next three years. Faster (or slower) decline in IDD revenues could affect our cash flow forecasts.

- **Higher or lower interest costs due to higher or lower interest rates.** HKBN's net debt to EBITDA was 3.0x as at the end of Aug-14, and we estimate interest costs for FY15E to be HK$146 mn (16% of EBITDA) and for FY16E to be HK$117 mn (11% of EBITDA) as full benefit from recent re-financing activity kicks in. While HKBN has hedged circa 85% of its debt through interest rate swaps (fixed HIBOR at 1.453%) for 3.5 years, future increase in interest rate could affect its interest cost and thus its cash flow and dividend. For sensitivity, 0.5% increase in average interest cost could affect its FY16-17E adjusted free cash flow by ~3%.

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Companies Mentioned *(Price as of 09-Mar-2015)*

HKBN (1310.HK, HK$9.00, NEUTRAL, TP HK$10.1)
HKT Trust (6823.HK, HK$10.08, NEUTRAL, TP HK$11.0)
Hutchison Telecommunications HK Holdings Ltd. (0215.HK, HK$3.76, OUTPERFORM, TP HK$4.1)
PCCW (0008.HK, HK$4.8, NEUTRAL, TP HK$5.7)
SmarTone Telecom (0315.HK, HK$14.8, OUTPERFORM, TP HK$15.3)

Disclosure Appendix

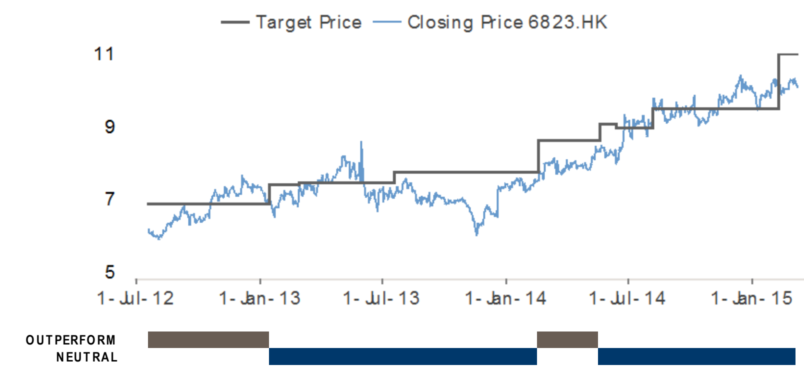
Important Global Disclosures

I, Chate Benchavitvilai, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

3-Year Price and Rating History for HKT Trust (6823.HK)

6823.HK Date	Closing Price (HK$)	Target Price (HK$)	Rating
19-Jul-12	6.18	6.88	O
15-Jan-13	6.97	7.41	N
28-Feb-13	7.34	7.46	
19-Jul-13	7.10	7.75	
18-Feb-14	7.51	8.62	O
20-May-14	8.38	9.05	N
13-Jun-14	7.99	8.95	
06-Aug-14	9.33	9.50	
09-Feb-15	10.06	11.00	

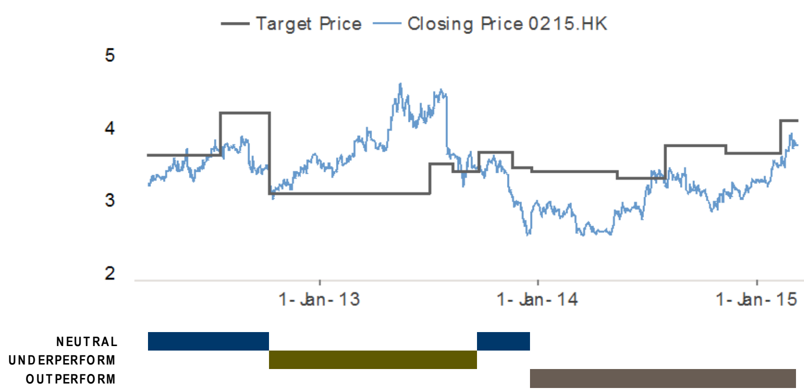
** Asterisk signifies initiation or assumption of coverage.*



3-Year Price and Rating History for Hutchison Telecommunications HK Holdings Ltd. (0215.HK)

0215.HK Date	Closing Price (HK$)	Target Price (HK$)	Rating
21-Mar-12	3.23	3.62	N
19-Jul-12	3.74	4.20	
09-Oct-12	3.32	3.10	U
03-Jul-13	4.25	3.50	
12-Aug-13	3.64	3.40	
23-Sep-13	3.49	3.66	N
18-Nov-13	3.06	3.45	
20-Dec-13	2.83	3.40	O
12-May-14	2.84	3.30	
31-Jul-14	3.33	3.75	
10-Nov-14	3.10	3.65	
09-Feb-15	3.48	4.10	

** Asterisk signifies initiation or assumption of coverage.*



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3-Year Price and Rating History for PCCW (0008.HK)

0008.HK	Closing Price	Target Price	
Date	(HK$)	(HK$)	Rating
19-Jul-12	3.15	3.63	O
15-Jan-13	3.35	3.76	
28-Feb-13	3.69	4.10	
18-Feb-14	3.49	4.30	
20-May-14	4.41	4.80	N
13-Jun-14	4.22	4.63	
06-Aug-14	4.80	4.90	
09-Feb-15	5.29	5.70	

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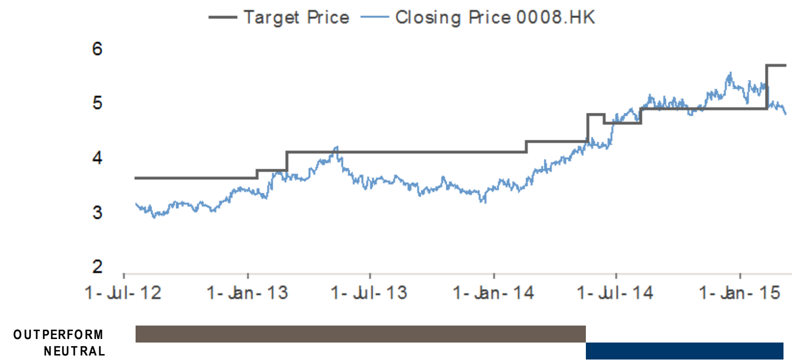
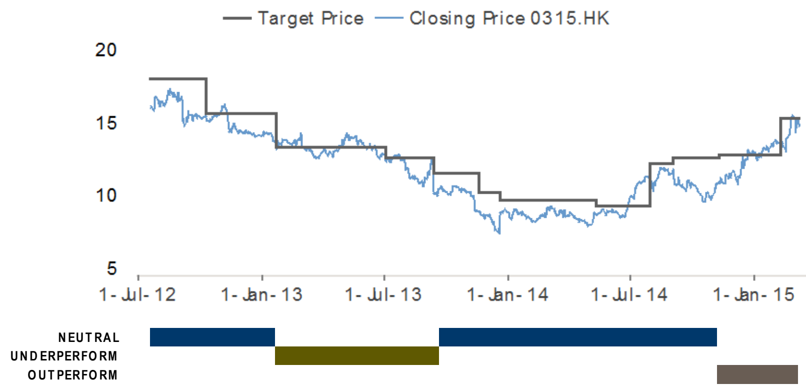


3-Year Price and Rating History for SmarTone Telecom (0315.HK)

0315.HK	Closing Price	Target Price	
Date	(HK$)	(HK$)	Rating
19-Jul-12	16.02	18.00	N
09-Oct-12	15.46	15.60	
21-Jan-13	13.60	13.30	U
03-Jul-13	12.42	12.60	
12-Sep-13	10.36	11.50	
22-Sep-13	10.40	11.50	N
18-Nov-13	8.89	10.20	
20-Dec-13	8.81	9.65	
11-May-14	8.80	9.25	
31-Jul-14	11.26	12.20	
03-Sep-14	11.78	12.60	
10-Nov-14	10.90	12.80	O
09-Feb-15	13.60	15.30	

** Asterisk signifies initiation or assumption of coverage.*



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Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.

Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.

**Relevant benchmark by region: As of 10th December 2012, Japanese ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2012, U.S. and Canadian as well as European ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. For Latin American and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe. For Australian and New Zealand stocks, 12-month rolling yield is incorporated in the absolute total return calculation and a 15% and a 7.5% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively. The 15% and 7.5% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively. Prior to 10th December 2012, Japanese ratings were based on a stock's total return relative to the average total return of the relevant country or regional benchmark.*

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Price Target: (12 months) for PCCW (0008.HK)

Method: Our target price of HK$5.7 per share for PCCW is based on (1) PCCW's 63% stake in HKT Trust (6823.HK) at our target valuation for HKT Trust, (2) sum-of-the-parts DCF-based valuation for PCCW's remaining businesses using 7.8% weighted average cost of capital (WACC). We value PCCW's equity stake in PCPD using discount to its current market value. We also apply 20% holding company discount on PCCW's stake in HKT Trust. At our target price, PCCW would be trading at an FY15E proportionately consolidated adjusted EV/EBITDA of 10.1x and a dividend yield of 4.6%.

Risk: The risks that may impede achievement of our target price of HK$5.70 per share for PCCW are: (1) either faster-than-expected, or slower-than-expected growth in the residential and corporate broadband market from the current level; (2) the prospect that competitors take a larger or smaller proportion of the market share of net additions; (3) that costs and capex forecasts prove higher or lower than expected; (4) that competition leads to higher or lower attrition of revenue per user than expected; and (5) regulatory risks—e.g. change in laws that lead to lower revenue and/or higher costs than expected.

Price Target: (12 months) for Hutchison Telecommunications HK Holdings Ltd. (0215.HK)

Method: Our target price of HK$4.1 per share for HTHK is based on a sum-of-the-parts DCF (discounted cash flow) valuation with a 6.3% weighted average cost of capital (WACC) and 0.0% terminal growth rate for cellular and 0.8% for fixed line operations. At our target price, HTHK would be trading at an FY15E adjusted proportionately consolidated EV/EBITDA 8.5x.

Risk: Risks to our target price of HK$4.1 per share for HTHK include: (1) either faster than expected, or slower than expected growth in the cellular market, from the current level; (2) the prospect that competitors take a larger or smaller proportion of the market share of net additions; (3) that capex forecasts prove higher or lower than expected; (4) that competition leads to higher or lower attrition of revenue per user than expected; and (5) regulatory risks, e.g., changes in laws that lead to lower revenue and/or higher costs than expected. Key risks to its Wireline business include: (1) faster or slower cannibalization of voice revenue; (2) faster or slower rollout of broadband lines than expected; (3) better success in reducing employment-related costs; and (4) better success in lowering capex requirements.

Price Target: (12 months) for SmarTone Telecom (0315.HK)

Method: Our target price of HK$15.30 per share for SmarTone is based on a DCF (discounted cash flow) valuation with 6.3% weighted average cost of capital (WACC) and 0.0% terminal growth rate. At our target price, SmarTone would be trading at an FY6/16E proportionately consolidated EV/EBITDA (adjusted for amortisation of subsidies) of 9.9x.

Risk: Risks that could cause the share price to diverge from our target price of HK$15.30 per share for SmarTone include: (1) either faster-than-expected, or slower-than-expected growth in the cellular market, from the current level; (2) the prospect that competitors take a larger or smaller proportion of the market share of net additions; (3) that capex forecasts prove higher or lower than expected; (4) that competition leads to higher or lower attrition of revenue per user than expected; and (5) regulatory risks—e.g., change in laws that lead to lower revenue and/or higher costs than expected.

Price Target: (12 months) for HKBN (1310.HK)

Method: Our HK$10.10/share target price for HKBN is based on DCF valuation with 7.3% WACC and 0.3% terminal growth rate. At our target price, HKBN would be trading at an FY8/16-17E FCF yield and dividend yield of 4.7-5.5%.

Risk: Risks to our forecasts and target valuation for HKBN include (1) More or less aggressive broadband pricing environment, (2) Lack of ability to bundle mobile data services compared to peers, (3) Higher or lower capex requirement for network, (4) Faster or slower decline in IDD services, (5) Higher or lower interest costs due to higher or lower interest rates

Price Target: (12 months) for HKT Trust (6823.HK)

Method: Our target price of HK$11.0 per share for HKT Trust and HKT Limited share stapled units is based on a sum-of-the-parts DCF (discounted cash flow) valuation with 5.1% weighted average cost of capital (WACC) and -0.8% terminal growth rate for TSS operations. At our target price, HKT Trust and HKT Limited share staple unit would be trading at an FY15E adjusted EV/EBITDA of 12.6x and a dividend yield of 5.2%.

Risk: The risks that may impede achievement of our target price of HK$11.0 per share for HKT Trust and HKT Limited share stapled units are: (1) either faster-than-expected, or slower-than-expected growth in the residential and corporate broadband market from the current level; (2) the prospect that competitors take a larger or smaller proportion of the market share of net additions; (3) that costs and capex forecasts prove higher or lower than expected; (4) that competition leads to higher or lower attrition of revenue per user than expected; and (5) regulatory risks e.g. change in laws that lead to lower revenue and/or higher costs than expected.

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