



Rating Buy

Asia
China

Telecommunications
Wireless

Company China Mobile

Reuters
0941.HK

Bloomberg
941 HK

Exchange
HSI

Ticker
0941

ADR Ticker
CHL

ISIN
US16941M1099

Date
17 July 2017

Company Update

Price at 14 Jul 2017 (HKD)	82.25
Price target - 12mth (HKD)	110.00
52-week range (HKD)	99.00 - 80.30
HANG SENG INDEX	26,389

James Wang

Research Analyst
(+852) 2203 6145
james-z.wang@db.com

Peter Milliken, CFA

Research Analyst
(+852) 2203 6190
peter.milliken@db.com

Too cheap to ignore – now the sector top pick

Low expectations providing rerating opportunities

With CM having underperformed the HSI by ~20% YTD, we move the stock to our top pick among Chinese telcos. For a telco making 83% of the industry's profit, CM's current discount to peers (China and regional) appears unjustified. Given low expectations, we see significant rerating potential driven by: 1) solid earnings growth with the government likely to be more forgiving of stronger profit at the telcos; 2) improving pay-out, driving 13% p.a. dividend growth over the next three years, 3) potential for lower-than-expected capex at the FY. With CM trading on 9.1x FY17E PE ex-cash, investors are not paying much for the potential upside. Buy.

Cheap valuation and low expectations

CM currently trades on an 11% discount vs. its peers on an EV/EBITDA basis, compared to other dominant industry players, which can trade at up to 50-60% premiums (e.g., Indonesia and Thailand) due to their scale and cash flow generation. We think such a rerating can be delivered by better-than-expected earnings and dividend payout. We estimate that CM can easily deliver a 16% improvement to the bottom line via lower admin expenses and by aligning its depreciation policy with the peers and we expect CM to deliver a 3ppt increase in dividend payout each year as part of a wider effort to increase SOE payouts.

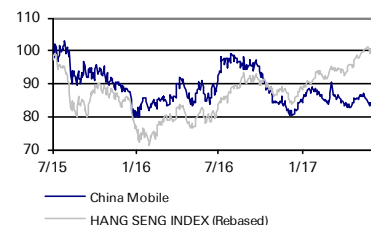
Government to be more tolerant of industry profit growth

We believe the government could be more forgiving on industry profit growth as part of an effort to save up for 5G investments and to facilitate CU's recovery which may see CM start to deliver better NPAT growth than in recent years. Separately, we see the potential for a lower-than-expected capex, a special dividend and relaxation of spectrum re-farming restrictions as other potential catalysts that could see CM rerate over the next 12 months.

Valuation and risks

We derive our target price using a DCF valuation, with an allowance for a contribution from associates and cash. Our valuation uses 7.5% WACC and a 0% perpetual growth rate. Downside risks relate to regulation and competition. See p. 14.

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-2.4	-2.7	-11.1
HANG SENG INDEX	2.0	8.8	22.4

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	668,335.0	708,421.0	756,718.3	800,084.2	839,532.8
EBITDA (CNYm)	240,028.0	256,677.0	276,379.1	293,672.4	309,240.2
Reported NPAT (CNYm)	108,539.0	108,741.0	114,961.5	122,130.7	129,910.9
DB EPS FD(CNY)	5.30	5.31	5.61	5.96	6.34
PER (x)	15.1	14.2	12.7	12.0	11.3
EV/EBITDA (x)	5.2	4.4	3.4	2.9	2.5
DPS (net) (CNY)	2.26	2.39	2.75	3.10	3.49
Yield (net) (%)	2.8	3.2	3.9	4.3	4.9

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items

² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Deutsche Bank AG/Hong Kong

Distributed on: 16/07/2017 19:42:33 GMT

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Model updated: 13 April 2017

Running the numbers

Asia

China

Wireless

China Mobile

Reuters: 0941.HK

Bloomberg: 941 HK

Buy

Price (14 Jul 17) HKD 82.25

Target Price HKD 110.00

52 Week range HKD 80.30 - 99.00

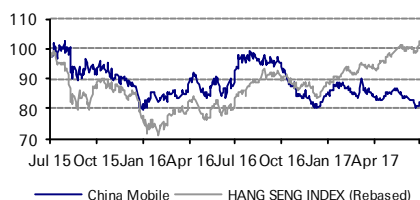
Market Cap (m) HKDm 1,681,061

USDm 215,319

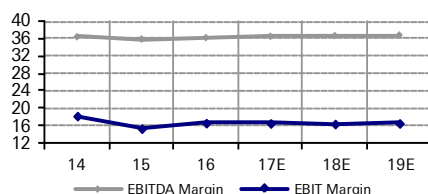
Company Profile

China Mobile Limited provides a full range of mobile telecommunications services in all 31 provinces, autonomous regions and directly-administered municipalities in Mainland China as well as in Hong Kong via its wholly-owned China Mobile Peoples Telephone Co Ltd.

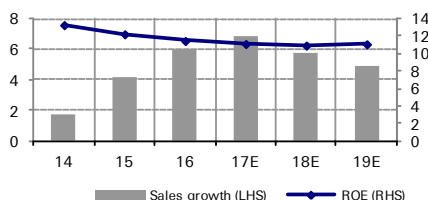
Price Performance



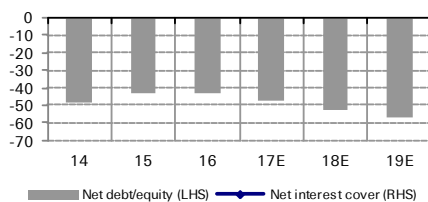
Margin Trends



Growth & Profitability



Solvency



James Wang

+852 2203 6145

james-z.wang@db.com

Fiscal year end 31-Dec

Financial Summary

	2014	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	5.38	5.30	5.31	5.61	5.96	6.34
Reported EPS (CNY)	5.38	5.30	5.31	5.61	5.96	6.34
DPS (CNY)	2.35	2.26	2.39	2.75	3.10	3.49
BVPS (CNY)	42.6	44.9	47.8	53.1	55.9	58.6
Weighted average shares (m)	20,103	20,438	20,475	20,475	20,475	20,475
Average market cap (CNYm)	1,321,195	1,632,078	1,549,374	1,460,208	1,462,855	1,462,855
Enterprise value (CNYm)	909,392	1,236,933	1,131,779	942,162	864,772	778,562

Valuation Metrics

P/E (DB) (x)	12.2	15.1	14.2	12.7	12.0	11.3
P/E (Reported) (x)	12.2	15.1	14.2	12.7	12.0	11.3
P/BV (x)	1.69	1.58	1.47	1.34	1.28	1.22
FCF Yield (%)	3.0	3.8	4.2	6.6	9.2	10.1
Dividend Yield (%)	3.6	2.8	3.2	3.9	4.3	4.9
EV/Sales (x)	1.4	1.9	1.6	1.2	1.1	0.9
EV/EBITDA (x)	3.9	5.2	4.4	3.4	2.9	2.5
EV/EBIT (x)	7.8	12.0	9.6	7.5	6.6	5.6

Income Statement (CNYm)

Sales revenue	641,448	668,335	708,421	756,718	800,084	839,533
Gross profit	641,448	668,335	708,421	756,718	800,084	839,533
EBITDA	233,665	240,028	256,677	276,379	293,672	309,240
Depreciation	116,225	136,832	138,090	150,262	161,424	169,347
Amortisation	106	274	499	499	499	499
EBIT	117,334	102,922	118,088	125,618	131,749	139,394
Net interest income/(expense)	15,921	15,397	15,770	16,608	18,885	20,719
Associates/affiliates	8,248	23,615	8,636	8,481	9,482	10,235
Exceptionals/extraordinaries	0	0	0	0	0	0
Other pre-tax income/(expense)	1,089	1,800	1,968	2,102	2,223	2,332
Profit before tax	142,592	143,734	144,462	152,809	162,339	172,680
Income tax expense	33,187	35,079	35,623	37,744	40,098	42,652
Minorities	126	116	98	104	110	117
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	109,279	108,539	108,741	114,961	122,131	129,911
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	109,279	108,539	108,741	114,961	122,131	129,911

Cash Flow (CNYm)

Cash flow from operations	211,022	235,089	253,701	272,112	286,216	298,357
Net Capex	-170,798	-172,448	-189,044	-176,000	-152,016	-151,116
Free cash flow	40,224	62,641	64,657	96,112	134,200	147,242
Equity raised/(bought back)	8,215	1,024	0	0	0	0
Dividends paid	-50,934	-47,933	-47,004	-56,331	-63,508	-71,451
Net inc/(dec) in borrowings	0	-8,149	-1,722	52,585	0	0
Other investing/financing cash flows	24,308	-1,553	-5,360	8,180	9,456	10,536
Net cash flow	21,813	6,030	10,571	100,546	80,148	86,327
Change in working capital	5,347	17,751	23,187	22,894	20,936	19,202

Balance Sheet (CNYm)

Cash and other liquid assets	418,862	403,172	425,710	526,256	606,404	692,730
Tangible fixed assets	658,136	673,643	712,209	732,902	718,447	694,997
Goodwill/intangible assets	36,066	36,111	37,051	37,051	37,051	37,051
Associates/investments	70,571	172,673	124,074	132,520	142,002	152,237
Other assets	112,814	142,296	221,950	234,885	246,494	257,050
Total assets	1,296,449	1,427,895	1,520,994	1,663,614	1,750,397	1,834,065
Interest bearing debt	4,992	4,995	4,998	4,989	4,989	4,989
Other liabilities	432,814	502,532	533,858	567,565	598,211	626,245
Total liabilities	437,806	507,527	538,856	572,554	603,200	631,234
Shareholders' equity	856,576	917,336	979,021	1,087,839	1,143,866	1,199,382
Minorities	2,067	3,032	3,117	3,221	3,331	3,449
Total shareholders' equity	858,643	920,368	982,138	1,091,059	1,147,197	1,202,831
Net debt	-413,870	-398,177	-420,712	-521,267	-601,415	-687,741

Key Company Metrics

Sales growth (%)	1.8	4.2	6.0	6.8	5.7	4.9
DB EPS growth (%)	-11.1	-1.5	0.2	5.7	6.2	6.4
EBITDA Margin (%)	36.4	35.9	36.2	36.5	36.7	36.8
EBIT Margin (%)	18.3	15.4	16.7	16.6	16.5	16.6
Payout ratio (%)	43.2	42.5	45.1	49.0	52.0	55.0
ROE (%)	13.3	12.2	11.5	11.1	10.9	11.1
Capex/sales (%)	26.6	25.8	26.8	23.3	19.0	18.0
Capex/depreciation (x)	1.5	1.3	1.4	1.2	0.9	0.9
Net debt/equity (%)	-48.2	-43.3	-42.8	-47.8	-52.4	-57.2
Net interest cover (x)	nm	nm	nm	nm	nm	nm

Source: Company data, Deutsche Bank estimates



Figure 1: Half year P&L

China Mobile		+852 2203 6145	james-z.wang@db.com		
Capitalization Summary					
Share Price (\$)	82.25				
Target price (\$)	110.00		Shares o/s	20,103	
Upside	34%		Mkt Cap (RMBm)	1,436,211	
Horizon	12 months		EV (RMBm)	1,015,499	
Rationale	DCF				
Income Statement (Y.E. Dec) RMBm					
	2015				
	proforma	2016	2017F	2018F	2019F
Mobile service revenue	552,161	578,213	604,796	626,733	647,378
Change		5%	5%	4%	3%
Broadband and others	31,928	45,209	61,129	77,355	91,425
Change		42%	35%	27%	18%
Service revenue	584,089	623,422	665,924	704,087	738,803
Change		0%	7%	6%	5%
Revenue	668,335	708,421	756,718	800,084	839,533
Change		4%	6%	6%	5%
Networks expenses	(53,991)	(53,852)	(57,523)	(60,820)	(63,819)
Employee expenses	(74,805)	(79,463)	(84,231)	(89,285)	(94,642)
Other expenses	(299,785)	(318,928)	(339,084)	(356,806)	(372,331)
Operating expenses	(428,581)	(452,243)	(480,838)	(506,911)	(530,792)
Change		5%	6%	5%	5%
EBITDA	240,028	256,677	276,379	293,672	309,240
Change		2%	7%	6%	5%
EBITDA margin	36%	36%	37%	37%	37%
D&A	(136,832)	(138,090)	(150,262)	(161,424)	(169,347)
Others	25,141	10,105	10,084	11,205	12,069
EBIT	128,337	128,692	136,201	143,454	151,961
Change		1%	0%	5%	6%
EBIT margin	19%	18%	18%	18%	18%
Net interest income	15,397	15,770	16,608	18,728	20,229
Income tax and minorities	(35,195)	(35,721)	(37,848)	(40,169)	(42,648)
Net profit	108,539	108,741	114,961	122,013	129,542
Change		-1%	0%	6%	6%
EPS	5.31	5.31	5.61	5.96	6.33
DPS	2.26	2.39	2.75	3.10	3.48
Key operating metrics					
	2015	2016	2017F	2018F	2019F
Mobile subscribers (m)	826.2	848.9	868.9	884.9	899.9
Mobile subscriber growth	2.4%	2.7%	2.4%	1.8%	1.7%
Mobile ARPU (RMB)	56.4	57.5	58.7	59.6	60.5
Mobile ARPU growth	-8.5%	2.1%	2.0%	1.5%	1.5%
Revenue growth	4.2%	6.0%	6.8%	5.7%	4.9%
Balance Sheet (Y.E. June)					
	2015	2016	2017F	2018F	2019F
Cash	403,172	425,710	517,775	588,384	664,309
Gross debt	4,995	4,998	4,989	4,989	4,989
Net debt	(398,177)	(420,712)	(512,786)	(583,395)	(659,320)
Net debt to EBITDA	-1.7	-1.6	-1.9	-1.99	-2.13
Total assets	1,427,895	1,520,994	1,655,133	1,732,377	1,805,643
Shareholders' equity	917,336	979,021	1,079,357	1,125,847	1,170,962
Return Information					
	2015	2016	2017F	2018F	2019F
ROIC	11.8%	11.1%	10.6%	10.8%	11.0%
ROA	7.6%	7.1%	6.9%	7.0%	7.2%
ROE	11.8%	11.1%	10.7%	10.8%	11.1%
Capex/Sales	26%	27%	23%	19%	18%
Cashflow					
	2015	2016	2017F	2018F	2019F
Operating cash flow	235,089	253,701	263,631	276,773	288,243
Capex	172,243	188,209	176,000	152,016	151,116
Free cash flow (post capex)	62,846	65,492	87,631	124,757	137,127
FCF yield	4.3%	4.5%	6.0%	8.5%	9.4%
Valuation & Leverage Metrics					
	2015	2016	2017F	2018F	2019F
P/E	13.5	13.5	12.7	12.0	11.3
FCF yield	4.3%	4.5%	6.0%	8.5%	9.4%
DY	3.2%	3.3%	3.9%	4.3%	4.9%
EV/EBITDA	4.4	4.1	3.4	3.0	2.6
P/BV	1.59	1.49	1.36	1.30	1.25
Payout ratio	43%	45%	49%	52%	55%
Net debt/equity	-43%	-43%	-48%	-52%	-56%
Net debt/EBITDA	-1.7	-1.6	-1.9	-2.0	-2.1

	1H16	2H16	1H17F	2H17F
	305,668	272,545	316,988	287,808
	6%	4%	4%	6%
	19,755	25,454	28,126	33,002
	30%	52%	42%	30%
	325,423	297,999	345,114	320,811
	7%	7%	6%	8%
	370,351	338,070	391,791	364,927
	7%	5%	6%	8%
	(236,102)	(216,141)	(250,392)	(230,446)
	10%	1%	6%	7%
	134,350	122,327	141,649	134,730
	3%	12%	5%	10%
	36%	36%	36%	37%
	(68,118)	(69,972)	(72,877)	(77,385)
	5,064	5,041	4,957	5,127
	71,296	57,396	73,729	62,472
	6%	-6%	3%	9%
	19%	17%	19%	17%
	7,508	8,262	8,304	8,304
	(18,232)	(17,489)	(19,170)	(18,677)
	60,572	48,169	62,863	52,099
	6%	-6%	4%	8%
	1H16	2H16	1H17F	2H17F
	837.0	848.9	858.9	868.9
	2.4%	2.7%	2.6%	2.4%
	61.3	53.9	61.9	55.5
	3.2%	1.0%	1.0%	3.0%

Source: Deutsche Bank, company data



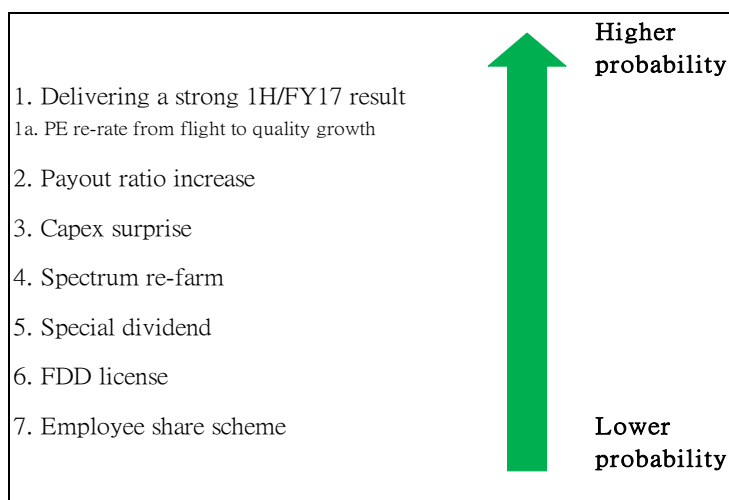
CM now the top pick

We have changed our sector top pick to China Mobile, followed by China Unicom and then China Telecom (previously CT>CU>CM). The rationale for moving CM to our top pick are:

- **Valuation cheap:** CM is trading at 9.1x FY17E PER (ex-cash basis), cheaper than both CT and CU on FY17E EV/EBITDA and PER bases and, on a regional basis, one of the cheapest market leaders.
- **Expectations are low:** with consensus expecting only 6% NPAT growth and very little in the way of dividend increases;
- **Regulatory risk lessening:** with the government likely to be more forgiving of improving telco profitability in order to prepare for 5G;
- **Solid industry trends as well as a number of profit cushions** could see CM deliver better-than-expected profits over the medium term. We estimate CM could generate RMB17bn in additional profits via tighter cost control and changes in accounting policies;
- **Prospect of improving dividend payout:** we could see double-digit growth in dividends this year;
- **Potential to deliver lower-than-expected capex at the full year:** with the company typically spending less capex than it has guided;
- **Other low-likelihood catalysts for outperformance** could include: receiving the FDD license and / or permission to re-farm low-frequency spectrum, employee share scheme as part of the wider SOE reforms, special dividends at the full year upon receipt of the RMB53bn TowerCo currently owes CM.

The following table summarizes our view on the key drivers for share price outperformance for CM.

Figure 2: Path towards outperformance for CM



Source: Deutsche Bank



While we still like CT for its strong operating momentum, we think the rerating opportunity for CM is likely to outweigh the additional earnings growth that CT delivers.

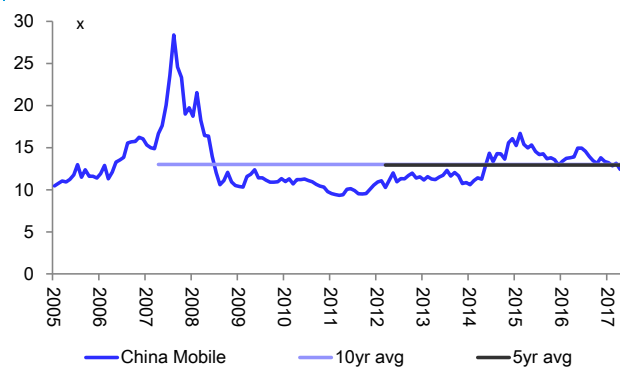
We explore these in the following sections.

For a dominant market player, the valuation is too cheap

While CM is trading broadly in line with its long-run average on a 12-month forward PE basis, it is trading 19% below the 10-year average on an ex-cash basis. Furthermore, we would argue that CM's historical PE is depressed due to its weak 3G network, which it has now fixed in the 4G era.

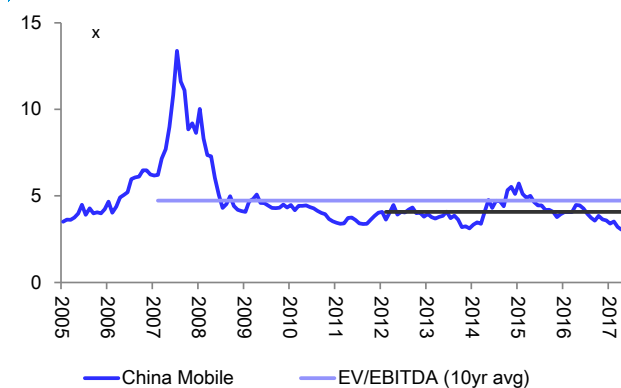
On an EV/EBITDA basis, CM is trading 25% below the five-year average and 35% below the 10-year average. CM's FY17E EV/EBITDA and PER are also below the peer group and, on an ex-cash basis, the stock is trading on a PE of 9.1x.

Figure 3: 12-month forward PER broadly in line with LR average



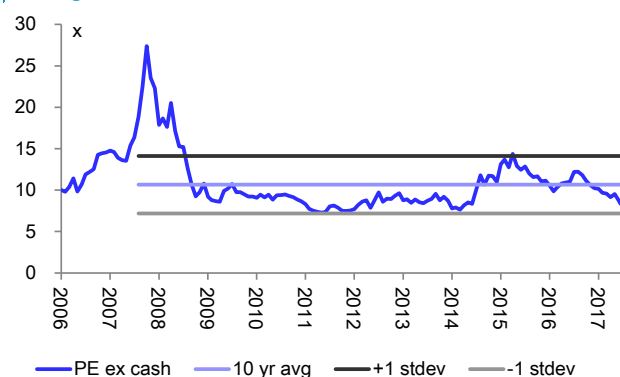
Source: Deutsche Bank, company data

Figure 4: 12-month forward EV/EBITDA below LR average



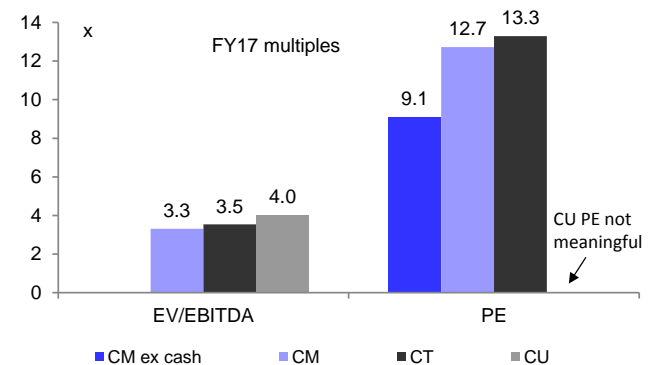
Source: Deutsche Bank, company data

Figure 5: 12-month forward PER ex cash below LR average



Source: Deutsche Bank, company data, Bloomberg Finance LP

Figure 6: PER and EV/EBITDA vs. peers



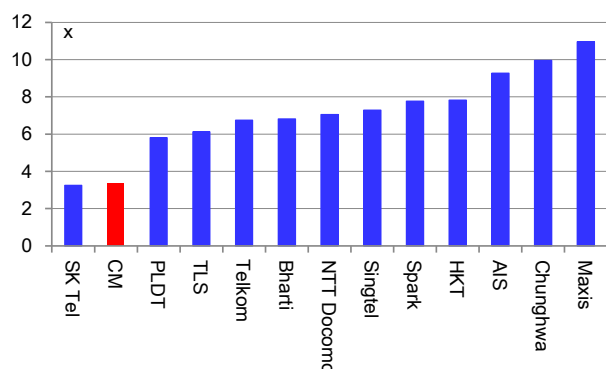
Source: Deutsche Bank, company data
Note: based on DB forecasts, allows for RMB53bn cash receivable from TowerCo



One of the cheapest market leaders in the APAC region

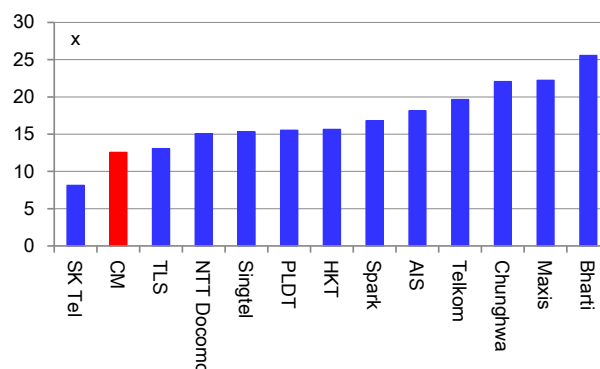
If we compare CM with the regional leaders in mobile, CM is among the cheapest, second only to SK Telecom, which is affected by regulatory uncertainty, corporate governance issues and low payout.

Figure 7: FY17E EV/EBITDA



Source: Deutsche Bank, company data

Figure 8: FY17E PER

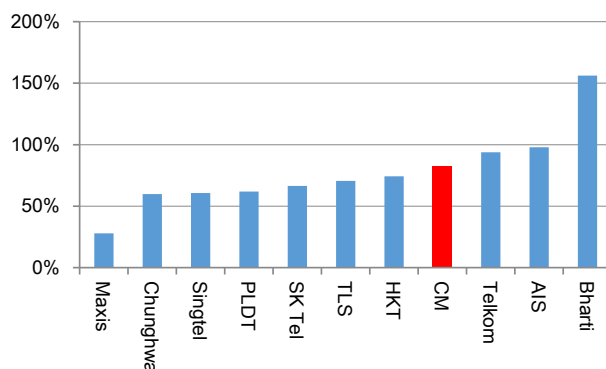


Source: Deutsche Bank, company data

A number of market leaders trade at significant premiums to their peers due to the certainty of their cash flows and earnings, quality of their brand and strong balance sheets (e.g., Telkom and AIS). We believe CM shares these traits as evidenced by:

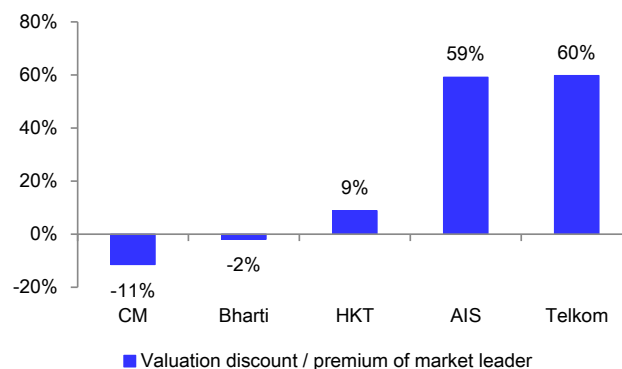
- 83% share of industry profits, one of the highest in the region;
- Largest proportion of high value and sticky customers;
- Highest level of 4G coverage, albeit the coverage gap to peers has narrowed;
- Very strong balance sheet and free cash flow generation.

Figure 9: Share of industry profit by operator in their respective regions



Source: Deutsche Bank, company data

Figure 10: Valuation premium of top five market leaders (by NPAT share) vs peers (FY17E EV/EBITDA basis)

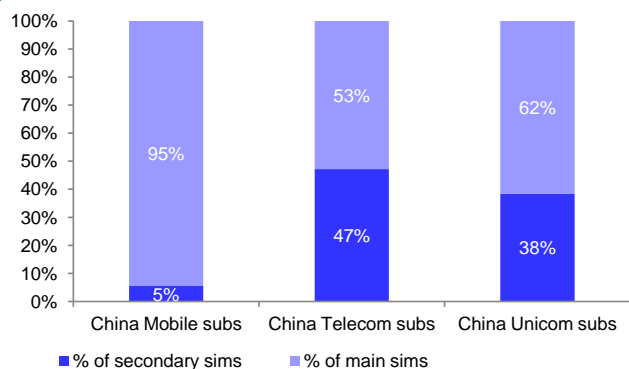


Source: Deutsche Bank, company data

Note: for HK, we use Bloomberg Finance LP consensus forecasts, Bharti compared vs. Idea only and excludes Reliance Comm, which is very indebted

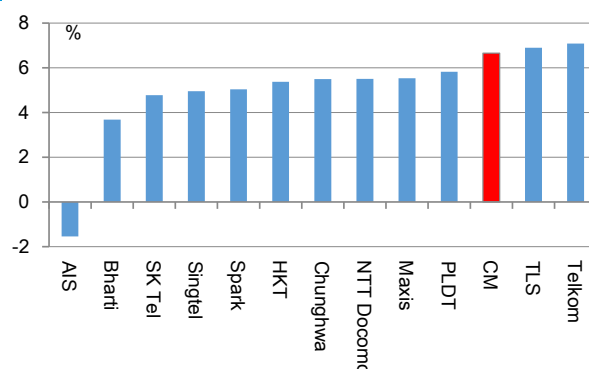


Figure 11: CM has the highest proportion of main sim users (who tend to be stickier)



Source: Deutsche Bank, based on an online survey that DB conducted in March 2016

Figure 12: One of the highest FCF yields among regional leaders



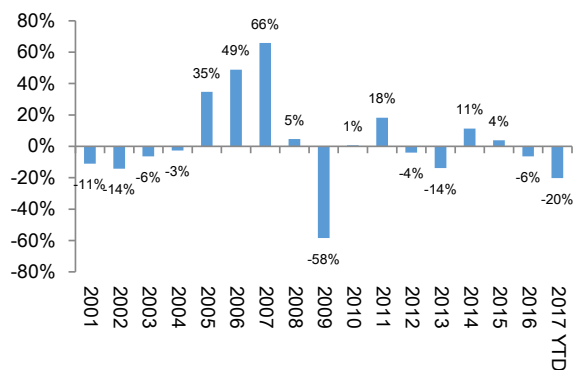
Source: Deutsche Bank, company data

Furthermore, we think CM is well positioned in a thriving market with the Chinese telecom sector having one of the better revenue growth potentials and more benign regulatory environments.

Compared with HSI

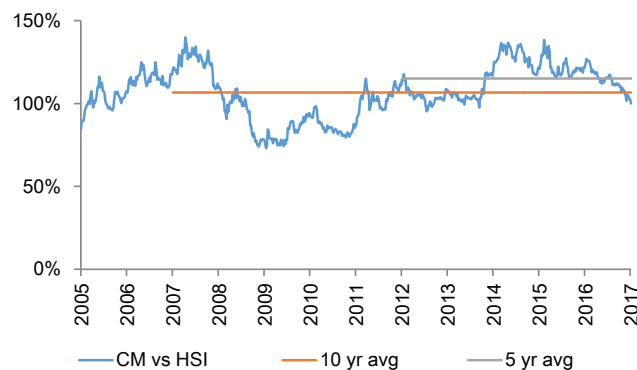
We would also highlight that it is rare for CM to underperform the HSI to such an extent. The last time CM underperformed was in 2009 when CM received the TD-SCDMA license and missed out on the market recovery. CM is now trading 6% below its 10-year relativity vs. the HSI, 13% vs. the five-year relativity.

Figure 13: CM historical annual performance vs. HSI



Source: Deutsche Bank, Bloomberg Finance LP

Figure 14: 12-month forward PER valuation vs. HSI



Source: Deutsche Bank, company data, Bloomberg Finance LP

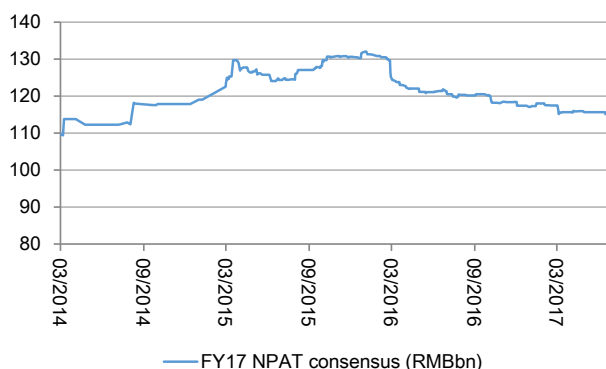
Expectations not high

We believe CM's recent weak share price performance is due to the following: 1) weak 1Q17 NPAT growth despite solid top-line trends; 2) smaller-than-expected increase in FY16 dividend payout; 3) smaller-than-expected capex guidance declines in FY17.



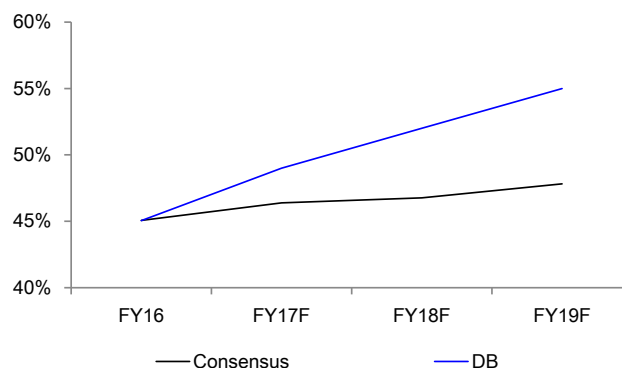
However, consensus forecasts have also declined a long way with consensus now forecasting 6% NPAT growth and a very gradual increase in dividend payout over time.

Figure 15: CM consensus forecasts have declined



Source: Deutsche Bank, Bloomberg Finance LP

Figure 16: Dividend payout expectation (DB vs. consensus)



Source: Deutsche Bank, Bloomberg Finance LP

Regulatory risk lessening

We believe regulatory risks for both the sector and CM are lessening as evidenced by:

- Limited impact in FY16 from tariff reduction and speed upgrade requirements and manageable impact from measures announced in FY17 to date;
- A recognition by the think-tank for MIIT of the important role that the telcos play in both building out the 5G network and in contributing to economic growth via both the 5G capex and its own related revenues (as per CAICT's 5G white paper);
- Limited signs of material asymmetric regulation on CM. We do note that the delay in handing out the FDD license and denying CM the right to re-farm its low frequency spectrum is somewhat restricting CM's competitive threat to peers but not overly damaging.

The telcos in China have gone a long way in building out the telecom infrastructure in the country, which is one of the reasons why Chinese telcos trade at significantly lower EV/EBITDA multiples vs. the regional peers. With the need for them to contribute to the 5G build-out, this is likely to result in the government being more forgiving should the telcos generate stronger revenue and profits over the next three years.

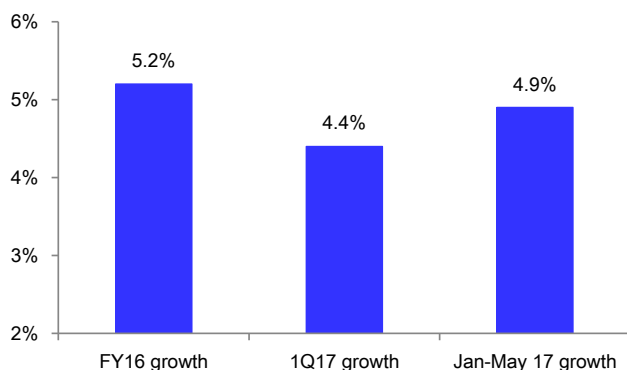


Solid industry trends with mobile driving the improvement

Industry trends remain encouraging with the MIIT data showing a slight pickup in mobile service revenue in recent months (from 4.4% in 1Q17 to 4.9% in the five months to May), which is driving an overall improvement in sector revenue as shown below.

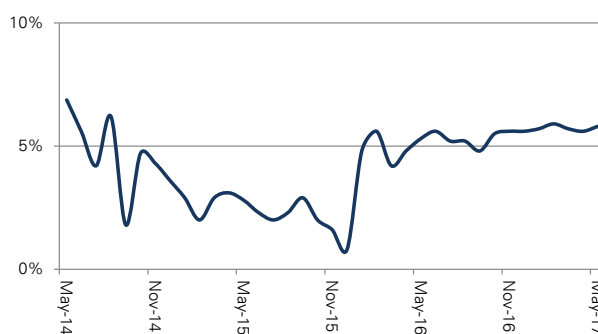
For CM, overall mobile net adds picked up in April and May. While the 4G net adds have declined, this is likely the result of its higher 4G penetration.

Figure 17: Mobile service revenue growth has picked up in recent months



Source: Deutsche Bank, MIIT

Figure 18: Driving a slight improvement in overall service revenue growth



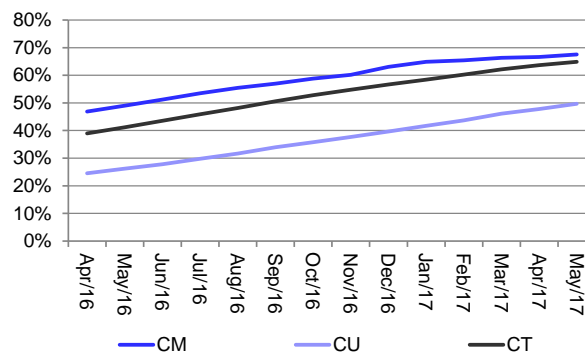
Source: Deutsche Bank, MIIT

Figure 19: CM's overall mobile net adds have picked up in recent months



Source: Deutsche Bank, company data
Note: rolling three-month average net adds shown

Figure 20: 4G penetration higher vs. peers



Source: Deutsche Bank, company data

Larger profit buffers for China Mobile

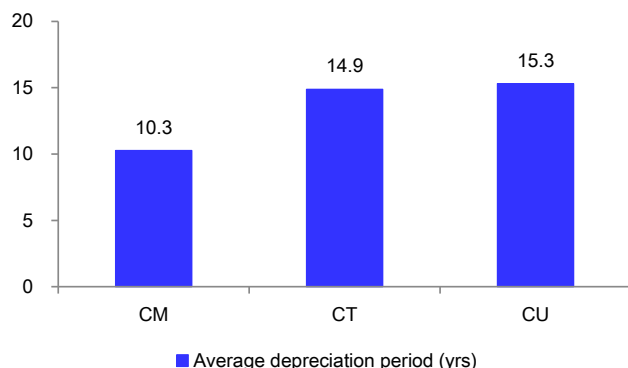
Furthermore we believe China Mobile has the largest profit buffers among the three telcos. We believe this comes from the following areas:

- Shortest average depreciation period of 10 years vs. a peer average of 15 years;



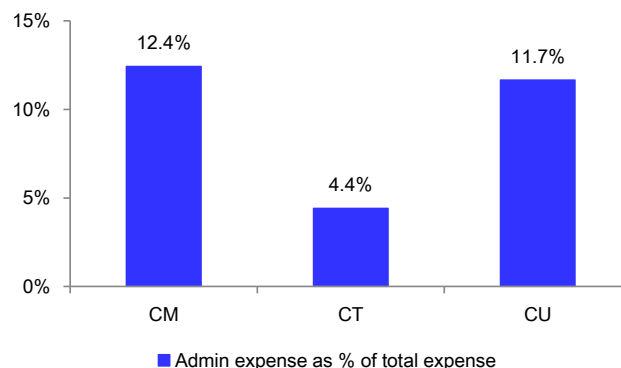
- Highest proportion of administrative spend despite its scale at 12.4% vs. a peer average of ~8%; and
- Elevated asset write-off rates in recent periods.

Figure 21: CM has the shortest depreciation period



Source: Deutsche Bank, Company Data

Figure 22: Admin expense highest in the industry



Source: Deutsche Bank, Company Data

We estimate a one-year increase in the depreciation period, a 10% reduction in admin expenses and the reversal of the write-off could total to RMB17bn in net profits as shown below (16% of FY16 NPAT).

Figure 23: Earnings improvement cushions

RMBm	Scenario	FY16 reported result	Adjusted result	Impact on net profit	% of FY16 net profit
Depreciation	Increase depreciation period to 11 years	138,090	126,056	9,026	8%
Admin expense (other expenses)	Reduce by 10%	56,220	50,598	4,217	4%
Write-off	Reduce to historical levels	7,216	2,000	3,912	4%
Total				17,154	16%

Source: Deutsche Bank, Company data

While it is not possible to expect that all of these changes could occur overnight, we do see these factors providing potential cushions for profitability for CM over time.

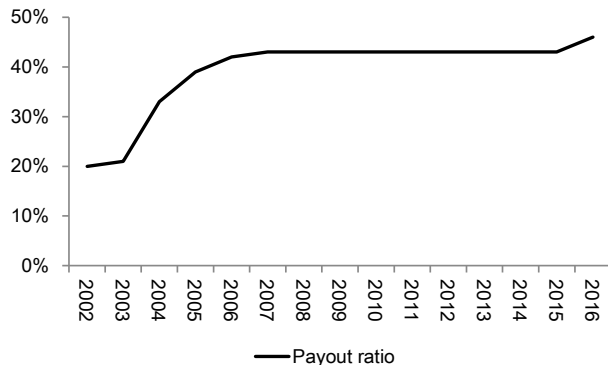
CM on the path towards an improving payout

2016 was the first year in the past 10 years when CM increased its dividend payout ratio, following a change in leadership in 2015. We believe CM will look to gradually step up its dividend payout over time, increasing its payout by 3 percentage points p.a. over the next three years, which would deliver a 13% p.a. increase in the absolute dividend during this period as shown below.

As discussed in the previous sections, we believe a 3% increase in payout ratio each year would be a positive surprise for investors with consensus forecasting an increase of only 1 percentage point each year.

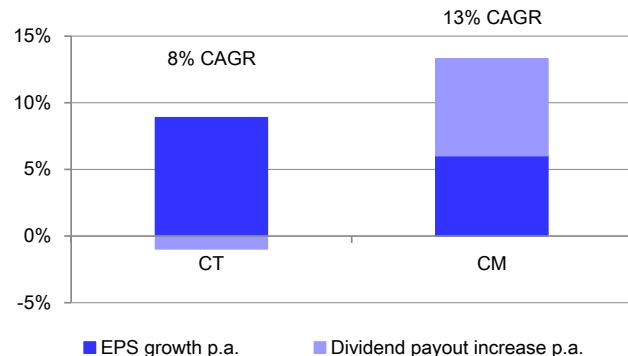


Figure 24: 2016 was the first year of payout increase since 2007



Source: Deutsche Bank, company data

Figure 25: CM to see 13% p.a. dividend growth in the next three years (2016-2019F)

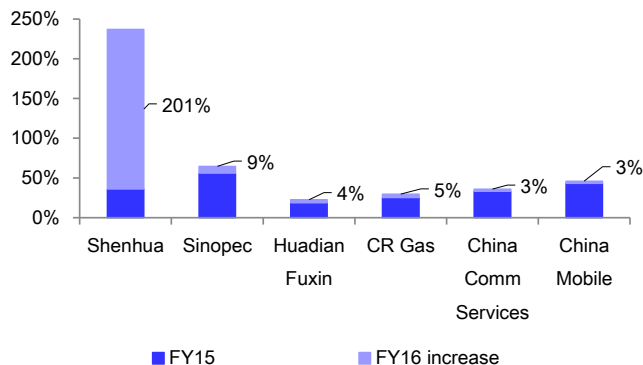


Source: Deutsche Bank forecasts

Why we think the payout ratio will increase?

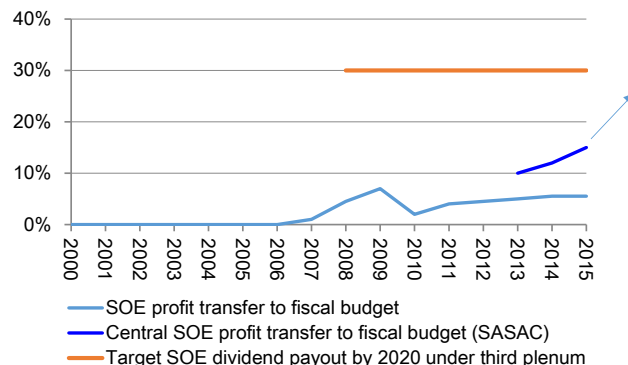
Under the third plenum, the Chinese central SOEs must reach an average payout ratio of 30%. We saw some examples of this progress at the FY16 results with Sinopec, Shenhua and a number of utility SOEs in China having increased their payout ratios. China Mobile's increase would be at the lower end of what the peer SOEs have delivered in terms of payouts as shown below.

Figure 26: Examples of payout increases at FY16 result



Source: Deutsche Bank, company data

Figure 27: SOE payout ratio increase a medium term trend

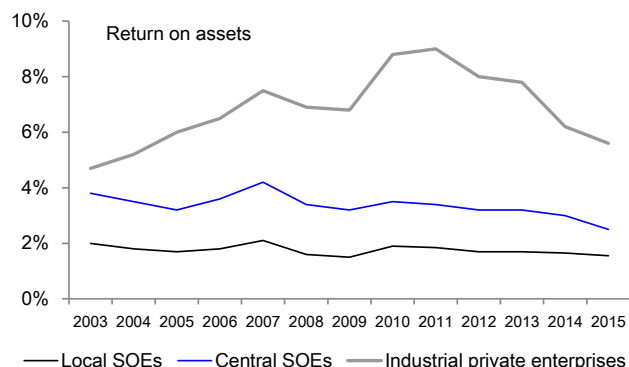


Source: Deutsche Bank, IMF

Furthermore, with the government looking to boost returns of the SOEs, we think an increase in payout ratio will be one of the ways to achieve this purpose. For CM, we estimate that every 10% reduction to CM's cash holdings can improved its ROE by 0.5-1% as shown below.

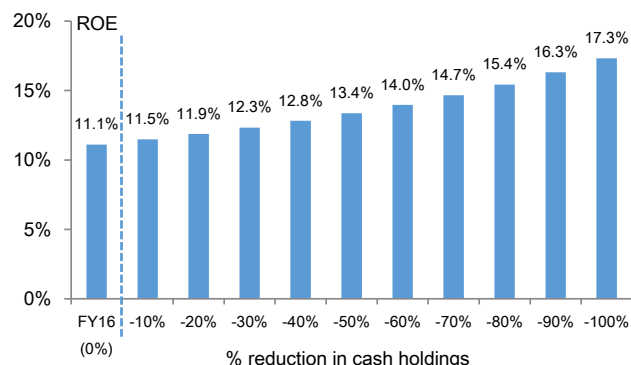


Figure 28: Government needing to boost SOE returns which are sub-par



Source: Deutsche Bank, IMF

Figure 29: Reducing cash holding is an easy way to boost CM's returns



Source: Deutsche Bank, Company Data

With SASAC's role moving towards more of an asset manager rather than a business manager, we think that improving the ROE will be increasingly focused upon as a key assessment metric for SASAC.

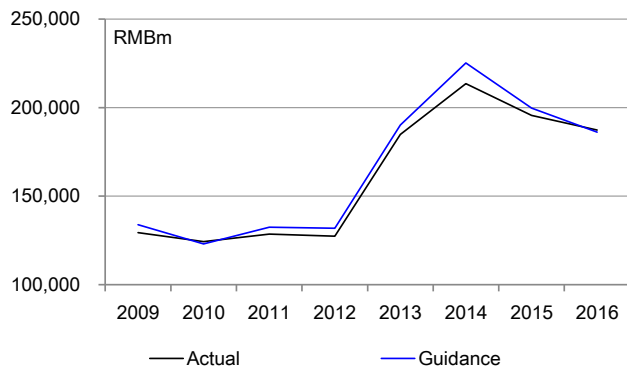
Potential to deliver lower-than-expected capex

The 6% decline in CM's FY17 capex guidance was disappointing, particularly given it was less than the peers and CM is one-year ahead of the peers on its 4G investments. However, we do think there is a good chance that CM's actual capex may come in under its guidance on the basis of:

- A solid track record of positive surprises on the actual capex spent – on average CM has beaten capex guidance by ~RMB4bn p.a. over the past eight years;
- Potential savings on business networks and building and infrastructures which are at an all-time high; and
- Historically CM's mobile spend per sub is typically 35-40% lower than peers. We estimate that CM's 4G capex spend per 4G subscriber is 31% below peers as at FY16 but will decline to 14% by the end of FY17, which appears high compared with the historical trend. This could result in either actual 4G capex being below guidance or potentially a significantly lower 4G capex guidance for FY18.

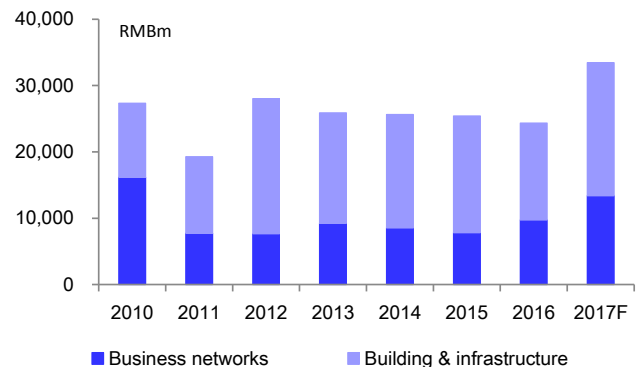


Figure 30: CM historically has tended to positively surprise on the capex



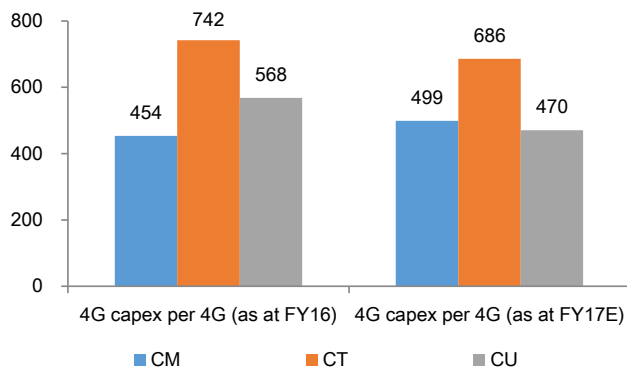
Source: Deutsche Bank, company data

Figure 31: Spend on business networks and infrastructure seems high compared with historical levels



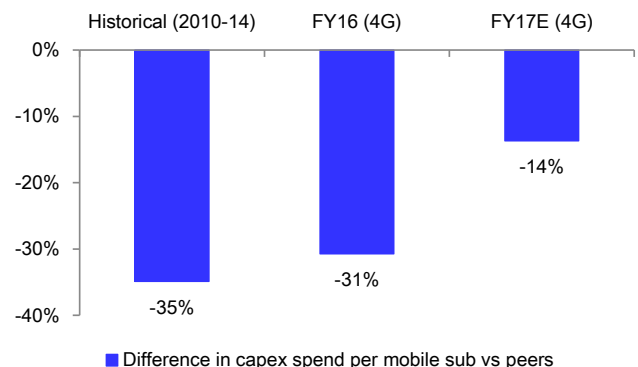
Source: Deutsche Bank, company data

Figure 32: 4G capex per sub (CM vs. peers)



Source: Deutsche Bank, company data
Note: FY17 estimates based on company's 4G capex guidance and 4G net adds guidance

Figure 33: CM typically spends 35% less capex per sub than peers historically compared with 14% by FY17



Source: Deutsche Bank, company data

Other low-likelihood catalysts for outperformance

Other low likelihood catalysts for outperformance include the following:

- Potential for a special dividend post the RMB53bn payment received from the TowerCo at the end of FY17 (~HKD3/share);
- Granting of the FDD license which will allow CM to further reduce the cost of rolling out its 4G network given the larger coverage radius for the FD-LTE technology;
- Allowing CM to re-farm the lower-frequency bands currently used for 2G and 3G;
- Potential for employee share ownership schemes in the future with a number of SOEs about to embark on such programs as part of the mixed ownership trials.



Valuation and risks

We derive our target price using a DCF valuation, with an allowance for a valuation contribution from the TowerCo and other associates. Our DCF-based valuation uses 7.5% WACC (risk-free rate of 3.0%, risk premium of 5.0%, beta of 0.9) and a 0% perpetual growth rate. We assign a 0% terminal growth rate to the company to reflect longer-term market share losses.

We apply a 40% discount to CM's cash holdings to reflect the low rate at which cash is returned to shareholders. We have applied a 30% HoldCo discount to the TowerCo stake and the valuation of other associates to reflect uncertainty in respect of the valuation and typical holding company discounts.

Figure 34: Detailed valuation of CM

HKDm	FY17E EBITDA	Valuation	Implied EV/EBITDA
EV using DCF valuation	311,479	1,817,507	5.8
TowerCo stake at 30% discount		68,962	
Associates and others at 30% discount		50,661	
Net cash at 40% discount		317,848	
Equity NPV		2,254,978	
NPV per share/target price (HKD)		110	

Source: Deutsche Bank estimates, company data

Downside risks include the following:

- Asymmetric regulation;
- Intense competition in the mobile business, particularly as its early 4G adopters start to roll off contracts;
- Higher-than-expected capex, particularly in future years.



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
China Mobile	0941.HK	82.25 (HKD) 14 Jul 17	14

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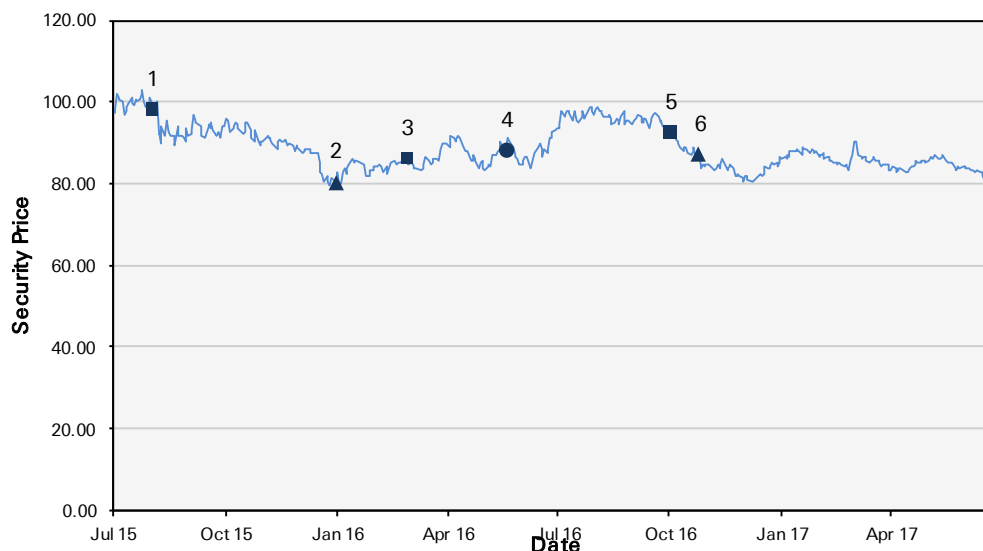
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Historical recommendations and target price: China Mobile (0941.HK) (as of 7/14/2017)



Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

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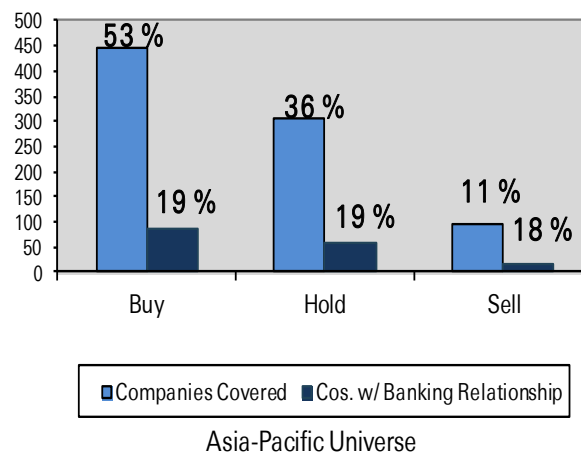
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David Folkerts-Landau

Group Chief Economist and Global Head of Research

Raj Hindocha
Global Chief Operating Officer
Research

Michael Spencer
Head of APAC Research
Global Head of Economics

Steve Pollard
Head of Americas Research
Global Head of Equity Research

Anthony Klarman
Global Head of
Debt Research

Paul Reynolds
Head of EMEA
Equity Research

Dave Clark
Head of APAC
Equity Research

Pam Finelli
Global Head of
Equity Derivatives Research

Andreas Neubauer
Head of Research - Germany

Spyros Mesomeris
Global Head of Quantitative
and QIS Research

International locations

Deutsche Bank AG

Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG

Große Gallusstraße 10-14
60272 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG

Filiale Hongkong
International Commerce Centre,
1 Austin Road West, Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.

2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank AG London

1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank Securities Inc.

60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500
