



Rating
Buy

Asia
Hong Kong

Telecommunications
Telecommunications

Company
CITIC Telecom

Reuters	Bloomberg	Exchange	Ticker
1883.HK	1883 HK	HSI	1883

Date
1 March 2018

Results

Price at 28 Feb 2018 (HKD)	2.26
Price target - 12mth (HKD)	3.20
52-week range (HKD)	2.57 - 1.96
HANG SENG INDEX	30,845

7% DY, positive developments

Tough year in Macau, but the firm holds up

2017 net profit rose 4% to HK\$896m, and underlying profit was approximately flat, which is a good result considering conditions cycled down. Management seems confident that the upcycle will follow, so upped DPS 21% to HK\$0.16 and suggested payout will be held and DPS will be flat to rising ahead, which suggests its sector leading 7% dividend yield will hold or increase.

During 2017, the Macau business was under pressure from the December 2016 broadband price cut (ARPU down 16%), the ongoing fixed line decline, and from enterprise revenue dropping 25% as projects got delayed. If that was not enough, there was the worst storm in five decades, which left Macau underwater, caused power cuts and created a transport shut down. Management believes these events will not be repeated in 2018, setting it up for a pick-up. The other winds in Macau, the political ones, that led to broadband price cuts, also appear to have abated. Network upgrades led to high rankings in world network tests, and good performance in the storm. Add to that Macau's desire to succeed as a smart city, and it appears CTM is aligned with the government again. This is encouraging, and smart city will be an opportunity.

Beyond Macau, the company is developing an interesting story in value-added services. Its managed services business, CPC, is growing at double-digit rates, and is set up for Belt-and-Road demand as Chinese firms expand. The SMS business is now taking off again, thanks to apps, Datamall is growing rapidly, and the IDC business is a driver. We notice significant management energy for these businesses. On top of this, the company is looking to degear in the coming one-to-two years, which we think is healthy. The firm remains too much of a niche play for many, but is emerging as a relatively interesting story again, with very attractive valuation multiples in our view. BUY.

Company busy, as it deals with sector change for better and worse

The Macau core businesses of mobile, fixed line and internet services when combined saw flat service revenues. But as noted above, a better cycle seems at hand.

Enterprise revenue rose 14%, due to the acquisition of Linx and Acclivis (Pacific Internet). While revenues from CPC grew by around 15%, this was offset by contraction in Macau, as resort launches cycled off. Further growth looks likely as China's crackdown on illegal VPNs should reduce competition for licensed

Valuation & Risks

Peter Milliken, CFA

Research Analyst

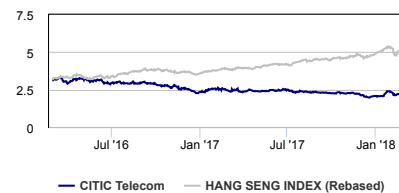
+852-2203 6190

Key changes

Sales (FYE)	7,366 to 7,638	↑	3.7%
Op prof margin (FYE)	19.5 to 19.8	↑	1.3%
Net profit (FYE)	890.4 to 955.9	↑	7.4%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-4.2	6.6	-7.0
HANG SENG INDEX	-6.2	5.7	29.9

Source: Deutsche Bank

Valuation and Risks

Our DCF-based TP is set using a WACC of 6.8% (risk-free rate 2.4%, beta 1.0x, risk premium 5%) and terminal growth of 1%. Key downside risks: 1) Rising interest rates, 2) increased competition in Macau, 3) Low ROI M&A



providers like CPC. Management appeared very upbeat about opportunities to benefit from Chinese companies expanding out of China, and Eurasian companies expanding into East Asia.

International business was flat YoY, with the company seeming to have transitioned through the painful voice contraction of recent years. Datamall helped, as did SMS, which turned upwards, with revenue gaining 32%, as app-based SMS took off. It was suggested that Datamall is hitting a new growth phase helped by a strong new partnership in China, and a move beyond the B2B2C model.

Generally, the company appears busy in rolling out new services to take advantage of its 130 points of presence and communications platform as a service to roll out new calling and managed services globally.

Valuation and risks

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Forecasts and ratios					
Year End Dec 31	2016A	2017A	2018E	2019E	2020E
Sales (HKDm)	7,699.1	7,520.3	7,637.8	7,744.9	7,931.3
EBITDA (HKDm)	2,010.5	2,152.1	2,171.3	2,257.4	2,397.4
Reported NPAT (HKDm)	844.4	951.1	955.9	1,013.4	1,124.4
Reported EPS FD(HKD)	0.25	0.27	0.27	0.29	0.32
DB EPS FD(HKD)	0.25	0.27	0.27	0.29	0.32
OLD DB EPS FD(HKD)	0.25	0.27	0.26	0.28	-
% Change	0.0%	-1.2%	3.5%	3.1%	-
DB EPS growth (%)	-	8.6	0.5	6.0	11.0
PER (x)	11.6	8.8	8.4	7.9	7.1
EV/EBITDA (x)	8.1	6.8	6.2	5.8	5.3
DPS (net) (HKD)	0.13	0.16	0.17	0.18	0.20
Yield (net) (%)	4.6	6.8	7.6	8.1	9.0

Source: Deutsche Bank estimates, company data



1H results

Figure 1: P/L Summary

Income Statement	1H15	2H15	1H16	2H16	1H17	2H17	YOY %	HOH %	Comment
Mobile service	624	621	575	590	614	607	3%	-1%	Sub led growth
Internet	407	426	462	460	468	466	1%	0%	Data centre growth offset 16% BB ARPU drop
International	806	749	657	668	655	686	3%	5%	Better mix, SMS growing again
Enterprise	1004	1103	1084	1172	1270	1294	10%	2%	China bandwidth sales, Macau weaker
Fixed	182	175	160	162	150	131	-19%	-13%	
Service revenue	3,023	3,073	2,939	3,067	3,157	3,253	6%	3%	
Equipment sales	1,327	927	885	808	435	675	-16%	55%	
Total revenue	4,350	4,000	3,824	3,876	3,592	3,928	1%	9%	
EBITDA	991	1,040	1,001	1,010	1,097	1,055	4%	-4%	Led by exceptionals
Margin	22.8%	0	0	0	0	0	3%	-12%	
Depreciation & amortization	-326	-348	-334	-323	-344	-352	-9%	-2%	
Associates & JVs	-1	1	1	-5	-2	0	99%	98%	
EBIT	664	693	668	682	751	703	3%	-6%	
Net interest	-169	-177	-176	-152	-163	-160	-5%	2%	
Other non-operating income	0.0	0	0	0	0	0			
Pre-tax	495	516	492	530	588	543	2%	-8%	
Tax	-93	-103	-77	-89	-90	-75	15%	16%	
Minorities	-6	-7	-6	-7	-6	-8	-28%	-40%	
Net Profit	396	406	410	435	492	459	6%	-7%	

Source: Deutsche Bank, Company

Highlights of 2017

Mobile:

- Postpaid ARPU +1.8%, prepaid ARPU flat
- Mobile subs up 13%

Internet:

- Broadband ARPU down 16%, following December 2016's stepwise cut to an estimated HK\$279. Broadband subs up 4% and TVB Anywhere being added as a service, which should be good for improving stickiness and customer satisfaction.
- The new HK IDC will open its first phase around August, allowing a new growth driver over the medium-term to kick in.

Enterprise

- Macau impacted by a lull in casino/resort launches, but management optimistic that would normalize shortly, and were optimistic about prospects for CPC given its improved networks and the illegal VPN crackdown
- The first company in HK to be granted ISO27017, Information Security Controls for Cloud Service. A useful marketing line. Its CITIC Tower redevelopment will launch in August, allowing it to start filling demand it says it has been turning away for two years.

International

- Datamall recorded \$69m in revenue, up 4x YoY, helped by opening in Singapore, Korea, Thailand and Indonesia
- International voice revenues fell 11%
- A service allowing corporate phone networks to accept internet based calls is also being launched in the US, Singapore and HK.

Underlying earnings

- Management suggested that Macau storm costs and legal fees to get the Linx deal closed (in all 14 countries), came close to offsetting the HK



\$50m exceptional gain on property revaluation. FX and other gains also cycled positively, leaving underlying earnings roughly flat.

Strategy

The company appears set on becoming a significant alternative player in private cloud and related managed services, in the Pearl River delta, particularly for companies looking to do business in both China and through One-belt One-road nations. It will do so by leveraging on its recent acquisitions in the region and Eastern Europe, and by developing its data centres, and cooperation with CITIC Networks (which has sold 39% at a valuation of RMB7.8bn to an unknown third party - almost triple the price CITIC Telecom almost achieved).

CPC has previously been focused on as being a VPN player for foreign companies wanting networks in China. Now it is evolving into a three-way player, serving foreign companies, but also Chinese companies going outside of China, and selling new, more complicated services to European clients at the old Linx. We believe the bundles of cloud, managed services, connectivity and related services is a sizeable market with room for further growth.

Optionality

CITIC Telecom appears to be trying to remain a stand-alone operator, talking an aggressive strategy of expansion, to align with national objectives. We believe part of this aggressiveness is due to CITIC Telecom being a possible target of China Unicom's mixed ownership. For this reason, we included it in our regional model portfolio, when writing our 2017 FITT*.

Three policies are being pursued in China, mixed ownership, SOE reform and Three Network Convergence that suggest consolidation is required. Tidying up the sector, by folding CITIC Group's telecom assets (CITIC Telecom, CITIC Networks, and its 50% stake in the mobile JV with China Broadcasting Networks) into China Unicom seems aligned with such policies.

China Unicom, in our view, should consider such a deal as: 1) It would clean up the industry, as per SOE reform, 2) It provides an international unit, that CU is lacking, with switches globally, Macau, data centre capacity in HK, and relationships with telcos and multinationals, 3) CITIC Telecom earned approximately as much as CU in 2016, so can boost earnings, and 4) We believe Unicom is particularly advantaged by bringing CBN and CITIC into the fold, as should it get a large proportion of the 700MHz spectrum, it would suddenly move from a spectrum disadvantage in low-band to spectrum superiority on a per sub basis. (Please ask for our report for details).

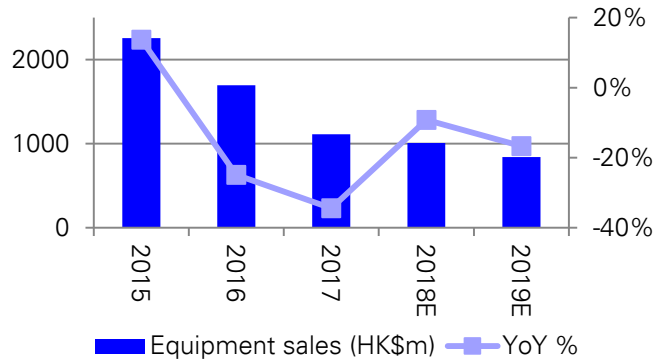
While we flag this optionality, it is not our base case.

*M&A Spike heralds value-added era, 12 July



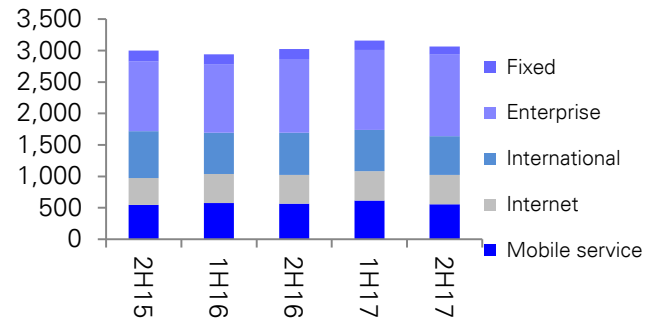
Half yearly charts

Figure 2: Equipment sales (HK\$m)



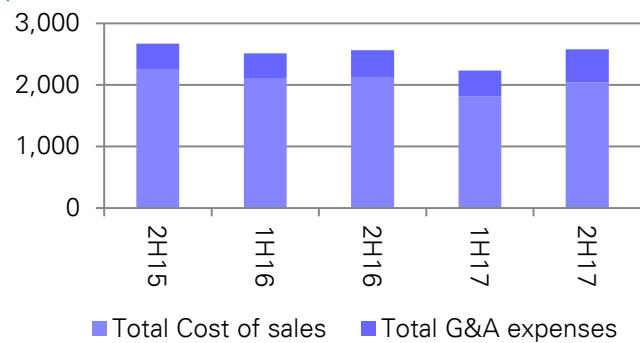
Source: Deutsche Bank, Company data

Figure 3: Service revenues (HK\$bn)



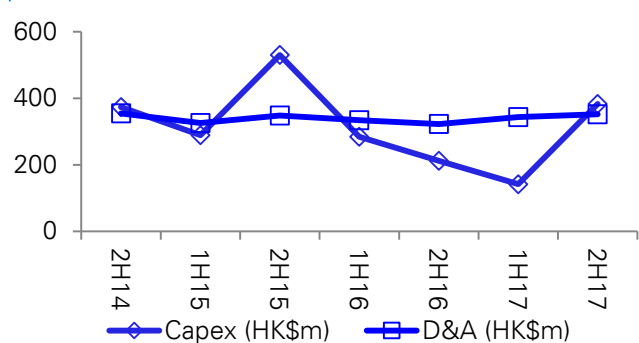
Source: Deutsche Bank, Company data

Figure 4: Opex (HK\$m)



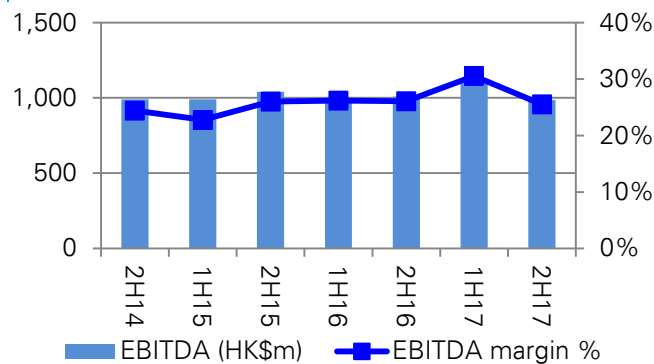
Source: Deutsche Bank, Company data

Figure 5: Capex vs. depreciation



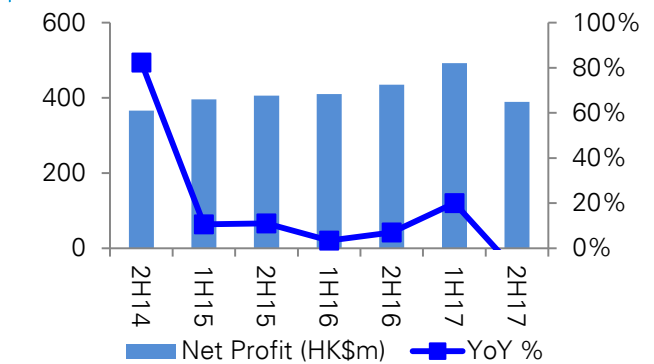
Source: Deutsche Bank, Company data

Figure 6: EBITDA



Source: Deutsche Bank, Company data

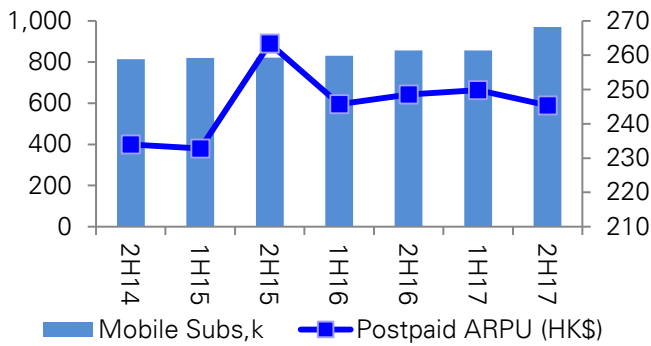
Figure 7: Net profit



Source: Deutsche Bank, Company data

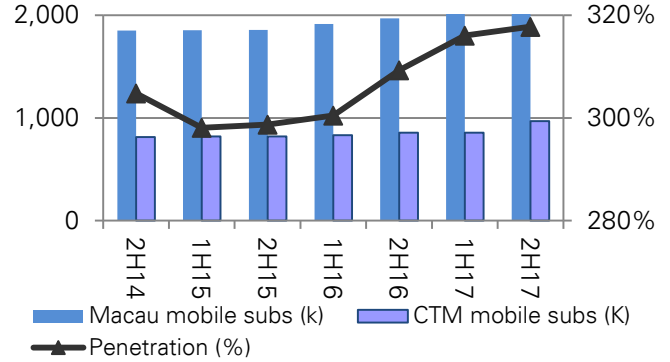


Figure 8: Postpaid ARPU and mobile subs



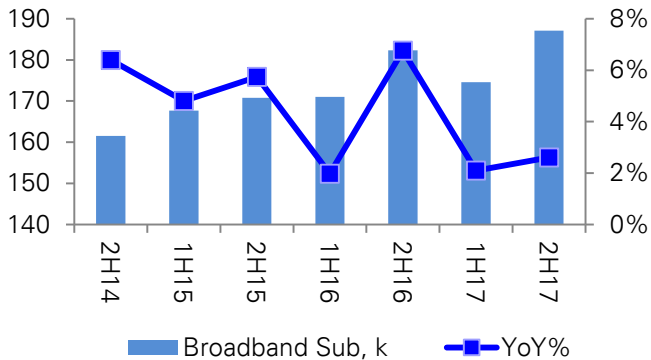
Source: Deutsche Bank, Company data

Figure 9: Mobile share and penetration



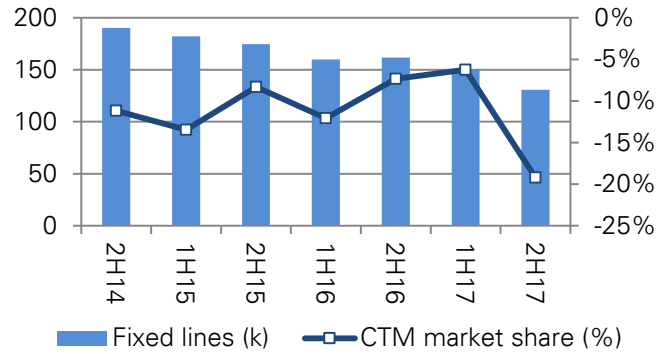
Source: Deutsche Bank, Company data

Figure 10: Broadband subs and YoY



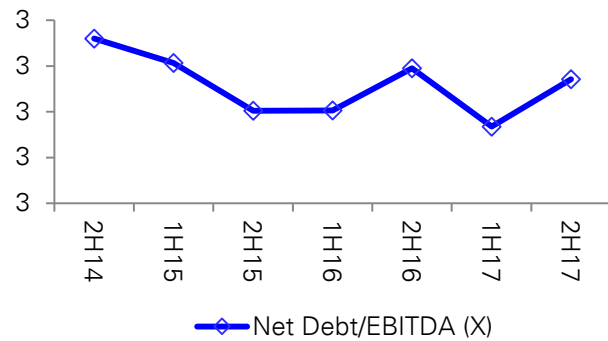
Source: Deutsche Bank, Company data

Figure 11: Fixed line revenue



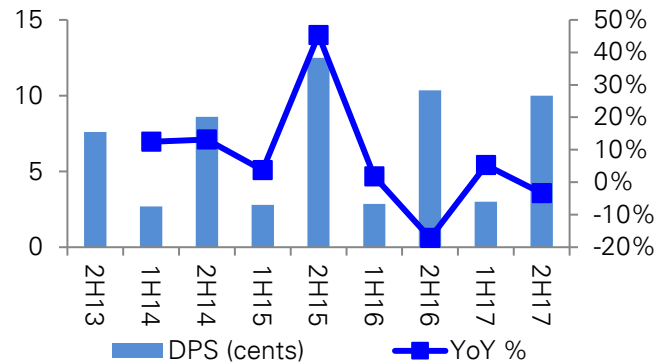
Source: Deutsche Bank, Company Data, EBITDA annualized

Figure 12: Gearing



Source: Deutsche Bank, Company data, CFO is cash from operations

Figure 13: DPS



Source: Deutsche Bank, Company data



Model updated: 01 March 2018

Running the numbers

Asia
Hong Kong
Telecommunications

CITIC Telecom

Reuters: 1883.HK Bloomberg: 1883 HK

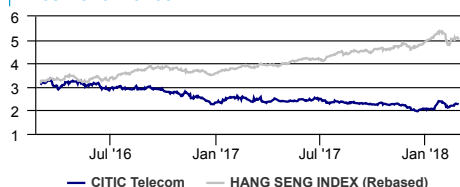
Buy

Price (28 Feb 18) HKD 2.26
Target Price HKD 3.20
52 Week range HKD 1.96 - 2.57
Market cap (m) HKDm 7,713.7
 USDm 985.7

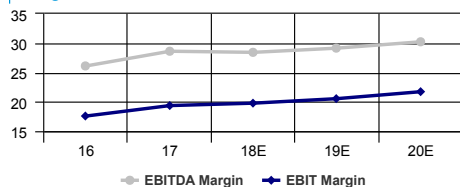
Company Profile

CITIC Telecom is the emerging telecom flagship of the CITIC group, and owns Macau's incumbent fixed line operations CTM plus a large hubbing business and data centres in Hong Kong.

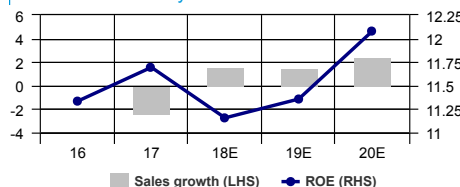
Price Performance



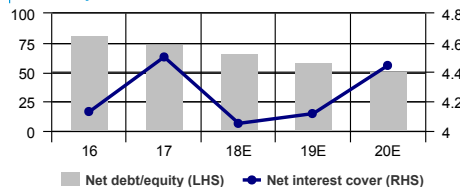
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 31-Dec

Financial Summary

	2016	2017	2018E	2019E	2020E
DB EPS (HKD)	0.25	0.27	0.27	0.29	0.32
Reported EPS (HKD)	0.25	0.27	0.27	0.29	0.32
DPS (HKD)	0.13	0.16	0.17	0.18	0.20
BVPS (HKD)	2.3	2.4	2.5	2.6	2.7
Weighted average shares (m)	3,413	3,541	3,541	3,541	3,541
Average market cap (HKDm)	9,822	8,334	7,714	7,714	7,714
Enterprise value (HKDm)	16,293	14,557	13,525	13,088	12,599

Valuation Metrics

P/E (DB) (x)	11.6	8.8	8.4	7.9	7.1
P/E (Reported) (x)	11.6	8.8	8.4	7.9	7.1
P/BV (x)	1.01	0.87	0.92	0.88	0.84
FCF Yield (%)	10.6	12.1	12.7	13.5	15.0
Dividend Yield (%)	4.6	6.8	7.6	8.1	9.0
EV/Sales (x)	2.1	1.9	1.8	1.7	1.6
EV/EBITDA (x)	8.1	6.8	6.2	5.8	5.3
EV/EBIT (x)	12.0	10.0	9.0	8.2	7.3

Income Statement (HKDm)

Sales revenue	7,699	7,520	7,638	7,745	7,931
Gross profit	3,470	3,668	3,777	3,937	4,147
EBITDA	2,011	2,152	2,171	2,257	2,397
Depreciation	488	526	491	496	504
Amortisation	169	170	170	170	170
EBIT	1,354	1,456	1,511	1,592	1,724
Net interest income/(expense)	-328	-323	-373	-386	-388
Associates/affiliates	-4	-2	-1	0	1
Exceptionals/extraordinary	0	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0
Profit before tax	1,022	1,131	1,137	1,205	1,337
Income tax expense	165	165	166	176	196
Minorities	13	14	14	15	17
Other post-tax income/(expense)	0	0	0	0	0
Net profit	844	951	956	1,013	1,124
DB adjustments (including dilution)	0	0	0	0	0
DB Net profit	844	951	956	1,013	1,124

Cash Flow (HKDm)

Cash flow from operations	1,533	1,536	1,618	1,680	1,800
Net Capex	-497	-525	-600	-600	-600
Free cash flow	1,037	1,011	1,018	1,080	1,200
Equity raised/(bought back)	13	14	14	15	17
Dividends paid	-451	-566	-612	-649	-720
Net inc/(dec) in borrowings	429	-76	-300	-300	-300
Other investing/financing cash flows	-132	-82	6	5	9
Net cash flow	896	301	126	152	206
Change in working capital	33	-110	1	1	2

Balance Sheet (HKDm)

Cash and other liquid assets	1,459	1,636	1,762	1,914	2,120
Tangible fixed assets	3,189	3,312	3,421	3,525	3,622
Goodwill/intangible assets	11,475	11,451	11,281	11,111	10,941
Associates/investments	7	6	6	6	6
Other assets	2,052	2,180	2,209	2,236	2,283
Total assets	18,183	18,584	18,679	18,793	18,972
Interest bearing debt	7,901	7,825	7,525	7,225	6,925
Other liabilities	2,382	2,329	2,365	2,398	2,456
Total liabilities	10,283	10,154	9,890	9,624	9,381
Shareholders' equity	7,871	8,396	8,741	9,105	9,510
Minorities	29	34	48	64	81
Total shareholders' equity	7,900	8,430	8,789	9,169	9,591
Net debt	6,442	6,190	5,763	5,311	4,805

Key Company Metrics

Sales growth (%)	nm	-2.3	1.6	1.4	2.4
DB EPS growth (%)	na	8.6	0.5	6.0	11.0
EBITDA Margin (%)	26.1	28.6	28.4	29.1	30.2
EBIT Margin (%)	17.6	19.4	19.8	20.5	21.7
Payout ratio (%)	53.4	59.6	64.0	64.0	64.0
ROE (%)	11.3	11.7	11.2	11.4	12.1
Capex/sales (%)	6.4	7.0	7.9	7.7	7.6
Capex/depreciation (x)	0.8	0.8	0.9	0.9	0.9
Net debt/equity (%)	81.6	73.4	65.6	57.9	50.1
Net interest cover (x)	4.1	4.5	4.1	4.1	4.4

Source: Company data, Deutsche Securities estimates



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
CITIC Telecom	1883.HK	2.26 (HKD) 28 Feb 2018	1, 6, 7, 9, 13, 14, 15

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr>. Aside from within this report, important conflict disclosures can also be found at <https://gm.db.com/equities> under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

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1. Within the past year, Deutsche Bank and/or its affiliate(s) has managed or co-managed a public or private offering for this company, for which it received fees.
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6. Deutsche Bank and/or its affiliate(s) owns one percent or more of a class of common equity securities of this company calculated under computational methods required by US law.
7. Deutsche Bank and/or its affiliate(s) has received compensation from this company for the provision of investment banking or financial advisory services within the past year.
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The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Peter Milliken



Historical recommendations and target price. CITIC Telecom (1883.HK)

(as of 02/28/2018)



Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

** Analyst is no longer at Deutsche Bank

- | | |
|---|--|
| 1. 03/20/2017 Hold, Target Price Change HKD 3,00 Peter Milliken | 2. 06/04/2017 Upgraded to Buy, Target Price Change HKD 3,20 Peter Milliken |
|---|--|

Equity Rating Key

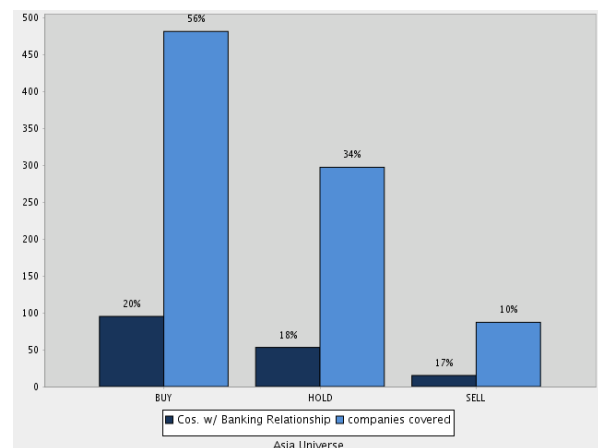
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

Equity rating dispersion and banking relationships





Additional Information

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