

CHINA MOBILE ATTRACTIVE – AT LAST

1 March 2010

In a major change of view we have upgraded our recommendation for China Mobile from a Sell to a Buy. Consensus earnings now reflect the impact of competition, while the company's share of new adds is close to stabilising. Management is likely to increase the dividend payout policy with the 2009 earnings announcement, now that capex should have peaked, and with international acquisitions unlikely. Adjusted for cash PER is under 10x with upward earnings surprises possible.

Cellular: China Mobile Preferred Stock

- China Mobile Share Of New Adds Now 50%
- Consensus Earnings 2010 Down 25% Since Mid-2008
- Current Cash About US\$32bn (RMB 11 per share)
- More Generous Dividend Payout Likely.
- Overseas Deals Less Probable
- Capex Peaked
- "A" Share Listing Probable
- Unicom and Telecom Still Under Pressure

Fixed: Subscriber Losses Continue – Still Largely PHS

- PHS Still 15% Of Total – Set To Close Next Year
- Residential Customers Switching To Cellular
- IP-TV Remains Stalled
- Broadband Still Strong

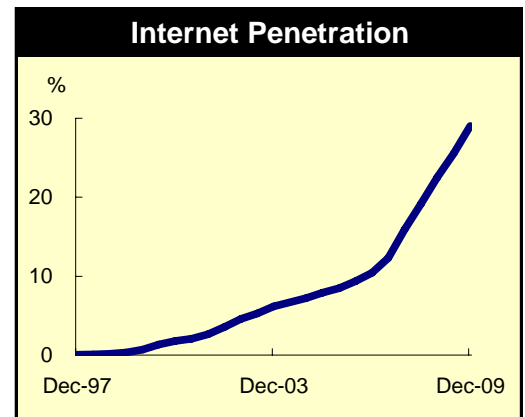
Earnings: Effects Of Mobile Competition Becoming Apparent

- China Mobile Now Seeing Only Slow Growth
- Unicom and Telecom Mobile Operations Loss-making
- Competition Remains Rational
- Little Improvement Likely Until 2011

Watch For: Increasing 3G Handset Subsidies

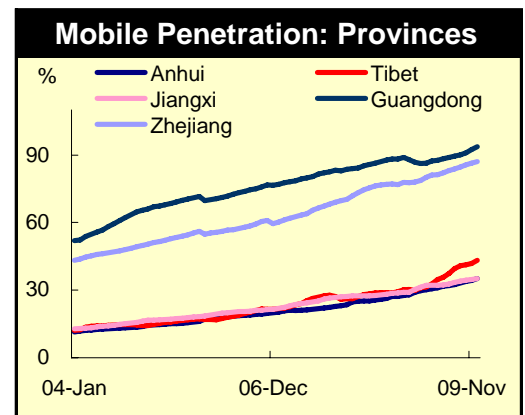
- China Mobile New Adds Should Stabilise Around 45%
- Increasing Emphasis On 3G Services
- Mobile "A" Share Listing

Internet Penetration Far From Mature



Source: CNNIC

Even Tibet 43%



Source: CEIC

- China Mobile: Buy
- China Unicom: Sell
- China Telecom: Hold



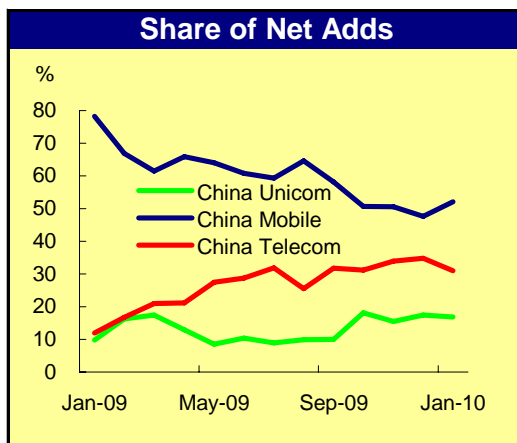
China Mobile looks again worth investors' attention, now that the impact of cellular competition is fully apparent. Management appears willing to distribute a larger proportion of cash flow, while in the long-term LTE offers an exit from TD-SCDMA. Unicom and Telecom are both still struggling.

China Mobile: Upgraded To Buy

We have reversed our long-held Sell recommendation for China Mobile, upgrading it to a Buy on the strength of stabilizing share of new adds and the likelihood that management will signal a more generous dividend policy with the up-coming full-year results. China Telecom remains a Hold; China Unicom a Sell.

Our negativity in recent years was because we anticipated growing competition as 3G arrived, with three companies in the mobile sector, putting significant pressure on new add numbers and ARPU. Cash flow was looking to be affected by high capex needs.

With the roll-out of 3G networks, and bedding down of the restructuring of the telecoms companies a significant fall in China Mobile's share of new subscribers was inevitable. We believe, however, that that process is now largely complete. From its peak over 90% in the summer of 2008, Mobile has now dropped to about 50% of new adds (an average of 50.2% over the last four months). The figure will fluctuate from month-to-month, but we are looking for an average around 45%.

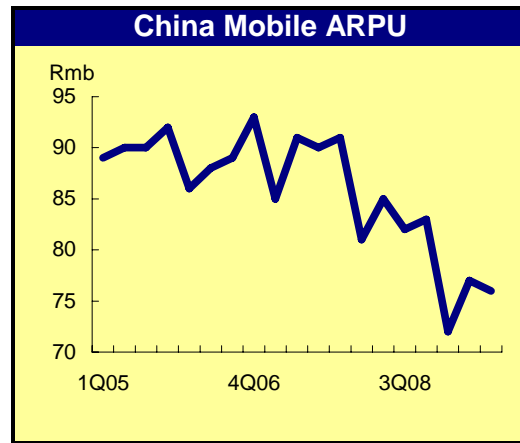


Source: Companies

Accompanying the fall in share of new adds, and the pressure on ARPU that became apparent over the last 18 months, has been a steady reduction in consensus earnings expectations for Mobile, with expected 2010 earnings falling 25% since mid-2008, a strong contrast to the situation up to 2008 when China Mobile was regularly surprising on the

upside. With the current competitive reality now fully understood by the market we do not expect to see further significant downgrading unless Mobile's share of new adds slips towards the 30-40% range – unlikely given the strong reputation for coverage and quality of the company's network – or competitive pressures intensify substantially, which we do not expect since neither of the other companies has the balance sheet to support an all-out price war.

By the end of this year the risks for ARPU are likely to be on the upside, as experience of 3G encourages users to adopt more value-added services.



Source: China Mobile

We estimate that China Mobile currently has about US\$32bn in net cash, RMB11 per share. The company had been retaining cash because of high capex needs (regularly revised upwards) and ambitions for international acquisitions.

Recent conversations with management, however, make it clear that the overseas opportunities that have been considered were not attractively priced and the likelihood of a purchase is much lower than the market had previously thought.

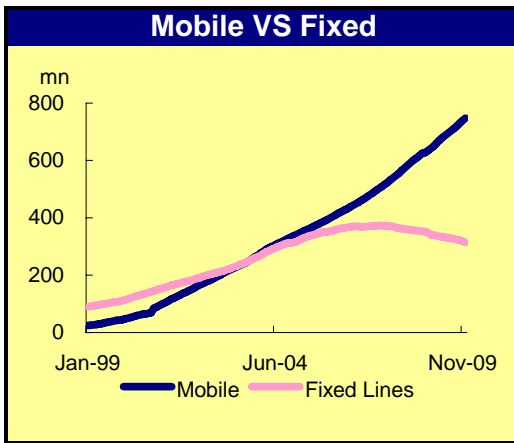
At the same time we believe that capex has peaked. The burden of 3G network capex is with the parent company, and the eventual upgrade to LTE is likely to be relatively much cheaper than 3G, both because equipment costs continue to fall and because some of the upgrade is software only.

We therefore believe that at the upcoming results announcement the company will make it clear that future payouts will be increased significantly. A special dividend is a clear possibility, in addition to an upward revision of the company's current 43% dividend payout policy, probably to about 50%.

An "A" share listing (most likely not involving the issue of any additional shares – the company hardly needs more cash at present) could well be revisited, which would also be likely to benefit investor sentiment.

The company's current PER falls to under 10x if adjusted for cash, which we believe has become attractive in view of the falling likelihood that it will be blown on an ill-conceived overseas venture and increasing probability of distribution to shareholders. Hence the upgrade to Buy.

We calculate that China Unicom and China Telecom are each still losing money on their mobile operations. Their profits come from their fixed line activities. The number of fixed phone lines continues to shrink, however (China Telecom fixed's fixed line subscriber base fell 9.5% during 2009, while China Unicom's fell 6.2%). Only broadband continues to boom (up 21% and 31% respectively last year).



Source:CEIC

China Unicom - Sell

We remain negative on China Unicom which has achieved only a 17% share of new mobile adds over the last four months despite the perceived advantage of operating the "best" 3G technology with the widest handset range – WCDMA. Reversing this performance is likely to be expensive in terms of handset subsidies. We expect profit to be down in both 2009 (looking at underlying results) and 2010.

We do not put any significance, however, on the company's announcement warning that 2009 profits would be down over 50% on 2008. The prior year numbers were in particular distorted by the RMB26.1bn gain on the sale of the CDMA network to China Unicom.

We are unconvinced too by the benefits to China Unicom of its possible participation in the consortium bidding for Nigeria Telecommunications (Nitel). The confusion over whether any part of Unicom is or is not involved does not generate confidence. Nor does the high price the consortium has bid (over twice that offered by the second-place bidder). It certainly seems a high piece to offer for a company that operates the smallest of nine cellular operators in the country with a market share under 1%.

China Telecom - Hold

Our mild preference for China Telecom (Hold) over China Unicom is supported by its faster sign-up of new subscribers, and the greater (33%) share of new subscribers it has signed in the last four months. As the smaller network (59.1mn subscribers at the end of January) the new adds also have a greater impact. Total subscriber base increased 101% during 2010. China Telecom's parent is undertaking most of the mobile capex, reducing the immediate cost to the company of this rapid growth.

RECOMMENDATIONS	
China Mobile	BUY
China Unicom	SELL
China Telecom	HOLD



STOCKS



Telecom Valuations											
	Y/E	Currency	Mkt Cap		Price		EPS		PER		
			(bn)	US\$(bn)	25-Feb	08	09E	10E	08	09E	10E
Australia											
Telstra	Jun	AU\$	37.0	34.1	3.2	0.329	0.316	0.327	9.7	10.1	9.8
Hong Kong/China											
China Mobile*	Dec	HK\$	1,536.7	198.3	76.8	6.276	6.622	6.670	12.2	11.6	11.5
China Telecom*	Dec	HK\$	276.0	35.6	3.7	(0.016)	0.202	0.211	nm	18.1	17.3
China Unicom*	Dec	HK\$	219.4	28.3	10.6	0.261	0.488	0.443	40.6	21.7	23.9
Hutchison Int.	Dec	HK\$	10.3	1.3	1.6	0.390	0.423	(0.287)	4.1	3.7	nm
Smartone	Jun	HK\$	3.5	0.5	6.0	0.076	0.138	0.166	79.3	43.7	36.3
India											
Bharti Airtel	Mar	INR	1,060.8	22.8	331.1	20.70	23.76	na	16.0	13.9	na
MTNL	Mar	INR	45.3	1.0	79.7	3.27	(4.9)	(4.6)	24.4	nm	nm
Reliance	Mar	INR	325.2	7.0	229.7	29.29	18.46	na	7.8	12.4	na
TCOM	Mar	INR	80.5	1.7	470.2	10.82	(5.97)	9.70	43	nm	48.5
Indonesia											
Indosat	Dec	IDR	27,713	2.9	5,500	346	289	338	15.9	19.1	16.3
PT Telkom	Dec	IDR	167,328	17.7	8,650	538	601	677	16.1	14.4	12.8
Japan											
KDDI Corp	Mar	JPY	2,126	23.1	477,000	42,505	53,350	na	11.2	8.9	na
NTT	Mar	JPY	6,092	66.2	3,730	34,507	346	na	0.1	10.8	na
NTT DoCoMo	Mar	JPY	6,039	65.6	130,300	10,396	11,899	na	12.5	11.0	na
Malaysia											
Digi.com	Dec	MYR	17.5	5.2	21.6	1.287	1.390	1.465	16.8	15.5	14.7
Telekom Malaysia	Dec	MYR	11.7	3.4	3.0	0.183	0.153	0.163	16.6	19.9	18.7
New Zealand											
Telecom NZ	Jun	NZ\$	4.4	3.3	2.5	0.220	0.211	0.207	11.4	11.8	12.1
Philippines											
Globe	Dec	PHP	128.4	2.7	985	84.8	95.7	101.1	11.6	10.3	9.7
PLDT	Dec	PHP	485.7	10.3	2,600	181.7	215.4	231.1	14.3	12.1	11.2
Singapore											
Mobile One	Dec	SG\$	1.8	1.3	1.8	0.168	0.170	0.175	10.5	10.4	10.1
SingTel	Mar	SG\$	48.6	34.8	3.1	0.217	0.242	0.257	14.3	12.8	12.1
Starhub	Dec	SG\$	3.7	2.6	1.9	0.176	0.176	0.179	11.0	11.0	10.8
South Korea											
Hanaro	Dec	KRW	1,480	1.3	5,140	(419)	22	88	nm	233.6	58.3
KT Corp	Dec	KRW	11,646	9.9	39,750	2,217	5,701	5,972	17.9	7.0	6.7
LG Telecom	Dec	KRW	3,985	3.4	9,000	1,023	990	1,261	8.8	9.1	7.1
Taiwan											
Chunghua	Dec	TW\$	579.9	17.9	63.3	4.96	4.74	4.67	12.7	13.4	13.6
FarEasTone	Dec	TW\$	124.5	3.8	37.0	2.83	3.03	3.10	13.1	12.2	12.0
Taiwan Mobile	Dec	TW\$	228.4	7.1	58.4	4.66	4.76	4.94	12.5	12.3	11.8
Thailand											
Adv. Info. Service	Dec	THB	261.0	7.8	88.0	5.76	6.03	6.31	15.3	14.6	13.9
Total Access	Dec	US\$	2.5	2.5	1.2	0.082	0.092	0.091	14.7	13.1	13.2
True Corp	Dec	THB	20.7	0.6	3.7	0.180	0.094	0.169	20.4	39.1	21.8

* Research-Works Estimates

Source: Bloomberg



STOCKS

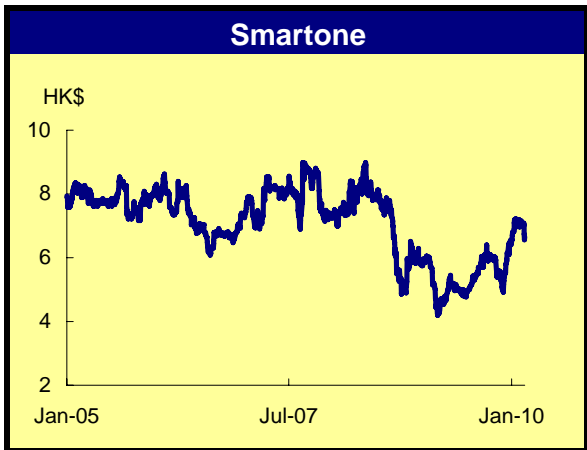
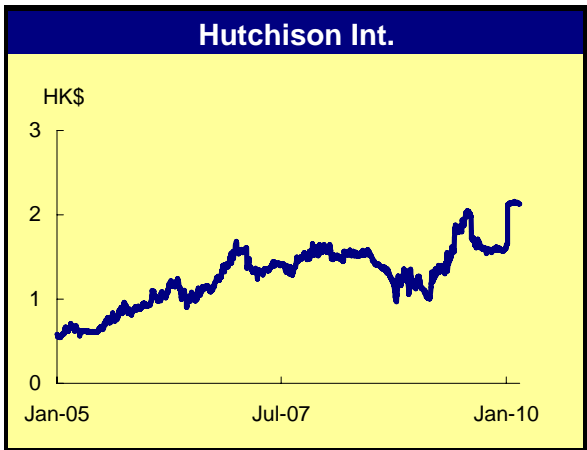
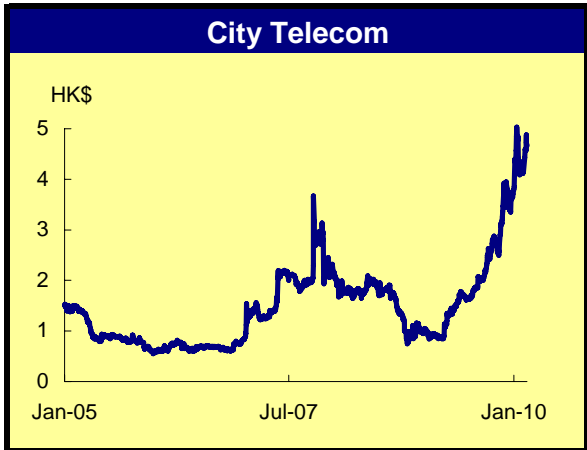
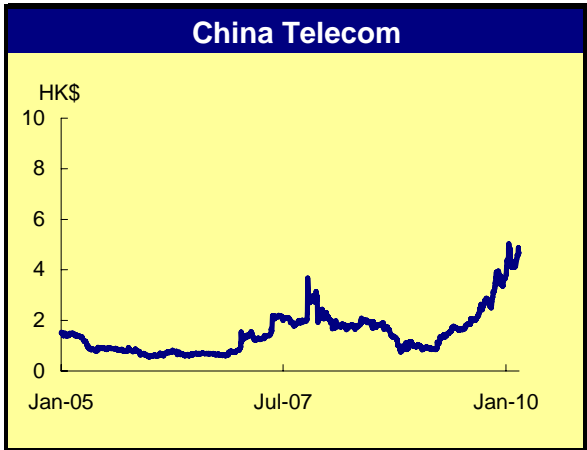
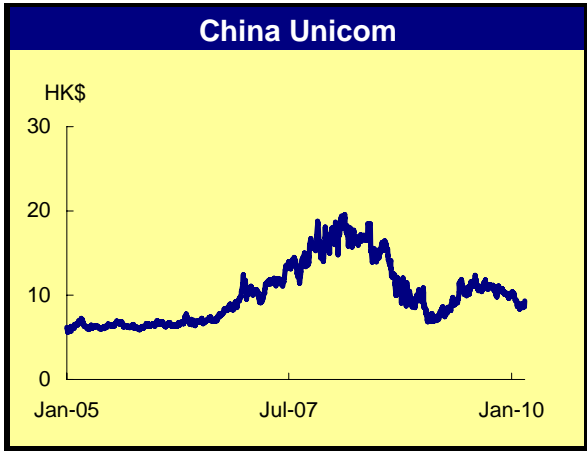
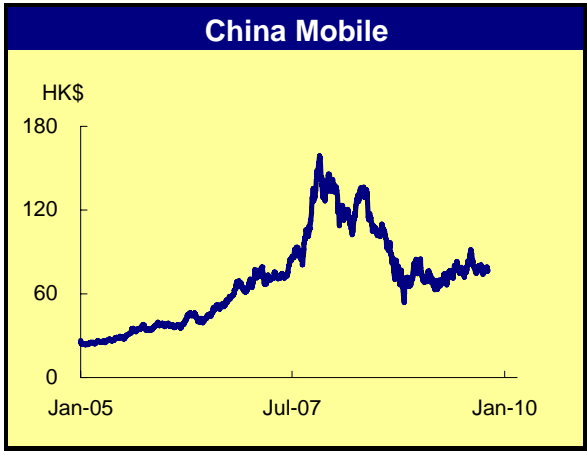


Share Prices and Performance for Telecom Companies

% chg at Feb 25th	Ticker	Currency	Last Price	1 Week	1 Mth	3 Mths	6 Mths	12 Mths	24 Mths	
Australia										
	Telstra	TLS AU	AU\$	3.01	(3.8)	(12.8)	(10.9)	(10.1)	(20.2)	(37.7)
Hong Kong/China										
	China Mobile	941 HK	HK\$	76.45	(0.3)	1.8	1.6	(2.9)	8.5	(33.8)
	China Telecom	728 HK	HK\$	3.30	(1.5)	(2.4)	(6.8)	(14.9)	17.9	(44.2)
	China Unicom	762 HK	HK\$	8.65	(2.5)	(6.1)	(19.8)	(20.2)	17.2	(50.3)
	Hutchison Int.	2332 HK	HK\$	2.13	(0.5)	(0.5)	34.0	25.3	106.4	(64.7)
	PCCW	8 HK	HK\$	2.12	(3.2)	(3.2)	12.2	3.4	(45.5)	(52.5)
	Smartone	315 HK	HK\$	6.56	(6.2)	(8.4)	29.4	15.1	39.6	(11.5)
	UTStarcom	UTSI US	US\$	2.20	5.3	(6.8)	20.9	25.0	94.7	(25.2)
India										
	Bharti Airtel	BHARTI IN	INR	276	(2.0)	(16.5)	(2.0)	(32.3)	(13.8)	(35.0)
	MTNL	MTNL IN	INR	71	(4.7)	(13.3)	(5.0)	(24.9)	8.8	(40.7)
	Reliance	RCOM IN	INR	155	(7.7)	(13.6)	(9.6)	(41.2)	0.1	na
	TCOM	Tcom IN Equity	INR	280	(7.1)	(17.4)	(24.3)	(44.9)	(30.2)	(42.9)
Indonesia										
	Indosat	ISAT IJ	IDR	5100	(1.9)	(1.9)	(1.0)	(1.9)	17.2	(30.1)
	PT Telkom	TLKM IJ	IDR	8300	(4.6)	(10.3)	(8.3)	(4.0)	27.7	(17.0)
Japan										
	KDDI Corp	9433 JP	JPY	474,500	(3.8)	(10.1)	1.6	(9.3)	(2.4)	(27.1)
	NTT	9432 JP	JPY	3,885	(1.9)	(1.6)	6.1	(3.6)	(5.0)	(18.2)
	NTT DoCoMo	9437 JP	JPY	138,700	(0.9)	0.1	6.2	(2.0)	(8.0)	(9.3)
Malaysia										
	Digi.com	DIGI MK	MYR	22.52	3.1	2.7	2.7	2.5	6.7	(6.2)
	Telekom Malaysia	T MK	MYR	3.26	0.6	4.2	7.6	6.5	(8.4)	3.1
New Zealand										
	Telecom NZ	TEL NZ	NZ\$	2.31	(1.3)	(3.3)	(5.3)	(15.7)	(6.1)	(40.6)
Philippines										
	Globe	GLO PM	PHP	970	1.6	3.7	1.0	(4.4)	23.6	(35.3)
	PLDT	TEL PM	PHP	2585	0.8	(3.7)	(0.2)	1.4	19.1	(9.0)
Singapore										
	Mobile One	M1 SP	SG\$	2.06	0.5	1.0	17.7	23.4	33.8	2.5
	SingTel	ST SP	SG\$	3.01	(1.0)	(2.3)	2.4	(5.6)	16.2	(22.6)
	Starhub	STH SP	SG\$	2.13	0.9	(2.3)	8.7	(4.5)	6.5	(28.0)
South Korea										
	Hanaro	033630 KS	KRW	4,950	0.6	(8.2)	13.1	(1.0)	1.3	(56.7)
	KT Corp	030200 KS	KRW	43,750	(6.5)	(6.6)	10.3	13.6	15.7	(8.9)
	LG Telecom	032640 KS	KRW	7,570	(4.8)	(14.0)	(9.9)	(1.8)	(11.3)	(7.8)
	SK Telecom	017670 KS	KRW	172,500	(2.5)	(2.8)	(2.5)	(0.3)	(11.5)	(15.0)
Taiwan										
	Chunghua	2412 TT	TW\$	59.3	0.0	(7.2)	(7.1)	(3.0)	(6.5)	(22.2)
	FarEasTone	4904 TT	TW\$	37.6	0.5	(1.1)	0.7	1.6	17.9	(27.8)
	Taiwan Mobile	3045 TT	TW\$	59.8	(0.3)	(3.2)	(1.2)	18.2	30.9	9.3
Thailand										
	Adv. Info. Service	ADVANC TB	THB	87.75	(0.6)	3.5	5.1	1.4	10.4	(17.2)
	Total Access	DTAC SP	US\$	1.05	1.9	6.1	1.9	8.8	34.6	(22.8)
	True Corp	TRUE TB	THB	2.88	2.9	(5.3)	(7.1)	18.0	87.0	(48.1)

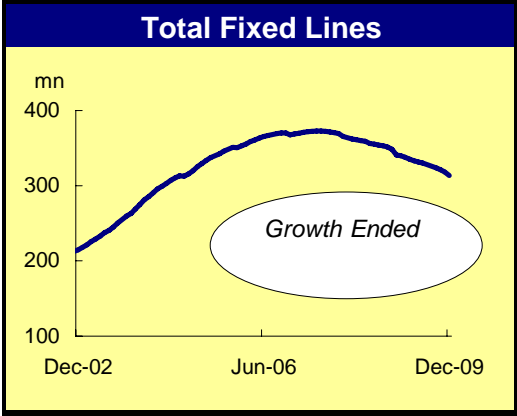
Source: Bloomberg

STOCKS

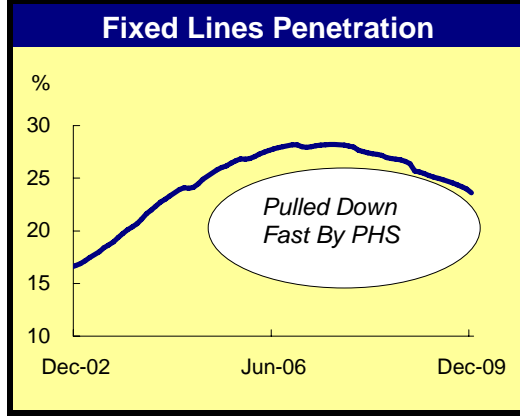


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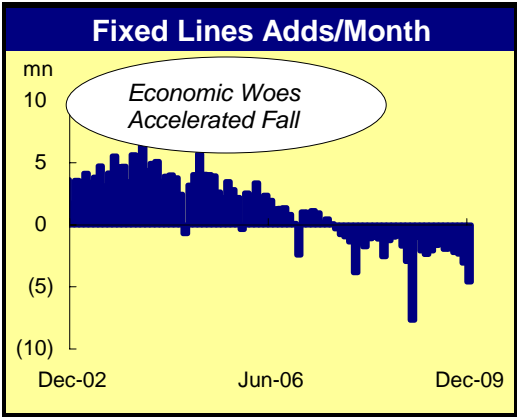
FIXED LINES/PHS - CHINA



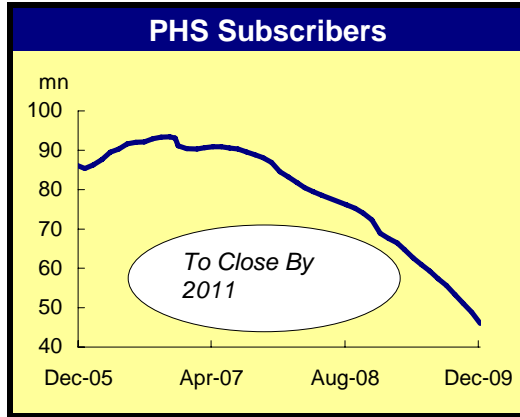
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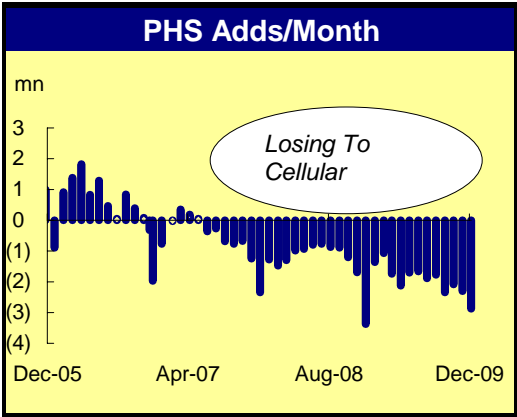
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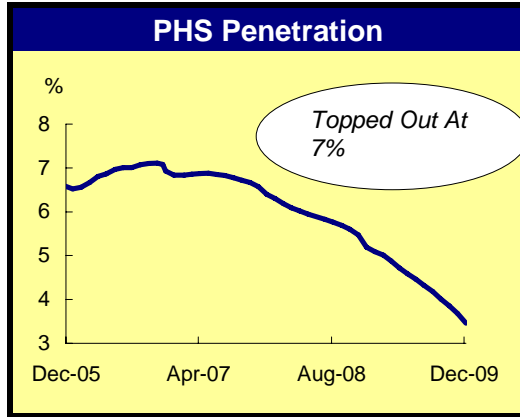
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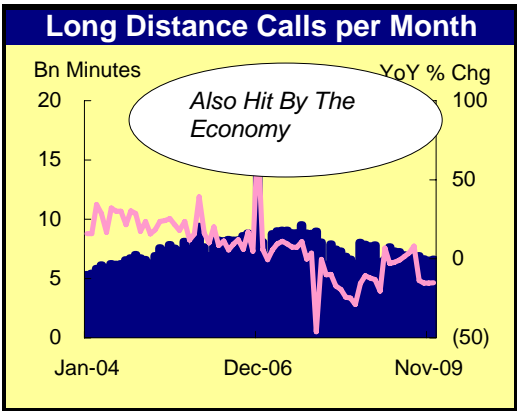
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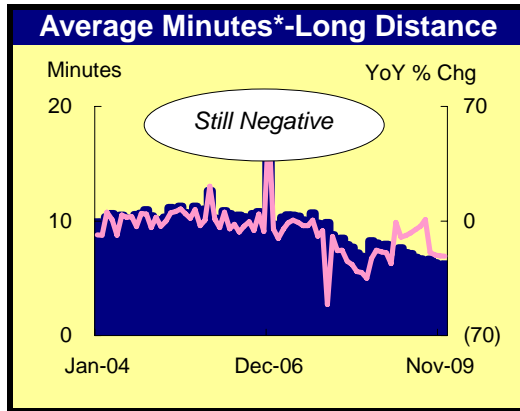
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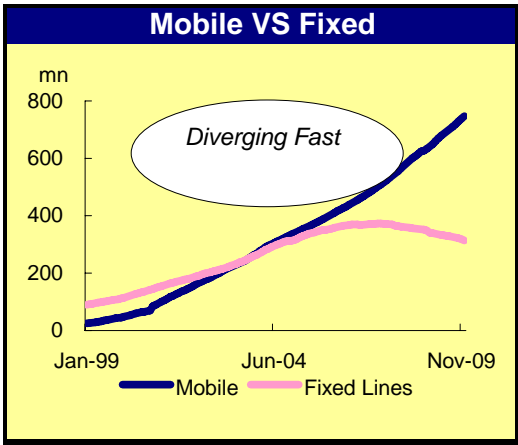
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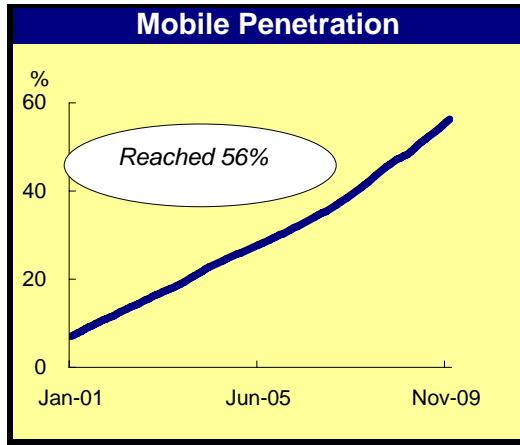
*Monthly Average Minutes per User

Source: MIIT, Research-Works Estimates⁷

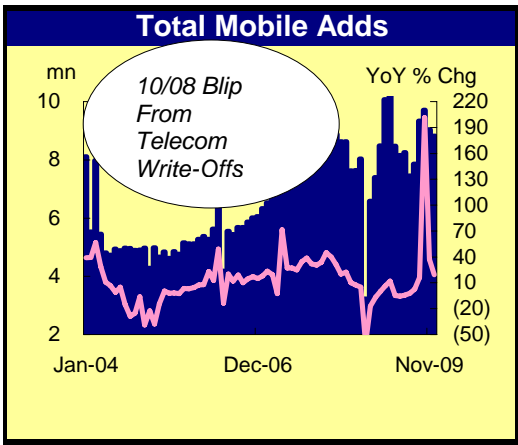
MOBILE - CHINA



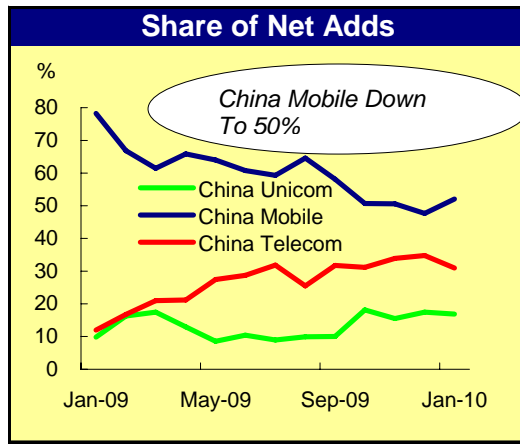
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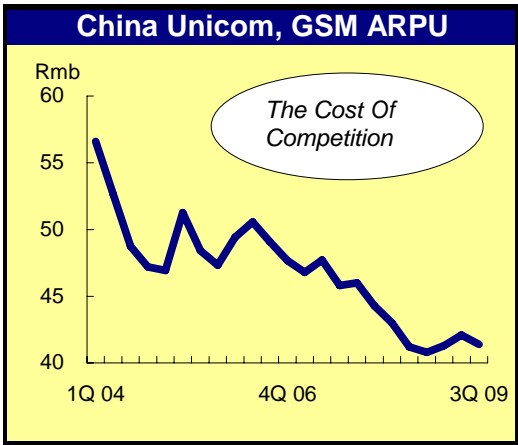
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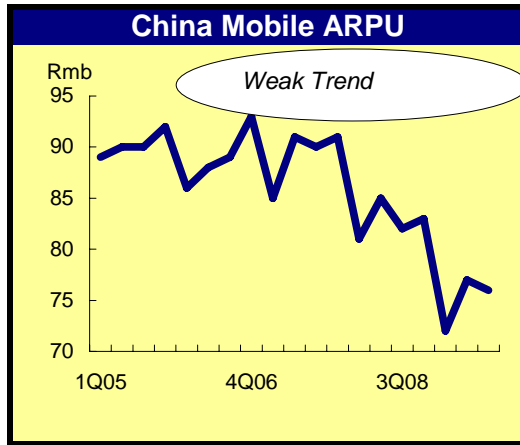
Source: MIT



Source: Companies

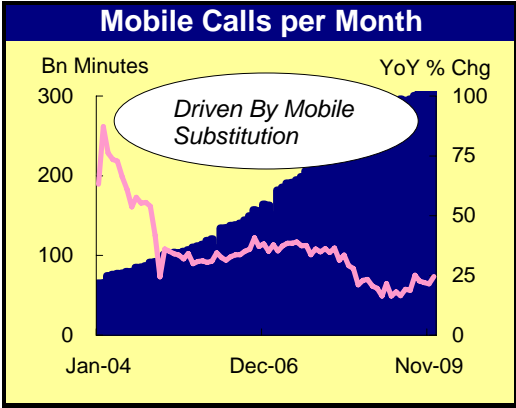


Source: China Unicom

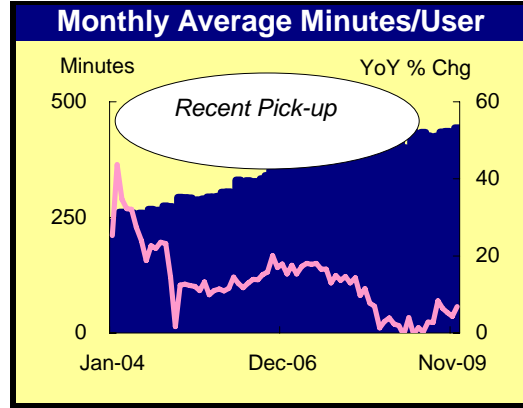


Source: China Mobile

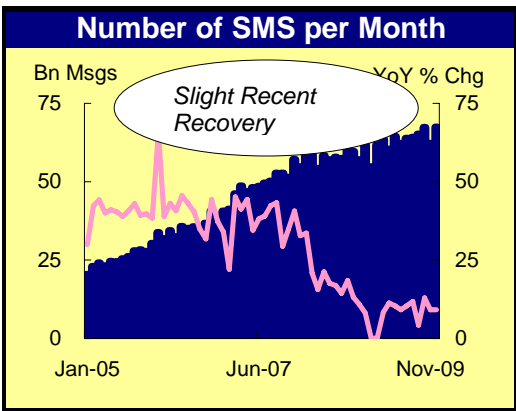
MOBILE - CHINA



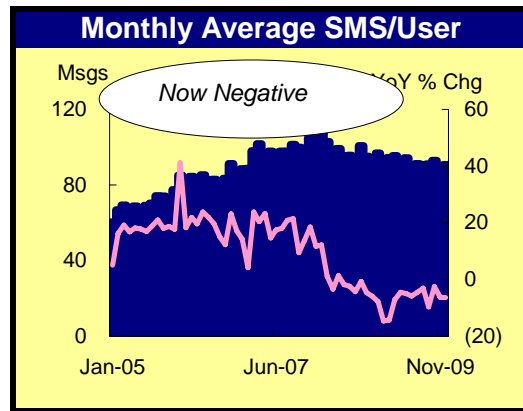
Source: MITT



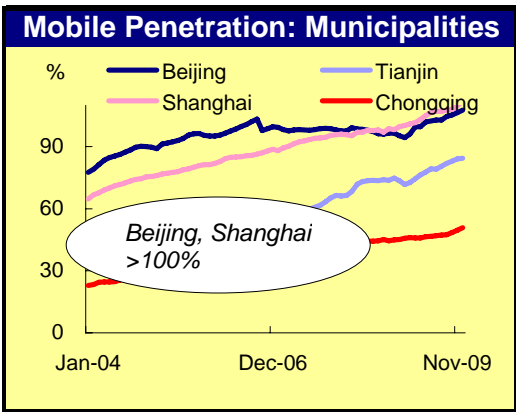
Source: MITT, Research-Works Estimates



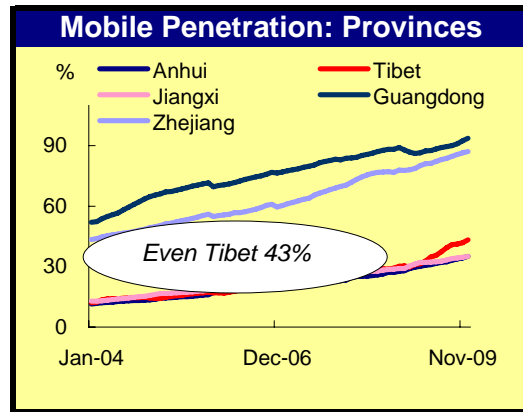
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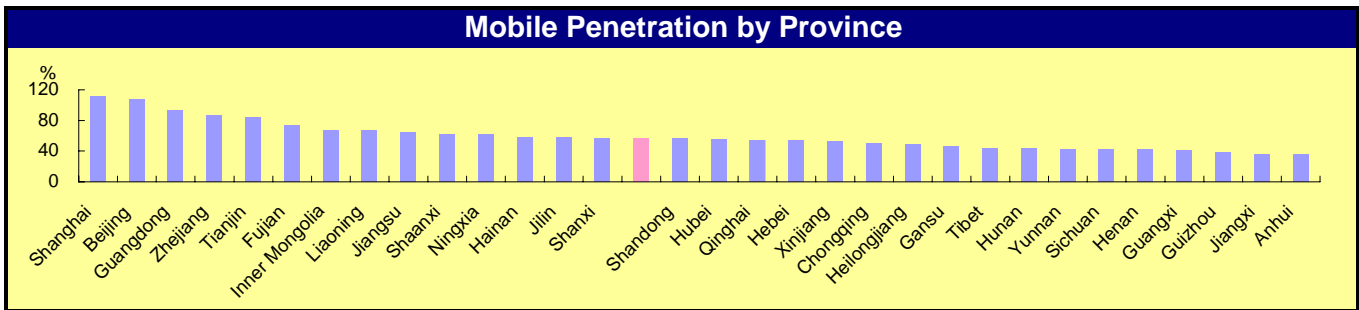
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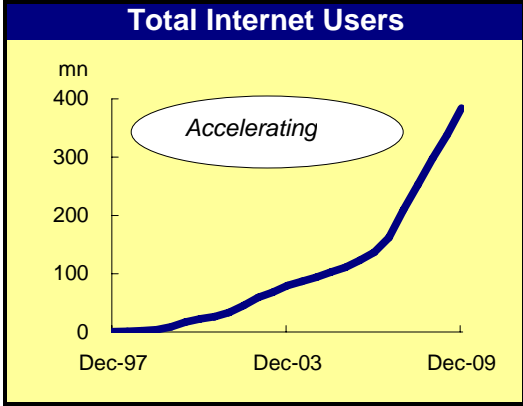
Source: CEIC, Research-Works estimates



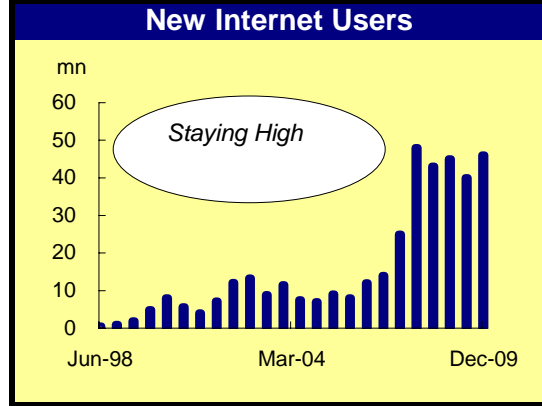
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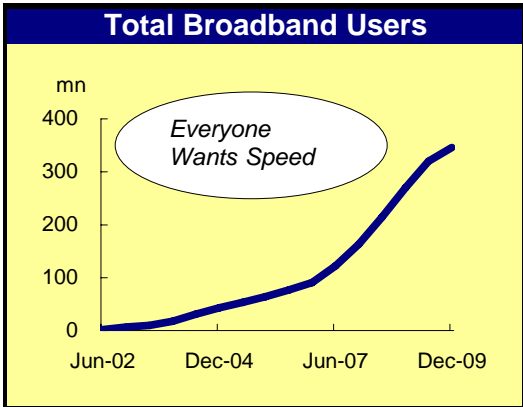
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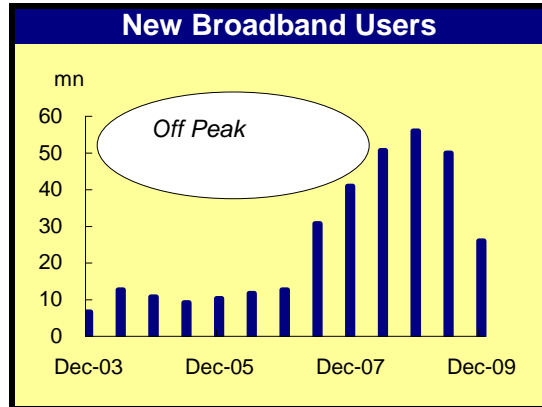
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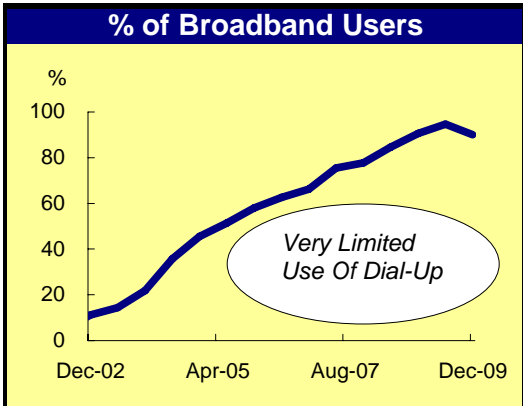
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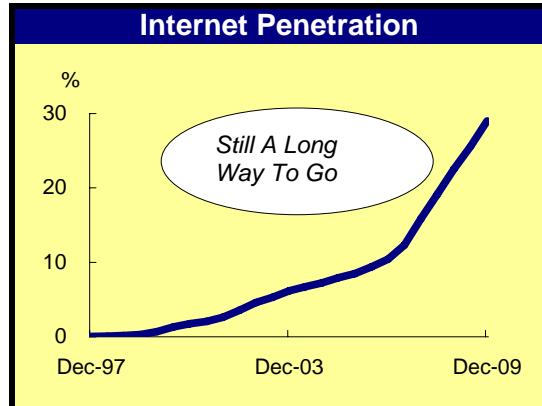
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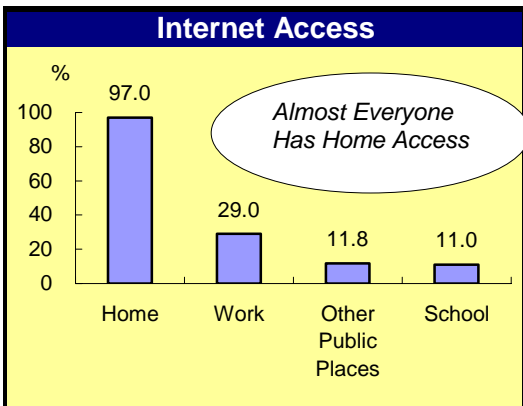
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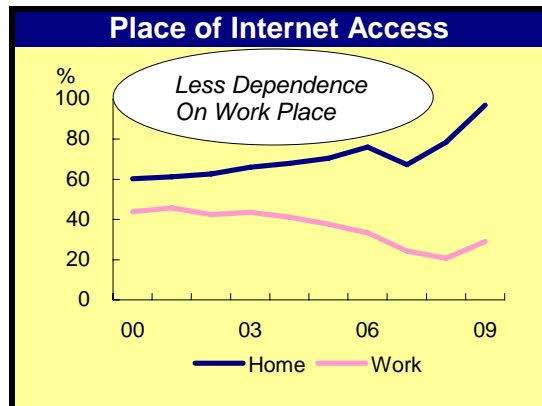
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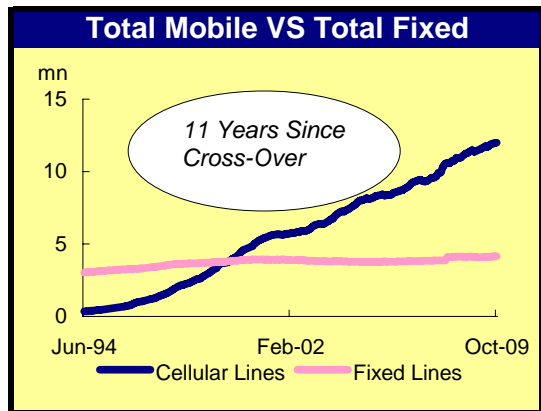
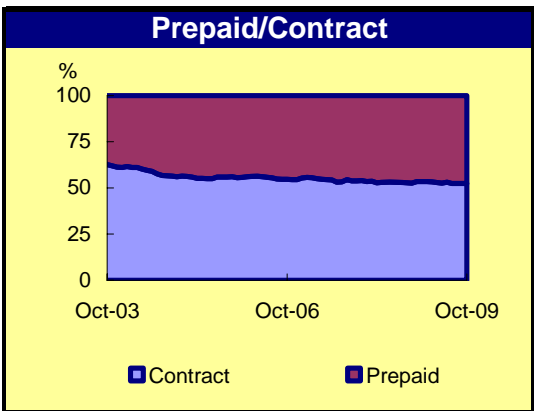
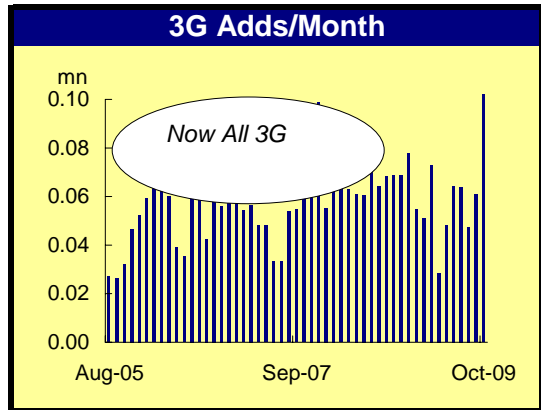
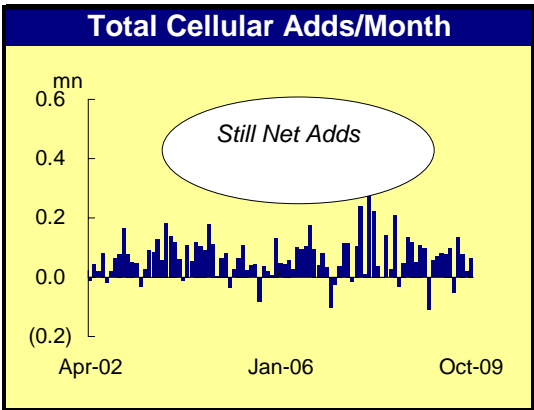
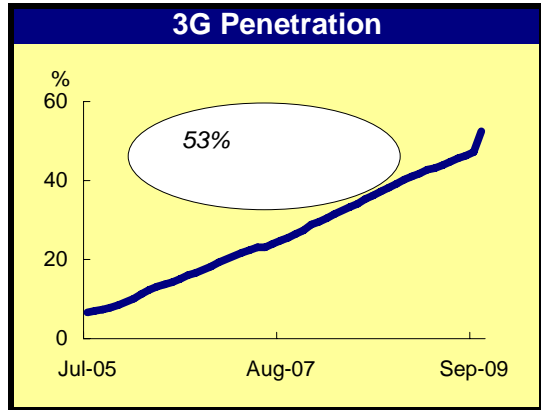
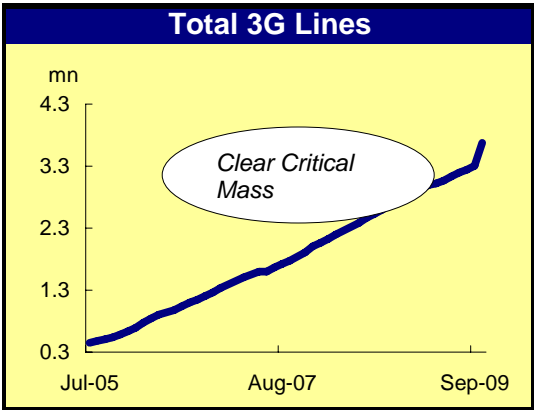
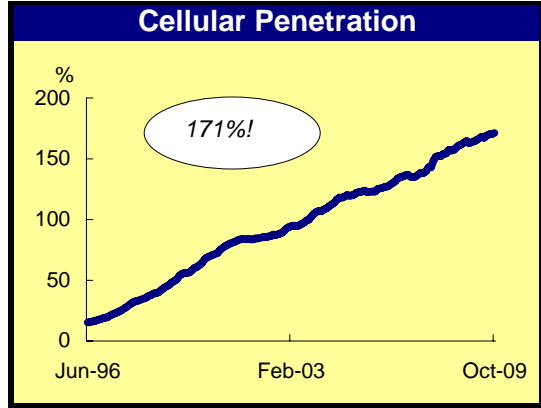
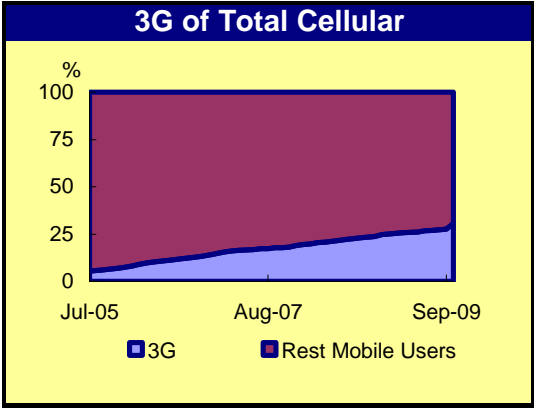


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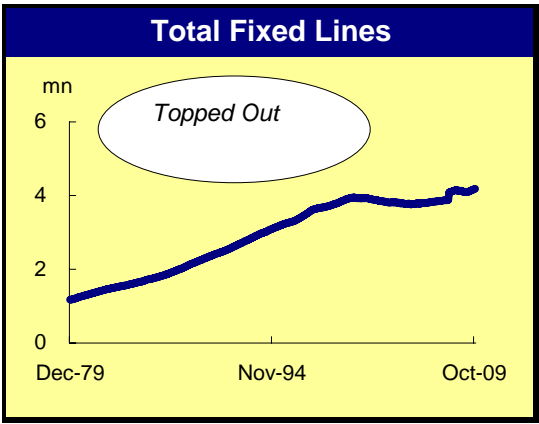


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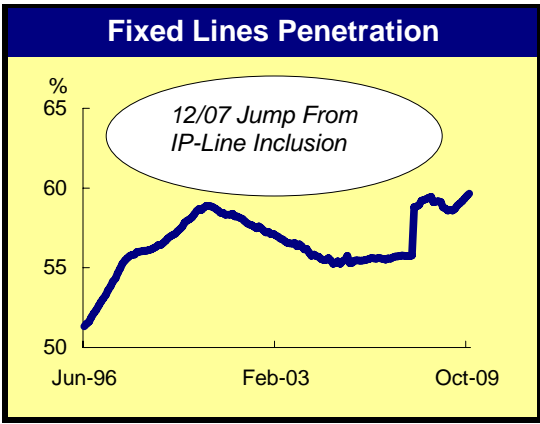
MOBILE - HONG KONG



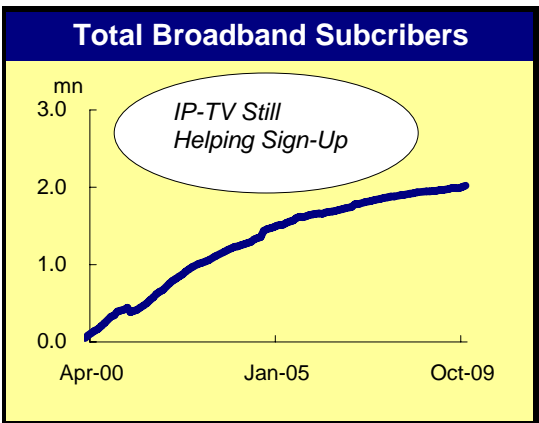
70s FIXED/BROADBAND - HONG KONG 20s



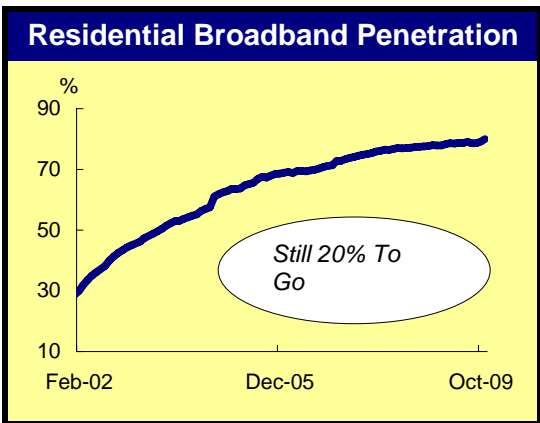
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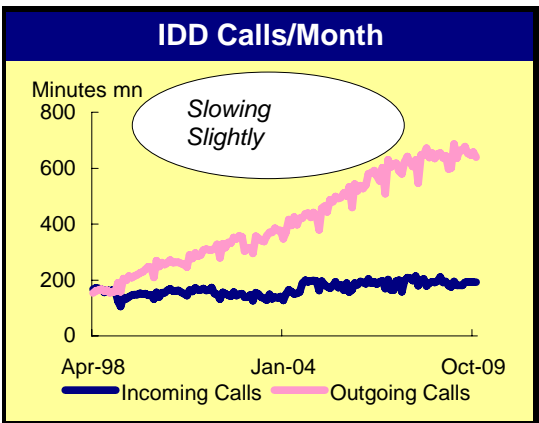
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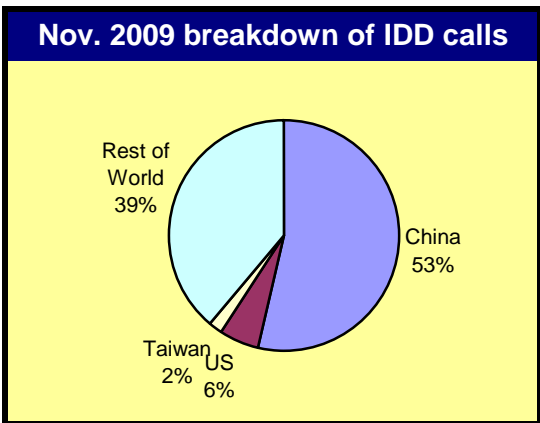
Source: CEIC



Source: CEIC



Source: CEIC



Source: OFTA of HK