

Thursday, March 4 2010
China Mobile: Downgraded To Hold

We are **disappointed by China Mobile's announcement that it is in talks to buy a strategic stake** (20%, new shares, according to market speculation) **in Shanghai-listed Shanghai Pudong Development Bank**. At the pre-suspension price this would cost it about Rmb40bn. While the company can well-afford the investment (year-end 2009 cash was about Rmb240bn), we had been encouraged by indications from management that overseas investments were looking much less likely, and that as a result of this, as well as peaking capex, the dividend payout policy was under review. As well as immediately enhancing the yield this seemed to indicate a reassuringly responsible attitude to the cash pile, and our confidence that it would not be blown was increasing.

The proposed transaction, assuming that it goes ahead, is likely to be presented as being both an attractive investment opportunity in its own right (immediately EPS enhancing, as a result of the low interest income on cash) and providing the opportunity for co-operation in a mobile payment mechanism.

We fail to see, however, why an investment tying China Mobile to a second (at best) tier bank is preferable to a consulting arrangement or jv. There is no clear reason why a payment mechanism needs the full structure of a bank behind it.

Nor we do not see the advantage in China Mobile undertaking essentially unrelated financial investments.

In short **our concerns about China Mobile's approach to its cash holdings are revived by this announcement**.

Only last week we upgraded our recommendation from a Sell to a Buy for two main reasons:

- We believed that the reduction in expectations for the company as a result of increased competition in the sector was largely completed
- We thought that an enhanced cash payout was likely, and that as noted above this reflected a sensible approach by management to the company cash

The first of these factors remains in place, but not the second. We believe that the current valuation is not demanding, but also that **market concerns about the future use of cash will remain** and that this will colour investors' thoughts about management's attitudes towards the minority shareholders more generally. We do not generally tweak recommendations too frequently, but on this occasion **we are cutting our Buy recommendation to a Hold**.

Best regards

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