

Presentation for Puget Sound Council, August 25, 2009

Stock: China Mobile Limited

Ticker: CHL

Trades: As an ADR on the

Presenter: Christopher Hodgkin

email: [chodgkin@yahoo.com](mailto:chodgkin@yahoo.com)



**CAUTION: No investment recommendation is made or implied by this presentation. Every investor must make his or her own stock study and perform his or her own due diligence before making any investment decision.**

## **Basic Information about China Mobile Limited**

- ✿ As noted, trades as an ADR
  - ✿ Initial Public Offering in 1997
- ✿ Wireless telephone provider
  - ✿ Offers a full range of wireless telephone and value added services throughout China (and internationally)
  - ✿ Rapidly moving into the wireless data field
- ✿ China's largest wireless telephone company
  - ✿ Has 493 million subscribers
  - ✿ Ranked No. 5 (up from 16) in the Financial Times Global 500 companies
- ✿ Was sole wireless service provider for Beijing Olympics

## Basic Financial data (From Morningstar)

- ❁ *Note: Accounting standards used by CHL are IFRS (International Financial Reporting Standards rather than GAAP as used by US corporations.*
- ❁ Market capitalization: \$206 billion
- ❁ Sales:     2008: 59.1B  
              2007: 46.9B  
              % increase: 26%
- Earnings: 2008: 3.97B  
                  2007: 2.81B  
                  % increase: 41%
- ❁ Income is from usage fees (63%), monthly fees (4%), value added fees (28%) and other (5%)

## **More basic financial information**

- ✿ Cash Flow is strong
  - ✿ Operating cash flow 20-30B
  - ✿ Plenty to cover capital expenditures, purchases of competitors, dividends
  - ✿ Interest is less than 300M; plenty of coverage
- ✿ Dividend yield 3.4% (but may carry ADR fees)
- ✿ Long term debt: 4.9B
- ✿ Strong balance sheet including 30B in cash

## Sources of Information

- ✿ Much less information than for a US company of equivalent size
- ✿ Yahoo Finance has some basic information
- ✿ Morningstar's free offerings have some additional information
  - ✿ Good source for company filings
- ✿ Company issues an annual report
  - ✿ However, monetized in RMB, not in dollars
  - ✿ Exchange rate makes it not easily translatable to dollars
- ✿ Company also issues an SEC Form 20-F, required by foreign companies listed on US exchanges, but has less information than 10-K.

## **Prospects and strategy for growth**

- ✿ Past growth has included numerous acquisitions (Ann Rpt pg. 4-5)
- ✿ Continues to add subscribers faster than its competitors
- ✿ Promotes three brands targeting different demographic groups: middle to high-end, mass-market, and youth
- ✿ Continues to promote and develop services for the rural market.
- ✿ Is expanding internationally (e.g. Pakistan)

## **Competition**

- ✿ CHL is one of three licensed mobile telecommunications service providers in Mainland China
- ✿ Others are China Telecom (CHA) and China Unicom (CHU)

## Risks and Concerns

- ✿ Is 75% controlled by Chinese government
- ✿ Has had monopoly protections in past, but government is now promoting more competition and has extended favorable treatment to its competitors
  - ✿ Goal of government is to encourage three providers “of comparable scale and standing.” [Form 20-F, pg. 29]
- ✿ Rates are regulated and set (or in some cases limited) by the government
- ✿ New subscribers are likely to be lower profit rural users
- ✿ 3G network uses government developed TD-SCDMA, which is purportedly not as mature as other 3G technologies and may incur additional costs
- ✿ Global recession is reducing China’s GDP and impacting CHL
- ✿ China’s WTO membership (as of 2001) may require China to further open its markets to foreign competition

## On to the SSG

- ✿ Top right corner box gives us basic information – none looks like a problem
- ✿ Section 1 lines look great
- ✿ But wait - check out Recent Quarterly Figures. Oops!
  - ✿ We can see why in the Quarterly Trend Analysis (formerly PERT-A)
- ✿ Pre-tax profit is moving up
- ✿ ROE is moving up
- ✿ Debt to Equity is moving down
- ✿ All good signs
  - ✿ We pass the “Barbed Wire Test” strongly.
- ✿ So we can move on to the analysis

## Picking sales and earnings growth numbers

- ✿ Toolkit's Analysts Growth Rate Estimate is 23.0%.
- ✿ Personally, I would never project five year earnings growth at that rate.
- ✿ I also downloaded the data feed from StockCentral. They give no analysts estimates, but the default TakeStock growth projection is 20%.
- ✿ The Historical Growth table gives us sales growth rates in the mid-20s, but the trend is down.
- ✿ As a **first look only** – just to see whether the stock is worth further study – let's see what 13% sales growth gives us
- ✿ Using the Revenue-based (formerly Preferred Procedure) process:
  - ✿ I accepted the Pre-tax Profit Margin default of 33.9%
  - ✿ I don't understand the one year low tax rate, so used 30% instead
  - ✿ I accepted the shares out default
  - ✿ This gives an EPS growth rate of 10.2%

## Sections 2 and 3

- ✿ I used the Alt-M option for PEs
- ✿ I used 34.3 as the low price
- ✿ This puts the stock in the Buy zone
  - ✿ Upside-downside ratio is 3.3 to 1
  - ✿ Projected Total Return is 18.3%
  - ✿ Projected Average Return is 13.2%
- ✿ Not sterling, but possible

**Please base your poll responses on the information provided to this point**

**A stock study doesn't end there. We should cross-check our views against other sources of information**

- ✿ Let's see how reasonable our projections look against other estimate
  - ✿ Manifest Investing projects sales (not earnings) growth of 12%.
  - ✿ A bit below ours, but in the ballpark
- ✿ AAI's Stock Investor Pro database gives estimates from two analysts for 5-year earnings growth: one is 2.4%, the other is 27.5%, avg is 15.0% I have no idea what to do with those numbers.
- ✿ Zachs gives us 2009 earnings estimate of \$4.12 and 2010 of \$4.36
  - ✿ Let's graph those to see how they compare with our projection line
- ✿ Both Zachs and Yahoo give a five year earnings growth projection of 4.2%. Ouch.

## **And never forget to check the latest information**

- ✿ After I had selected this stock for presentation and done much of the analysis of it, the company reported, it's first half earnings on August 20.
- ✿ Net profit was up only 1.5% from a year earlier
- ✿ Sales were up 8.9% from a year earlier
- ✿ This does not make us happy campers!
- ✿ But while the stock price dropped on this news, it did not crash.

## So, what can we say?

✿ On the plus side:

- ✿ This is the market leader in a potentially huge market
- ✿ The company has shown a remarkably consistent ability to grow
- ✿ The company has strong financials and cash flow

✿ However:

- ✿ The company is facing increased competition
- ✿ The government is assisting the competition in order to create a more competitive market
- ✿ The analysts are clearly conflicted
- ✿ We don't know whether the last half-year was a temporary stumble, or an indication of long term problems.