

Chinese Telecoms

UNDERWEIGHT (Unchanged)

Unlocking the value of towers?

- A Bloomberg article retouched on the already known tower spin-off story by stating the tower company may sell up to 20% in a private placement for up to USD10b value. We believe it is difficult to arrive at a value for the tower company with no terms yet agreed upon.
- Many complex issues remain before tower sharing agreement could be settled by the end of August: mainly compensation for the asset injection and tower lease fee.
- We believe it is difficult to unlock the value of towers in the near term unless cost savings could be demonstrated. This is not going to be easy without the consolidation of existing towers, in our view.

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Market consensus view favors Unicom on tower value

The market consensus view is that tower asset monetization would have the biggest positive impact on Unicom shares since it has the smallest market cap, Telecom next and Mobile least. This could be true only if the tower value could be realized in the near term, in our view. We believe smaller operators should benefit from near-term tower capex savings in such an event, but tower leasing fee and network maintenance operating fees are likely to rise to pressure margins for the operators to neutralize the value. We believe value cannot be created unless the existing towers could be consolidated to realize cost savings for the operators and allow the tower company to generate adequate returns on the invested capital.

What's Our View

We have a HOLD rating on China Mobile, SELL on Unicom and Telecom. With the recent share price correction, absolute downside risk has waned, but earnings risks keep us at bay. We are closing our recommendation of Long Mobile, Short Unicom as the trade has already generated 14% since our recommendation.

Stock	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x)		P/B (x)		Dividend yld (%)	
						14A	15E	14A	15E	14A	15E
China Mobile	259,397.8	Hold	98.20	107.96	10	14.4	14.5	1.8	1.7	2.9	2.9
China Telecom	46,254.8	Sell	4.43	4.52	2	16.1	19.6	1.0	1.0	2.1	1.8
China Unicom	33,737.0	Sell	10.92	11.65	7	17.2	18.5	0.9	0.9	2.3	2.2

Unlocking the value of towers is not easy

According to Bloomberg, the tower company may aim to sell up to 20% to investors prior to the potential IPO in 2017. Based on our discussions with China Mobile, this news is not official from the tower company. **As for the update on the towers situation, nothing has changed.** Related parties are still hammering down on terms of the towers injection, lease payments, compensation and etc. These terms are originally scheduled to be completed by the end of August.

We believe tower spin-off terms will be complex with difficult issues for agreement including: 1) How many towers will be injected; 2) whether the compensation for the towers will be cash or adjustment in equity shareholding of the tower company; 3) tower leasing costs for each operator which will ultimately determine the value of the tower company and compensations; 4) when the towers can be consolidated and how will the future tower location be determined when each operator will have different location needs due to one's unique signal propagation characteristics; and 5) how much excess return will the tower company be allowed to generate from the operators, which will ultimately determine the value of the tower company.

The market consensus view is that tower asset monetization will have the biggest impact on Unicom since it has the smallest market cap, Telecom next and Mobile least. If the market believes tower sharing will lead to large upside then the resulting trade idea from this perspective will likely to be long Unicom or Telecom and short Mobile.

We take a view that the impact of tower spinoff is neutral. We have difficulty envisioning significant value creation for the tower company when the three shareholders are the tower lessees. We believe the impact will be neutral to modest upside value unless the tower company is able to generate significant synergy from consolidating towers to reduce maintenance and site lease costs. However, we believe this will take a long time even if synergy could be achieved.

We believe the government's intent is not to redistribute the wealth of the telecom players. China Mobile has the largest number of towers and the company has to be fairly compensated for injecting its towers for sharing. Both Unicom and Telecom may benefit from saving upfront tower capex but they also need to make fair payments for gaining access to towers without having to invest upfront capex. In this respect, we believe tower leasing fee and the related network operating maintenance costs are likely to lead to lower margins for the telecom operators - at least in the short-term - until the tower company can consolidate the injected existing towers. This is a case of value transfer from one entity to another: a zero sum game unless synergy cost savings could be realized.

Capex saving for 2015 is likely to be limited. According to China Mobile, its 4G network requires limited number of tower expansion in the future. China Telecom stated that it has budgeted only 6% capex savings for tower sharing in 2015.

At current price level, we are closing our recommendation of the long Mobile, short Unicom trade since the trade has already generated more than 14% return since we suggested it in our initiation report.

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