

**Analyst: Kelvin Li**
**CHINA COMMUNICATIONS SERVICES CORPORATION LIMITED** (中國通信服務)

Sector	: Technology Hardware & Equipment	Chairman	: WANG Xiaochu
HKSE Code	: 0552	Vice Chairman & CEO	LI Ping
Market Price	: HK\$5.51 (05/09/2007)		
HSI	: 24,069.17 (05/09/2007)		
H Shares Issued	: 1,633.48 million		
H-share Mkt. Cap.	: HK\$9,000.5 million		
52 weeks Hi/ Lo	: HK\$6.30 / HK\$3.25		

**SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30<sup>TH</sup> JUNE 2007**
**Interim Results Highlights**

	1H2007	1H2006	y-o-y
	RMB million	RMB million	change
• Revenue	7,365	6,372	+15.6%
• Gross profit	1,281	1,165	+10.0%
• <b>Attributable profit to shareholders</b>	<b>374</b>	<b>194</b>	<b>+92.8%</b>
	RMB	RMB	
• EPS – basic	0.069	0.049	+40.8%
• Interim DPS	-	-	N/A

- China Communications Services (CCS) reported a 92.8% y-o-y rise in net profit to RMB374 million for the six months ended 30<sup>th</sup> June 2007. In fact, the stunning y-o-y earnings growth during the first half was mainly distorted by a deficit on revaluation of property, plant and equipment before CCS' listing in December 2006. Excluding the RMB105.3 million revaluation deficit in 1H06, CCS' net profit would have grown by 25.0% y-o-y.
- Revenue surged a solid 15.6% y-o-y to RMB7.37 billion in 1H07, mainly driven by growth in telecom infrastructure construction services. Cost of revenues rose 16.8% y-o-y to RMB6.08 billion, largely in line with the top-line expansion. As a result, gross profit grew 10.0% y-o-y to RMB1.28 billion, while the gross profit margin fell to 17.4% in 1H07 from 18.3% a year earlier.
- EPS for 1H07 was RMB0.069, up 40.8% y-o-y. No interim dividend was declared (1H06: Nil).
- As of 30/06/2007, CCS had a total debt of RMB113 million (31/12/2006: RMB95.5 million). With a cash on hand of RMB6.93 billion, CCS was in a strong net cash position totalling RMB6.8 billion, compared with a net cash of RMB7.0 billion as at the end of 2006.

**Breakdown of revenue by customer groups:**

	1H2007		1H2006		y-o-y
	RMB million	%	RMB million	%	Change
China Telecom	3,358	45.6%	3,275	51.4%	+2.5%
China Mobile	1,090	14.8%	682	10.7%	+59.9%
China Unicom	250	3.4%	236	3.7%	+6.2%
Others	2,666	36.2%	2,179	34.2%	+22.3%
<b>Total</b>	<b>7,365</b>	<b>100.0%</b>	<b>6,372</b>	<b>100.0%</b>	<b>+15.6%</b>

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### **Business highlights**

- Breakdown of service revenue by business segments

	1H2007		1H2006		y-o-y
	RMB million	%	RMB million	%	Change
Telecommunications infrastructure services	3,677	49.9%	3,146	49.4%	+16.9%
Business process outsourcing services	2,740	37.2%	2,457	38.5%	+11.5%
Applications, contents and others	948	12.9%	769	12.1%	+23.3%
<b>Total</b>	<b>7,365</b>	<b>100.0%</b>	<b>6,372</b>	<b>100.0%</b>	<b>+15.6%</b>

- Revenue from **telecommunications infrastructure services** (TIS) grew 16.9% y-o-y to RMB3.7 billion, accounting for nearly half of the Group's total. It was mainly driven by robust demand for construction services for telecommunications infrastructure, especially from the two mobile carriers. Construction related revenue rose 15.4% y-o-y to RMB2.7 billion, being the Group's largest revenue contributor.
- The **business process outsourcing** (BPO) segment reported an 11.5% y-o-y rise in revenue to RMB2.7 billion, comprising 37.2% (1H06: 38.5%) of the Group's total. In fact, it was mainly driven by a higher maintenance volume, as China Telecom outsourced and increased the maintenance work of its network in order to enhance service quality and boost customer loyalty.
- The segment of **applications, content and others** (ACO) picked up steam during the first half, thanks to business development with government agencies and corporate customers. Revenue from the segment amounted to RMB948 million, up 23.3% y-o-y from RMB769 million in 1H06. As the segment is still in its infant stage, its contribution would become more important to CCS but remain volatile in the next couple of years.
- China Telecom remained the largest client and contributed revenue of RMB3.4 billion, but it was up only 2.5% from a year earlier. Thus, contribution from China Telecom in CCS' total revenue dropped to 45.6% in 1H07 from 51.4% a year earlier. China Mobile has become a more important client amid accelerating mobile substitution in the Mainland. Revenue contributed from China Mobile surged a sharp 59.9% y-o-y to RMB1.1 billion in 1H07, comprising 14.8% (1H06: 10.7%) of the Group's total.

### **Outlook & Prospects**

- **Acquisition of 13 provincial businesses completed** CCS completed its acquisition, from its parent China Telecommunications Corporation, of telecom support service assets in 13 provinces as well as certain fixed assets and company equity interests within CCS' current operating areas, which helped boost the total business coverage to 19 provinces and regions. According to CCS, the purchase price of the acquired assets represented a 16.4x FY07E P/E, based on an earnings estimate of RMB283 million this year, while the deal should lift CCS' FY07E EPS by more than 20%. Besides earnings accretion and cost synergies, the timing of the acquisition actually makes perfect sense, as it would provide CCS with a much stronger platform to ride on the rising trend of service outsourcing among telecom and mobile operators as well as boosting infrastructure spending once the 3G licenses are issued.
- **Sluggish business volume from China Telecom** PRC fixed-line carriers were hard hit during the first half of the year, amid growing mobile substitution in the Mainland. To cope with the challenging operating environment, the fixed-line operators have turned cautious on their capex. We therefore saw sluggish growth in revenue contribution from China Telecom during 1H07. However, we still see robust outlook ahead for CCS, amid rising trend for outsourcing among mobile and telecom operators and upcoming business opportunities from the launch of 3G services.
- **Fairly valued** Trading at 31x FY07E P/E and 22x FY08E P/E, the counter is fairly valued, given the fast-growing mobile industry in the Mainland. We still rate a "Hold" on CCS, as the robust business outlook for the building of 3G infrastructure should continue supporting share prices.

**Recommendation: HOLD**

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