

Analyst: Kelvin Li
CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED (中國網通)

Sector	: Telecommunications	Chairman	: ZHANG Chunjiang
HKSE Code	: 0906	CEO	: ZUO Xunsheng
Market Price	: HK\$21.80 (25/03/2008)		
HSI	: 22,464.52 (25/03/2008)		
Shares Issued	: 6,684.045 million		
Mkt. Cap.	: HK\$145,712.1 million		
52 weeks Hi/ Lo	: HK\$27.00 / HK\$14.90		

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2007
Final Results Highlights

	FY2007	FY2006	<i>y-o-y change</i>
	RMB million	RMB million	
• Revenue from continuing operations	84,005	84,194	-0.2%
• Total operating expenses	(66,739)	(64,643)	+3.2%
• Operating profit	18,600	18,972	-2.0%
• Profit from continuing operations (a)	11,471	11,478	-0.1%
• Profit from discontinued operations (b)	624	1,487	-58.0%
• Profit attributable to shareholders (a+b)	12,095	12,965	-6.7%
• <i>Pro-forma revenue*</i>	<i>82,488</i>	<i>81,788</i>	<i>+0.9%</i>
• <i>Pro-forma EBITDA*</i>	<i>41,244</i>	<i>42,058</i>	<i>-1.9%</i>
• <i>Pro-forma net profit*</i>	<i>9,954</i>	<i>9,072</i>	<i>+9.7%</i>
• EPS – basic	RMB1.81	RMB1.96	-7.7%
• <i>EPS – basic (from continuing operations)</i>	<i>RMB1.72</i>	<i>RMB1.74</i>	<i>-1.1%</i>
• DPS – final	HK\$0.592	HK\$0.553	+7.1%
• DPS – total	HK\$0.592	HK\$0.553	+7.1%

Remarks (*): Excluding Discontinued Operations (Operations in Guangdong province and Shanghai Municipality and Asia Netcom) as well as Upfront Connection Fees

- China Netcom reported a 6.7% y-o-y drop in net profit to RMB12.1 billion for FY2007, as its core fixed-line business stayed under pressure amid continued substitution of mobile from fixed line in the Mainland. Nonetheless, it was better than consensus forecast of a drop to RMB10.5 billion.
- Excluding discontinued operations and upfront connection fees, China Netcom's revenue from continuing operations grew a mere 0.9% y-o-y on a pro-forma basis to RMB82.5 billion in FY07. The Group reported a pro-forma EBITDA of RMB41.2 billion for FY07, down 1.9%, while EBITDA margin contracted 1.4 percentage points to 50.0% from 51.4% a year earlier. For FY07, the Group's pro-forma net profit grew 9.7% y-o-y to RMB10.0 billion.
- EPS was RMB1.81, against RMB1.96 in FY06. A final dividend of HK\$0.592 (FY06: HK\$0.553) was proposed, representing a payout ratio of near 35% (FY06: 30%).
- As of 31/12/2007, the Group held total debts of RMB51.6 billion (31/12/2006: RMB71.3 billion). With cash on hand of RMB5.4 billion (31/12/2006: RMB7.7 billion), the Group's net debt to shareholders' equity ratio eased to 56.3% from 85.7% a year earlier.

This report has been prepared solely for information purposes and we are not soliciting any action based upon it. Neither this document nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information which we consider reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein, while its group companies may from time to time have interests in securities of the company or companies mentioned herein.

Business highlights

- Breakdown of turnover (excluding discontinued operations) by activities

	FY2007		FY2006		y-o-y Change
	RMB million	%	RMB million	%	
Local usage fees	19,989	23.8%	22,059	26.2%	-9.4%
Monthly telephone service	12,387	14.7%	16,546	19.7%	-25.1%
Upfront installation fees	1,283	1.5%	1,364	1.6%	-5.9%
Interconnection fees	8,376	10.0%	8,432	10.0%	-0.7%
DLD usage fees	8,769	10.4%	9,495	11.3%	-7.6%
ILD usage fees	791	0.9%	819	1.0%	-3.4%
Value-added services	6,114	7.3%	5,341	6.3%	+14.5%
Broadband services	13,835	16.5%	9,916	11.8%	+39.5%
Other internet-related service	532	0.6%	516	0.6%	+3.1%
Managed data service	1,284	1.5%	1,413	1.7%	-9.1%
Leased Line income	2,521	3.0%	2,540	3.0%	-0.7%
ICT service	3,990	4.7%	855	1.0%	+366.7%
Other Services	2,617	3.1%	2,492	3.0%	+5.0%
Upfront connection fees	1,517	1.8%	2,406	2.9%	-36.9%
Total	84,005	100.0%	84,194	100.0%	-0.2%

- FY07 recorded another challenging operating year for China Netcom amid mobile substitution. The Group's **traditional business** (local voice, local long distance voice, interconnection and other services) reported revenue of RMB53.8 billion, down 12.0% y-o-y on a pro-forma basis, accounting for 65.3% (FY06: 74.8%) of the Group's total revenue from continued operations. During FY07, the client base of the Group's voice services further contracted on mobile substitution, with the number of fixed-line subscribers down 2.8% to 110.8 million. Local call volume posted a 5.6% drop and long-distance call volume was nearly flat. As a result, the Group's local access ARPU (including local voice, long distance voice & value-added services (VAS)) fell by 9.6% to RMB36.6. Excluding contribution from VAS, the drop in Group's voice ARPU was even higher at 12.3%.
- The **Innovative business** (broadband & other internet-related services, ICT, VAS, advertising & media business, business & data communications services) segment maintained its growth momentum. VAS generated revenue of RMB6.1 billion, up a 14.5%. For broadband, the number of subscribers grew 37.0% to 19.77 million, boosting the Group's share in the northern China broadband market to 88.9% from 87.5% in FY06. Broadband ARPU grew 3.9% y-o-y to RMB67.4, boosting broadband revenue by 39.5% to RMB13.8 billion in FY07. Information and communication technologies (ICT) service, a new service introduced in 2006, reported a sharp 367% rise in revenue to RMB4.0 billion in FY07, accounting for 4.8% (FY06: 1.0%) of the Group's total, adding another new source of growth. Overall, revenue from the segment grew a robust 38.9% y-o-y to RMB28.7 on a pro-forma basis, representing 34.7% (FY06: 25.2%) of the Group's total revenue.

Outlook & Prospects

- Fixed-line operation still struggling** Mobile substitution was severe in 2007 and it has shown little signs of relief so far in 2008. For Jan-Feb 2008, China Netcom lost another 1.2 million fixed-line subscribers, bringing the client base down a further 1.1% to 109.6 million. Nonetheless, the growth in broadband subscriber base stayed healthy (+1.3 million in Jan-Feb 08), which helped offset the drop in fixed-line clients and contain the overall client base.
- Still prefer the mobile sector** China Netcom's non-voice businesses showed robust growth momentum in FY07 but it was somehow offset by the traditional voice segment. We still prefer the Mainland mobile sector to the fixed-line sector, as we see the industry's competitive landscape to stay put before any future sector reform. Nonetheless, trading at an undemanding 14x FY08E P/E, its near-term share prices should be supported by the possible launch of 3G licenses in 2008 and we recommend a "HOLD" on the counter.

Recommendation: HOLD



Important Disclosure / Analyst Certification / Disclaimer

This document is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (BEA).

The research analyst primarily responsible for the content of this report, in part or in whole certifies that the views on the companies and their securities mentioned in this report accurately reflect his/her personal views. The analyst also certifies that no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. Information and opinions expressed herein reflect a judgment as of the date of this document and are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is not to be taken in substitution for the exercise of judgment by respective readers of this report, who should obtain separate legal or financial advice. East Asia Securities Company Limited and / or The BEA Group accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or further communication given in relation to this report.

At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA along with its affiliates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its associates, its directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company or companies mentioned in the report.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of, or located in, any locality, state country or other jurisdiction, publication, availability or use would be contrary to law and regulation.