HSBC
Global Research

Global Telecoms, Media & Technology
Asia Telecoms
November 2010

Asia Telecoms

Data everywhere

Telcos are seeing strong demand for wireless data: we expect revenues to improve, with users willing to pay to get access to their data everywhere.

Until recently, handset exclusivity has been a primary investment parameter. With greater parity in operator handset portfolios, we expect network quality to become a differentiator, and capex a competitive weapon.

We forecast an earnings recovery in China, Japan and Korea, and earnings decline in India and Taiwan.

Our key Overweights are China Telecom, KDDI, eAccess, KT Corp, LG U+, XL Axiata, and Telstra.

Asian telecoms valuation summary

Company (priced at 9 November 2010) USD m	Ticker	Price local	Target	Pot return	Rating	MCAP	EV	EV/EBITDA 2011e	EV/EBITDA 2012e	PE 2011e	PE 2012e	Dividend yield 2010e	Dividend yield 2011e	Dividend yield 2012e
China / HK														
China Mobile	0941.HK	81.8	81.0	-0.9%	N	211,646	172,381	4.7x	4.3x	12.1x	11.7x	3.6%	3.7%	4.3%
China Telecom	0728.HK	4.1	5.1	24.7%	OW	42,710	50,915	3.4x	2.7x	10.2x	8.7x	2.3%	2.7%	3.1%
China Unicom	0762.HK	11.0	6.7	-39.0%	UW	33,381	47,070	4.9x	4.3x	32.0x	21.7x	0.6%	1.0%	1.5%
PCCW	0008.HK	3.1	3.0	-3.5%	OW	2,918	6,073	6.4x	6.2x	11.3x	10.2x	4.9%	5.7%	6.8%
Comba Tel. Systems	2342.HK	8.3	11.1	34.4%	OW (V)	1,403	1,355	8.3x	7.5x	12.3x	12.4x	1.9%	2.0%	2.0%
CITIC 1616	1883.HK	2.6	2.7	3.8%	OW (V)	800	563	7.5x	6.6x	12.1x	11.4x	4.0%	4.1%	4.4%
SmarTone	0315.HK	10.9	11.8	8.5%	OW	718	573	3.2x	0.2x	16.0x	16.3x	4.7%	6.3%	6.2%
South Korea														
SK Telecom	017670.KS	174,500	179,000	2.6%	N	12,676	16,679	3.7x	3.2x	7.8x	6.4x	5.4%	6.2%	7.7%
KT Corp	030200.KS	46,300	67,000	44.7%	OW	10,876	16,186	2.9x	2.4x	5.6x	4.5x	5.4%	7.2%	8.9%
LG U+	032640.KS	7,150	8,700	21.7%	OW	3,311	3,995	2.2x	2.0x	6.2x	5.4x	4.9%	4.8%	5.7%
SK Broadband	033630.KQ	5,340	6,200	16.1%	N	1,422	2,491	4.2x	3.5x	24.4x	9.5x	0.0%	2.0%	5.9%
Japan														
NTT DoCoMo Inc.	9437.T	136,900	141,000	3.0%	N	74,180	67,484	3.4x	3.3x	11.6x	11.6x	3.8%	3.8%	3.9%
NTT	9432.T	3,750	4,000	6.7%	N	73,043	149,210	3.5x	3.2x	10.3x	9.7x	3.2%	3.2%	3.7%
SoftBank Corp.	9984.T	2,804	2,400	-14.4%	UW	37,560	62,509	5.8x	5.5x	11.6x	11.5x	0.2%	0.2%	0.2%
KDDI Corp	9433.T	469,000	528,000	12.6%	OW	26,027	31,057	2.8x	2.6x	7.8x	7.3x	2.8%	2.8%	2.8%
eAccess Ltd	9427.T	63,500	88,000	38.6%	OW (V)	2,756	3,095	6.6x	4.4x	16.7x	6.4x	3.8%	1.3%	1.3%
Taiwan and Australia														
Chunghwa Telecom	2412.TW	76.7	75.0	-2.2%	N	24,681	21,463	7.0x	7.1x	15.1x	15.0x	5.9%	5.9%	5.9%
Taiwan Mobile Co.	3045.TW	68.3	69.0	1.0%	N	8,615	8,739	9.4x	9.5x	12.9x	12.6x	7.5%	7.9%	8.3%
Far EasTone	4904.TW	44.4	39.0	-12.2%	UW	4,801	3,909	5.2x	5.1x	14.4x	13.9x	6.2%	5.6%	5.7%
Telstra Corp	TLS.AX	2.7	3.3	24.5%	OW	33,477	47,453	4.7x	4.3x	10.6x	9.0x	10.6%	10.6%	10.7%
India														
Bharti Airtel	BRTI.BO	334.6	370.0	10.6%	N (V)	28,712	28,960	8.9x	7.2x	19.9x	14.8x	0.0%	0.0%	0.0%
Reliance Communications	RLCM.NS	181.1	170.0	-6.1%	UW (V)	8,445	12,940	8.7x	7.1x	24.0x	21.4x	0.0%	0.0%	0.0%
Idea Cellular Ltd	IDEA.BO	69.9	75.0	7.4%	N (V)	5,211	6,666	9.8x	7.4x	45.6x	45.6x	0.0%	0.0%	0.0%
GTL Infrastructure	GTLI.BO	46.1	39.0	-15.4%	UW (V)	997	1,484	23.4x	15.1x	NM	53.8x	0.0%	0.0%	0.0%
Tulip Telecom	TULP.BO	178.4	235.0	31.8%	OW	584	782	5.7x	4.5x	9.5x	7.2x	0.0%	0.0%	0.0%
Indonesia														
PT Telkom	TLKM.JK	8,150	9,600	17.8%	N	18,451	26,632	6.0x	5.4x	14.0x	11.9x	4.2%	4.2%	4.7%
Indosat	ISAT.JK	5,750	5,800	0.9%	UW	3,509	5,802	4.9x	4.7x	20.4x	15.2x	0.9%	1.7%	2.3%
XL Axiata	EXCL.JK	5,900	7,700	30.5%	OW (V)	5,637	6,652	5.8x	5.1x	12.4x	10.6x	0.3%	1.4%	4.7%
Singapore														
Singapore Telecom	STEL.SI	3.3	3.3	-1.8%	N	41,210	29,919	7.4x	6.9x	14.4x	13.8x	4.3%	4.5%	4.7%
StarHub	STAR.SI	2.8	2.9	3.9%	N	3,743	4,240	8.7x	8.1x	17.5x	15.6x	7.3%	7.9%	7.9%
M1 Ltd.	MONE.SI	2.2	2.3	3.8%	N	1,555	1,751	7.1x	6.8x	13.3x	12.6x	6.2%	6.8%	7.1%
China-Internet														
Tencent Holdings	0700.HK	181.5	240.0	32.2%	OW (V)	42,936	40,104	19.9x	14.8x	27.5x	21.1x	0.4%	0.5%	0.7%
Baidu.com Inc.	BIDU.OQ	110.4	116.0	5.1%	N (V)	29,876	28,874	31.0x	21.9x	50.5x	36.4x	0.0%	0.0%	0.0%
Netease.com	NTES.O	43.1	54.0	25.3%	OW (V)	5,598	4,381	7.1x	5.5x	11.8x	10.4x	0.0%	0.0%	0.0%
Shanda	SNDA.O	40.5	43.0	6.2%	N (V)	2,931	1,126	2.9x	2.2x	12.4x	10.4x	0.0%	0.0%	0.0%
Perfect World Co	PWRD.O	31.8	33.0	3.7%	N (V)	1,830	1,448	4.5x	2.6x	7.9x	6.1x	0.0%	0.0%	0.0%
South Korea-Internet														
NHN Corp	035420.KQ	195,500	211,000	7.9%	N	8,465	7,527	10.5x	8.5x	14.1x	11.5x	0.0%	0.0%	0.5%
NCsoft	036570.KS	262,500	320,000	21.9%	OW (V)	5,148	4,534	12.5x	8.7x	20.4x	14.8x	0.3%	0.4%	0.7%
Daum Communications	035720.KQ	80,400	113,000	40.5%	OW	962	798	6.2x	4.4x	12.5x	8.9x	0.0%	0.0%	1.2%
NEOWIZ Games	095660.KS	53,100	53,000	-0.2%	OW (V)	1,008	867	6.1x	5.0x	11.1x	9.5x	0.0%	1.9%	7.5%
CJ Internet	037150.KQ	14,150	16,000	13.1%	N (V)	290	114	1.4x	0.9x	8.3x	7.6x	1.4%	1.8%	2.0%
GAMEVIL INC	063080.KQ	32,350	39,000	20.6%	OW (V)	161	122	5.9x	4.1x	10.3x	7.6x	0.0%	1.5%	2.0%
COM2US Corporation	078340.KQ	16,550	18,500	11.8%	OW (V)	150	116	15.2x	10.0x	20.9x	14.0x	0.0%	0.0%	0.0%
Asia Pac Average (ex Internet stocks)						**20,321**	**23,403**	**7.8x**	**6.4x**	**15.1x**	**14.2x**	**3.0%**	**3.2%**	**3.7%**

Source: HSBC estimates, Thomson DataStream

HSBC

Asia telecoms – Sector outlook by market

Region	Australia	China	India	Indonesia	Japan	South Korea	Singapore	Taiwan
Market view								
Investment thesis	Capacity constraints resulting in higher capex. Biggest sector overhang is NBN outcome.	Neutral on China telcos due to high 3G rollout costs, weak industry earnings and high regulatory risk	Neutral on Indian telcos due to fierce market competition, high regulatory risk and consolidation still 12-18 months away	Cautious on Indonesian telcos with softened price competition in voice while broadband market provides upside	Cautious on large cap Japanese telcos with saturation in both wireline and wireless data, while voice remains weak	Presently at the sweet spot with fast networks, attractive tariffs and services and services are coupled with strong smartphone demand	Neutral on Singapore as revenue growth driven by mobile data, broadband and pay TV offset by margin squeeze from higher subsidies-media content	Cautious on Taiwan telcos since we expect competition to remain intense from cable and data demand weak
Market size and structure	PSTN revenue decline offset by strong growth in mobile data. WBB penetration at 16% levels.	Limited changes in market structure. MNP will lower industry margins but not alter market share	Fastest growing market distorted by price sensitive, double SIM prepaid nature.	Overcrowded with 11 operators but top 3 control c90% of wireless market	Market structure relatively stable, but NTT breakup debate expected to continue for the 6-12 months	Has been surprisingly behind on wireless data adoption rates, but changing fast with advent of iPhone	3 key features of the market are high penetration levels, quad play focus and government presence	Big 3 have equal share in wireless but wireline tariff reductions to hurt CHT the most
Growth vs yield	Incumbent expected to generate strong, stable cash flows with 10% dividend yield.	Govt. controls the sector and is currently focused on investment M&A rather than near term returns	Telcos consider themselves in growth mode and recent international expansion clouds yield outlook	Incumbent controls sector FCF generation and dividend payouts back to the government	Historically preferred growth over yield and we don't see this changing	Telcos have historically focused on margins, than on market share	Smaller players have healthy capital management policies but SingTel stuck between growth and yield	Capital reductions (or stock dividends, in addition to straight cash dividends) is the primary stock driver
Fundamental view								
Revenues	Flattish revenue growth, telco revenues at 3% of GDP	2009-12e Revenue CAGR of 5%. Telco revenues as % of GDP expected to decline 2.0% by FY12e	Muted sector revenue growth at 5% for FY11e before recovering in FY12e	FY10-13e CAGR of 6% puts growth between India and China	Revenue decline expected with stagnant data and falling voice	Industry wireless data revenue to grow 16% in 2010	Revenue growth expected to be driven by mobile data, telco revenues to contribute 3% to GDP	Revenue growth to be affected by weak data service demand, competition from cable and regulatory tariff control on fixed
Earnings	Earnings CAGR of 2% over next 3 years	8-9% profit growth in next two years	Sharp earnings drop of 12% expected in FY11e	Strong earnings CAGR of 16% between FY10-13e	High cost structure doesn't leave much room for margin expansion	Churn and marketing are expected to come down for the sector, LGU+ most upside from this trend	Likely margin squeeze from excessive investments made in media content, as well as bundling- and handset-related subsidies	Data revenue growth (from a small base) is starting to offset the impact of mandatory price controls.
Free cash flows	Incumbent expected to generate strong, stable cash flows with 11% FCF yield	CM controls 75-80% of sector FCFs.	Surge in capex, spectrum purchases and international investments have reduced FCF forecasts	Historically high capex to ramp up coverage-capacity has dampened FCF in previous years but outlook now changing with lower capex	High capex chasing growth has been the story so far in Japan but key risk could be a change to low capex, high payout strategy	Healthy operating FCF growth with margin expansion and stable capex to sales	Healthy overall but near-term margin pressure and capex intensity for smaller players and lower associate earnings	Sluggish; muted capex spend in line with lower data demand
Dividends	Competitors like Optus unlikely to match Telstra's yield-multiples	We expect payouts at CM and CT to increase when they complete domestic A-share offerings, around mid-2010.	No upside risk here, only Bharti may payout just a token dividend	XL Axiata turned FCF positive in FY10 and initiated payout in 2010	Yields of 2-4% are low relative to both telco and domestic peers, and capital expenditure still remains high	Yields at KT Corp and SK Telecom are high, relative to regional peers (outside Taiwan)	Higher yields at StarHub and M1 (7-8% levels) while SingTel tries to balance growth and dividends	We see FET's ability to raise dividends and match CHT & TWM as limited post CM's acquisition
Key stock	**Telstra (TLS.AX, OW, AUD3.30)**	**China Tel (728HK, OW, TP HKD5.1)**	**Bharti (BRTI.BO, INR370, N(V))**	**XL Axiata (EXCL IJ, OW (V), TP IDR7,700)**	**KDDI (9433 JP, OW, TP JPY528,000); eAccess (9427 JP, OW(V), TP JPY95,000)**	**KT Corp (030200.KS, TP KRW67,000, OW); LG U+ (032640.KQ, OW, TP KRW8,700)**	**SingTel (STEL.SI,TP SGD3.26, N)**	**CHT (2412.TW, TP TWD75.0, N)**
Reasons	Operational concerns overdone; NBN deal likely to progress under framework deal terms; dividend unlikely to be cut	Improving fixed-wireless bundling strategy, and strong execution in the CDMA business.	High quality player caught in low quality market and trying to escape into the new frontier of Africa	XL should provide healthy growth over 2010-13. Such growth justifies the pricey valuation - the main barrier is relatively low trading volume - cUSD1.3m daily turnover.	Attractive valuations and improving prospects in both wireless and wireline after sustained under-performance; eAccess - the leader in mobile broadband, with surplus capacity and a strong network.	KT has the best wireless network positioning amongst Asian operators and is pursuing wireless data growth at little incremental cost. LG U+ has a solid network migration plan and upside from cost reductions.	FCFs to be under strain in FY11e with lower margins, higher capex and lower associate dividends. Fairly priced with a modest 5% yield	Most exposed to mandatory price controls than peers. Competitive risks in broadband from cable triple play. High yields offset by earnings risks, lack of +ve catalysts.

Source: HSBC estimates

HSBC

Contents

We acknowledge the contribution to this report made by Rajesh Raman, Inder Kalra and Harbhajan Singh.

HSBC

Summary

The shift toward a data-centric wireless business model creates capacity pressures which are altering the supply and demand balance in the sector. We have shifted towards a more positive view on wireless data in Asia in the last six months. We believe best-in-class operators that have a balanced handset subsidy strategy and superior network quality will be able to both take market share *and* increase operating margins. We see the re-linking of data usage and revenues and the emergence of high-quality, low-cost smartphones as powerful secular catalysts. We favour integrated operators with a strong track record of network investment. We view capex as a competitive weapon that limits the potential for sustained pricing disruption from sub-scale operators. Our top picks are well-positioned around this shift toward a data-centric model.

Our sector view

The shift toward a data-centric wireless business model represents a seismic shift in the telecom business with profound implications for network strategy, capex-opex ratios, customer segmentation, and market structure. For the past decade or so, telcos has been viewed as an inherently deflationary sector, where sustained declines in voice pricing were the backdrop for steady declines in average revenue per user (ARPU). The consensus view has been that the telecom sector is ex-growth. In the past 2-3 years since the introduction of the iPhone, a combination of better devices, ample network capacity, and high-quality customized content has sparked a surge in data traffic. Big wireless players in developed markets are seeing data traffic consumption surge 100-200% a year leading to a sharp shift in the demand-supply balance. The HSBC Global Telco Team has explored this theme of capacity crunch in a series of thematic reports beginning in November 2009 and most recently in the September 2010 report *SuperFrequonomics*. This report provides a review by market and operator of our growth assumptions and drivers, and provides a thematic framework to guide investors on how to play the Asian wireless data story.

While we have made key upgrades since our last Asian sector report on 21 July 2010 (*Balance shifts from growth to yield*) we remain cautious on the overall outlook. In emerging markets particularly, management teams are fixated on subscriber and revenue growth rather than free cash flow (FCF) and net profit growth. For this reason, the historical investor preference for wireless operators in underdeveloped telecom markets is starting to break down. We have been cautious on the key markets of China and Indonesia, and recently downgraded our outlook for Indonesia (*Enjoy the ride but watch the road,* 4 November 2010). In contrast, the

faster adoption of smartphones and data services in Japan, Korea, Hong Kong and Australia has offered – and continues to offer – opportunities. Recently, we have seen far fewer value destructive investments in non-core businesses, where telcos have struggled to create value. We are much more positive on the current focus on IT systems and integration opportunities within local markets, and related investments in cloud computing. These areas are compatible with telco strengths, and results from the Korean telcos in 2010 suggest that this area has significant potential. As we discussed in our July report *Growth vs. Yield*, yield remains a key investment criterion. The Taiwanese telcos have outperformed over the past six months as a result of rotation into high-yield assets, and StarHub has also benefited. We like Telstra on its improving risk-reward profile, and highlight its prospective 2011 yield of 10%.

With regard to the network impacts of the growth in wireless data, we believe Asian telcos are mostly better positioned than their European peers. This is the result of higher historical levels of investment, with shareholder returns less linked to FCF, and thus more freedom with capex. It is also the result of encouragement from policy makers, resulting in world-leading wireless/wireline networks seen in Japan and Korea. For the same reasons, operators in Asia have been more forthcoming regarding the impact of the 'data explosion'. In particular, we highlight KT Corp in Korea: as one of the best integrated wireline/wireless networks in Asia, with half its iPhone traffic flowing over a WiFi network. China Telecom is moving towards a similar model and leveraging its 100,000 WiFi hotspots to stimulate data usage in the price-sensitive youth segment, where China Mobile struggles to compete given its limited WiFi and fibre base. For these reasons, we continue to prefer integrated operators, and note the increasing importance of additional network capabilities (WiFi hotzones and TD or WiMAX networks are good examples).

Government policy via both direct ownership and the application of indirect pressure remains a major overhang risk for Asian telco stocks. This can effectively cap earnings growth and dividend flows to minority investors. Asian operators tend to be more focused on keeping capex high and prices and dividend payouts low rather than maximising shareholder returns. China is moving towards a Korean style model of promoting domestic vendors at the expense of domestic operators and using asymmetric regulatory policy to shape market structure. Typical regulatory and policy tools include interconnect rates, market share caps, spectrum licensing, and network technology selection. In this context we often see a poor alignment of controlling shareholder-management interests and minority shareholder interests and an operating environment that provides limited room for independent management teams to outperform industry peers.

In the telecom services space we cover 30 stocks in eight countries in Asia Pacific but have just eight Overweight rating (up from five in July), eight Underweights (from nine), and 16 Neutrals. While this report is focused on telecom services, we also highlight our broader Asia TMT coverage, which includes 10 stocks in the Internet, media, and telecom equipment sectors. We have six Overweights and four Neutrals, reflecting our preference for these subsectors. We are OW(V) on both Tencent and NetEase and are bullish on the China online gaming, online advertising, and e-commerce markets and believe these emerging companies are much better structural proxies for the China domestic consumption story. The surge in Internet-broadband penetration, absence of any government-controlled competitor and very high OP margins-returns on capital provide a very positive backdrop. In Korea we like Daum Communications, which is highly geared to the uptake in mobile ad spending that we expect to see as the smartphone penetration rate surges, and NC Soft, a leading global game developer that is geared to the China story. We are also bullish on the structural outlook for the China vendor-VAS segments space with Overweights on Comba and Citic 1616. Our Neutral rating on

ZTE reflects our cautious near-term view on China capex and handset margins, but we remain structural bulls on the emergence of China as a major force in the global TMT technology space. Please see the Appendix for details on valuations and risks for the internet stocks mentioned above.

Our favourite stocks

Most of our OW calls are on stocks that have, or will soon find, a sweet spot for handling data traffic growth costs and a better alignment of majority-minority shareholder interests. We like the country-macro backdrop in Korea, and see the situation in Japan improving.

- **China Telecom (728 HK, OW, TP HKD5.1):** China Telecom is our only OW in the China space and one of our top regional telco services picks. It has executed a remarkable turnaround in the CDMA business and should surpass Verizon as the largest CDMA operator in the world in 1Q11 with over 100m subscribers. It has expanded handset inventory and aggressively bundled services, but careful cost management and a preferential off-balance sheet lease structure for the CDMA network should allow a doubling of net profit margins (NPM) to 8.5% in 2010. Our target price on HKD5.1 is based on 13x 2011e EPS. Our estimates are well above consensus for FY11.

- **Telstra (TLS ASX, OW, TP AUD3.3):** Telstra is unloved and under-owned. A high-profile regulatory battle with the government regarding the National Broadband Network (NBN) and a string of guidance cuts as market share falls in all areas has prompted share price declines amid speculation that the company may be forced to cut its dividend. We see these fears as overblown, and have upgraded on an improving risk-reward profile. We see the cAUD1bn investment in operating costs in FY June 2011 as a positive, allowing Telstra to leverage the strength of its network (which we see as a sustainable competitive advantage). We expect recent pragmatism to prevail regarding the NBN negotiations, and expect the company to maintain its current dividend of AUD0.28 per share. We value Telstra using a dividend-discount model – our fair value is AUD3.3 per share. An Asia Super Ten idea.

- **KT Corp (030200.KS, OW, TP KRW67,000):** KT provides a rare combination of growth and yield at compelling valuations. KT has undergone a dramatic transformation over the last two years via the full integration of former wireless unit KTF, the shift towards a bundled services model designed to lower sales and marketing costs, and a new CEO with the political power to push through a 16% cut in the workforce. The key challenges are the technical issue of the foreign ownership cap being filled, smartphone-related marketing expenditure remains high, and local investors remain focused on top-line growth. We are 20% and 38% above consensus OP estimates for FY11-12, respectively, and value the stock using a multiple of 8x 2011e EPS.

- **LG U+ (032640.KQ, OW, TP KRW8,700):** LG U+ offers a similar story to KT with higher execution risk, less clarity on management strategy, but cheaper valuations and lots of room under the foreign ownership cap. Network migration has been a risk, but the migration to LTE in early 2011 solves this. With its all-IP wireline network, LG U+ will have one of the most modern networks globally by end 2011, and its management team is rightly focused on developing cloud computing and integrated services to leverage this. As for China Telecom and KDDI, near-term sentiment regarding CDMA smartphone availability has weighed on the stock, but supply is likely to improve in 2011. LG U+ trades at 6.3x our 2011e EPS – we use a multiple of 8x to derive our target price.

- **XL Axiata (EXCL.IJ, OW(V), TP IDR7,700):** XL has shown strong recent revenue and profit growth. Its strength has been in maximising its network utilisation using differentiated pricing across various time bands and cities. Management is now focusing on the 'small screen' wireless broadband area, offering potential for further growth. While recognising the importance of building scale, management is also focused on returns, and continues to allocate capex prudently. The main barrier to entry, and the key risk, is XL's relatively small cUSD1.3m daily turnover. There are no indications that Axiata (Not Rated) will be selling down its stake further. XL Aciata trades at a 2011e PE of 12x.

- **KDDI (9433 JP, OW, JPY528,000):** We upgraded KDDI in our 5 October 2010 report *Network effects.* After sustained under-performance, we believe the bad news is in the price. We see a turnaround in wireless performance as SoftBank's ability to continue to take high-value subscriber market share is constrained, and also see improving fixed line prospects as the coverage area of the 'Giga Value' high-speed fibre service is expanded. We value KDDI by applying 9x to March 2011e EPS.

- **eAccess (9427.T, OW(V), TP JPY88,000):** eAccess executed a 'business combination' with former equity affiliate eMobile in July 2010, giving it full benefit of the rapid growth in sales and profitability of this company – the premier wireless broadband business in Japan. With eMobile already having hit OP breakeven, we expect a slower rate of growth (and lower marketing costs) and expanding margins. EMobile has a modern 3G network which enables it to pursue data growth unequivocally. We value eAccess using a PE-based approach in line with the peer group.

Our least favourite stocks

- **China Unicom (762.HK, UW, TP HKD6.7):** We remain sceptical of China Unicom's 3G strategy and execution capabilities, believe the clear technology advantages of WCDMA are fully offset by the balance sheet constraints of capex-subsidies, and argue the stock is fundamentally overvalued. The consensus bull argument for CU is that its big technology advantage with the iPhone will translate into market share gains among high-end subscribers. CU's initial strategy of positioning 3G as a high-end service and churning away high-end China Mobile subscribers has failed and it has resorted to aggressive price cuts to drive 3G sub growth. We note that the high on-balance sheet capex and opex more than offset its handset advantages. We forecast a more moderate rebound in profitability for CU as higher depreciation and net interest costs erode the EBITDA growth. Our target price is based on an average of 13x blended 2010-11 EPS and a DCF fair value of HKD9.7.

- **SoftBank (9984 JP, UW, TP JPY2,400):** Softbank is one of the clear losers vis-à-vis our capacity crunch thesis, as a combination of aggressive iPhone sales and structural underinvestment in network capacity has driven a surge in customer complaints. The primary driver of near-term strategy is its goal of halving the March 2009 total of JPY1.9trn of net interest-bearing debt by March 2012, and reducing it to zero by March 2015. Progress is on track and SoftBank's balance sheet has improved but we believe the May 2010 announcement of a 78% hike in capex is a sign of things to come. We value the stock based on a sum-of-the-parts approach, using DCF. The primary catalyst is slowing momentum in the monthly net subscriber additions figures: we see its recent momentum with the iPhone as difficult to sustain, with network problems resulting in lower churn-in.

- **Indosat (ISAT IJ, UW, TP IDR5,800):** Since unveiling a new management team and going on a global road show after 3Q10 results, Indosat's share price has rebounded. We believe the earnings recovery will last into 2011-12 but expect a slowdown with penetration into lower income markets. Indosat is also likely to have to move to prevent XL's move towards the No. 2 position. Potential developments include the sale of 14,000 of its towers as part of a deleveraging exercise. We use a DCF valuation methodology to derive our TP of IDR5,800.

Stocks we believe are correctly priced

- **Bharti Airtel (BRTI.BO, N(V), TP INR370):** Bharti is one of the best GEM wireless operators in the world, but the combination of irrational competitive dynamics in Indian wireless and a volatile and confusing regulatory climate have impacted the stock in the past year. However, over the past 6-9 months, there have been signs that the competitive pressure in India may be waning and tariffs have started to stabilize. Moreover, the outlook for African operations may improve as major African operators like MTN have shown an inclination towards tower sharing. However, the regulatory uncertainties still prevail in the Indian market, hence we have a N(V) rating on the stock. We value the company in two parts: Indian operations using a blend of DCF and PE and African operations using DCF. Our FY11 earnings estimate is 7% below consensus. Potential upside risks come from an earlier than expected listing of tower assets and sector consolidation.

- **China Mobile (941 HK, N, TP HKD81):** China Mobile is the strongest operator in the China space but our Neutral rating reflects the overhang risk of MNP, the company's ability to execute TD and protect its high-end, post-paid subscriber base, and the strategic focus on M&A-expansion rather than returning excess cash to shareholders. CM is our top fundamental pick in the China telco services space, but our Neutral rating reflects a lack of clarity over the scope and timing of asymmetric regulation and the company's ability to execute TD and protect its high-end, post-paid contract subscriber base. CM is one of the most dominant wireless operators in the world, controlling 80% of cash flows based on a subscriber base of 500m customers. However, as part of the 3G licensing industry restructuring process, the Chinese government announced plans to balance the competitive playing field and saddle CM with the national service responsibility for developing TD-SCDMA – the so-called Chinese 3G standard. In our view regulatory/competitive risk for CM is overstated as we believe there is a de facto *quid pro quo* with the government over delaying the introduction of MNP until TD is commercially viable. CM has just begun a five city trial of the successor 4G version of LTE (TD-LTE) and we are increasingly optimistic about its potential to be a viable global standard-migration path for underutilised Wimax spectrum. We also believe CM will continue to move towards a more convergent network-business model and could invest in the CATV space, which is fragmented, underfinanced, and in need of additional state support. The FCF growth outlook for CM is bright but the management's focus on channelling excess cash into non-core growth investments rather than raising the dividend payout limits potential returns to minority shareholders. We value CM based on a mid-cycle PE target multiple of 12x and are in line with consensus.

- **Chunghwa Telecom (2412.TW, N, TP TWD75):** CHT has recovered well from the impact of the economic downturn (most evident in its wireline services to SMEs) and from the impact of price competition in mobile. As for the other Taiwanese telcos, wireless data revenue growth (albeit from a

small base) is helping to offset the impact of mandatory price controls. The rejection of the proposed acquisition of CATV operator Kbro by Taiwan Mobile is also positive for CHT. However, given stock appreciation over the past six months, we believe the advantages of the yield are now priced in. We estimate a yield of 8.9% for CHT for 2011. We value the stock by applying 15x 2011e EPS.

- **Singapore Telecom (STEL.SI, N, TP SGD3.26):** SingTel is one of the best examples in our coverage universe of a stock caught between growth and yield. It is a well run company with a strong balance sheet, excellent investor outreach, and a compelling portfolio of investments in the leading GEM wireless operations, including Bharti, PTT, AIS and Globe. In the past five years SingTel has refocused on its core Singapore business (iPhone, EPL rights) and turned around the Australian alternative carrier Optus. SingTel's traditional growth strategy of buying low penetration, high sub growth GEM wireless assets is now challenging and as such it recently improved its payout to up to 70%. We value SingTel on a sum-of-the-parts (SOTP) methodology where its various parts are valued using appropriate methodologies depending on their stage of growth such as DDM, PE, and DCF.

HSBC

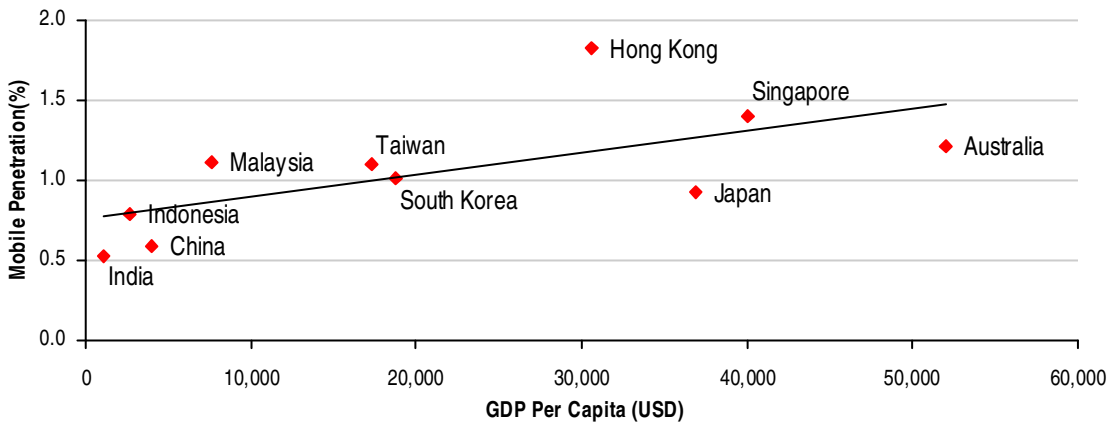
Analysis teardown

- Telco services as a percentage of GDP is the baseline for our forecasts
- Costs: network (capex) and marketing (opex) are the main drivers
- PE, DCF and dividend screens are the basis of our valuations

Our revenue forecasts

We tend to start with a market level view and rely on telecom services as a percentage of nominal GDP as the baseline for our market level forecasts. This top-down methodology captures the relative size of the telco sector in the economy and helps to identify the addressable market for both listed and unlisted companies. It also helps address the substitution and cannibalisation effects we see between wireless and wireline, and packet and circuit-switched. The long-term approach is less effective in capturing short-term swings caused by new product launches, branding campaigns, and shifts in coverage. Asian markets such as China, India and Indonesia have some of the lowest wireless voice tariffs in the world with some of the highest minutes of use (MOU), leading to fairly low elasticity of demand. Given our cautious regional view on data services, our current forecasts suggest telco sectors in most markets will continue to shrink relative to their overall contribution to the economy. In contrast, in most developed markets where broadband data-content-media services provide a larger portion of the revenue mix, we believe telcos can continue to grow revenue at headline GDP (e.g. 1-2%). A stabilisation of the size of the telco service relative to GDP via some combination of voice-data ARPU increases would provide a significant potential long-term catalyst to our regional telco view.

Mobile penetration rates in Asia vs GDP per capita



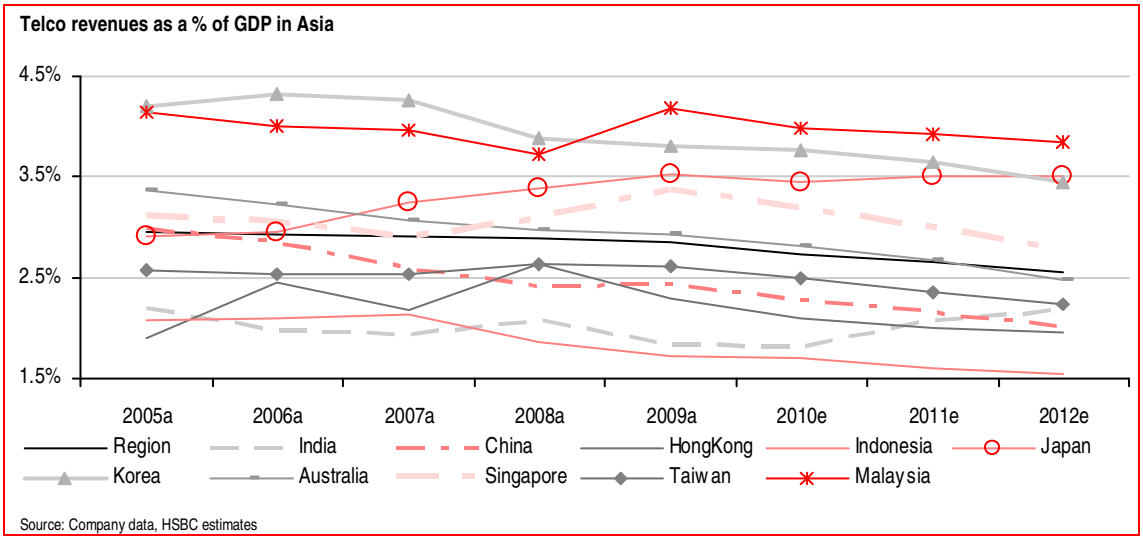
Source: Company data, HSBC

A look at the chart suggests that most Asian countries have historically seen their sector telco spend as a percentage of GDP in the 2-4% range, with Malaysian telcos (Not Rated) displaying one of the highest proportion to GDP at c4.5% and Indonesia and Indian telcos at the bottom end of the range at c2%. We expect this picture to be largely stable but this approach helps us take a useful top-down view in forecasting our sector revenue growth for each of these regions, keeping in mind the cyclical nature of the broader economy. Mobile penetration as a percentage of GDP per capita is another useful metric that we often use to correlate the relationship between the development status of the wireless market with the per capita income levels in the country and the degree of urbanisation. For instance, we see that mobile penetration levels are high in markets such as Japan, Australia, Hong Kong and Singapore which have high value subscribers due to their higher per capita income; therefore mobile services affordability and data service consumption are much higher compared to emerging Asia markets like India and Indonesia.

Our cost forecasts

The two key cost categories are sales and marketing costs in the opex line and network investments in the capex line. Operating costs are largely driven by the marketing-business strategy departments, which set a target level of market share and work backwards. In mature markets, marketing and retention costs – including handset subsidies – as a percentage of sales can often match or exceed capex to sales. The industry standard is that these costs are booked in the quarter they occur – e.g. at the beginning of a two-year contract. This opex component becomes increasingly important as the industry begins to put more emphasis of smartphones, which tend to generate both higher near-term subsidies and higher long-term revenues.

We believe the industry average is about 18 months to break even on a 24-month iPhone contract, highlighting the importance of linking the handset subsidy level. Our cautious view on CU is based our belief that an aggressive iPhone push is unlikely to churn high-end subscribers away from CM in the absence of MNP. We are optimistic about the outlook for Android-based smartphones, as they have the potential to support iPhone level data traffic but at significantly lower handset subsidy levels. Lenovo has targeted a USD100 smartphone in China by 2012, which could create a viable mass market for wireless broadband services in China. However, the shift towards a smartphone-driven, data-centric wireless business model requires a lot more network capacity and a higher long-term capex to sales ratio.



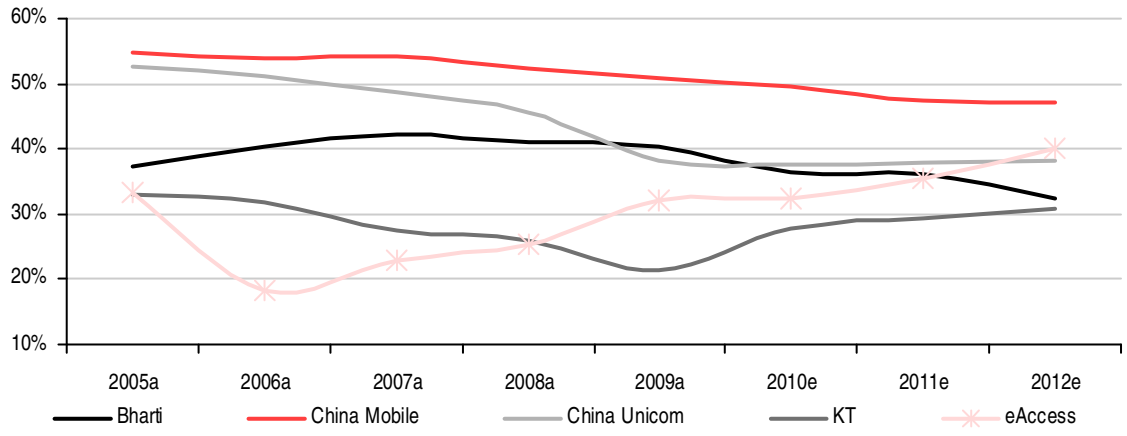
Capex costs are driven largely by finance/business strategy departments and are usually based on available cash flows rather than required network capacity. We argue that global capex levels, particularly in Europe, have fallen below sustainable levels. Developed market capex to sales ratios have plunged below 10%, reflecting the operator focus on meeting targets for operating FCF. This cyclical management of what is effectively a structural industry has created a capex deficit, particularly for operators pushing iPhones and data cards. We have seen several increases in capex guidance from leading iPhone players, including AT&T and Softbank, and estimate sustainable capex to sales ratios will return to 12-14%.

In contrast, we forecast a slight decline in Asian capex to sales ratios off a much higher base. Asia capex ratios have traditionally been higher, reflecting a combination of higher subscriber growth, a pro-investment regulatory policy approach, and a less management-investor focus on operating free cash guidance-targets. Asia telco capex to sales ratio for our eight country sample, excluding Hong Kong, was in the 20-21% range in 2005-09. We forecast the ratio to drop to 17% in FY10-12 on a reported basis and 18.5% if we adjust for the off-balance sheet, parent company level capex. China-India capex will come down as 3G capex flows through, but we expect an uptick in China when commercial scale LTE-CATV convergence capex flows through in 2012-14. We believe most Asian operators are well positioned vis-à-vis the looming wireless data capacity crunch as they have an "inventory" on underutilised network capacity based on over-investment in past years. We believe KT and eAccess are particularly well positioned to cope with the wireless data capacity crunch front because they have strong, integrated networks.

Company opex, capex, FCF charts

Our company EBITDA margin chart highlights margin compression at CM and CU and margin expansion at KT and eAccess. The steady decline in CM capex reflects our view that 3G capacity crunch will be mild and elasticity of demand for wireless voice muted. The steady capex to sales for KT is based on our view that it will be able to handle the surge in smartphone data traffic via WiFi-Wibro network offload, rather than a big increase in core wireless base stations. The op FCF margin chart highlights a sharp rebound, reflecting a pre-Zain stabilisation of core India EBITDA margins in the 35% range and a sharp drop in capex to sales to 15%.

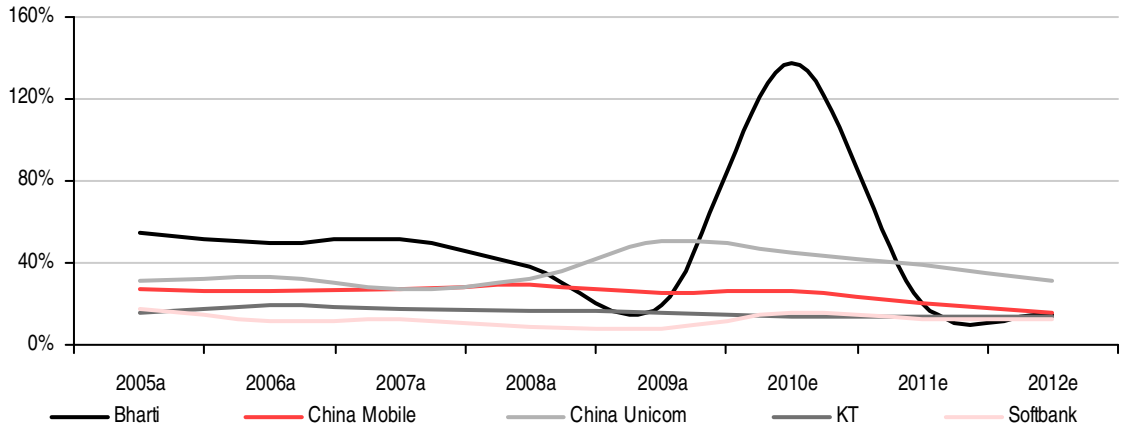
EBITDA margin trends for key stocks



Note: For companies with y/e March, we use the following fiscal year (e.g. FY2011 figures for 2010e) for comparison.
Source: HSBC estimates, Company data

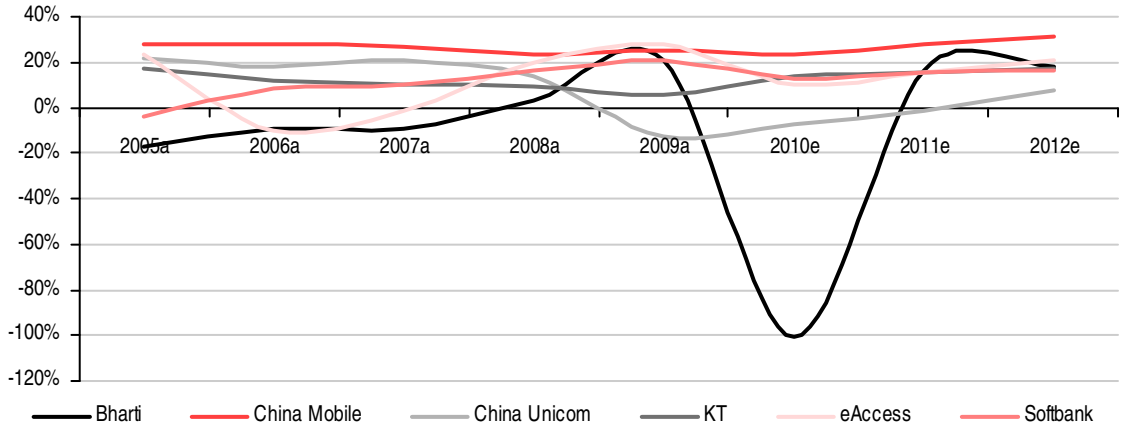
HSBC

Capex/sales trends for key stocks



Note: For companies with y/e March, we use the following fiscal year (e.g. FY2011 figures for 2010e) for comparison.
Source: HSBC estimates, Company data

Op FCF margins for key stocks



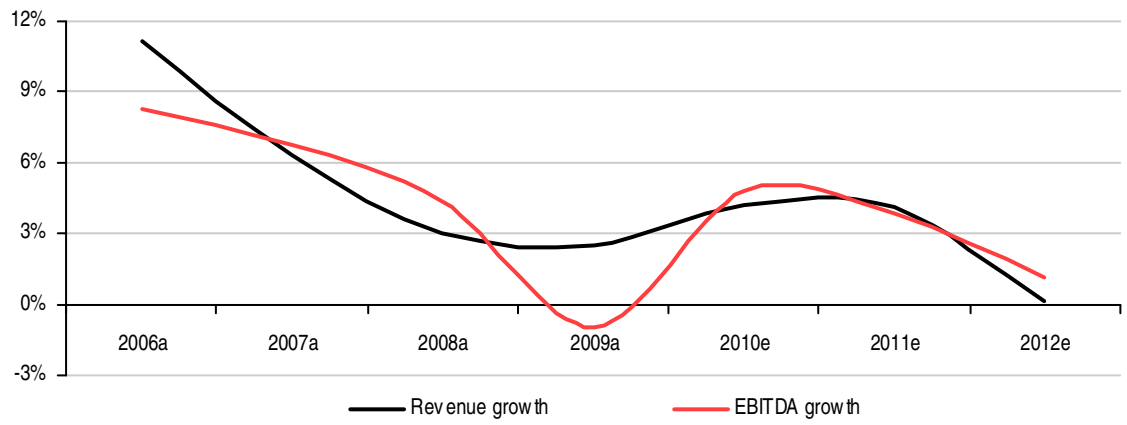
Note: For companies with y/e March, we use the following fiscal year (e.g. FY2011 figures for 2010e) for comparison
Source: HSBC estimates, Company data

HSBC

Regional charts

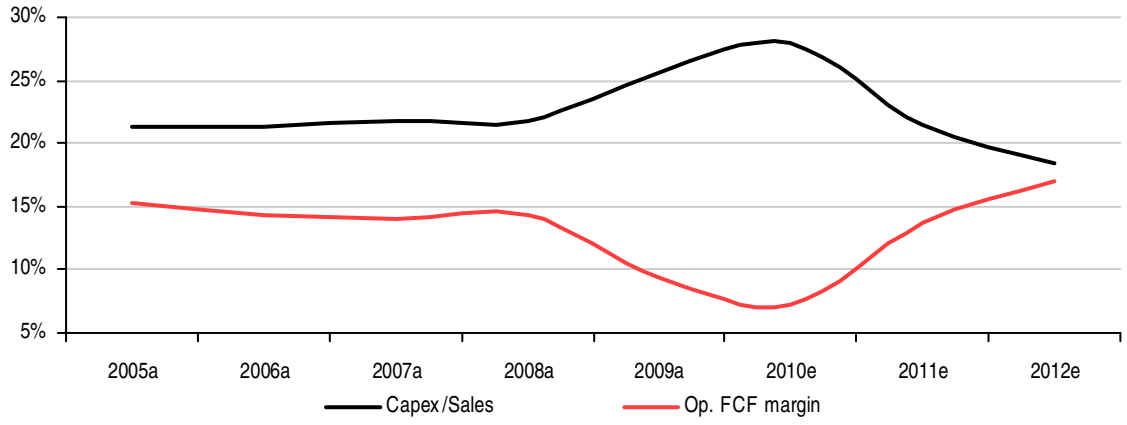
The regional revenue-EBITDA chart highlights a sharp deceleration in both categories from 2006-09, with overall EBITDA growth actually negative in 2009 for the first time. Our forecasts suggest that revenue and EBITDA growth will stabilise at the 3% level, well below GDP growth. These conservative forecasts reflect our cautious view on 3G services in both China and India. The regional capex-sales and operating FCF highlight the value destructive "bulge" of higher capex and lower op FCF during the 3G transition with a fairly optimistic narrowing on the funding gap by 2012. We note that some regional-global investors have looked as this trend line as a buy signal on a regional, country, and company basis on the view that rising op FCF could lead to higher dividend distributions. We see limited upside to our dividend forecasts as most of the telcos continue to see themselves as growth companies, basing dividend payouts on net income rather than op FCF, and benchmark their yields to local blue chips rather than regional-global telco services yield names. In summary, we argue most operators in the region are reluctant to accept the shift from the S-curve to the yield curve.

Revenue and EBITDA growth for Asian stocks

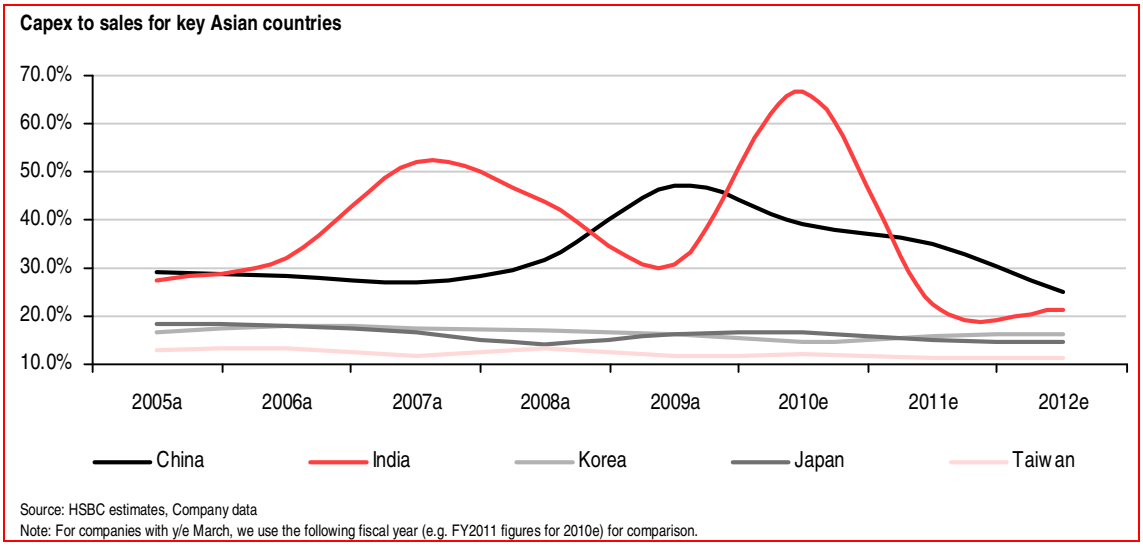


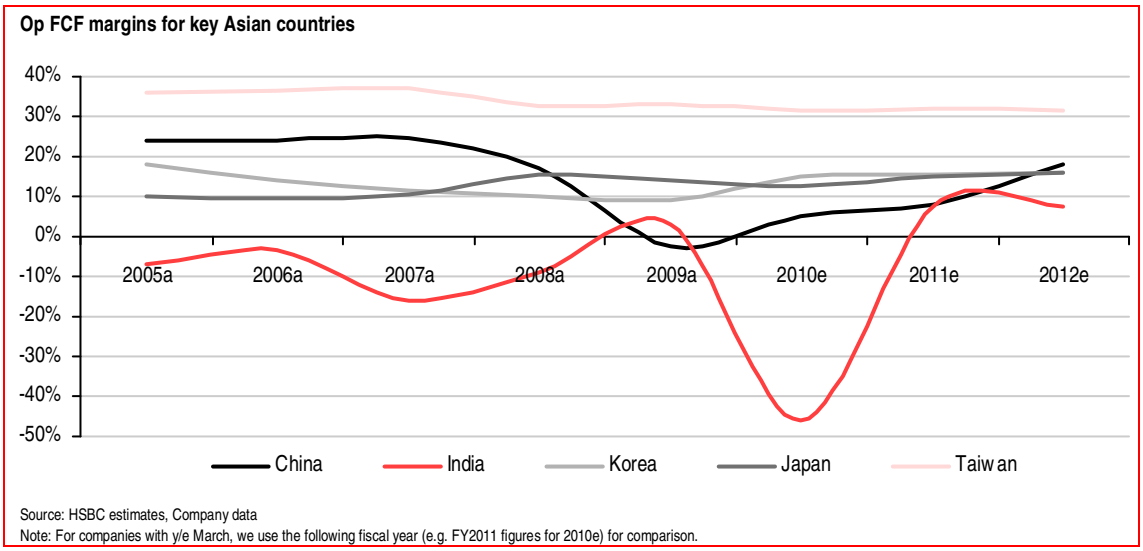
Note: For companies with y/e March, we use the following fiscal year (e.g. FY2011 figures for 2010e) for comparison.
Source: HSBC estimates, Company data

Capex/sales and op FCF margin for Asian stocks



Note: For companies with y/e March, we use the following fiscal year (e.g. FY2011 figures for 2010e) for comparison.
Source: HSBC estimates, Company data





Earnings forecasts and ratings – HSBC vs consensus

Our net profit forecasts and ratings vs. consensus estimates and ratings are outlined below. We have used 'clean' net profits from both HSBC and consensus (Reuters net profit number, pre-excerpt).

HSBC

HSBC net profit forecasts vs. consensus

	HSBC		Consensus		HSBC vs. Cons.		HSBC	Consensus rating		
	2011e	2012e	2011e	2012e	2011e	2012e	rating	OW	N	UW
China (RMBm)										
China Mobile	117,812	122,115	123,830	129,400	-4.9%	-5.6%	N	16	13	1
China Telecom	27,808	32,758	19,477	22,493	42.8%	45.6%	OW	18	9	1
China Unicom	6,996	10,183	7,730	11,008	-9.5%	-7.5%	UW	11	6	12
HK (HKDm)										
PCCW	1,859	2,060	1,881	2,068	-1.2%	-0.4%	OW	6	3	0
SmarTone	363	357	293	303	24.0%	17.5%	OW	3	2	4
South Korea (KRWb)										
SK Telecom	1,703	2,064	1,693	1,838	0.6%	12.3%	N	21	7	0
KT Corp	1,962	2,422	1,555	1,668	26.1%	45.2%	OW	25	2	0
LG U+	592	684	523	612	13.1%	11.7%	OW	7	15	2
SK Broadband	63.4	164.7	60	130	6.2%	26.2%	N	7	11	5
Japan (JPYb)										
NTT DoCoMo	511	523	514	538	-0.5%	-2.9%	N	14	7	0
NTT	510	579	535	571	-4.7%	1.4%	N	15	5	0
SoftBank Corp.	263	263	217	248	20.8%	6.0%	UW	11	6	3
KDDI Corp	271	298	237	261	14.4%	14.2%	OW	6	14	2
eAccess Ltd	25	34	23	30	8.7%	13.3%	OW (V)	6	2	1
Taiwan (TWDm)										
Chunghwa Telecom	49,388	49,427	46,578	46,991	6.0%	5.2%	N	7	5	0
Taiwan Mobile Co.	15,797	16,199	15,451	16,048	2.2%	0.9%	N	9	4	1
Far EasTone	10,053	10,392	9,587	10,113	4.9%	2.8%	UW	6	4	4
Australia (AUDm)										
Telstra Corp	3,116	3,663	3,314	3,375	-6.0%	8.5%	OW	7	7	6
India (INRm)										
Bharti Airtel	86067	115,741	86,490	110,314	-0.5%	4.9%	N (V)	20	10	4
RCOM	17,427	30,696	24,597	32,650	-29.2%	-6.0%	UW (V)	9	9	16
Idea Cellular Ltd	5,058	13,675	7,767	12,372	-34.9%	10.5%	N (V)	8	6	18
Tata Communications	(5,747)	(3,878)	(4,665)	(1,434)	23.2%	170.4%	UW (V)	3	2	9
Tata Teleservices	(6,868)	(6,255)	(5,521)	(8,360)	24.4%	-25.2%	UW (V)	1	1	5
MTNL	(8,463)	(7,140)	(6,788)	(5,501)	24.7%	29.8%	UW (V)	1	2	15
Indonesia (IDRb)										
PT Telkom	11,478	13,483	13,230	14,546	-13.2%	-7.3%	N	13	7	0
Indosat	1,529	2,051	1,593	2,036	-4.0%	0.7%	UW	8	8	3
XL Axiata	4,083	4,770	3,763	4,478	8.5%	6.5%	OW (V)	14	1	0
Singapore (SGDm)										
Singapore Telecom	3,819	4,181	4,192	4,504	-8.9%	-7.2%	N	9	10	1
Starhub	274	307	307	331	-10.7%	-7.1%	N	8	4	7
M1 Ltd.	151	158	164	171	-8.4%	-7.7%	N	13	4	2

Note: For companies with y/e March, we use the following fiscal year (e.g. FY2012 figures for 2011e) for comparison.
Source: HSBC estimates, Reuters consensus

HSBC

Our valuation methodologies

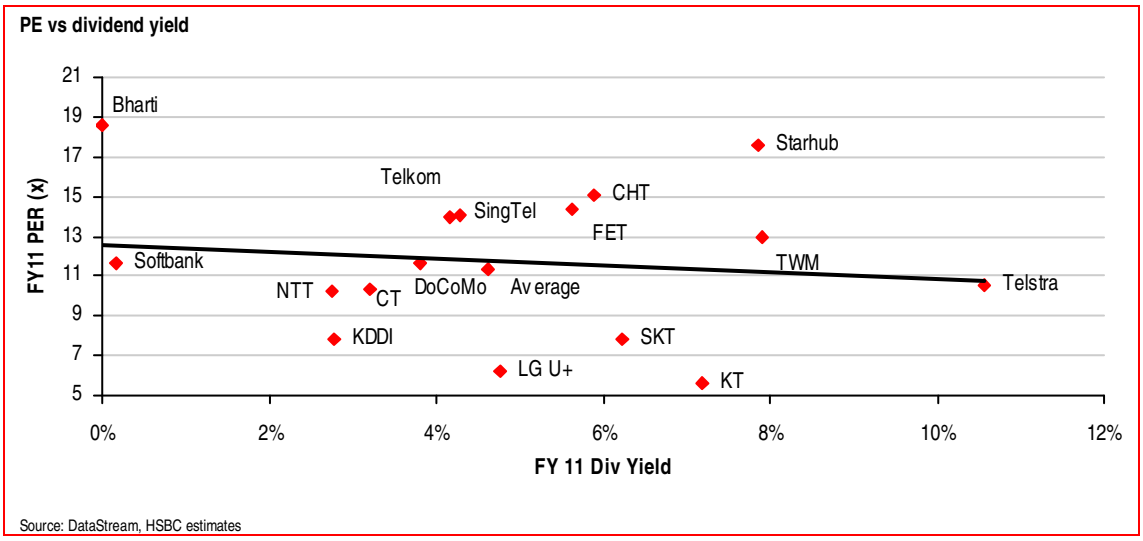
In valuing Asian telecom companies, our primary methodologies are PE or DCF-based. Our choice depends on factors such as timing of value creation (front or back-loaded), near-term earnings growth, multiple expansion due to outside factors, including market liquidity or any uncertainty over long-term cash flow drivers leading to reliance on short-term drivers. For the DCF, we usually use a standardised risk-free rate and risk premium assumption to determine our cost of equity, while the cost of debt depends on the local market range.

We generally tend to use a target debt to capital ratio of 30% since in our experience this has been the traditional long-term range for most telcos in Asia. To determine the appropriate PE multiple, we look at 1-year historical forward band charts to determine the mid-cycle trading range. As a complement, in case of higher multiple companies such as those in the China internet space with superior earnings growth, we also use the PEG ratio to drive our valuations.

We also consider relative comparisons for determining our target multiple, based on regional peers average. We sometimes use an EV/EBITDA multiple in cases where the company has high operating and financial leverage, to help determine the value of the company based on its operating profitability exposure. Our recent experience though has been to use a blended PE/DCF forecast that captures both short-term earnings drivers and long-term value generated by the company's FCF.

Dividend screen

From a dividend yield perspective, Taiwan, Korea, and Australia are the best yield markets in our coverage universe, with Telstra being a clear standout. We see a similar grouping for FCF yield vs dividend yield with the addition of PCCW at the high end of the FCF yield axis. We also tend to look at the yield differentials between domestic 10-year sovereign and company dividend yields in the region to get a sense of best yield stories, with local risk free sovereign yields as a useful proxy. We think that Southeast Asian stocks in Singapore, Malaysia, Thailand and the Philippines are generally higher dividend yield plays given that much of the region is nearing the developed, ex-growth market stage and largely stable capex to sales ratios generate free cash flows can be distributed to shareholders.



Source: DataStream, HSBC estimates

HSBC

Absolute price performance

Asian telcos price performance (as of 9 November 2010)

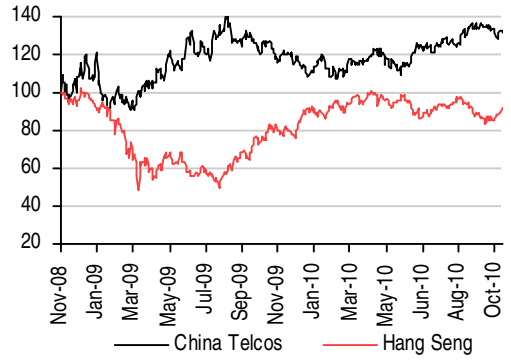
	MCAP (USDm)	1 Week	1 Month	3 Months	6 Months	9 Months	12 Months	Qtr to date	Year to date
China/HK									
China Mobile LTD	211,646	4.4%	0.9%	0.5%	11.2%	9.7%	13.1%	4.1%	13.5%
China Telecom Corporation	42,710	2.8%	-3.5%	5.4%	20.9%	28.4%	19.8%	-3.5%	26.9%
China Unicom	33,381	0.5%	-2.1%	3.2%	18.7%	31.6%	6.0%	-2.8%	7.4%
ZTE Corporation	11,914	-0.3%	-5.2%	12.2%	10.1%	4.0%	-3.3%	-3.1%	-6.4%
China Communication Service	3,575	2.3%	3.4%	18.5%	36.4%	18.5%	15.4%	4.3%	25.7%
CITIC 1616 Holding Ltd	800	-1.1%	-6.5%	19.8%	9.2%	19.8%	-11.9%	-7.5%	-1.1%
SmarTone Telecom	718	-1.4%	5.0%	33.1%	31.8%	54.8%	102.2%	7.3%	70.3%
Comba Telecom systems	1,403	-4.8%	-0.2%	16.7%	-2.2%	35.2%	22.4%	-1.8%	13.9%
PCCW	2,918	0.3%	7.4%	15.6%	33.9%	40.1%	63.4%	8.2%	62.6%
Korea									
KT Corp	10,876	3.9%	0.7%	8.7%	-1.7%	-0.5%	16.9%	1.3%	18.4%
SK Telecom	12,676	1.2%	-2.8%	2.4%	2.4%	-2.5%	-5.0%	0.6%	1.8%
SK Broadband Co Ltd	1,422	-4.0%	-4.5%	-2.9%	-9.1%	8.1%	14.7%	-2.2%	10.9%
LG Telecom	3,311	-2.1%	-6.7%	-8.6%	-11.8%	-13.5%	-19.9%	-3.3%	-16.0%
Indonesia									
PT Telkom	18,451	-5.8%	-10.4%	-3.0%	7.2%	-6.3%	-6.3%	-11.4%	-13.8%
Indosat	3,509	-5.0%	-1.7%	23.9%	1.8%	14.0%	12.9%	3.6%	20.6%
India									
Bharti Airtel	28,712	-2.2%	-7.0%	1.4%	14.1%	6.4%	2.5%	-10.4%	-0.5%
Idea Cellular Ltd	5,211	3.9%	-1.3%	-2.1%	10.2%	20.3%	38.0%	-5.2%	20.3%
Reliance Communications	8,445	-1.7%	-0.5%	1.4%	17.2%	6.8%	3.0%	6.6%	4.2%
MTNL	957	-3.0%	1.6%	-1.7%	-3.1%	-9.1%	-7.3%	7.2%	-9.9%
Tata Communications	2,051	2.7%	-6.2%	13.3%	20.4%	1.6%	-14.7%	2.0%	-7.0%
Tata Teleservices	999	0.9%	0.2%	-1.9%	7.6%	-2.7%	-10.2%	5.4%	-12.9%
Taiwan									
Taiwan Mobile Co.	8,615	-0.3%	4.9%	8.9%	14.8%	13.8%	13.5%	5.9%	9.5%
Chunghwa Telecom	24,681	6.7%	6.8%	32.0%	32.0%	32.0%	20.6%	9.6%	17.2%
Far Eastone	4,801	0.8%	2.3%	-2.0%	17.2%	18.9%	19.7%	1.5%	16.4%
Japan									
NTT	73,043	3.6%	1.4%	0.4%	1.6%	-4.8%	1.9%	2.9%	2.7%
NTT DoCoMo Inc.	74,180	0.5%	-1.4%	-3.5%	-4.6%	-2.0%	4.5%	-2.2%	4.9%
SoftBank Corp.	37,560	7.3%	-1.0%	8.1%	30.9%	20.6%	27.2%	-0.8%	24.8%
KDDI Corp	26,027	4.2%	15.2%	6.4%	6.3%	-4.6%	-3.0%	14.9%	-6.9%
Jupiter Telecommunication	7,325	-0.8%	-5.2%	-5.0%	-5.6%	-6.1%	3.3%	-5.3%	-7.6%
eAccess Ltd	2,756	7.1%	2.4%	9.3%	-10.3%	11.9%	-4.0%	-0.8%	20.2%
Other Asia									
Singapore Telecom	41,210	3.8%	6.1%	7.9%	10.1%	11.2%	13.5%	4.5%	5.5%
Telstra Corp	33,477	0.0%	0.8%	-19.0%	-10.7%	-20.2%	-15.5%	2.3%	-21.9%

Source: DataStream

HSBC

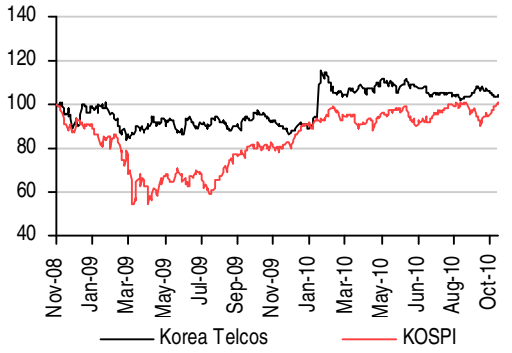
Relative price performance vs local market index

China telcos



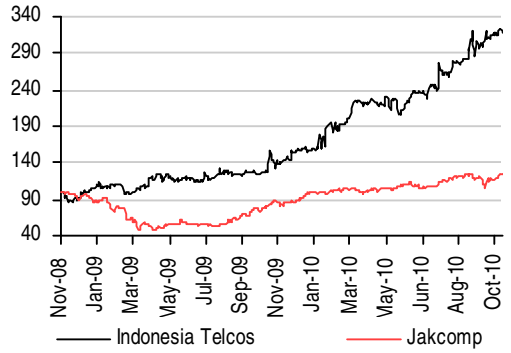
Source: Thomson DataStream

Korea telcos



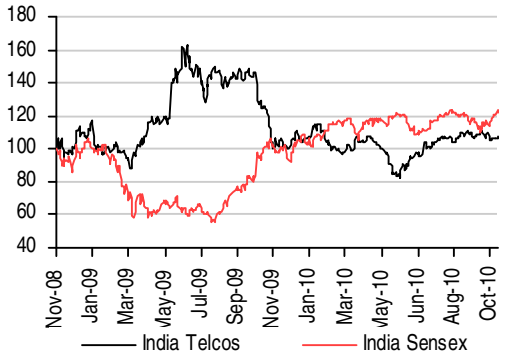
Source: Thomson DataStream

Indonesian telcos



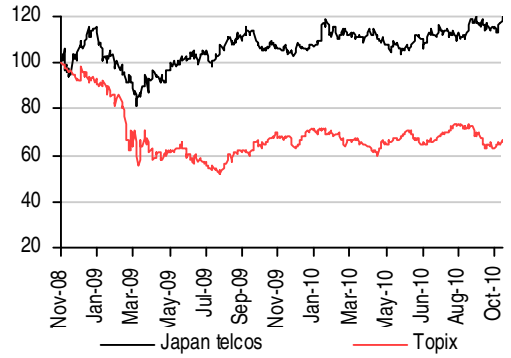
Source: Thomson DataStream

Indian telcos



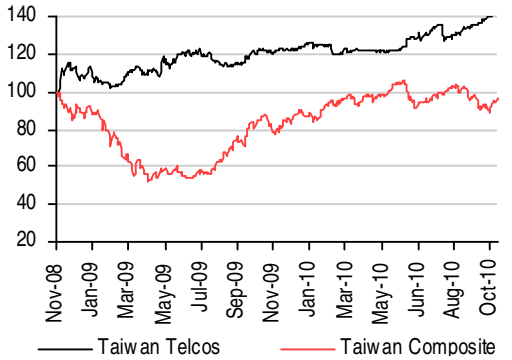
Source: Thomson DataStream

Japanese telcos



Source: Thomson DataStream

Taiwanese telcos

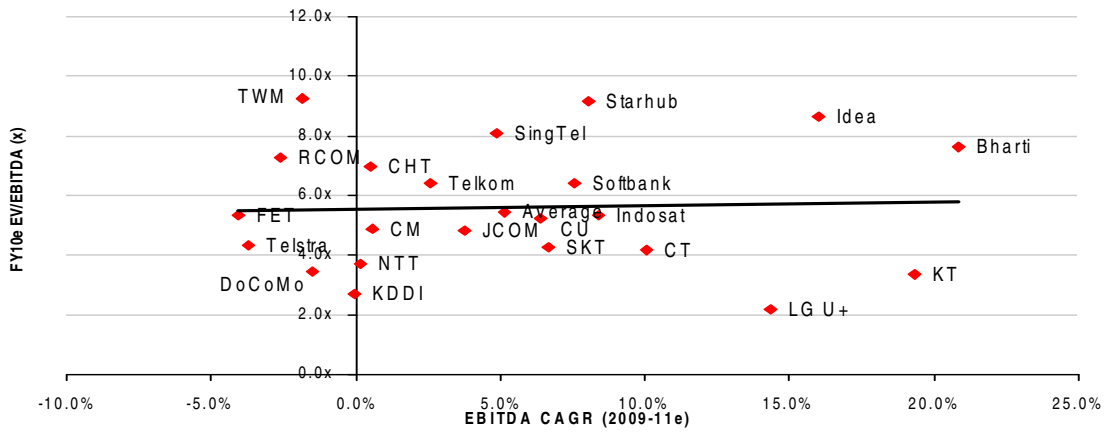


Source: Thomson DataStream

HSBC

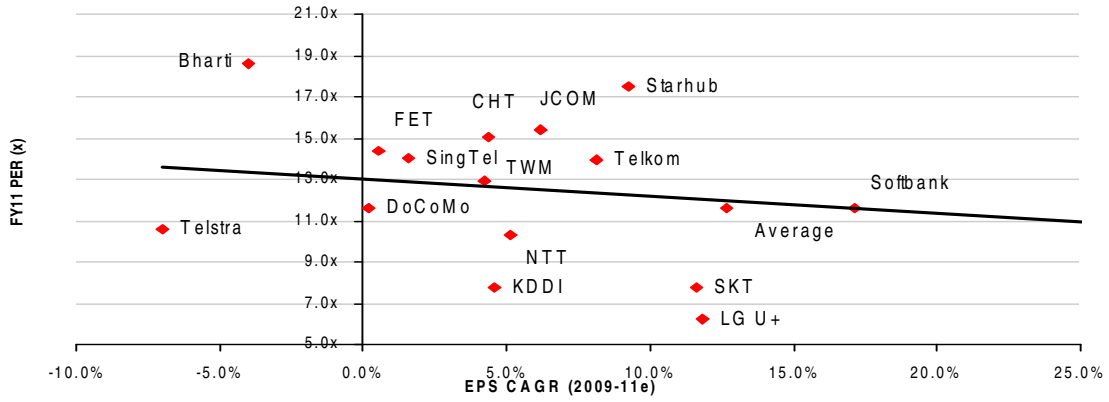
Comparison charts

FY10e EV/EBITDA (x) vs. 2009-11e EBITDA CAGR (%)



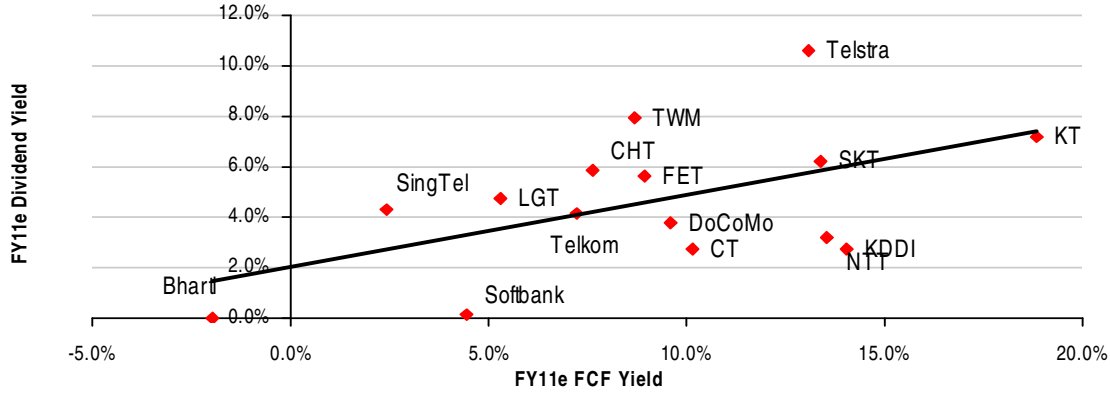
Source: Thomson DataStream, HSBC estimates

FY11e PE (x) vs 2009-11e EPS CAGR (%)



Source: Thomson DataStream, HSBC estimates

FCF yield (%) vs dividend yield (%) for FY11e



Source: Thomson DataStream, HSBC estimates

HSBC

Country and company profiles

HSBC

Australia

- Mobile data growth will offset PSTN decline but we expect operators to incur higher capex to meet capacity constraints
- National Broadband Network (NBN) outcome remains uncertain, and a substantial overhang for the sector
- OW Telstra — believe yield is secure and see operational upside

Market view

While a Financial Heads of Agreement deal was brokered with Telstra in June 2010, NBN uncertainty remains. This is the single largest overhang in Australian telecoms, with the potential to have far-reaching effects on the structure of the industry. Historically, Telstra's size and wireline dominance have resulted in what competitors claim is an asymmetric balance of power: the sale of much of Telstra's wireline infrastructure to the government-controlled NBN would significantly limit this.

Market size and structure

Our sector forecasts (next page) show the impact of Telstra's AUD1bn investment in opex in FY June 2011. It announced this with the aim of recovering lost market share, and expects a "high single-digit" decline in EBITDA margins as a result, from "flattish" revenues. It remains to be seen whether this drives a significant increase in competition. We believe fixed to mobile substitution levels of c8-10% will continue to increase.

Data growth outlook

Pending NBN clarification, wireless subscriber growth remains robust (particularly in smartphones and wireless data cards). PSTN declines have been exacerbated by the lack of a high-speed broadband alternative, prompting many households to substitute wireless for their fixed-line service.

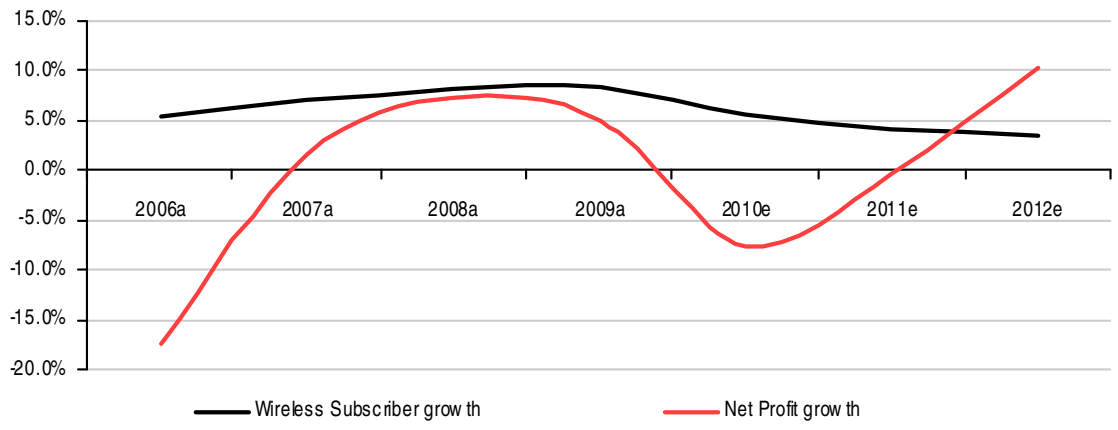
Telstra has seen considerable demand for the data services powered by its NextG 850 Mhz network, also noting in its FY09 results that wireless network traffic was doubling every 19 months. We see Telstra's Next G (wireless) and Next IP (wireline) networks as the foundation of its ability to improve its earnings profile: Telstra has the best network, in the best spectrum, in a geography that is notoriously difficult to cover.

While both SingTel Optus and Vodafone-Hutchison Australia have posted strong subscriber gains as a result of pricing discrepancies with Telstra, these price premiums are now being reduced. With networks increasingly congested, we expect Telstra's five-year investment in the Next G network to become a competitive weapon, as network quality increasingly becomes a differentiator.

HSBC

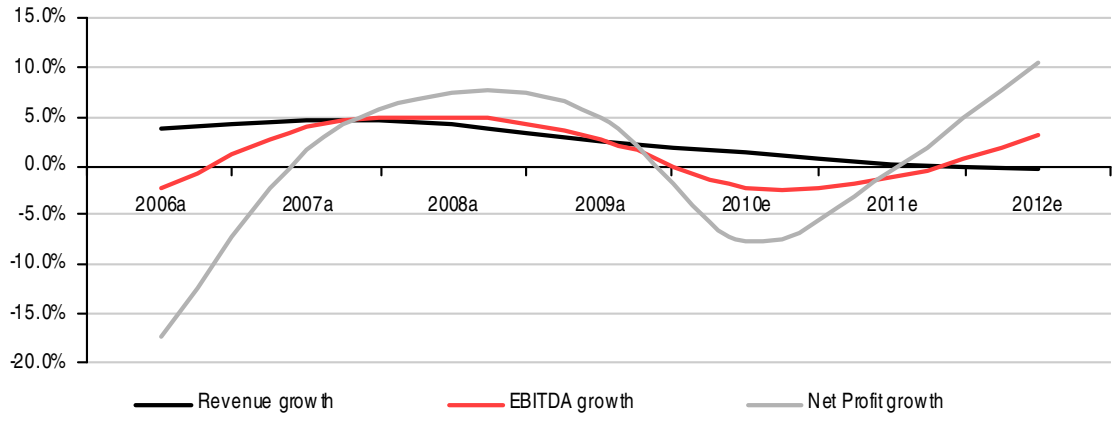
Australia: Market charts

Market position: Wireless subscriber growth vs. net profit growth



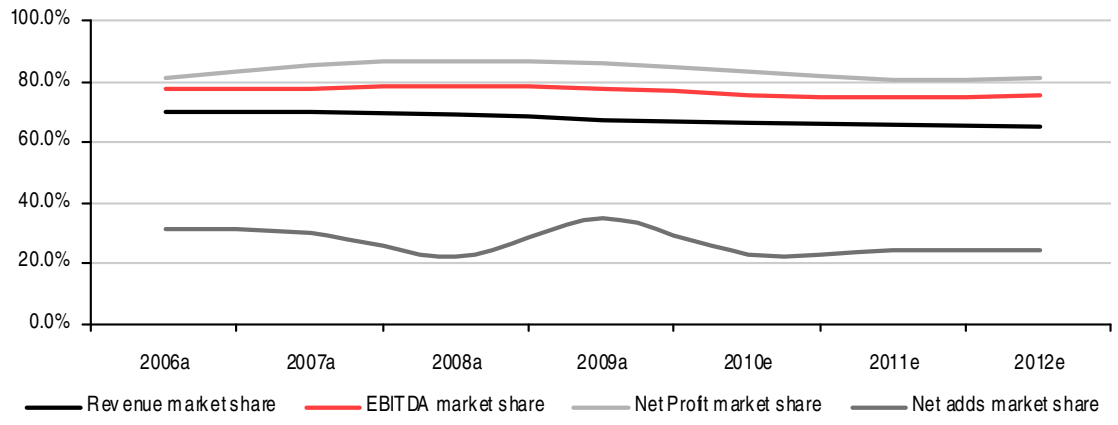
Source: Company reports, HSBC estimates. Note: data is calendarized for standardisation purposes.

Market growth: Revenue, EBITDA and net profit (YoY change)



Source: Company reports, HSBC estimates. Note: data is calendarized for standardisation purposes.

Market structure: Telstra's revenue, EBITDA, net profit and wireless net adds market shares (%)



Source: Company reports, HSBC estimates. Note: data is calendarized for standardisation purposes.

HSBC

Telstra (TLS)

- Investment in opex in FY June 2011 the right move – network advantages to help profits recover from FY June 2012
- NBN deal unlikely to be overturned; dividend secure at AUD0.28 – yield of 10.4% the highest in our Asian telco coverage
- Overweight: DDM-based TP of AUD3.3; an Asia Super Ten idea

Investment thesis

We believe recent pragmatism will prevail, and the NBN rapprochement between Telstra and the regulator will result in a final deal similar to the 'Heads of Agreement' brokered in June 2010 (which has NPV to Telstra of AUD11bn). With NBN risk receding, the focus has been on Telstra's poor operational performance: we expect this to improve in FY June 2012, when our estimates for operating profit are 8% above consensus. We believe the Board will maintain the current dividend of AUD0.28 per share, resulting in a prospective yield of 10.4% – the highest in our Asian telco coverage.

Forecasts, business outlook

In FY June 2010, Telstra made a basic mistake. It allowed its prices to remain high while competitors were cutting aggressively, losing substantial market share as a result. Arguably its brand also suffered as its high prices were not backed up by better customer service. This is the reason for the cAUD1bn increase in opex in FY June 2011 – to reduce subscriber churn and make Telstra fully competitive. Factoring in the additional guidance from the September 2010 Investor Day, our forecasts for FY June 2011 are in line with company guidance for a "high-single digit" y-o-y decline in EBITDA.

Data growth outlook

A centrepiece of Sol Trujillo's 2005 strategy review, the Next G wireless network has been an overall success, with products such as wireless broadband now with 1.8m subscribers and generating close to AUD1bn per year after a 3-year revenue CAGR of 109%. Given strong demand and high levels of fixed-mobile substitution, wireless broadband and data service provision will increase in importance. This favours larger operators – such as Telstra – with the ability to invest more than their peers.

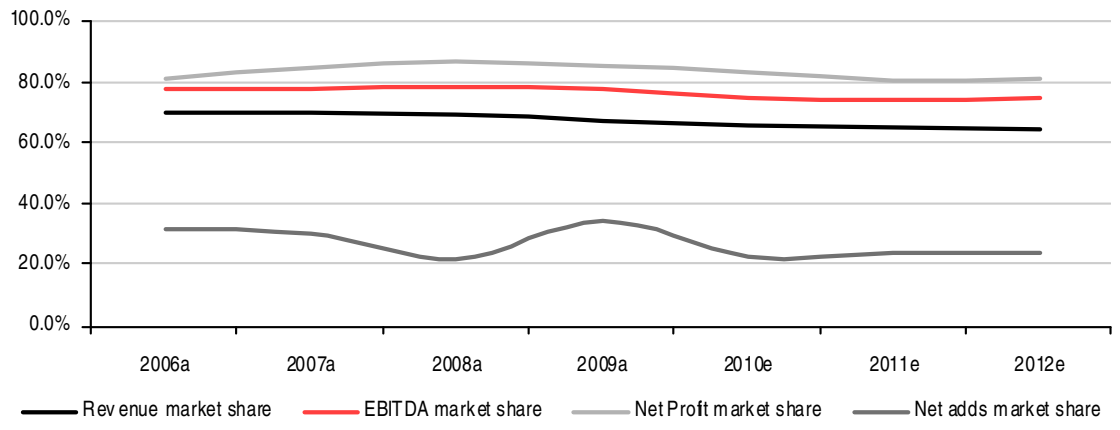
Valuation and risks

Due to the 9.5% decline in EBITDA in FY June 2011, we believe a PE-based approach does not reflect underlying trends: we use a DDM-based approach. We assume risk-free rate of 4%, beta of 1.1 and risk premium of 4.5% to arrive at a cost of equity of 9%. Our AUD3.3 target price implies a PE of 13.2x our June 2011 EPS estimate of AUD0.25. Risks to our view are operational weakness, a change to the existing NBN framework agreement, and a cut in the dividend.

HSBC

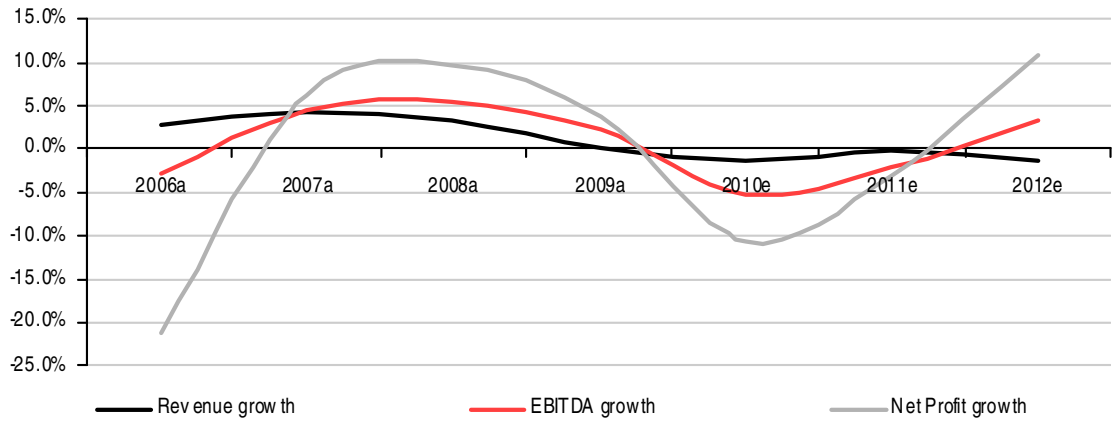
Telstra: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



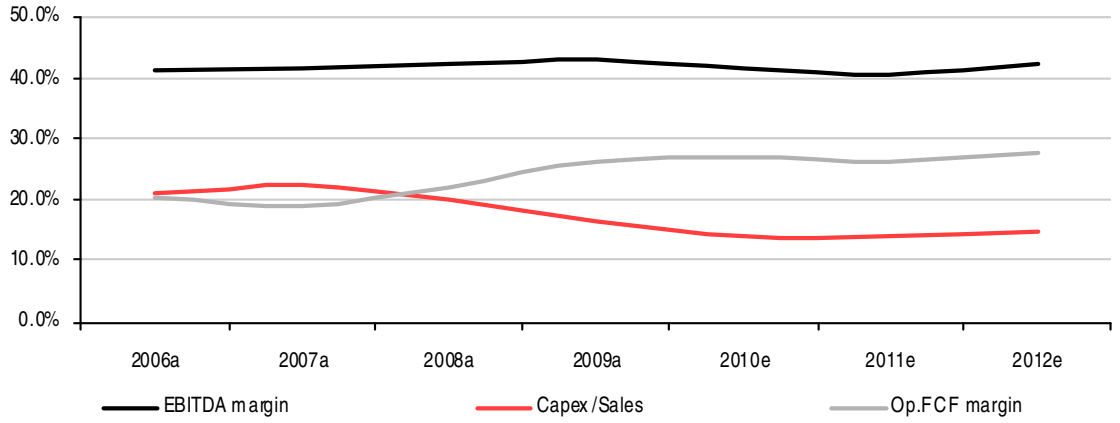
Source: Company reports, HSBC estimates. Note: data is calendarized for standardisation purposes.

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates. Note: data is calendarized for standardisation purposes.

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates. Note: data is calendarized for standardisation purposes.

HSBC

Financials & valuation: Telstra Corp

Overweight

Financial statements

Year to	06/2010a	06/2011e	06/2012e	06/2013e
Profit & loss summary (AUDm)				
Revenue	25,029	24,925	24,970	24,949
EBITDA	10,847	9,819	10,400	10,488
Depreciation & amortisation	-4,346	-4,444	-4,283	-4,160
Operating profit/EBIT	6,501	5,375	6,116	6,328
Net interest	-963	-923	-883	-812
PBT	5,538	4,452	5,233	5,516
HSBC PBT	5,538	4,452	5,233	5,516
Taxation	-1,598	-1,286	-1,520	-1,605
Net profit	3,883	3,109	3,653	3,848
HSBC net profit	3,877	3,116	3,663	3,861
Cash flow summary (AUDm)				
Cash flow from operations	8,629	7,540	8,121	8,124
Capex	-3,595	-3,490	-3,546	-3,583
Cash flow from investment	-3,466	-3,490	-3,546	-3,583
Dividends	-3,474	-3,484	-3,484	-3,519
Change in net debt	-2,820	-567	-1,091	-1,022
FCF equity	5,437	4,186	4,341	4,456
Balance sheet summary (AUDm)				
Intangible fixed assets	1,802	1,802	1,802	1,802
Tangible fixed assets	29,120	28,166	27,428	26,851
Current assets	7,419	5,731	5,736	5,734
Cash & others	2,688	1,000	1,000	1,000
Total assets	39,282	36,640	35,907	35,328
Operating liabilities	5,807	5,717	5,882	5,967
Gross debt	16,763	14,508	13,417	12,395
Net debt	14,075	13,508	12,417	11,395
Shareholders funds	12,696	12,321	12,456	12,750
Invested capital	29,846	28,982	28,084	27,420

Ratio, growth and per share analysis

Year to	06/2010a	06/2011e	06/2012e	06/2013e
Y-o-y % change				
Revenue	-2.3	-0.4	0.2	-0.1
EBITDA	-0.9	-9.5	5.9	0.9
Operating profit	-0.9	-17.3	13.8	3.5
PBT	-2.1	-19.6	17.6	5.4
HSBC EPS	-2.1	-19.6	17.6	5.4
Ratios (%)				
Revenue/IC (x)	0.8	0.8	0.9	0.9
ROIC	14.8	12.8	15.0	16.0
ROE	30.9	24.9	29.6	30.6
ROA	11.8	10.2	12.1	12.7
EBITDA margin	43.3	39.4	41.6	42.0
Operating profit margin	26.0	21.6	24.5	25.4
EBITDA/net interest (x)	11.3	10.6	11.8	12.9
Net debt/equity	108.2	106.4	96.4	86.1
Net debt/EBITDA (x)	1.3	1.4	1.2	1.1
CF from operations/net debt	61.3	55.8	65.4	71.3
Per share data (AUD)				
EPS Rep (fully diluted)	0.31	0.25	0.29	0.31
HSBC EPS (fully diluted)	0.31	0.25	0.29	0.31
DPS	0.28	0.28	0.28	0.29
Book value	1.02	0.99	1.00	1.02

Key forecast drivers

Year to	06/2010a	06/2011e	06/2012e	06/2013e
Mobile market share (%)	40	43	42	43
Wireless Voice ARPU, AUD	32	30	29	28
Wireless Data ARPU, AUD	19	21	22	23
Churn Rate Wireless (%)	-2	-2	-2	-2
WBB Revenue, AUD mn	787	1,143	1,370	1,551
Internet Revenue, AUD mn	2,948	3,215	3,320	3,403

Valuation data

Year to	06/2010a	06/2011e	06/2012e	06/2013e
EV/sales	1.9	1.9	1.8	1.8
EV/EBITDA	4.3	4.7	4.3	4.2
EV/IC	1.6	1.6	1.6	1.6
PE*	8.5	10.6	9.0	8.5
P/Book value	2.6	2.7	2.6	2.6
FCF yield (%)	16.6	12.8	13.3	13.6
Dividend yield (%)	10.6	10.6	10.7	10.8

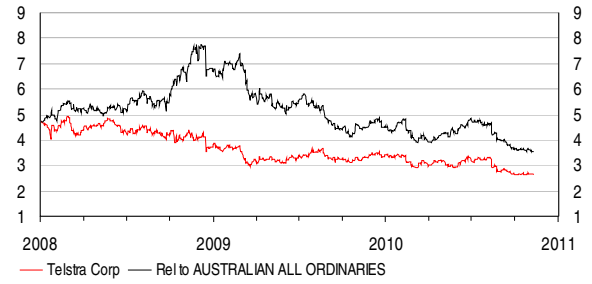
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (AUD)	2.65	Target price (AUD)	3.30	Potent'l return (%)	24.5

Reuters (Equity)	TLS.AX	Bloomberg (Equity)	TLS AU
Market cap (USDm)	33,477	Market cap (AUDm)	32,974
Free float (%)	50	Enterprise value (AUDm)	46,177
Country	Australia	Sector	Diversified Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

China

- We have shifted toward a more positive view on the China telco space, including an OW rating on China Telecom
- We forecast a strong recovery in profitability, reflecting a fairly rational-stable competitive outlook
- We are optimistic on Chinese data growth with bullish 3G ARPUs-sub forecasts and robust IPTV penetration into our forecast

Market view

We have shifted toward a more positive view on the China telco services space, post 1H10 results. The 3G transition has been slow and the expected spike in competitive intensity-churn has been muted. We forecast 5-6% revenue growth and 8-9% profit growth, due to reliance on off-balance sheet, parent company capex. We are bullish on 3G ARPUs, but the sharp contraction of the traditional fixed line business remains a drag. China is shifting towards a Japanese and Korean-style model of asymmetric regulation and integrated management of the services and equipment spaces. We believe the primary focus of the Chinese government will be on technology policy versus maximizing shareholders' returns.

Market size and structure

We forecast sector revenues to grow at a 2009-12 CAGR of 5% but telcos as a percentage of GDP to decline from 2.4% of nominal GDP in FY09 to 2.0% by FY12. The combination of robust Chinese GDP growth and lower tariffs will likely lead to the telco sector shrinking as a percentage of GDP. China Mobile (CM) controls 75-80% of the industry's earnings and the key issue is whether CM's 100m high-end, contract customers are vulnerable to churn. We believe there is a *quid pro quo* with the government over linking the timing of the introduction of mobile number portability (MNP) to the commercial viability of TD-SCDMA. We argue MNP will remain on hold till CM can solve the problem of a sub-scale ecosystem for TD handsets that can attract high-end users. Government technology policy rather then commercial market drivers will determine market structure in China.

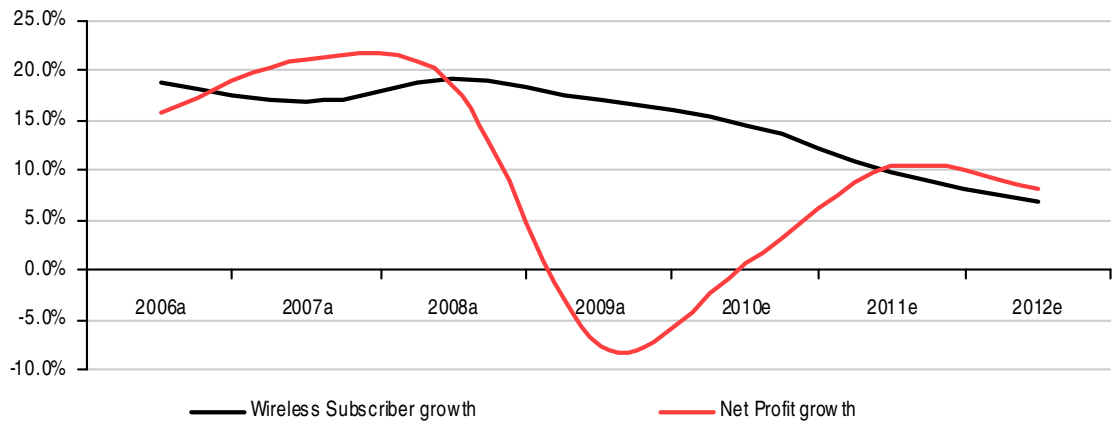
Data growth outlook

We are cautiously optimistic on the outlook for both wireless and wireline data services growth in China. Given the sensitive nature of the media space and the need for local language content in China, there is a larger role for SoEs. On the wireless side, Apple (NR) and Google (NR) are blocked from operating applications stores. We assume the China telcos will be able to grab a piece of the wireless content-services pie and have built that into our 3G assumptions. On the wireline side, we see a real opportunity in IPTV as the existing CATV players are fragmented, underfinanced and vulnerable.

HSBC

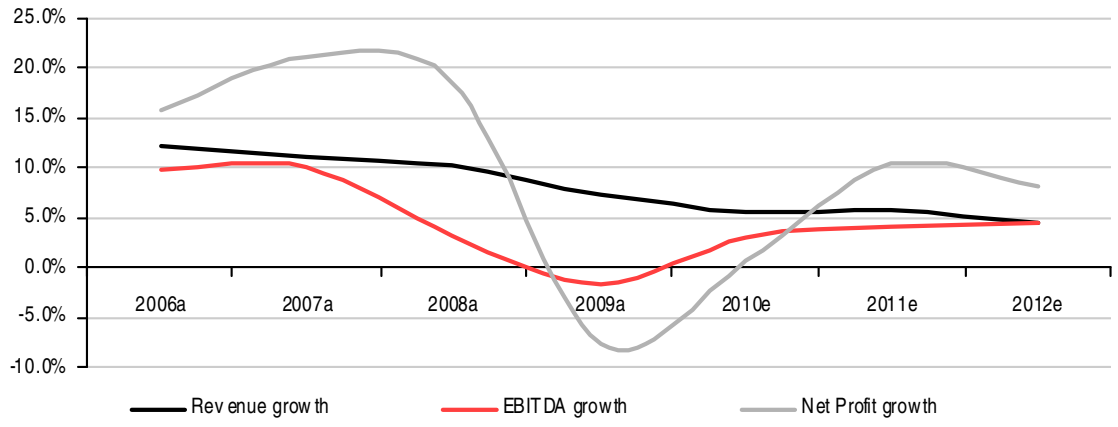
China: Market charts

Market position: Wireless subscriber growth vs. net profit growth



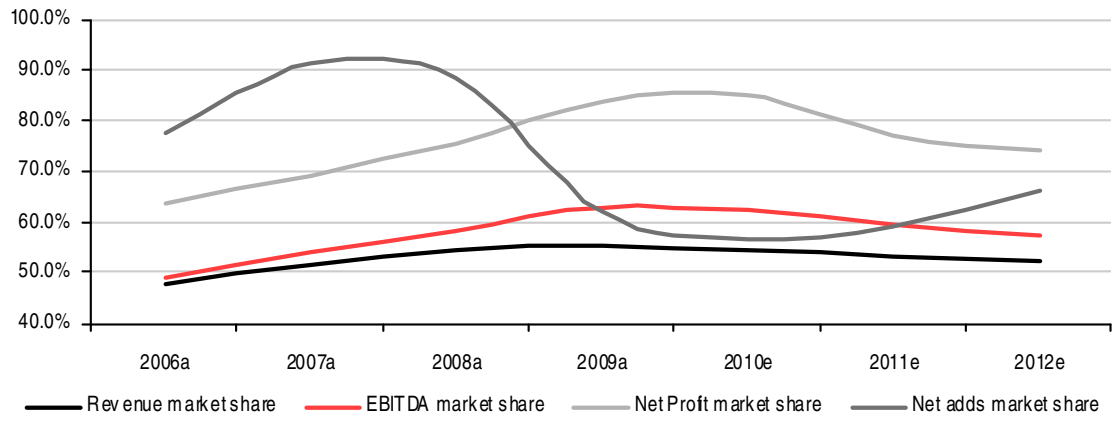
Source: Company reports, HSBC estimates

Market growth: Revenue, EBITDA and net profit (YoY change)



Source: Company reports, HSBC estimates

Market structure: China Mobile's revenue, EBITDA, net profit and wireless net adds market shares (%)



Source: Company reports, HSBC estimates

HSBC

China Mobile (941)

- Strongest telco operator in China, attractive valuation, but uncertainty over MNP timing and dividend limits upside
- We are in line with consensus and see limited upside risks to near-term earnings given MNP risk
- Neutral: HKD81 target price on mid-cycle PE of 12x

Investment thesis

China Mobile (CM) is well-positioned and trades at attractive valuation but we believe MNP-related regulatory risk limits upside. CM dominates the China telco space, generating c80% of industry free cash flows in 2010. It has the best network, brand and content, but has been saddled with the national service obligation of funding the development of TD-SCDMA. We do not believe TD is a viable mass market technology, but see a *quid pro quo* with the government regarding delaying asymmetric regulation until TD is viable.

Forecasts, business outlook

We forecast 3.5% top-line growth but flat earnings, reflecting gradual margin compression, with sales and marketing costs of RMB20bn in FY10. CM has suggested a FY10 3G sub target of 12m and we believe TD will have 35-40% market share. Our forecasts are based on average TD handset subsidies of cRMB1,000 and ARPU of RMB100. CM's emerging strategy of positioning TD as a fixed-line substitute for both voice and data is likely to mean higher subscriber numbers, but lower handset subsidies and ARPU.

Data growth outlook

CM is the best-positioned of the three China telcos in wireless content, reflecting its strong brand, significant net cash stockpile, and dominance of the high-end contract customer segment. CM is the most aggressive player in the content development area and had the most developed applications store at November 2010. However, we believe CM is vulnerable in wireline due to its lack of broadband network and content. We believe it will look for M&A opportunities in the CATV sector after 2012 to provide a last mile wireline solution.

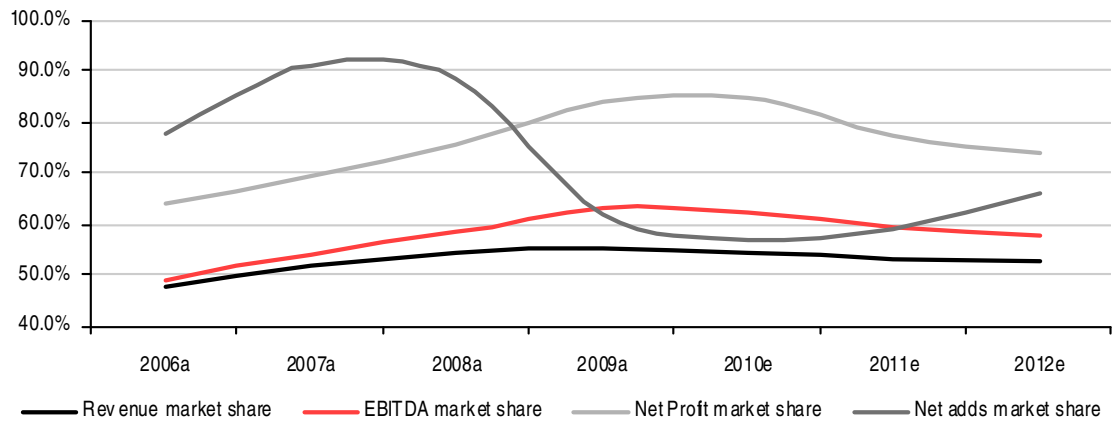
Valuation and risks

Our target price is based on mid-cycle PE of 12x and a blend of FY10e EPS of RMB5.79 and FY11e EPS of RMB5.8. The key risks relate to the ability to retain or convert high-end 2G accounts into higher-value 3G accounts, and in the introduction of MNP. A catalyst is the planned A-share/CDR listing in mid-2011, which could lead to both a higher dividend payout ratio and a technical bounce in the H-share stock price.

HSBC

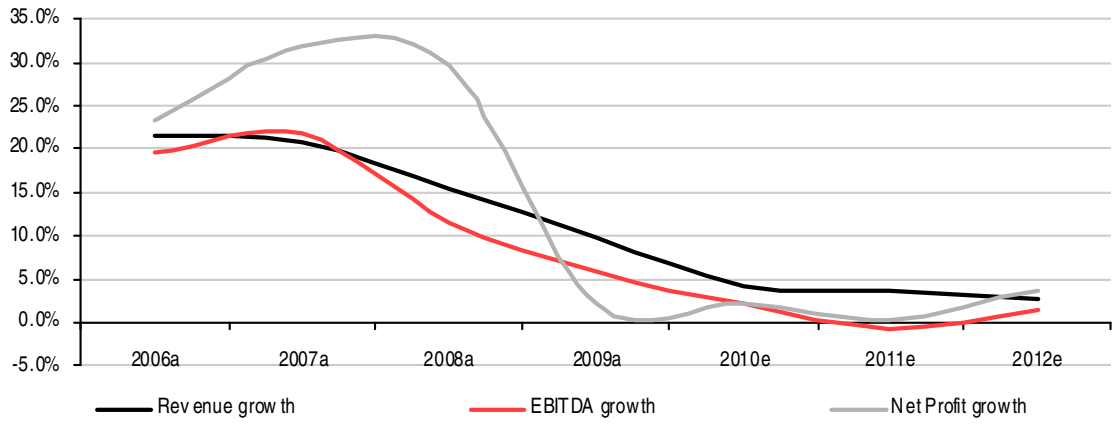
China Mobile: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



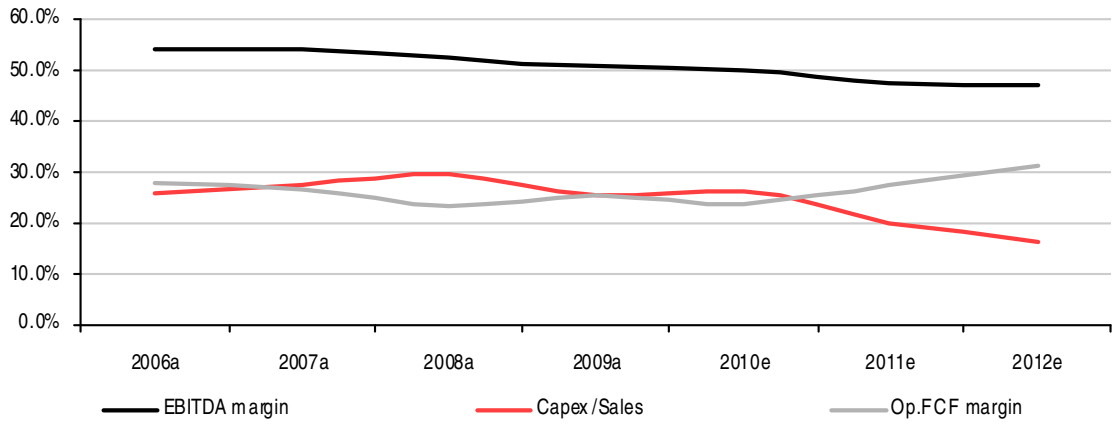
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in Revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: China Mobile

Neutral

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (CNYm)				
Revenue	452,103	471,136	487,412	499,950
EBITDA	228,967	233,744	231,796	234,912
Depreciation & amortisation	-80,235	-83,309	-82,571	-81,603
Operating profit/EBIT	148,732	150,436	149,225	153,309
Net interest	4,697	5,964	7,478	9,123
PBT	153,788	156,965	157,288	163,032
HSBC PBT	153,836	156,965	157,288	163,032
Taxation	-38,413	-39,241	-39,322	-40,758
Net profit	115,118	117,570	117,812	122,115
HSBC net profit	115,166	117,570	117,812	122,115
Cash flow summary (CNYm)				
Cash flow from operations	202,157	196,547	205,720	208,324
Capex	-115,314	-123,000	-98,000	-80,400
Cash flow from investment	-171,926	-124,501	-99,653	-82,220
Dividends	-48,614	-49,008	-51,687	-56,715
Change in net debt	-46,250	-29,959	-61,314	-77,006
FCF equity	91,370	73,547	107,720	127,924
Balance sheet summary (CNYm)				
Intangible fixed assets	37,621	37,621	37,621	37,621
Tangible fixed assets	426,309	463,753	477,094	473,304
Current assets	287,355	318,027	375,152	452,782
Cash & others	264,507	294,527	350,841	427,846
Total assets	751,368	819,485	889,951	963,792
Operating liabilities	210,122	206,854	213,432	219,104
Gross debt	33,551	33,612	28,612	28,612
Net debt	-230,956	-260,915	-322,229	-399,234
Shareholders funds	506,748	577,919	646,654	714,663
Invested capital	276,656	318,021	325,594	316,757

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	9.6	4.2	3.5	2.6
EBITDA	5.9	2.1	-0.8	1.3
Operating profit	2.9	1.1	-0.8	2.7
PBT	2.8	2.1	0.2	3.7
HSBC EPS	2.3	2.1	0.2	3.7
Ratios (%)				
Revenue/IC (x)	1.7	1.6	1.5	1.6
ROIC	41.7	37.9	34.8	35.8
ROE	24.3	21.7	19.2	17.9
ROA	16.5	15.1	13.9	13.3
EBITDA margin	50.6	49.6	47.6	47.0
Operating profit margin	32.9	31.9	30.6	30.7
EBITDA/net interest (x)				
Net debt/equity	-45.5	-45.1	-49.7	-55.8
Net debt/EBITDA (x)	-1.0	-1.1	-1.4	-1.7
CF from operations/net debt				
Per share data (CNY)				
EPS Rep (fully diluted)	5.67	5.79	5.80	6.01
HSBC EPS (fully diluted)	5.67	5.79	5.80	6.01
DPS	2.47	2.51	2.63	3.01
Book value	25.26	28.69	31.96	35.17

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	2.6	2.4	2.2	2.0
EV/EBITDA	5.1	4.9	4.7	4.3
EV/IC	4.2	3.6	3.3	3.2
PE*	12.4	12.1	12.1	11.7
P/Book value	2.8	2.4	2.2	2.0
FCF yield (%)	6.5	5.2	7.7	9.1
Dividend yield (%)	3.5	3.6	3.7	4.3

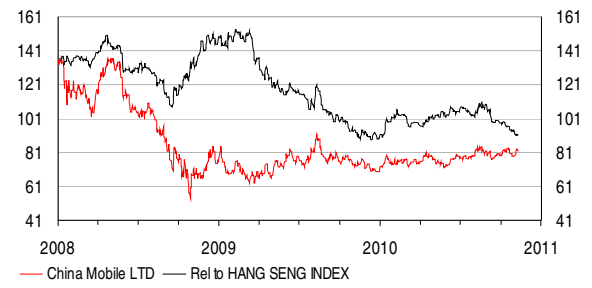
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (HKD)	81.75	Target price (HKD)	81.00	Potent'l return (%)	-0.9

Reuters (Equity)	0941.HK	Bloomberg (Equity)	941 HK
Market cap (USDm)	211,646	Market cap (HKDm)	1,640,302
Free float (%)	25	Enterprise value (CNYm)	1,145,819
Country	Hong Kong	Sector	Wireless Telecoms
Analyst	Tucker Grinnan	Contact	+852 2822 4686

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

China Unicom (762)

- China Unicom is our least preferred Chinese operator, as it has failed to capitalize on its technology advantage in 3G
- CU has the lowest net profit margin in our coverage universe as 85% of EBITDA is consumed by D&A and net interest expense
- Underweight: TP of HKD6.7 based on blended DCF-PE

Investment thesis

We are cautious on China Unicom (CU) as we see limited near-term upside from its aggressive 3G roll-out and high execution risks in the wireline business. The consensus bull argument for CU is that its technology advantage with WCDMA (enabling earlier deployment of the iPhone than peers) will translate into market share gains among high-value subscribers. We argue that the impact of funding 3G capex and handset subsidies on-balance sheet more than offsets this advantage. CU's wireline business is under pressure as customers migrate from fixed to mobile connections. CU has a much lower quality fixed-line base and limited success with bundling.

Forecasts, business outlook

CU gives geared exposure to China 3G demand, as a superior technology and on-balance sheet capex lead to a wide range of potential outcomes. CU reported disappointing 9M 2010 results, with net profit down 65% y-o-y. EBITDA margin fell to 36.4% from 40.6% in the same period in 2009. We have given CU the benefit of the doubt on 3G, assuming 28m accounts by end 2011. However, CU may not be able to attract high-end contracts to monetize its technology advantage without the introduction of MNP.

Data growth outlook

CU has failed to capitalise on its early launch of the iPhone, with high prices and lack of WiFi leading to sluggish demand initially. We forecast a gradual increase in wireless ARPU to RMB55.8 by end 2012, but note that content suppliers highlight execution challenges with CU.

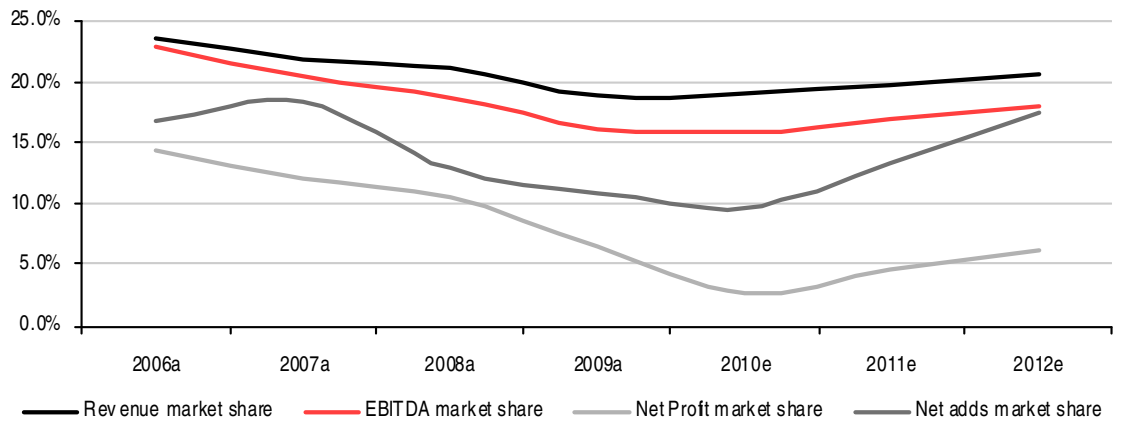
Valuation and risks

We use a blended PE-DCF methodology to fully reflect in our valuation the distortion of substantial investments in 3G capex. Our HKD6.7 target price is based on a simple average of 13x blended 2010-11 EPS, and a DCF fair value of HKD9.7. Potential catalysts include further outlays relating to handset subsidies, or indications that CU's network is struggling. The key upside risk relates to a rapid gain in market share of high-value subscribers following the introduction of MNP (a regional trial was announced in November 2010, but no national rollout has been confirmed).

HSBC

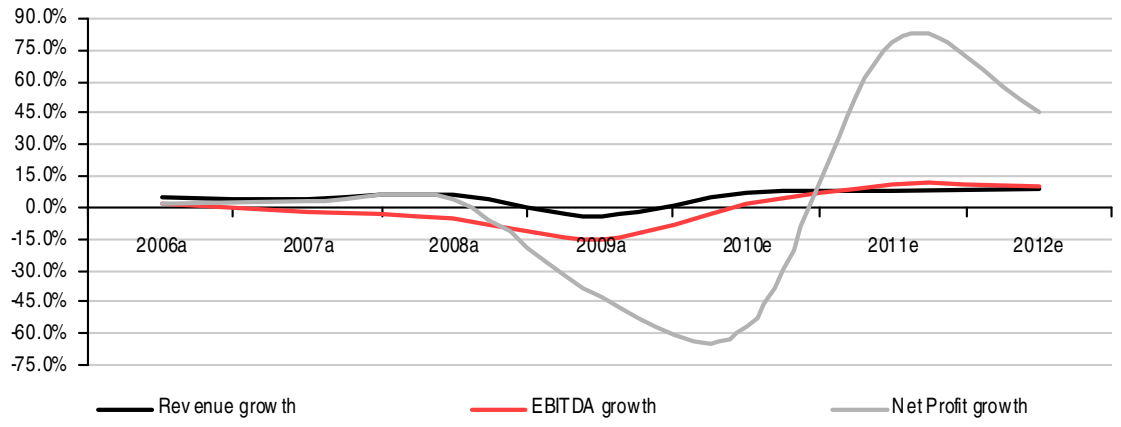
China Unicom: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



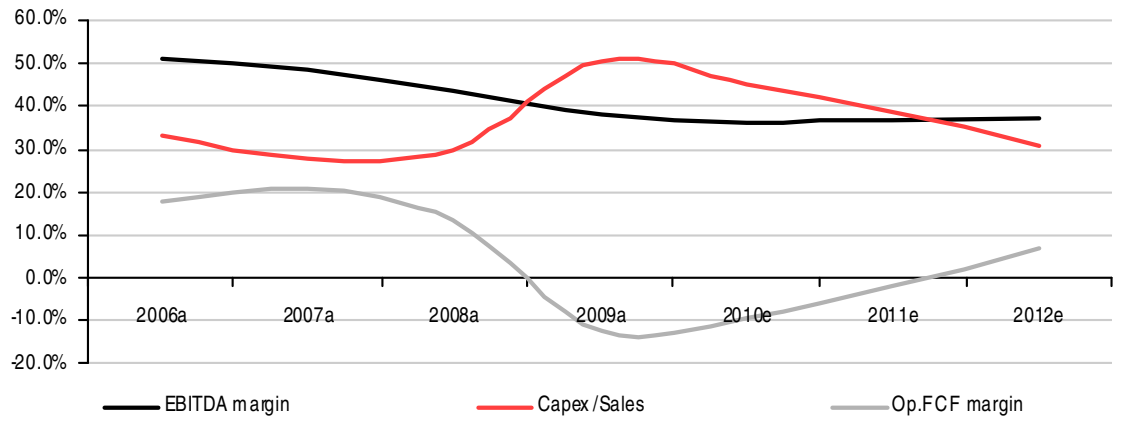
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: China Unicom

Underweight

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (CNYm)				
Revenue	153,945	165,361	180,102	196,694
EBITDA	58,608	59,529	66,322	73,491
Depreciation & amortisation	-47,587	-53,584	-55,560	-58,407
Operating profit/EBIT	11,021	5,945	10,762	15,083
Net interest	-945	-879	-1,446	-1,552
PBT	12,277	5,397	9,675	13,924
HSBC PBT	11,787	5,137	9,415	13,664
Taxation	-2,721	-1,214	-2,419	-3,481
Net profit	9,556	4,183	7,256	10,443
HSBC net profit	9,066	3,923	6,996	10,183
Cash flow summary (CNYm)				
Cash flow from operations	58,608	59,529	66,322	73,491
Capex	-78,130	-75,000	-70,000	-60,413
Cash flow from investment	-78,130	-75,000	-70,000	-60,413
Dividends	-3,770	-1,243	-2,218	-3,228
Change in net debt	44,154	27,077	10,900	-4,337
FCF equity	-23,188	-17,564	-7,543	8,045
Balance sheet summary (CNYm)				
Intangible fixed assets	19,569	19,569	19,569	19,569
Tangible fixed assets	358,886	380,302	394,742	396,747
Current assets	30,613	21,398	-11,343	-5,564
Cash & others	7,820	5,297	-28,890	-24,553
Total assets	409,068	421,269	402,968	410,752
Operating liabilities	138,272	125,837	122,200	121,759
Gross debt	71,730	96,284	72,997	72,997
Net debt	63,910	90,987	101,887	97,550
Shareholders funds	206,465	206,878	215,501	223,726
Invested capital	262,976	290,134	309,658	313,546

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	-3.7	7.4	8.9	9.2
EBITDA	-15.7	1.6	11.4	10.8
Operating profit	-48.9	-46.1	81.0	40.2
PBT	-67.0	-56.0	79.3	43.9
HSBC EPS	-42.7	-56.4	77.9	47.1
Ratios (%)				
Revenue/IC (x)	0.6	0.6	0.6	0.6
ROIC	3.5	1.7	2.7	3.6
ROE	4.4	1.9	3.3	4.6
ROA	2.7	1.3	2.2	2.9
EBITDA margin	38.1	36.0	36.8	37.4
Operating profit margin	7.2	3.6	6.0	7.7
EBITDA/net interest (x)	62.0	67.8	45.9	47.4
Net debt/equity	31.0	44.0	47.3	43.6
Net debt/EBITDA (x)	1.1	1.5	1.5	1.3
CF from operations/net debt	91.7	65.4	65.1	75.3
Per share data (CNY)				
EPS Rep (fully diluted)	0.40	0.18	0.31	0.44
HSBC EPS (fully diluted)	0.38	0.17	0.29	0.43
DPS	0.16	0.05	0.09	0.14
Book value	8.76	8.78	8.99	9.70

Key forecast drivers

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Mobile subscribers (in million	145	154	163	172
Wireless ARPU	42	45	50	56
Wireline subscribers	103	96	88	81
Broadband subscribers	39	48	55	61
Broadband ARPU	58	57	56	55

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	1.9	1.9	1.8	1.6
EV/EBITDA	4.9	5.3	4.9	4.3
EV/IC	1.1	1.1	1.0	1.0
PE*	24.8	56.9	32.0	21.7
P/Book value	1.1	1.1	1.0	1.0
FCF yield (%)	-10.5	-7.9	-3.4	3.6
Dividend yield (%)	1.7	0.6	1.0	1.5

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (HKD)	10.98	Target price (HKD)	6.70	Potent'l return (%)	-39.0

Reuters (Equity)	0762.HK	Bloomberg (Equity)	762 HK
Market cap (USDm)	33,381	Market cap (HKDm)	258,713
Free float (%)	22	Enterprise value (CNYm)	312,874
Country	Hong Kong	Sector	WIRELESS TELECOMS
Analyst	Tucker Grinnan	Contact	852 2822 4686

Price relative

Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

China Telecom (728)

- Our top China telco pick with strong management, improving execution, and a dramatic improvement in CDMA scale
- We are 40% above consensus for 2011 net income, reflecting a 12-16% improvement in operating profit margins
- Overweight: HKD5.1 TP based on target multiple of 13x 2011e

Investment thesis

We upgraded China Telecom (CT) to Overweight in August 2010 after 1H10 results, suggesting that CDMA losses would begin to decline on lower depreciation and interest expense. CT has the best management of the Chinese telcos and has shown strong execution in CDMA. The company purchased CU's CDMA assets in June 2008 and has outlined a target of 100m subs by 2012. It has pushed the vendor community to develop more low-end handsets and has aggressively bundled wireless/wireline services. CT has convinced a significant portion of high-value residential accounts to try CDMA as a second line. MNP is not built into its subscriber forecasts and CT hopes that the perception of CDMA as inferior to other technologies will narrow.

Forecasts, business outlook

Our view of the CDMA business has improved, and we are encouraged by progress with the bundling strategy in the wireline business. CT provides very limited disclosure regarding 3G, but we believe the current focus is shifting from wireless data cards to low-priced CDMA EV-DO handsets. At 9M 2010 results, EBITDA margin improved to 41.8% compared to 41.1% the previous year.

Data growth outlook

We are cautiously optimistic on the wireless data outlook for CT, as it has a high quality-high capacity EVDO network, the largest WiFi network in China, and an effective strategy selling bundled services to corporates. Content players suggest CT is more aggressive on securing deals with third party providers.

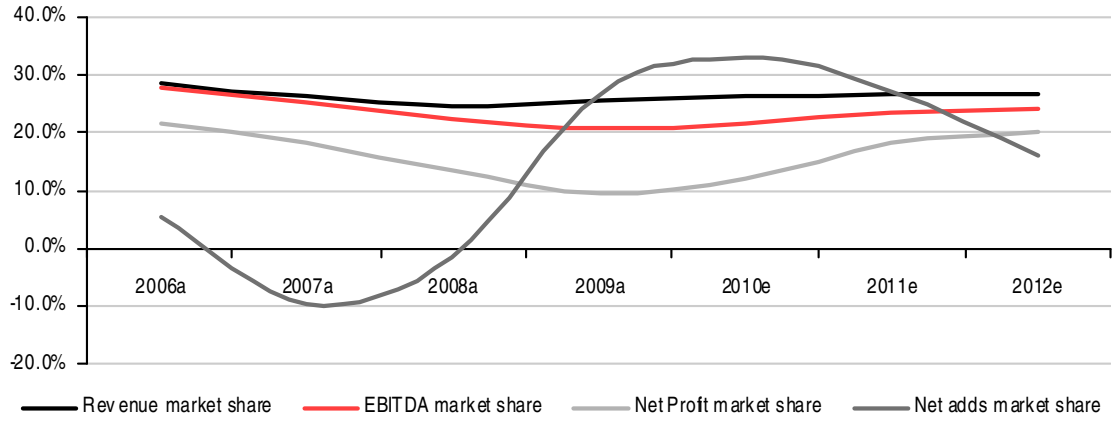
Valuation and risks

Our TP of HKD5.1 is based on a mid-cycle multiple of 13x 2011e earnings. A primary catalyst is the national rollout of MNP and a drop in CDMA handset costs or subsidies. We also note the possibility of CT launching a CDMA iPhone in 2011, following the probable launch by Verizon Wireless. The injection of provincial network businesses into the listed company (after improving profitability) is also a potential positive. The key downside risks are lower 3G handset ARPU and a drop in net subscriber addition market share.

HSBC

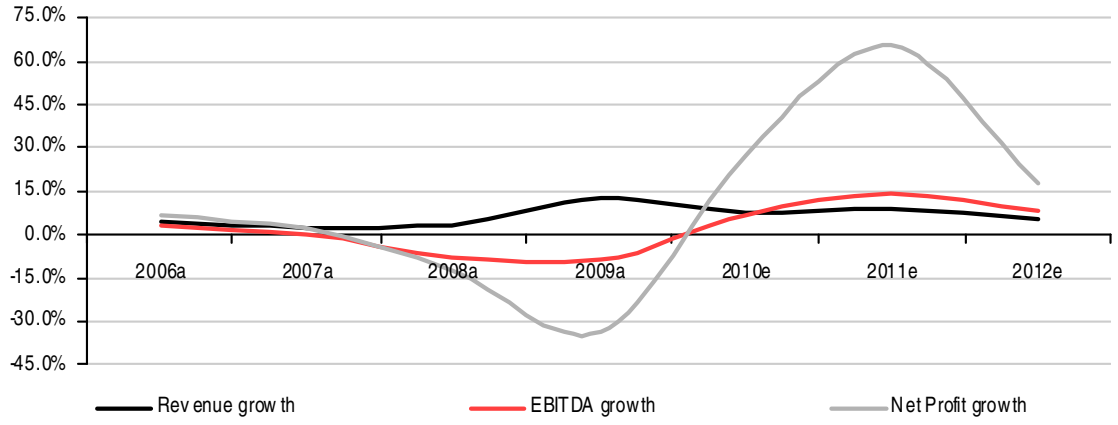
China Telecom: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



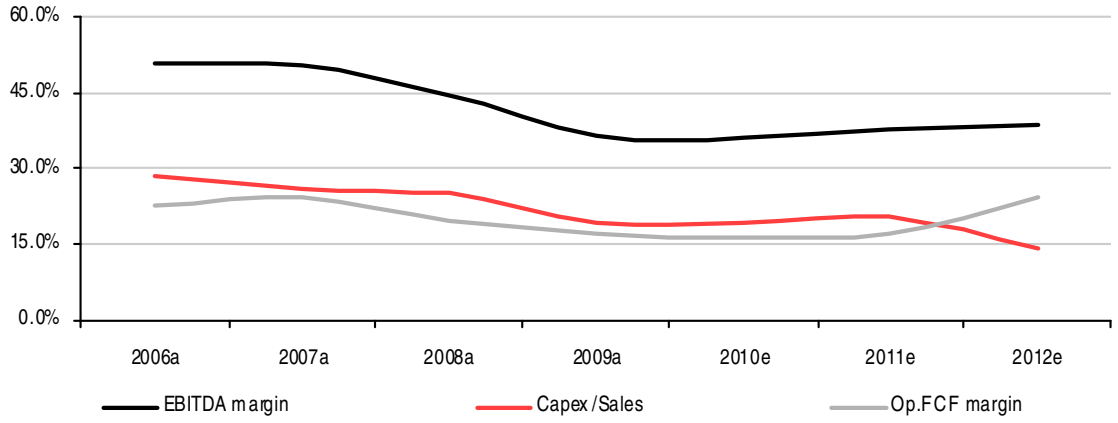
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: China Telecom

Overweight

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (CNYm)				
Revenue	209,370	225,297	244,393	257,288
EBITDA	75,654	80,684	91,659	99,030
Depreciation & amortisation	-52,243	-53,797	-52,294	-52,774
Operating profit/EBIT	23,411	26,888	39,364	46,256
Net interest	-4,375	-3,966	-2,246	-2,817
PBT	19,175	23,062	37,274	43,611
HSBC PBT	18,024	22,565	37,176	43,611
Taxation	-4,549	-5,641	-9,228	-10,689
Net profit	14,347	17,336	27,906	32,758
HSBC net profit	13,196	16,839	27,808	32,758
Cash flow summary (CNYm)				
Cash flow from operations	81,086	75,313	91,518	100,483
Capex	-40,311	-44,000	-50,000	-37,000
Cash flow from investment	-38,965	-43,677	-50,000	-37,000
Dividends	-6,493	-6,076	-6,399	-7,786
Change in net debt	-24,339	-15,688	-23,666	-42,203
FCF equity	31,851	21,706	30,045	49,977
Balance sheet summary (CNYm)				
Intangible fixed assets	25,209	20,991	18,750	16,472
Tangible fixed assets	308,734	295,308	283,134	269,603
Current assets	59,222	94,163	115,506	144,478
Cash & others	35,246	63,330	81,995	109,199
Total assets	394,884	411,796	418,848	432,148
Operating liabilities	95,371	90,477	92,666	95,757
Gross debt	105,923	118,319	113,319	98,319
Net debt	70,677	54,989	31,324	-10,880
Shareholders funds	221,732	232,992	254,500	279,471
Invested capital	262,548	256,656	242,728	225,597

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	12.1	7.6	8.5	5.3
EBITDA	-9.1	6.6	13.6	8.0
Operating profit	-20.1	14.9	46.4	17.5
PBT	10209.1	20.3	61.6	17.0
HSBC EPS	-34.2	27.6	65.1	17.8
Ratios (%)				
Revenue/IC (x)	0.8	0.9	1.0	1.1
ROIC	6.6	7.8	11.9	14.9
ROE	6.1	7.4	11.4	12.3
ROA	4.5	5.1	7.2	8.2
EBITDA margin	36.1	35.8	37.5	38.5
Operating profit margin	11.2	11.9	16.1	18.0
EBITDA/net interest (x)	17.3	20.3	40.8	35.1
Net debt/equity	31.7	23.5	12.3	-3.9
Net debt/EBITDA (x)	0.9	0.7	0.3	-0.1
CF from operations/net debt	114.7	137.0	292.2	
Per share data (CNY)				
EPS Rep (fully diluted)	0.18	0.21	0.34	0.40
HSBC EPS (fully diluted)	0.16	0.21	0.34	0.40
DPS	0.08	0.08	0.10	0.11
Book value	2.74	2.88	3.14	3.45

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	1.7	1.5	1.3	1.1
EV/EBITDA	4.7	4.2	3.4	2.7
EV/IC	1.3	1.3	1.3	1.2
PE*	21.5	16.9	10.2	8.7
P/Book value	1.3	1.2	1.1	1.0
FCF yield (%)	11.3	7.7	10.6	17.6
Dividend yield (%)	2.1	2.3	2.7	3.1

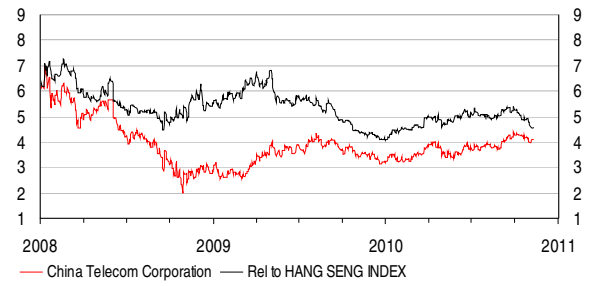
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (HKD)	4.09	Target price (HKD)	5.10	Potent'l return (%)	24.7

Reuters (Equity)	0728.HK	Bloomberg (Equity)	728 HK
Market cap (USDm)	42,710	Market cap (HKDm)	331,013
Free float (%)	17	Enterprise value (CNYm)	338,435
Country	Hong Kong	Sector	Diversified Telecoms
Analyst	Tucker Grinnan	Contact	+852 2822 4686

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

India

- The Indian telecom market has seen tariff stabilisation in the past 2-3 quarters
- We are optimistic on data growth driven by faster availability of low cost handsets; regulatory risk darkens outlook
- Long-term sector catalyst remains consolidation, which depends on regulatory clarification

Market view

India is a fiercely competitive market with an opaque regulatory structure and poor outlook for industry profitability in the near term. The Indian government's policy focus appears to have been on maximizing license-tax revenues and lower voice prices, rather then creating a transparent-stable regulatory regime. Our neutral industry stance is driven by tariffs stabilisation in the last 2-3 quarters. We are not bullish, as the market is overcrowded with c15 players and industry consolidation still c12-18 months away. Further, there is no clarity on the TRAI recommendations and as such regulatory risk darkens the sector outlook.

Market size and structure

India is one of the fastest growing markets in the world from a subscriber standpoint, but this growth is distorted by heavy use of multiple SIM cards and the human sub penetration rate in India is overstated by at least 20%. One defining characteristic of the Indian market is the limited role-success of state-owned operators, MTNL [UW(V)] and BSNL [Not Listed]. A second key defining feature is the large number of foreign players in the market as India allows foreign players to own a controlling 74% of a license. Vodafone, SingTel, Telenor, Etisalat, Maxis, and DoCoMo have all been investing in India as part of a high growth GEM wireless strategy. The third key characteristic is regulatory risk. Frequent changes in spectrum allocation policies and limited spectrum per operator are a significant negative.

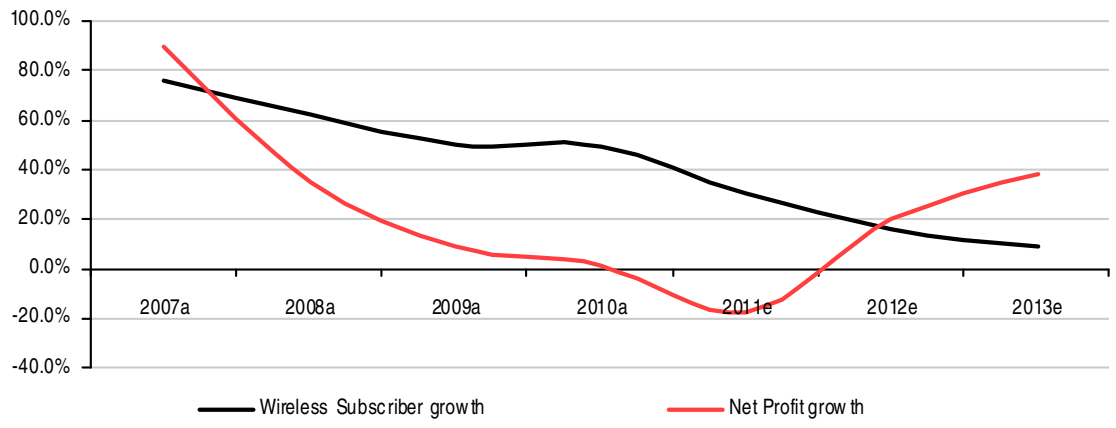
Data growth outlook

The contribution of data to wireless revenues is low, with VAS accounting for c11% of operators' revenues and only about 6% of revenues stemming from non-SMS-based VAS. However, there are encouraging trends in the penetration of internet subscribers, with the number of accounts as at June 2010 reaching 16.7m (19% y-o-y growth) and mobile data customers reaching 213.8m (68% y-o-y growth). With 3G services to be offered from end-2010, the scope for uptake in data services is inevitable. We are upbeat on data service pick-up in India driven by the ramp-up in the 3G ecosystem and availability of cheap handsets. We note that affordability will be a critical determinant of uptake and arrival of smartphones around the USD100 mark will act as a key catalyst. We estimate 16% of 2G subs to migrate to 3G by FY15.

HSBC

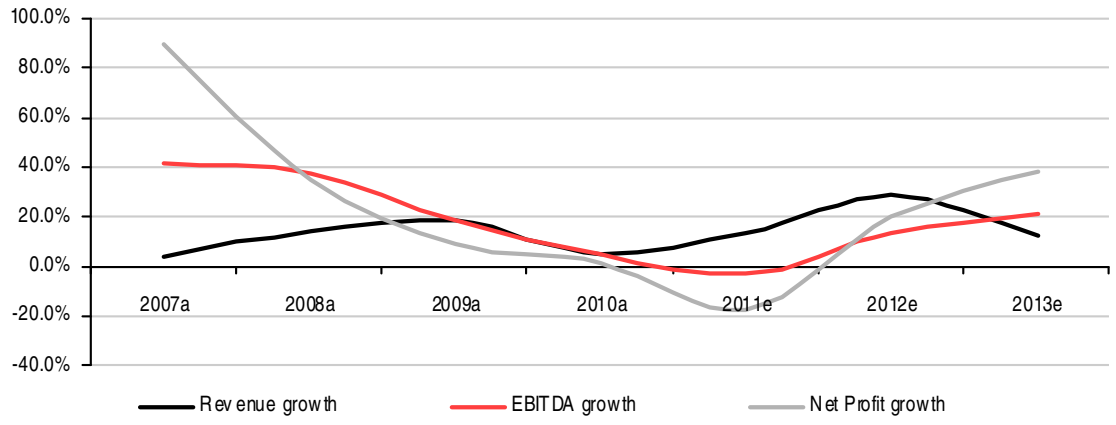
India: Market charts

Market position: Wireless subscriber growth vs. net profit growth



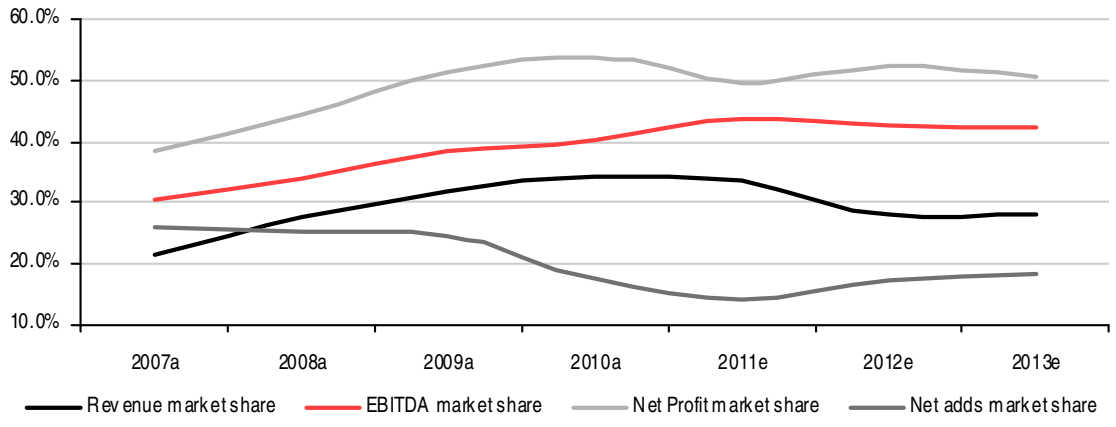
Source: Company reports, HSBC estimates

Market growth: Revenue, EBITDA and net profit (YoY change)



Source: Company reports, HSBC estimates

Market structure: Bharti's revenue, EBITDA, net profit and wireless net adds market shares (%)



Source: Company reports, HSBC estimates

HSBC

Bharti Airtel (BHARTI)

- Bharti is the best-run Indian telco, with leading revenue market share of 33%, a low cost model, and strong management team
- Given the fragmented market structure and opaque regulatory regime, Bharti struggles to leverage its scale advantage
- Neutral (V): TP of INR370, based on a blended DCF-PE

Investment thesis

Bharti is a high quality player with 900 MHz band spectrum, strong management capabilities and a proven track record of the minutes factory model. The launch of GSM services by RCOM [UW(V)] and Tata Teleservices [UW(V)] and the entrance of a range of new greenfield operators have led to irrational price competition. However, in the last 6-9 months new operators have become defensive in terms of pricing and roll-out allowing Bharti to win back c100bp revenue market share in the last quarter. In our view, Bharti is well positioned in the Indian market with the largest block of 900 MHz spectrum in the market and 3G spectrum in 13 circles covering 68% of India's population; the largest amongst all operators.

Forecasts, business outlook

We are neutral on the near-term outlook for the domestic business. ARPM over the last two quarters has started to stabilise with no aggressive new plans being launched. Moreover, Bharti has the best cost structure in the market and is committed to minimizing revenue market share losses. Our current forecasts assume ARPM will stabilize near current levels at 42 paisa per minute. We forecast a 20% drop in EPS in FY11. On a proforma basis, we estimate Zain will lead to EPS dilution of c8% in FY11 and c4% in FY12.

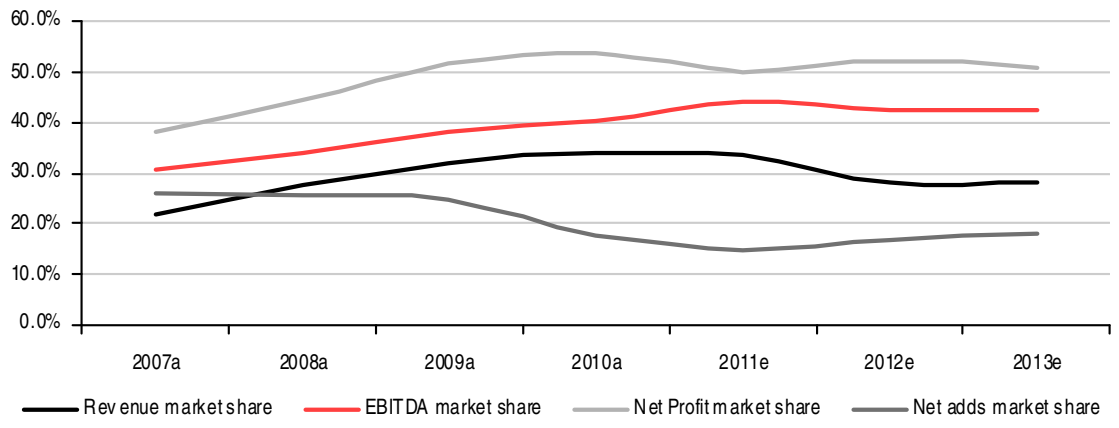
Valuation and risks

Given its access to a high end subscriber base we believe Bharti is well poised to benefit from 3G services — we estimate c15% of 2G subscribers to migrate to 3G by FY15. We value Bharti's India business at INR403 per share based on a blended DCF-PE basis and the Africa business at –INR33. Our SOTP based value for Bharti is INR370 and we are N(V) on the stock. Upside risks in our view are monetisation of towers and sector consolidation. We would view acceptance of the TRAI's recommendations as negative (estimated net impact of –INR67).

HSBC

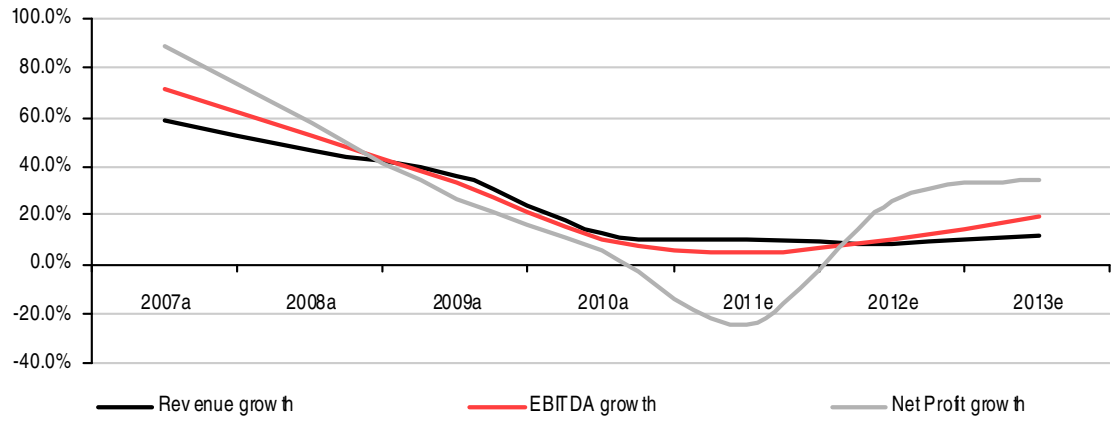
Bharti Airtel: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



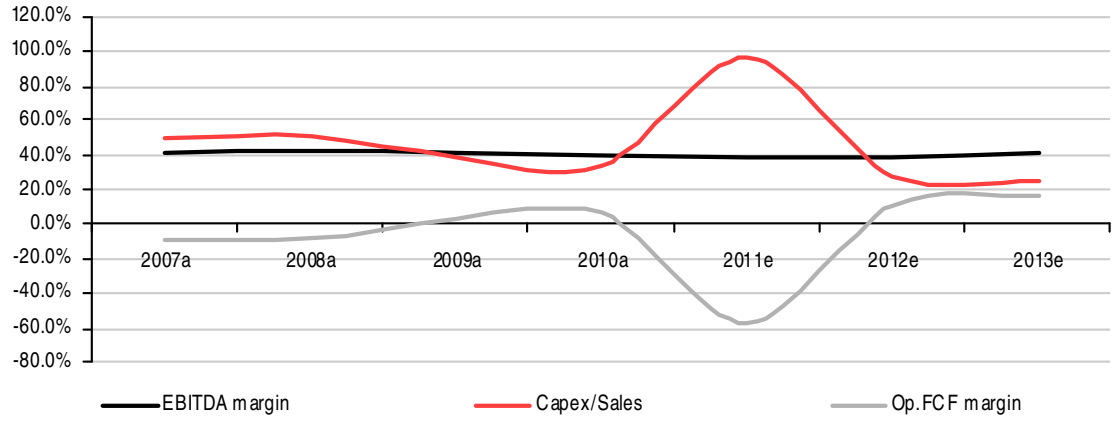
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: Bharti Airtel

Neutral (V)

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (INRm)				
Revenue	418,472	596,739	687,055	787,152
EBITDA	167,633	206,582	248,060	304,278
Depreciation & amortisation	-62,832	-103,681	-109,831	-123,799
Operating profit/EBIT	104,801	102,901	138,229	180,479
Net interest	-181	-19,198	-26,653	-27,916
PBT	105,088	84,110	111,576	152,563
HSBC PBT	105,088	84,110	111,576	152,563
Taxation	-13,453	-19,915	-23,989	-34,327
Net profit	89,765	63,875	86,067	115,741
HSBC net profit	89,765	63,875	86,067	115,741
Cash flow summary (INRm)				
Cash flow from operations	161,394	167,448	228,283	271,004
Capex	-141,535	-438,942	-154,808	-157,112
Cash flow from investment	-141,535	-438,942	-154,808	-157,112
Dividends	0	0	0	0
Change in net debt	-45,433	560,481	-46,823	-85,976
FCF equity	26,729	-288,779	48,343	88,471
Balance sheet summary (INRm)				
Intangible fixed assets	59,890	635,397	627,592	619,788
Tangible fixed assets	482,629	607,607	660,388	701,507
Current assets	137,685	130,699	143,031	154,060
Cash & others	77,685	39,212	39,212	39,212
Total assets	710,940	1,434,182	1,491,489	1,535,833
Operating liabilities	161,817	285,640	303,703	318,282
Gross debt	101,898	623,906	577,083	491,107
Net debt	24,213	584,694	537,871	451,895
Shareholders funds	421,940	492,621	578,688	694,429
Invested capital	440,702	1,048,852	1,088,096	1,117,861

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	13.2	42.6	15.1	14.6
EBITDA	10.5	23.2	20.1	22.7
Operating profit	0.7	-1.8	34.3	30.6
PBT	12.9	-20.0	32.7	36.7
HSBC EPS	6.0	-28.9	34.7	34.5
Ratios (%)				
Revenue/IC (x)	1.0	0.8	0.6	0.7
ROIC	21.3	10.3	10.1	12.8
ROE	24.7	14.0	16.1	18.2
ROA	14.5	7.4	7.5	9.3
EBITDA margin	40.1	34.6	36.1	38.7
Operating profit margin	25.0	17.2	20.1	22.9
EBITDA/net interest (x)	926.1	10.8	9.3	10.9
Net debt/equity	5.4	111.4	88.1	62.2
Net debt/EBITDA (x)	0.1	2.8	2.2	1.5
CF from operations/net debt	666.6	28.6	42.4	60.0
Per share data (INR)				
EPS Rep (fully diluted)	23.67	16.82	22.67	30.48
HSBC EPS (fully diluted)	23.67	16.82	22.67	30.48
DPS	0.00	0.00	0.00	0.00
Book value	111.26	129.74	152.41	182.89

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	2.9	3.0	2.5	2.1
EV/EBITDA	7.2	8.6	7.0	5.4
EV/IC	2.8	1.7	1.6	1.5
PE*	13.4	18.8	14.0	10.4
P/Book value	2.8	2.4	2.1	1.7
FCF yield (%)	2.2	-24.3	4.1	7.4
Dividend yield (%)	0.0	0.0	0.0	0.0

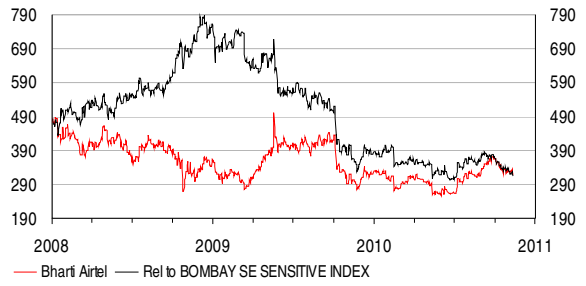
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	316.75	Target price (INR)	370.00	Potent'l return (%)	16.8

Reuters (Equity)	BRTI.BO	Bloomberg (Equity)	BHARTI IN
Market cap (USDm)	27,059	Market cap (INRm)	1,202,868
Free float (%)	32	Enterprise value (INRm)	1772404
Country	India	Sector	WIRELESS TELECOMS
Analyst	Rajiv Sharma	Contact	9122 22681239

Price relative



Source: HSBC

Note: price at close of 11 Nov 2010

HSBC

Reliance Comm (RCOM)

- Corporate actions have been a stock catalyst but we don't see any meaningful progress in the near term
- RCOM faces structural-financial challenges in monetizing its spectrum bank; we see limited upside from current levels
- Underweight (V): TP of INR170 based on blended PE-DCF

Investment thesis

We are cautious on RCOM due to balance sheet concerns as well as recent stock price performance. Our cautious stance is driven by low visibility on RCOM's ability to monetise tower assets. The GTL / RCOM potential transaction provided us with some comfort in this regard. However it has been two months since the transaction was called off and the company has not made another announcement in this regard. RCOM is the most geared major telco in India at almost 3.5x FY11e net debt/EBITDA and we expect the company to operate at high leverage levels in the near term. However, RCOM has a diverse spectrum bank, including national CDMA 800 and GSM 1800 in 14 circles and 900 MHz in eight circles and 3G spectrum in 13 service areas, which we believe will allow it to benefit from sector consolidation in the medium to long term.

Forecasts, business outlook

Weaker-than-expected 1QFY11 results have confirmed these weak operating trends for RCOM. We wee further pressure on RCOM's earnings driven by an increase in interest costs and amortization related to 3G capex. RCOM will need to repay its FCCBs in FY11-12. Without any strategic investments in the near term, the company will need to rely on short-term revolving credit to service its long-term debt obligations, which in our view raises structural risks for the stock. We forecast 280bp decline in FY11 EBITDA margin followed by another 30bp dip in FY12 on higher marketing and selling costs. Further, we forecast a 65% drop in EPS in FY11.

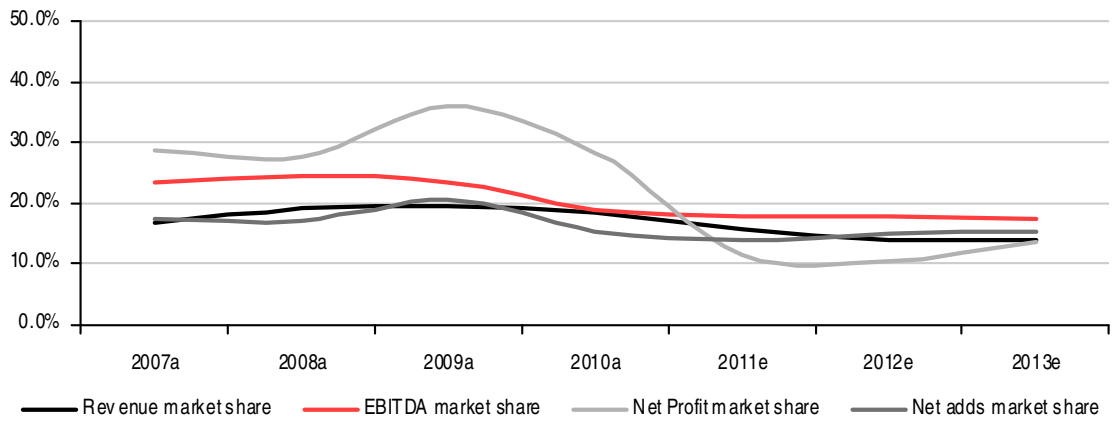
Valuation and risks

Given its access to a CDMA platform and focus of incumbents on the higher end of the market, we believe RCOM will be able to influence the data card market. We forecast 3G adoption at11% by FY15e. We value RCOM at INR170 based on a blended PE-DCF with a PE of 15x. We use a 13% COE (vs. the HSBC India baseline of 10.5%) reflecting RCOM's disclosure-balance sheet risks. In our view, ability to provide investors more clarity on corporate actions, ability to get additional 2G spectrum, and success in introducing a strategic partner or ability to monetize tower assets will positive risks for the stock.

HSBC

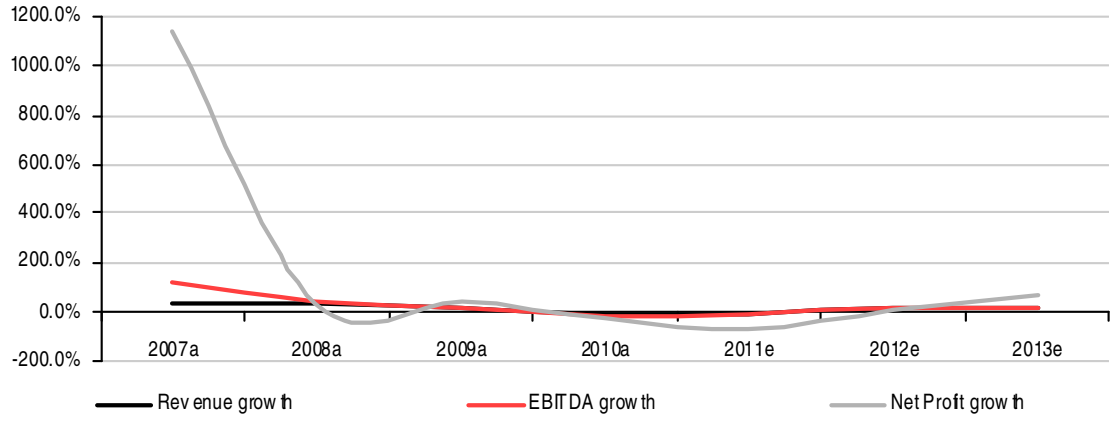
RCOM: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



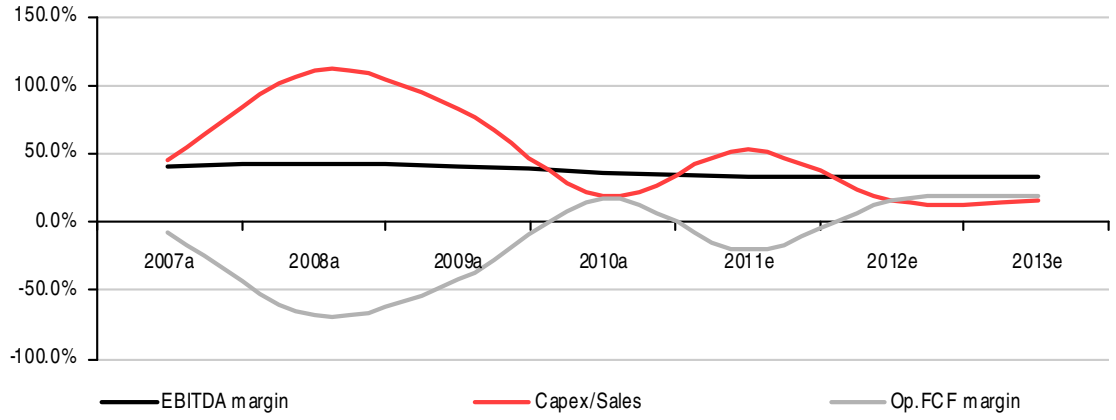
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: Reliance Communications

Underweight (V)

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (INRm)				
Revenue	222,504	216,103	250,023	285,144
EBITDA	78,870	70,529	80,665	96,006
Depreciation & amortisation	-37,466	-40,129	-45,135	-45,142
Operating profit/EBIT	41,404	30,400	35,531	50,864
Net interest	11,863	-12,272	-12,483	-11,333
PBT	52,891	18,128	23,048	39,531
HSBC PBT	53,267	18,128	23,048	39,531
Taxation	-4,454	-858	-3,918	-7,116
Net profit	47,041	15,583	17,427	30,696
HSBC net profit	47,344	15,583	17,427	30,696
Cash flow summary (INRm)				
Cash flow from operations	53,494	89,338	95,984	111,681
Capex	-41,587	-115,142	-40,593	-44,432
Cash flow from investment	-41,445	-114,560	-40,593	-44,432
Dividends	0	0	0	0
Change in net debt	-83,105	42,462	-43,283	-53,093
FCF equity	62,127	-40,969	38,990	48,800
Balance sheet summary (INRm)				
Intangible fixed assets	52,215	118,333	118,333	118,333
Tangible fixed assets	663,180	662,745	653,912	648,909
Current assets	164,152	165,286	168,667	172,109
Cash & others	48,585	48,000	48,000	48,000
Total assets	880,746	947,594	942,141	940,580
Operating liabilities	198,855	208,918	227,618	246,735
Gross debt	247,473	289,350	246,067	192,975
Net debt	198,888	241,350	198,067	144,975
Shareholders funds	387,825	401,342	418,769	449,465
Invested capital	632,107	689,446	665,294	644,617

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	-3.0	-2.9	15.7	14.0
EBITDA	-15.1	-10.6	14.4	19.0
Operating profit	-22.7	-26.6	16.9	43.2
PBT	-13.8	-65.7	27.1	71.5
HSBC EPS	-20.0	-67.3	11.8	76.1
Ratios (%)				
Revenue/IC (x)	0.3	0.3	0.4	0.4
ROIC	5.5	4.4	4.4	6.4
ROE	11.7	3.9	4.2	7.1
ROA	3.9	3.2	3.1	4.4
EBITDA margin	35.4	32.6	32.3	33.7
Operating profit margin	18.6	14.1	14.2	17.8
EBITDA/net interest (x)		5.7	6.5	8.5
Net debt/equity	50.3	58.9	46.2	31.4
Net debt/EBITDA (x)	2.5	3.4	2.5	1.5
CF from operations/net debt	26.9	37.0	48.5	77.0
Per share data (INR)				
EPS Rep (fully diluted)	22.92	7.55	8.44	14.87
HSBC EPS (fully diluted)	23.07	7.55	8.44	14.87
DPS	0.00	0.00	0.00	0.00
Book value	188.98	194.45	202.89	217.76

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	2.6	2.8	2.3	1.8
EV/EBITDA	7.3	8.7	7.1	5.4
EV/IC	0.9	0.9	0.9	0.8
PE*	7.8	24.0	21.4	12.2
P/Book value	1.0	0.9	0.9	0.8
FCF yield (%)	16.6	-11.0	10.4	13.1
Dividend yield (%)	0.0	0.0	0.0	0.0

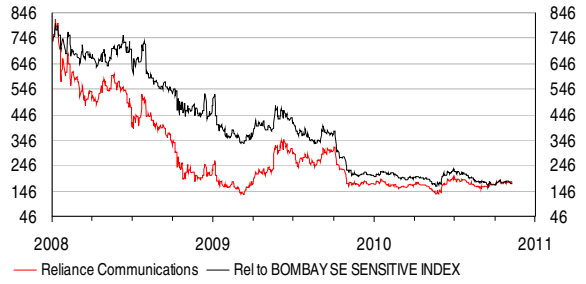
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	181.05	Target price (INR)	170.00	Potent'l return (%)	-6.1

Reuters (Equity)	RLCM.NS	Bloomberg (Equity)	RCOM IN
Market cap (USDm)	8,445	Market cap (INRm)	373,692
Free float (%)	35	Enterprise value (INRm)	615,042
Country	India	Sector	Diversified Telecoms
Analyst	Rajiv Sharma	Contact	+9122 22681239

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

Idea Cellular (IDEA)

- A well-run, pan-India player with the second biggest allocation of 900 MHz spectrum after Bharti
- Idea has been the best performing Indian telco stock over the past 12 months
- Neutral (V): TP of INR75 based on a blended DCF-PE including INR20 for stake in Indus

Investment thesis

Idea is the best-positioned second tier operator in India with excellent spectrum, a solid management team, and a good execution track record on the national rollout. Idea was one of the initial private sector players in the Indian wireless space, but failed to sustain traction due in large part to a lengthy ownership dispute. The Birla family acquired full control of the company in 2006 and has turned around the business. Idea has embarked on an aggressive campaign to build out a national footprint and has enjoyed surprisingly strong initial results in key circles, including Mumbai. The company won 3G spectrum in 11 circles that cover 75% and 80% of its subscriber and revenue base, respectively. We expect 16% of Idea's subscribers to migrate to 3G by FY15 driven by better visibility on the availability of low-cost 3G handsets and ramp-up of the overall ecosystem.

Forecasts, business outlook

We forecast a sharp 50% drop in EPS in FY11, due to a 380bp fall in EBITDA margin and surge in depreciation and interest costs driven by the 3G auction capex. Idea has been in growth mode since 2007 and has been FCF negative as sales and marketing costs-capex have surged to support the national rollout. We estimate Idea will become FCF positive in FY12 and have not built dividends into our near-term forecasts. One of the key medium-term issues with Idea will be whether it can compete head-to-head with Bharti and Vodafone for high-end customers without a significant 3G offering in metro circles.

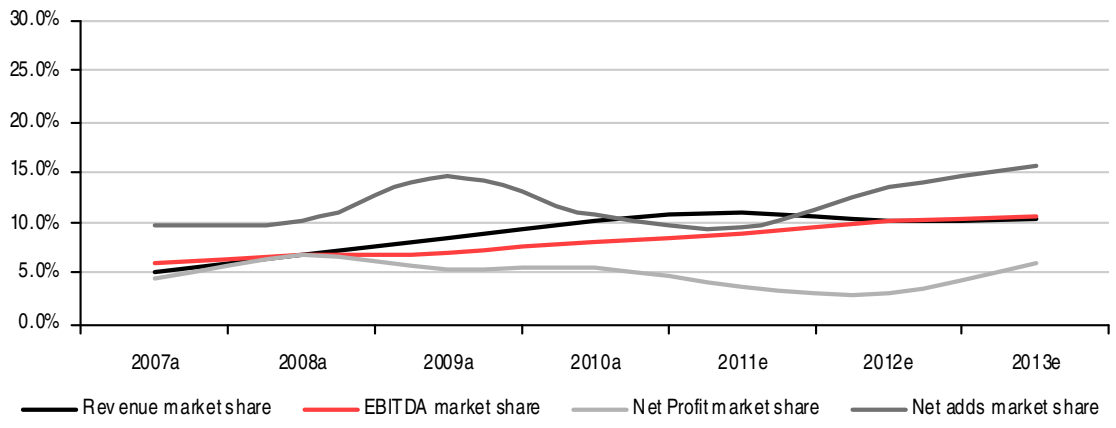
Valuation and risks

Given the fact that Idea has won 3G spectrum in markets that account for 80% of its revenues, we expect it to benefit meaningfully in 3G and also protect high-end subscribers post MNP. We estimate 3G adoption at 16% by FY15. Our TP of INR75 is based on a blended PE-DCF with INR55 for the core business and INR20 for Idea's proportional stake in the Indus tower business. We believe data revenues will be a key catalyst, given that Idea has won 3G spectrum in its strong circles. Downside risks include a sharp decline in revenue per minute and upside risks include earlier-than-estimated sector consolidation.

HSBC

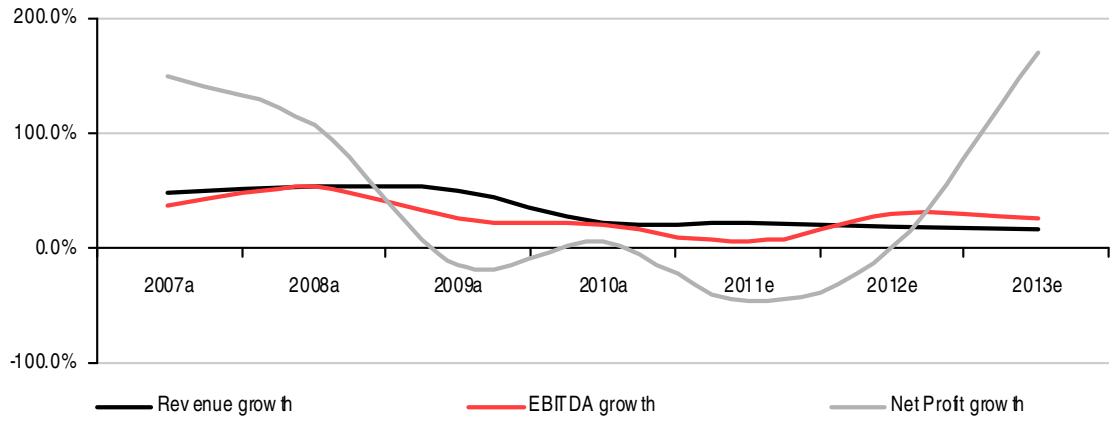
Idea Cellular: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



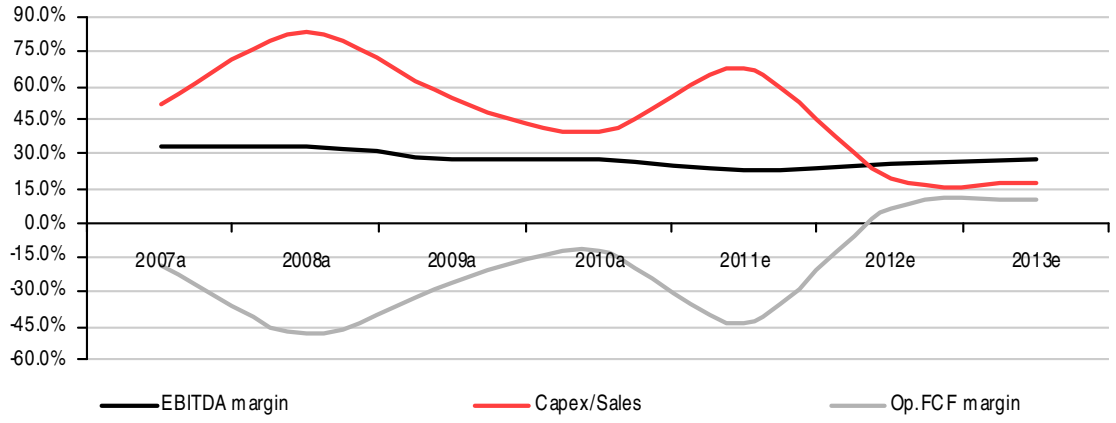
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

Financials & valuation: Idea Cellular

Neutral (V)

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (INRm)				
Revenue	124,469	152,057	181,770	212,861
EBITDA	34,071	35,945	46,581	58,628
Depreciation & amortisation	-20,148	-24,454	-30,936	-32,157
Operating profit/EBIT	13,923	11,491	15,646	26,471
Net interest	-4,005	-5,850	-9,764	-9,588
PBT	9,918	5,642	5,881	16,882
HSBC PBT	10,755	5,543	5,881	16,882
Taxation	-1,214	-490	-823	-3,208
Net profit	8,704	5,151	5,058	13,675
HSBC net profit	9,541	5,053	5,058	13,675
Cash flow summary (INRm)				
Cash flow from operations	38,351	35,557	42,844	52,961
Capex	-49,627	-102,736	-36,071	-36,919
Cash flow from investment	-27,231	-102,736	-36,071	-36,919
Dividends	0	0	0	0
Change in net debt	26,541	58,719	-6,774	-16,042
FCF equity	-21,448	-67,179	6,774	16,042
Balance sheet summary (INRm)				
Intangible fixed assets	61	61	61	61
Tangible fixed assets	187,143	265,922	271,057	275,819
Current assets	30,390	36,887	37,599	38,344
Cash & others	14,203	20,000	20,000	20,000
Total assets	217,594	302,870	308,717	314,224
Operating liabilities	32,801	39,453	47,016	54,890
Gross debt	78,593	143,109	136,335	120,293
Net debt	64,390	123,109	116,335	100,293
Shareholders funds	113,723	118,397	123,454	137,129
Invested capital	170,590	243,418	241,702	239,334

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	22.6	22.2	19.5	17.1
EBITDA	20.1	5.5	29.6	25.9
Operating profit	-2.9	-17.5	36.1	69.2
PBT	5.6	-43.1	4.2	187.1
HSBC EPS	5.7	-50.2	0.1	170.4
Ratios (%)				
Revenue/IC (x)	0.7	0.7	0.7	0.9
ROIC	2.6	5.4	6.6	9.9
ROE	7.7	4.4	4.2	10.5
ROA	5.2	4.0	4.4	6.9
EBITDA margin	27.4	23.6	25.6	27.5
Operating profit margin	11.2	7.6	8.6	12.4
EBITDA/net interest (x)	8.5	6.1	4.8	6.1
Net debt/equity	56.6	104.0	94.2	73.1
Net debt/EBITDA (x)	1.9	3.4	2.5	1.7
CF from operations/net debt	59.6	28.9	36.8	52.8
Per share data (INR)				
EPS Rep (fully diluted)	2.81	1.56	1.53	4.14
HSBC EPS (fully diluted)	3.08	1.53	1.53	4.14
DPS	0.00	0.00	0.00	0.00
Book value	36.68	35.88	37.41	41.55

Key forecast drivers

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Penetration	0	1	1	1
Market Share	0	0	0	0
ARPU (INR)	195	169	159	154
MoU (Minutes)	384	406	399	392
Revenue per Minute (RPM, INR)	0	0	0	0
EBIT Margin	0	0	0	0

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	2.4	2.3	1.9	1.6
EV/EBITDA	8.7	9.8	7.4	5.6
EV/IC	1.7	1.5	1.4	1.4
PE*	22.7	45.6	45.6	16.9
P/Book value	1.9	1.9	1.9	1.7
FCF yield (%)	-9.3	-29.1	2.9	7.0
Dividend yield (%)	0.0	0.0	0.0	0.0

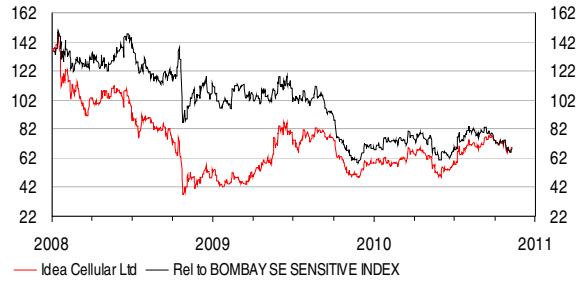
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	69.85	Target price (INR)	75.00	Potent'l return (%)	7.4

Reuters (Equity)	IDEA.BO	Bloomberg (Equity)	IDEA IN
Market cap (USDm)	5,211	Market cap (INRm)	230,589
Free float (%)	29	Enterprise value (INRm)	353,697
Country	India	Sector	Wireless Telecoms
Analyst	Rajiv Sharma	Contact	+9122 22681239

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

Tata Teleservices (TTLS)

- Lack of 3G spectrum in Mumbai and balance sheet concerns underpin our cautious view
- Profitability remains a concern; we forecast net losses till FY14
- Underweight (V): TP of INR15 based on DCF valuation

Investment thesis

Tata Teleservices (Maharashtra) (TTML), which represents a small portion of Tata's broader national wireless footprint, operates in the Mumbai and Maharashtra areas. TTML runs both CDMA and GSM network. The company in 2009 launched its GSM services in partnership with NTT DoCoMo, under the brand Tata DoCoMo. The GSM launch helped the company record a 59% jump in its subscriber base in the past year. Despite significant subscriber additions, the company's revenue market share has remained constant at 7.4%. TTML won 3G auctions in the Maharashtra circle; however, not winning 3G spectrum in Mumbai is a key negative for its GSM operations in the future. This in our view not only allows it to have any kind of scale with their 3G operations but also would mean significant 2G related capacity capex in Mumbai.

Forecasts, business outlook

We are cautious on the stock given its stretched balance sheet and margin pressures on the wireless business. Post 3G auctions its net debt/EBITDA stands at 9.8x. For FY11, we estimate TTML's revenue growth to be stable at 11%; however expect EBITDA margin to decline 570bp given poor subscriber quality. We estimate TTML will record net losses until FY14. We believe the key issue with the company is the fact that it didn't win 3G spectrum in Mumbai, which makes it difficult to improve revenue market share in the metro. Furthermore, it operates with only 4.4 MHz of GSM spectrum in Mumbai and this implies regular capacity capex for the company.

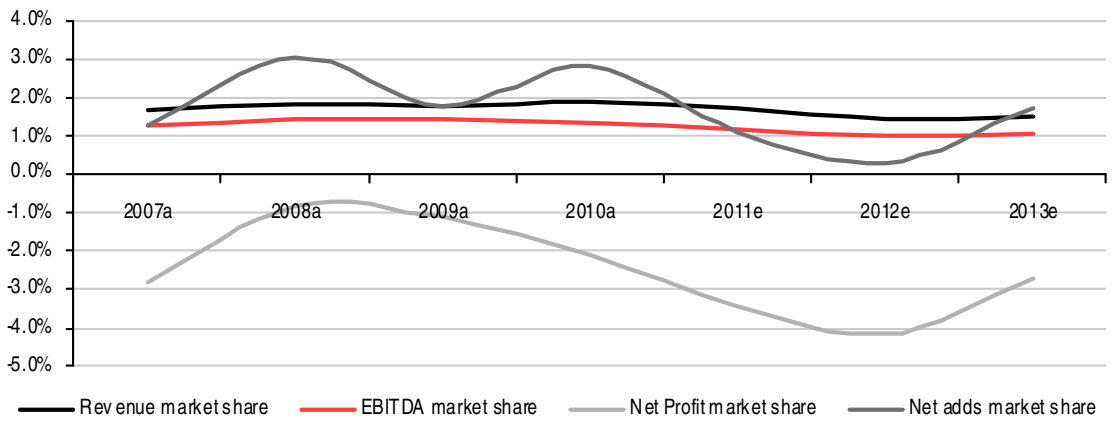
Valuation and risks

TTML has significantly benefited from data cards, as seen in the 22% contribution to wireless revenues from data cards. Given a lack of 3G spectrum in Mumbai, the company will have to heavily rely on its CDMA network to benefit from data opportunities. We value the stock at INR15 using a DCF approach. We apply a cost of equity of 12%, cost of debt of 10.5%, target debt-to-equity ratio of 15%, and a WACC of 12%. The ability to disrupt incumbents is an upside risk to our rating and estimates. Recent monetization of its tower assets will help to raise cUSD293m; the deal is likely to close this quarter. Data revenues and VAS account for c22% of the company's revenues (the highest in the industry) largely attributed to its ability to offer data cards.

HSBC

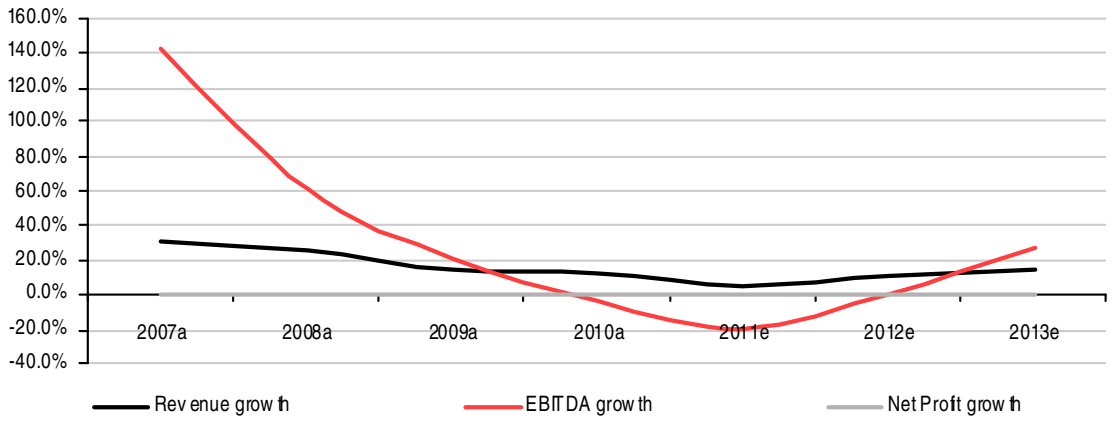
Tata Teleservices: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



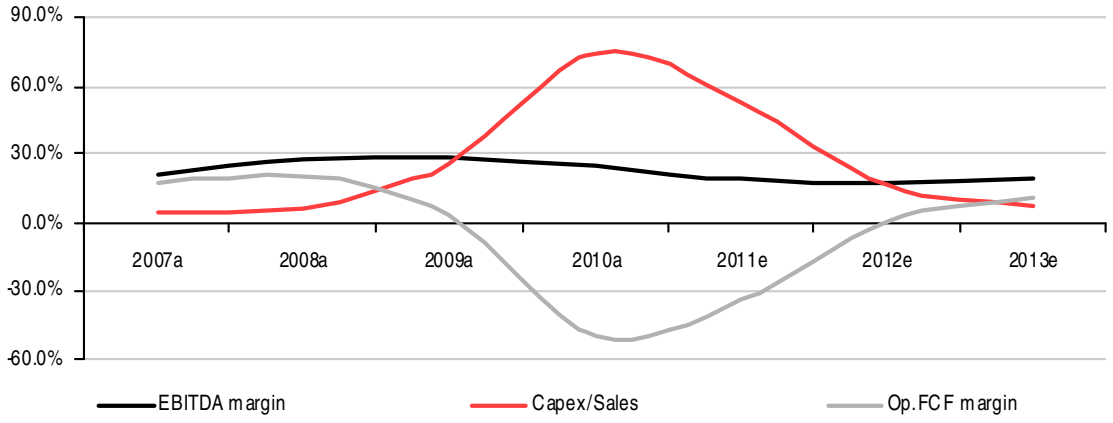
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: Tata Teleservices

Underweight (V)

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (INRm)				
Revenue	22,778	23,809	26,438	30,575
EBITDA	5,648	4,541	4,565	5,779
Depreciation & amortisation	-5,640	-6,089	-7,163	-7,512
Operating profit/EBIT	9	-1,548	-2,598	-1,733
Net interest	-3,505	-3,163	-4,270	-4,523
PBT	-3,180	2,076	-6,868	-6,255
HSBC PBT	-3,497	-4,669	-6,868	-6,255
Taxation	0	-76	0	0
Net profit	-3,180	2,000	-6,868	-6,255
HSBC net profit	-3,497	-4,745	-6,868	-6,255
Cash flow summary (INRm)				
Cash flow from operations	6,570	566	1,323	2,961
Capex	-16,926	-12,616	-4,356	-2,400
Cash flow from investment	-16,926	-12,616	-4,356	-2,400
Dividends	0	0	0	0
Change in net debt	6,002	5,383	3,033	-561
FCF equity	-10,401	-12,049	-3,033	561
Balance sheet summary (INRm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	41,559	48,086	45,278	40,167
Current assets	6,530	6,658	6,948	7,414
Cash & others	230	400	400	400
Total assets	48,089	54,744	52,226	47,581
Operating liabilities	15,529	14,753	16,071	18,242
Gross debt	39,400	44,953	47,985	47,424
Net debt	39,170	44,553	47,585	47,024
Shareholders funds	-6,967	-5,088	-11,957	-18,212
Invested capital	32,329	39,591	35,755	28,939

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	11.3	4.5	11.0	15.6
EBITDA	-3.9	-19.6	0.5	26.6
Operating profit	-99.3	-18316.6		
PBT			-430.9	
HSBC EPS				
Ratios (%)				
Revenue/IC (x)	0.7	0.7	0.7	0.9
ROIC	0.0	-3.9	-5.2	-3.3
ROE	65.0	78.7	80.6	41.5
ROA	0.7	10.1	-4.9	-3.5
EBITDA margin	24.8	19.1	17.3	18.9
Operating profit margin	0.0	-6.5	-9.8	-5.7
EBITDA/net interest (x)	1.6	1.4	1.1	1.3
Net debt/equity	0.0	0.0	0.0	0.0
Net debt/EBITDA (x)	6.9	9.8	10.4	8.1
CF from operations/net debt	16.8	1.3	2.8	6.3
Per share data (INR)				
EPS Rep (fully diluted)	-1.68	1.05	-3.62	-3.30
HSBC EPS (fully diluted)	-1.84	-2.50	-3.62	-3.30
DPS	0.00	0.00	0.00	0.00
Book value	-3.67	-2.68	-6.30	-9.60

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	3.7	3.7	3.5	3.0
EV/EBITDA	14.8	19.5	20.1	15.8
EV/IC	2.6	2.2	2.6	3.2
PE*				
P/Book value				
FCF yield (%)	-23.5	-27.3	-6.9	1.3
Dividend yield (%)	0.0	0.0	0.0	0.0

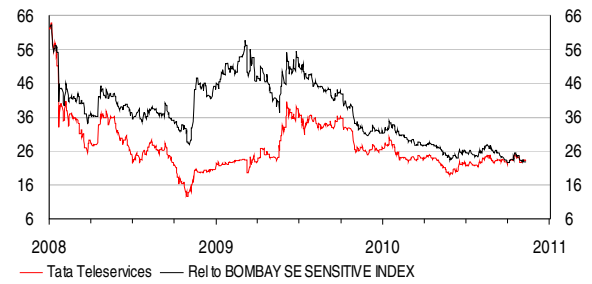
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	23.30	Target price (INR)	15.00	Potent'l return (%)	-35.6

Reuters (Equity)	TTML.BO	Bloomberg (Equity)	TTLS IN
Market cap (USDm)	999	Market cap (INRm)	44,205
Free float (%)		Enterprise value (INRm)	88,757
Country	India	Sector	Wireless Telecoms
Analyst	Rajiv Sharma	Contact	+9122 22681239

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

MTNL (MTNL)

- We don't see MTNL benefiting meaningfully from 3G services; mismatch between data strategy and subscriber quality
- Operational issues offset advantages of having good quality spectrum and getting 3G spectrum ahead of private players
- Underweight (V): TP of INR59 based on 0.4x FY2011e PB

Investment thesis

MTNL is a PSU telecom player, with operations in Delhi and Mumbai. Despite having 12.4 MHz spectrum in the 900 MHz band in a spectrum constrained market, MTNL's operational performance has been poor compared to the private operators. This can be attributed to the absence of a longer-term strategy and execution, as well as its state-owned enterprise culture. There has been no upside from early 3G roll-out and do not believe there is a 3G business case for the company. Our cautious view is also driven by MTNL's bloated employee cost structure and rising competition in the wireless business. The company has floated a roaming agreement wherein two operators can use its 3G spectrum for a price and offer 3G services in Delhi and Mumbai, an indication of its inability to leverage first mover advantage in getting 3G spectrum.

Forecasts, business outlook

We estimate MTNL's wireless revenues will remain low in FY11-12, driven by lack of marketing and poor subscriber retention. The company reported EBITDA margin of -92% in FY10, based on high employee costs and one-offs. However, we expect employee costs to normalize in FY11. The company paid cUSD2.5bn for 3G and BWA spectrum in Delhi and Mumbai – we view these investments as value destructive. Despite getting 3G and BWA spectrum two years in advance of the private operators, MTNL has failed to use the valuable spectrum to its advantage and has not benefited from early roll-out of 3G service, given poor subscriber quality and strong competition from private players in Delhi and Mumbai.

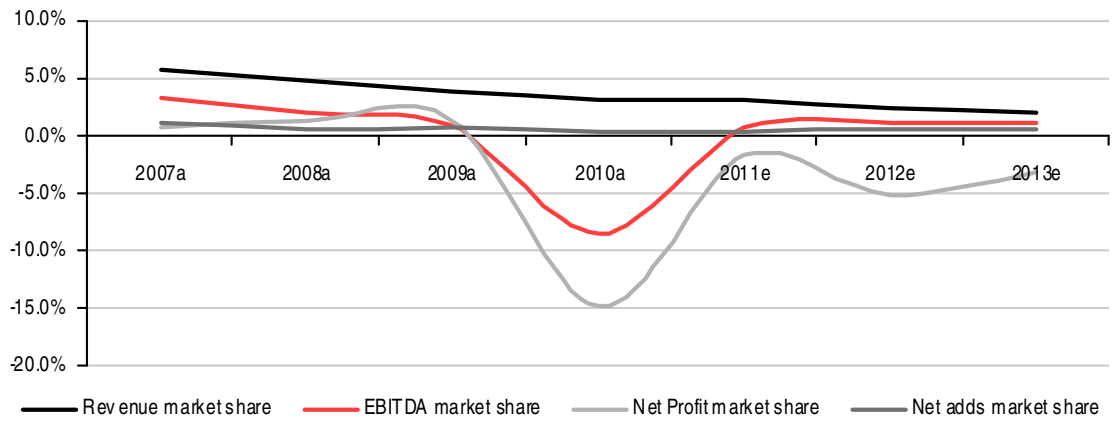
Valuation and risks

We value MTNL at INR59 based on 0.4x FY11e PB. We view the company's ability to monetize fixed-line assets and quality 900 MHz spectrum in the top-two metros of Delhi and Mumbai as an upside risk to our rating and estimates. We note that MTNL has some attractive fixed-line assets and good-quality 900 MHz spectrum in the metros, but its public sector status prevents the company from unlocking value in these assets. A merger with sister company BSNL would be a longer-term catalyst and key upside risk, but this may not be possible before listing of BSNL.

HSBC

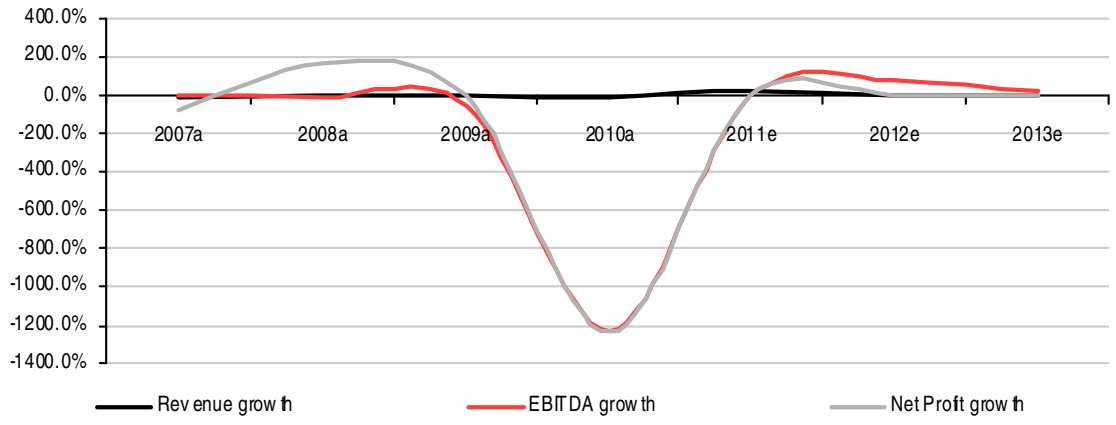
MTNL: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



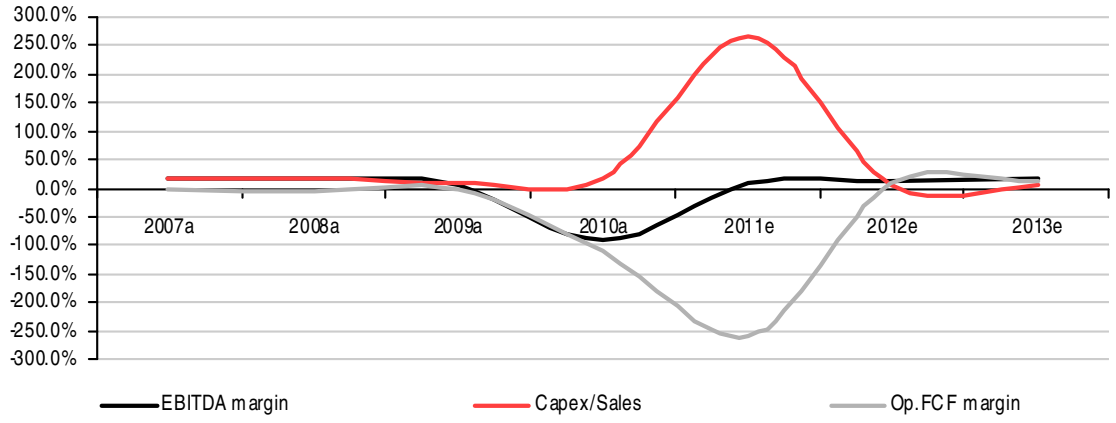
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: MTNL

Underweight (V)

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (INRm)				
Revenue	37,704	42,753	42,346	42,964
EBITDA	-34,780	3,075	5,592	6,834
Depreciation & amortisation	-7,285	-11,048	-11,137	-11,288
Operating profit/EBIT	-42,066	-7,973	-5,545	-4,455
Net interest	11,343	937	-1,549	-1,530
PBT	-31,054	-7,036	-7,094	-5,985
HSBC PBT	-30,722	-7,036	-7,094	-5,985
Taxation	5,905	4,581	-1,369	-1,155
Net profit	-25,149	-2,455	-8,463	-7,140
HSBC net profit	-24,817	-2,455	-8,463	-7,140
Cash flow summary (INRm)				
Cash flow from operations	-15,619	9,228	3,034	4,397
Capex	-7,023	-113,014	-2,081	-2,064
Cash flow from investment	-7,023	-113,014	-2,081	-2,064
Dividends	0	0	0	0
Change in net debt	22,642	103,787	-953	-2,332
FCF equity	-22,310	-103,787	953	2,332
Balance sheet summary (INRm)				
Intangible fixed assets	0	105,431	99,882	94,333
Tangible fixed assets	72,081	68,616	65,108	61,433
Current assets	132,865	110,084	109,917	109,802
Cash & others	25,486	3,000	3,000	3,000
Total assets	210,563	289,749	280,525	271,186
Operating liabilities	49,555	49,895	50,087	50,220
Gross debt	100	81,401	80,448	78,115
Net debt	-25,386	78,401	77,448	75,115
Shareholders funds	95,445	92,990	84,527	77,387
Invested capital	129,905	231,237	221,820	212,348

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	-17.6	13.4	-1.0	1.5
EBITDA	-1223.8		81.9	22.2
Operating profit				
PBT	-1102.6			
HSBC EPS	-1239.0			
Ratios (%)				
Revenue/IC (x)	0.3	0.2	0.2	0.2
ROIC	-25.9	-0.5	0.0	0.6
ROE	-23.0	-2.6	-9.5	-8.8
ROA	-11.3	-1.0	-2.3	-1.9
EBITDA margin	-92.2	7.2	13.2	15.9
Operating profit margin	-111.6	-18.6	-13.1	-10.4
EBITDA/net interest (x)	3.1		3.6	4.5
Net debt/equity	-26.6	84.3	91.6	97.1
Net debt/EBITDA (x)	0.7	25.5	13.8	11.0
CF from operations/net debt		11.8	3.9	5.9
Per share data (INR)				
EPS Rep (fully diluted)	-39.92	-3.90	-13.43	-11.33
HSBC EPS (fully diluted)	-39.39	-3.90	-13.43	-11.33
DPS	0.00	0.00	0.00	0.00
Book value	151.50	147.60	134.17	122.84

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	0.7	3.0	2.9	2.8
EV/EBITDA		41.7	22.2	17.7
EV/IC	0.2	0.6	0.6	0.6
PE*				
P/Book value	0.4	0.5	0.5	0.5
FCF yield (%)	-43.6	-208.5	2.0	5.1
Dividend yield (%)	0.0	0.0	0.0	0.0

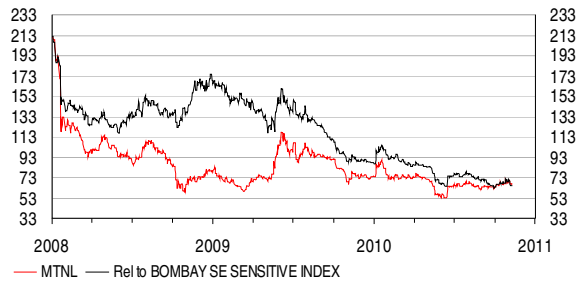
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	67.20	Target price (INR)	59.00	Potent'l return (%)	-12.2

Reuters (Equity)	MTNL.NS	Bloomberg (Equity)	MTNL IN
Market cap (USDm)	957	Market cap (INRm)	42,336
Free float (%)		Enterprise value (INRm)	128,175
Country	India	Sector	Diversified Telecoms
Analyst	Rajiv Sharma	Contact	+9122 22681239

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

Indonesia

- We forecast the Indonesia telco market will slow to a 6% revenue CAGR in FY10-13 from 15% in FY04-09
- A rational competitive environment leaves room for earnings growth of 16% over FY10-13e
- Wireless and fixed broadband are hampered by device prices and household affordability

Market view

We are relatively sanguine on the medium-term revenue growth prospects of the Indonesian telco market given the experience in Southeast Asia counterparts Thailand and Philippines during similar levels of market penetration. We forecast the Indonesia telco market will slow to a 6% revenue CAGR in FY10-13 from 15% in FY04-09. We acknowledge that mobile price competition has softened to a large extent among the big-three wireless players, and as such EBITDA and profits will provide a healthier 6% and 16% growth clip over a similar forecast period. We see emerging growth opportunities in both the fixed and mobile broadband market but we remain cautious given entry cost barriers for smartphones and PCs for the broader population.

Market size and structure

At face value, the wireless market is highly overcrowded with 10 operators operating both in GSM and CDMA. However, we note that the top-three operators control c89% of the market and that their grip on such remains fairly strong. XL Axiata (OW) has been the earnings and share price performer of the three large operators, posting double-digit revenue and earnings growth. PT Telkom (N) continues to dominate the fixed line, wireless and broadband subscriber market share space but its high base of revenues garnered from such dominance coupled with the secular decline in traditional fixed line services is stifling healthier growth rates. We remain relatively less enthusiastic about recent news flow of the potential consolidation in the fixed wireless market. A fourth, stronger player in the market could potentially increase market competitive intensity.

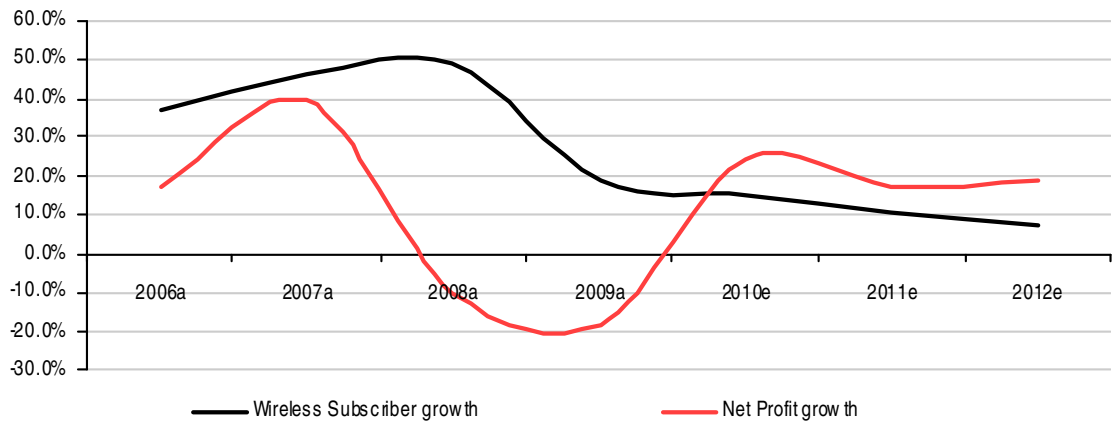
Data growth outlook

With PC penetration at c2% in 2008 and Indonesian operators not providing handset subsidies in the prepaid market, the key to a fixed or WBB penetration story will have to be the price of the access devices. The industry is moving towards addressing the opportunity of 'small screen' (i.e. handset) WBB access versus 'big screen' (i.e. laptops and PCs) and over the next 6-12 months, we expect more service launches in the space with more aggressive pricing and benefits once 3G handset pricing points fall in place.

HSBC

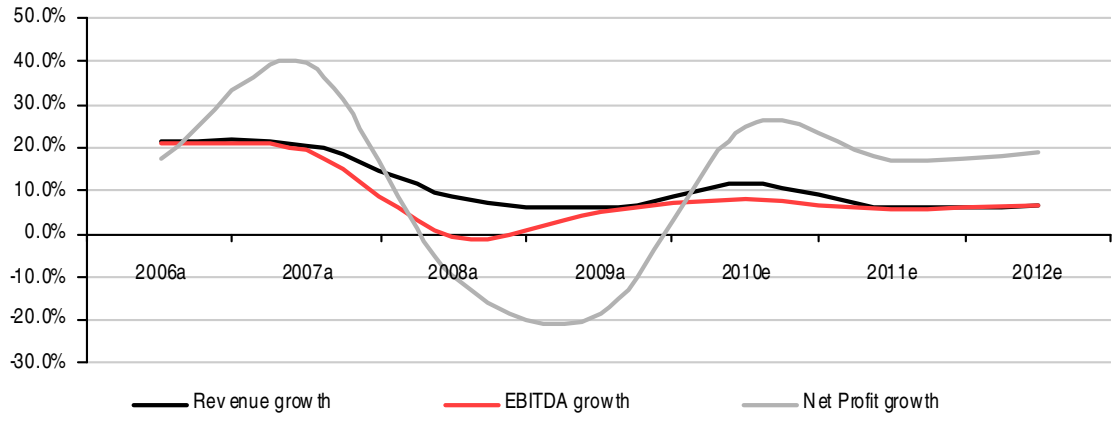
Indonesia: Market charts

Market position: Wireless subscriber growth vs. net profit growth



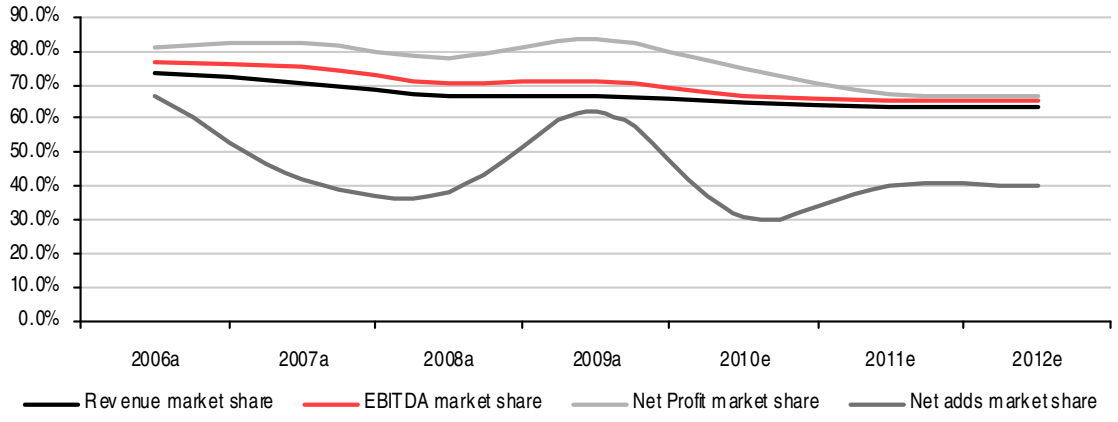
Source: Company reports, HSBC estimates

Market growth: Revenue, EBITDA and net profit (YoY change)



Source: Company reports, HSBC estimates

Market structure: Telkom's revenue, EBITDA, net profit and wireless net adds market shares (%)



Source: Company reports, HSBC estimates

HSBC

PT Telkom (TLKM)

- Dominant incumbent benefiting from lull in competitive environment but medium term to be challenged by high penetration, high base effect and fixed business decline
- A more aggressive capital management policy would provide a better balance of growth and yield
- Neutral: IDR9,600 TP based on DCF valuation methodology

Investment thesis

Telkom has underperformed the market by 36% y-t-d despite a relatively rational competitive environment today. The more direct exposure of its two main mobile competitors to the industry recovery is one reason. The high base effect of its 65% mobile subsidiary Telkomsel and continued slowdown of its traditional fixed-line businesses, which are muting the gains of the broadband initiatives, are the more fundamental drags on the share price, in our view.

Forecasts, business outlook

We believe Telkom is benefiting from the lull in the competitive environment but medium-term growth will be challenged by high mobile penetration, high base effect and decline of the fixed-line business. We forecast the recovery to pick up pace gradually and going into 2011, expect Telkom to deliver c4% growth in revenue and EBITDA and a 6% increase in earnings. Implicit to such forecasts is for current rational conditions to prevail.

Valuation and risks

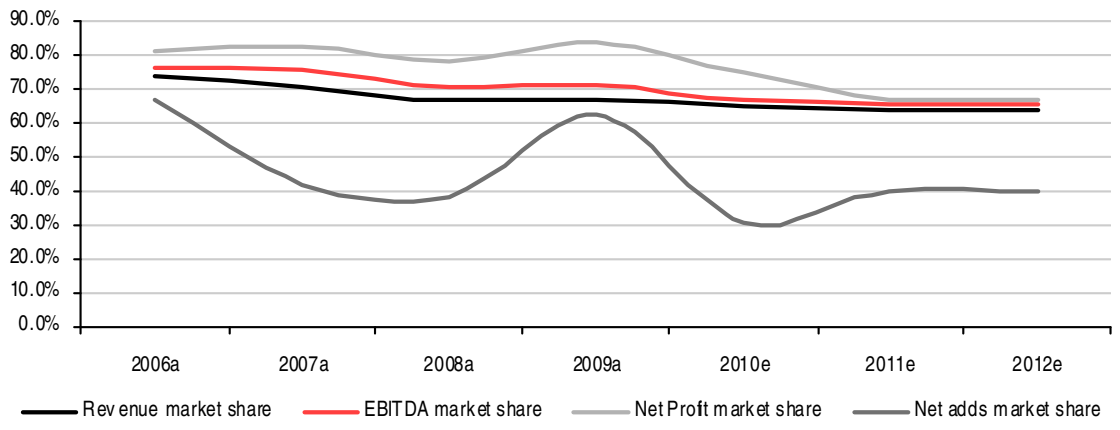
Telkom management has talked about cross bundling synergies but we have not yet seen any major execution; save for a joint package of fixed broadband ('Speedy'), wireless broadband ('Telkomsel Flash') and pay TV ('Yes TV') last year. A potential Telkomflexi ('Flexi') and Bakrie Tel (NR) fixed wireless CDMA merger entails both value creation and cannibalisation issues for Telkom. A merged CDMA entity could improve the economies of scale for Flexi as a standalone business but the overall impact to Telkom remains uncertain due to possible mobile revenue cannibalization at Telkomsel.

We value Telkom on a DCF basis with a COE of 13.8% to arrive at our target price of IDR9,600 with a Neutral rating. The downside risk is the re-emergence of irrational competition in the mobile space. Upside potential could be unlocked depending on the outcome of tower business sale plans and/or a significantly improved payout policy. Likewise, fund flows attracted by its now stable business prospects and underperformance are an upside risk.

HSBC

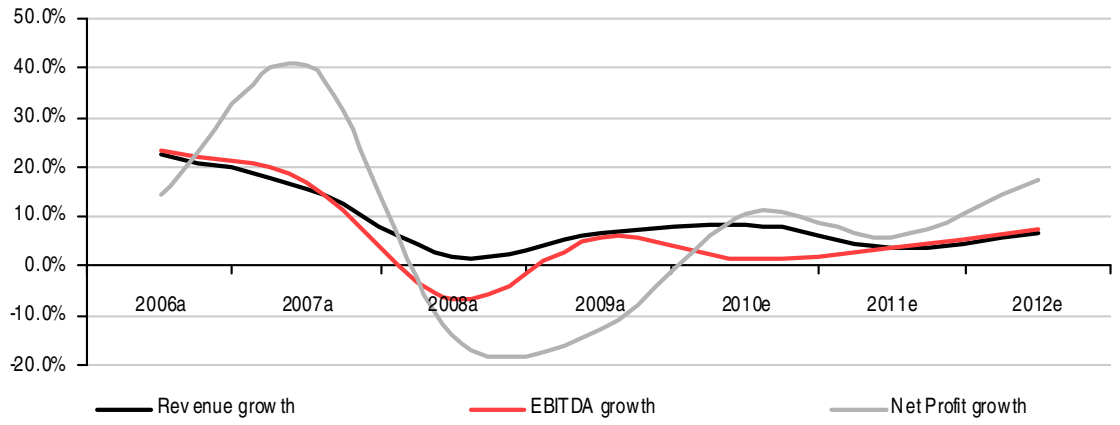
PT Telkom: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



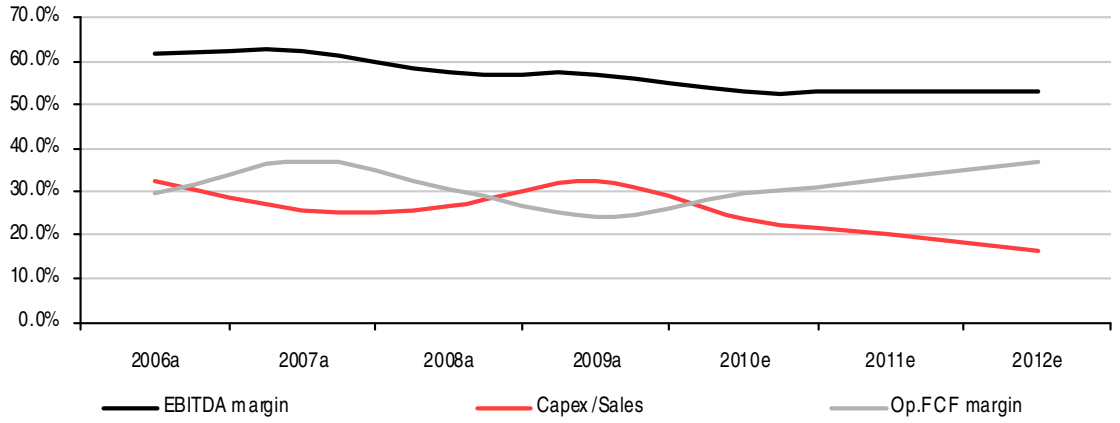
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: PT Telkom

Neutral

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (IDRb)				
Revenue	64,597	70,016	72,759	77,560
EBITDA	36,560	37,057	38,457	41,263
Depreciation & amortisation	-13,956	-14,518	-15,020	-14,742
Operating profit/EBIT	22,603	22,538	23,437	26,521
Net interest	-1,538	-1,591	-1,650	-1,468
PBT	22,349	21,387	21,798	25,052
HSBC PBT	21,065	20,948	21,787	25,052
Taxation	-6,373	-5,635	-5,761	-6,513
Net profit	11,332	11,351	11,607	13,603
HSBC net profit	9,820	10,868	11,478	13,483
Cash flow summary (IDRb)				
Cash flow from operations	26,537	26,208	27,265	30,017
Capex	-20,993	-16,557	-14,563	-12,896
Cash flow from investment	-20,993	-16,557	-14,563	-12,896
Dividends	-6,365	-7,064	-7,689	-6,687
Change in net debt	2,333	-1,743	-5,025	-10,433
FCF equity	4,552	12,125	16,427	20,887
Balance sheet summary (IDRb)				
Intangible fixed assets	2,428	2,039	2,029	2,029
Tangible fixed assets	76,420	77,158	76,700	74,855
Current assets	16,186	16,404	21,401	28,432
Cash & others	7,805	8,016	13,030	20,036
Total assets	97,560	99,084	103,614	108,799
Operating liabilities	25,101	23,419	23,345	23,872
Gross debt	22,131	20,598	20,588	17,161
Net debt	14,325	12,582	7,558	-2,875
Shareholders funds	38,990	38,072	42,991	49,112
Invested capital	62,128	64,167	63,756	61,408

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	6.4	8.4	3.9	6.6
EBITDA	5.6	1.4	3.8	7.3
Operating profit	1.3	-0.3	4.0	13.2
PBT	10.0	-4.3	1.9	14.9
HSBC EPS	-12.3	10.7	5.6	17.5
Ratios (%)				
Revenue/IC (x)	1.1	1.1	1.1	1.2
ROIC	27.9	26.3	27.0	31.4
ROE	26.8	28.2	28.3	29.3
ROA	18.4	17.5	17.4	18.9
EBITDA margin	56.6	52.9	52.9	53.2
Operating profit margin	35.0	32.2	32.2	34.2
EBITDA/net interest (x)	23.8	23.3	23.3	28.1
Net debt/equity	28.7	25.1	13.6	-4.6
Net debt/EBITDA (x)	0.4	0.3	0.2	-0.1
CF from operations/net debt	185.2	208.3	360.8	
Per share data (IDR)				
EPS Rep (fully diluted)	576.03	577.11	590.10	691.61
HSBC EPS (fully diluted)	499.15	552.52	583.56	685.49
DPS	288.00	340.00	340.00	380.39
Book value	1981.92	1935.61	2185.72	2496.95

Key forecast drivers

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Mobile ARPU (IDR)	47,163	40,792	38,372	38,637
Fixed wireless ARPU (IDR)	19,640	15,263	13,140	12,859
Mobile MoU	148	119	119	116
EBITDA Margin (%)	54	51	51	51
Capex/Sales (%)	31	23	19	16

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	3.7	3.4	3.2	2.9
EV/EBITDA	6.6	6.4	6.0	5.4
EV/IC	3.9	3.7	3.6	3.6
PE*	16.3	14.8	14.0	11.9
P/Book value	4.1	4.2	3.7	3.3
FCF yield (%)	2.0	5.4	7.3	9.3
Dividend yield (%)	3.5	4.2	4.2	4.7

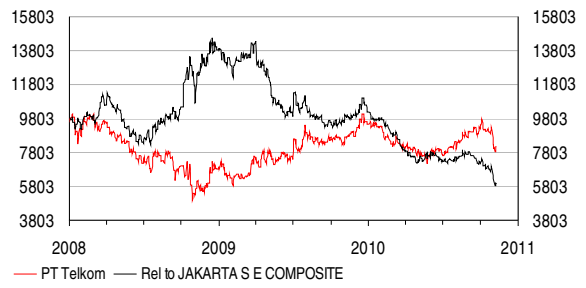
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (IDR)	8,150	Target price (IDR)	9,600	Potent'l return (%)	17.8

Reuters (Equity)	TLKM.JK	Bloomberg (Equity)	TLKM IJ
Market cap (USDm)	18,451	Market cap (IDRb)	164,304
Free float (%)	48	Enterprise value (IDRb)	237,151
Country	Indonesia	Sector	Diversified Telecoms
Analyst	Luis Hilado	Contact	+65 6239 0656

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

Indosat (ISAT)

- Recent stock re-rating has captured a V-shaped operational recovery for 2010-11
- We believe the rebound will hit natural limits of high market penetration and proactive and reactive competitors
- Underweight: TP of IDR5,800 based on DCF valuation

Investment thesis

Since unveiling new senior management team members and going on a global road show after its quarterly results, Indosat's share price has seen a rebound on both an absolute and relative basis. In our view, the top-down theme of a prevailing rational competitive environment and the bottom-up 'value' marketing strategy have enabled the share price to react ahead of the sharp earnings recovery. Part of the robust rebound vs. competitors is due to being hit the worst in the post-tariff war environment.

Forecasts, business outlook

We expect the earnings recovery to sustain in 2011-12 with 106%/34% y-o-y recurring profit growth on just 5-6% consolidated revenue growth as we anticipate a slowdown in industry revenue generation with the penetration into lower income market segments. This, coupled with active competition, should tighten up industry growth prospects in future years. Likewise, bouts of competitive heat could erupt as Indosat attempts to fend off XL's move towards a No. 2 position.

Valuation and risks

Management has eyed the WBB market as a potential new source to mine but the key challenge in the medium term remains access device pricing, whether small screen (smartphones) or big screen (laptops).

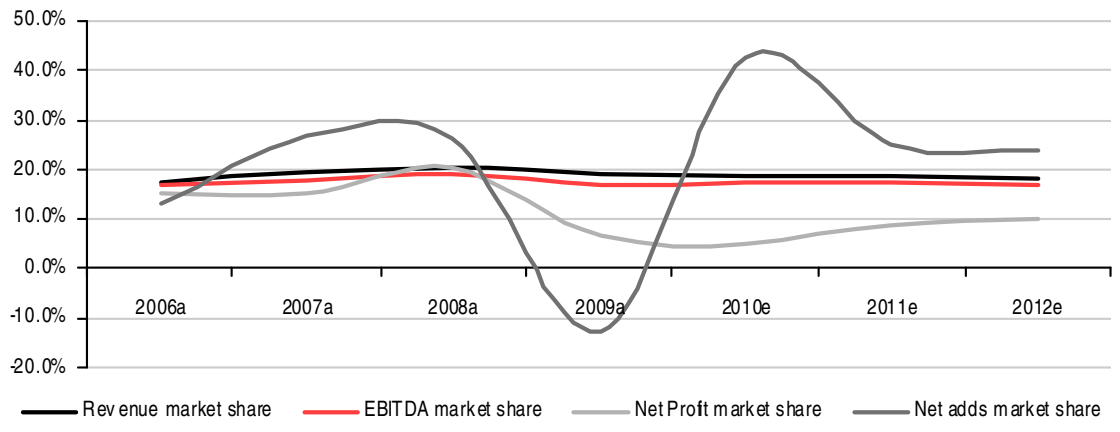
Reuters recently reported that Indosat could sell c14,000 of its towers for USD1.4bn as part of a deleveraging exercise. Assuming such valuation were applied, the residual value of Indosat's remaining businesses would imply 2010e and 2011e PEs of 27.8x and 14.2x; a significant premium to regional peers. Assuming the same per-tower valuation as its competitors would have Telkom and XL trading at 13.8x and 13.5x; and 16.2x and 11.5x.

We are Underweight Indosat with a IDR5,800 target price derived using a DCF methodology. We factor in a COE of 13.8% and a terminal growth rate of 5%. The main upside risk is any re-emergence of irrational competition in the mobile space while downside risks would come from Indosat pulling away from XL and securing its No. 2 position..

HSBC

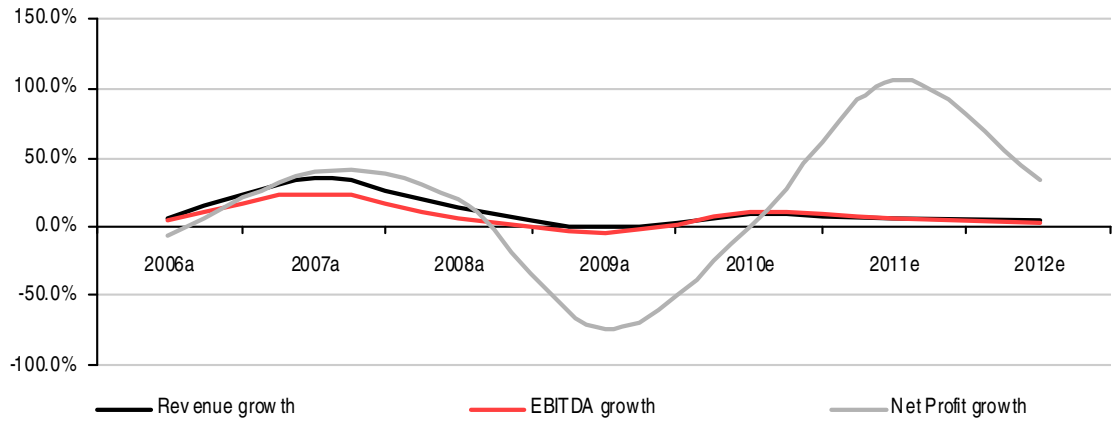
Indosat: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



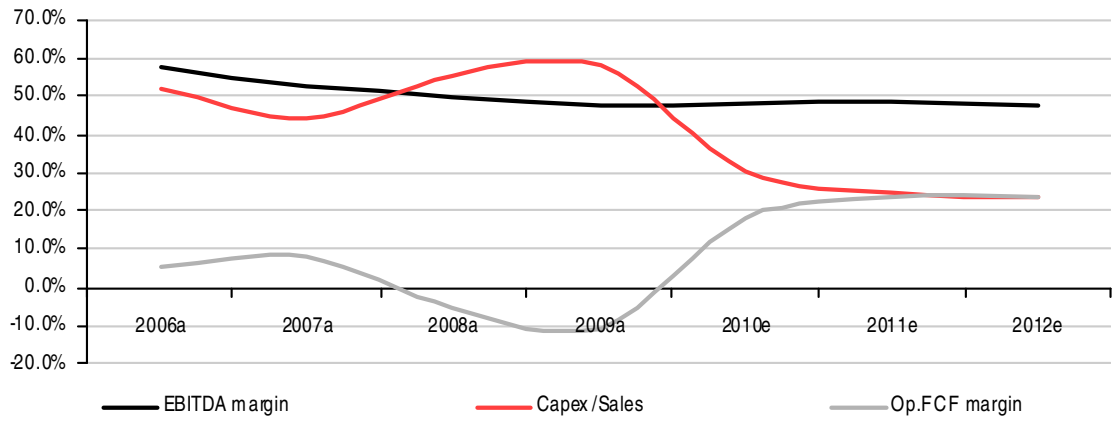
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: Indosat

Underweight

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (IDRb)				
Revenue	18,393	20,112	21,294	22,273
EBITDA	8,774	9,722	10,309	10,591
Depreciation & amortisation	-5,797	-6,500	-6,083	-5,941
Operating profit/EBIT	2,978	3,221	4,225	4,650
Net interest	-1,734	-2,291	-2,407	-2,152
PBT	2,232	1,106	1,869	2,498
HSBC PBT	1,479	1,157	2,045	2,725
Taxation	-677	-351	-467	-625
Net profit	1,498	693	1,353	1,825
HSBC net profit	745	744	1,529	2,051
Cash flow summary (IDRb)				
Cash flow from operations	4,051	7,717	6,606	6,992
Capex	-10,700	-6,097	-5,314	-5,279
Cash flow from investment	-9,725	-4,840	-5,264	-5,279
Dividends	-939	-749	-277	-541
Change in net debt	6,620	-2,127	-1,065	-1,172
FCF equity	-5,244	1,168	2,282	2,713
Balance sheet summary (IDRb)				
Intangible fixed assets	3,384	3,043	2,816	2,590
Tangible fixed assets	44,429	43,274	42,731	42,295
Current assets	6,321	8,253	7,108	6,168
Cash & others	2,836	5,129	3,969	3,000
Total assets	55,041	55,275	53,360	51,759
Operating liabilities	9,744	9,914	9,364	8,760
Gross debt	25,474	25,640	23,415	21,274
Net debt	22,638	20,511	19,446	18,274
Shareholders funds	17,958	17,620	18,432	19,526
Invested capital	41,555	39,526	39,321	39,293

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	-1.4	9.3	5.9	4.6
EBITDA	-5.5	10.8	6.0	2.7
Operating profit	-33.9	8.2	31.2	10.0
PBT	-4.0	-50.4	68.9	33.7
HSBC EPS	-74.2	-0.2	105.6	34.2
Ratios (%)				
Revenue/IC (x)	0.5	0.5	0.5	0.6
ROIC	5.9	5.8	8.5	9.3
ROE	4.2	4.2	8.5	10.8
ROA	5.4	4.4	6.1	6.8
EBITDA margin	47.7	48.3	48.4	47.6
Operating profit margin	16.2	16.0	19.8	20.9
EBITDA/net interest (x)	5.1	4.2	4.3	4.9
Net debt/equity	123.8	114.0	103.2	91.4
Net debt/EBITDA (x)	2.6	2.1	1.9	1.7
CF from operations/net debt	17.9	37.6	34.0	38.3
Per share data (IDR)				
EPS Rep (fully diluted)	275.71	127.59	248.92	335.83
HSBC EPS (fully diluted)	137.14	136.88	281.39	377.51
DPS	137.86	51.04	99.57	134.33
Book value	3304.66	3242.58	3391.94	3593.44

Key forecast drivers

Year to	12/2009a	12/2010e	12/2011e	12/2012e
ARPU (IDR '000)	33	36	34	34
Mobile Subscribers ('000)	33,130	40,464	43,134	45,479
Revenue (IDR bn)	18,393	20,112	21,294	22,273
EBITDA Margin (%)	48	48	48	48
Capex/Sales (%)	58	30	25	25
RoIC (%)	6	6	8	9

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	2.9	2.6	2.4	2.2
EV/EBITDA	6.1	5.3	4.9	4.7
EV/IC	1.3	1.3	1.3	1.3
PE*	41.9	42.0	20.4	15.2
P/Book value	1.7	1.8	1.7	1.6
FCF yield (%)	-16.8	3.7	7.3	8.7
Dividend yield (%)	2.4	0.9	1.7	2.3

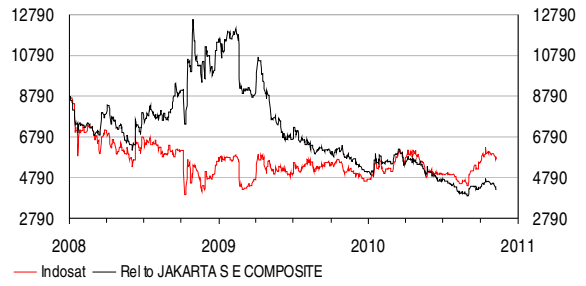
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (IDR)	5,750	Target price (IDR)	5,800	Potent'l return (%)	0.9

Reuters (Equity)	ISAT.JK	Bloomberg (Equity)	ISAT IJ
Market cap (USDm)	3,509	Market cap (IDRb)	31,245
Free float (%)	30	Enterprise value (IDRb)	51,666
Country	Indonesia	Sector	Wireless Telecoms
Analyst	Luis Hilado	Contact	+65 6239 0656

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

XL Axiata (EXCL)

- We expect XL to win share of subscribers, revenue and EBITDA while sticking to a returns-focused strategy
- XL could lead the way in improving capital management policies over the medium term
- Overweight (V): TP of IDR7,700 based on DCF

Investment thesis

'Late mover' advantage — XL's substantial 29% and 34% three-year historical revenue and EBITDA CAGR show the inroads management has made in catching up with the incumbents. By virtue of a relatively later start and continued profitable market share growth, we forecast XL will outpace the industry's medium-term growth with a three-year revenue CAGR of 10% and 9% against the 5% and 6% of Telkom.

Forecasts, business outlook

XL's recent strength has been in maximising its network utilisation using differentiated pricing across various time bands and cities. The combination of a nimble tariff decision process and flexible front and back-end systems to accommodate this has been a driver for XL's operational success. With management starting to focus on the 'small screen' WBB space, we could be surprised on the upside if similar execution success as with traditional mobile services is achieved. By 2012, we believe XL will begin outpacing Indosat in terms of wireless revenue share, reaching c22% against Indosat's c20%. Although cognisant of the importance of establishing scale to compete effectively, management is conscious of continuing to generate positive ROIC and allocating capex prudently. We forecast XL's ROIC to improve to 21% in 2011 from 8% in 2009.

Valuation and risks

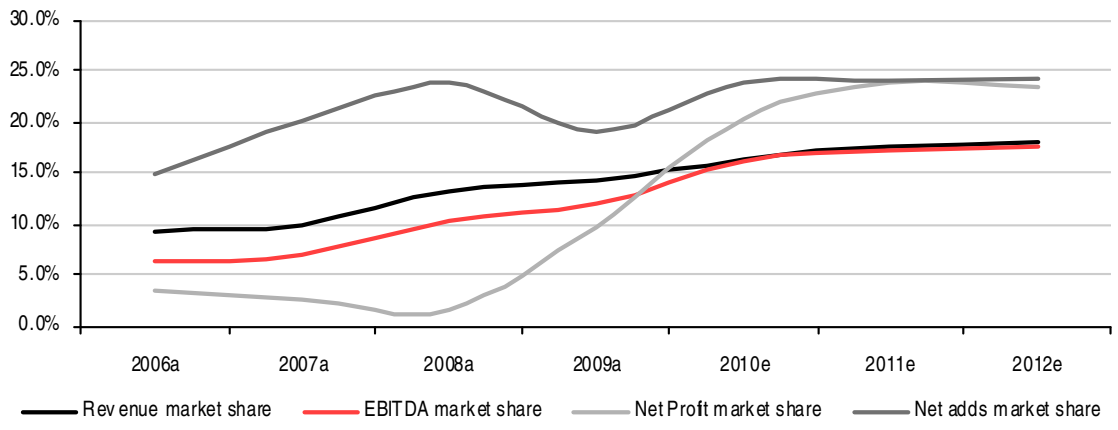
We think XL management, while continuing to strive for growth, could act ahead of its competitors in formulating a more progressive capital management policy. From reactivating its cash dividend policy to 10-20% for 2010-11, we forecast a 50% payout by 2012, translating into a 4% dividend yield. An improving FCF yield and balance sheet are things we believe management and its major shareholder, Axiata (NR), will not leave ignored for long.

We are Overweight (V) on XL with a IDR7,700 target price derived using a DCF methodology. We factor in a COE of 13.8% and a terminal growth rate of 5%. The main risk to investing in the stock is the relatively small USD1.3m daily turnover and the re-emergence of irrational competition in the mobile space.

HSBC

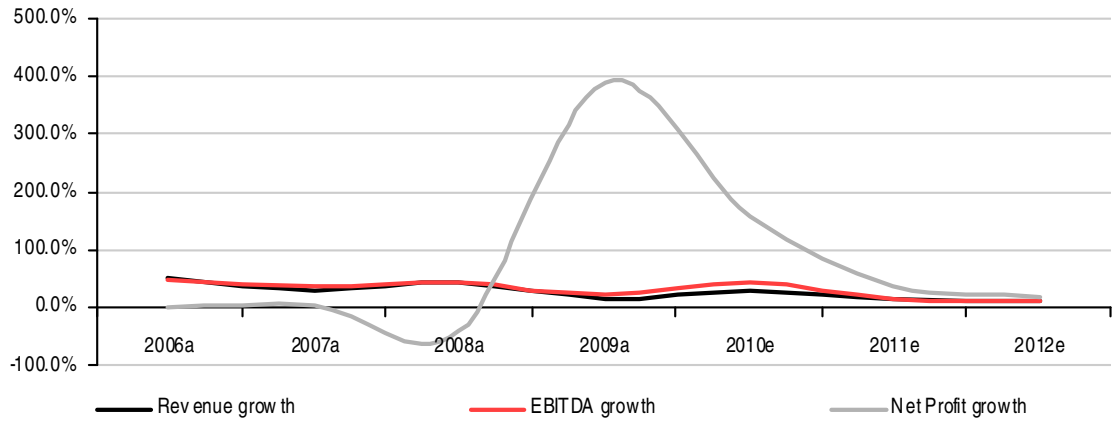
XL Axiata: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



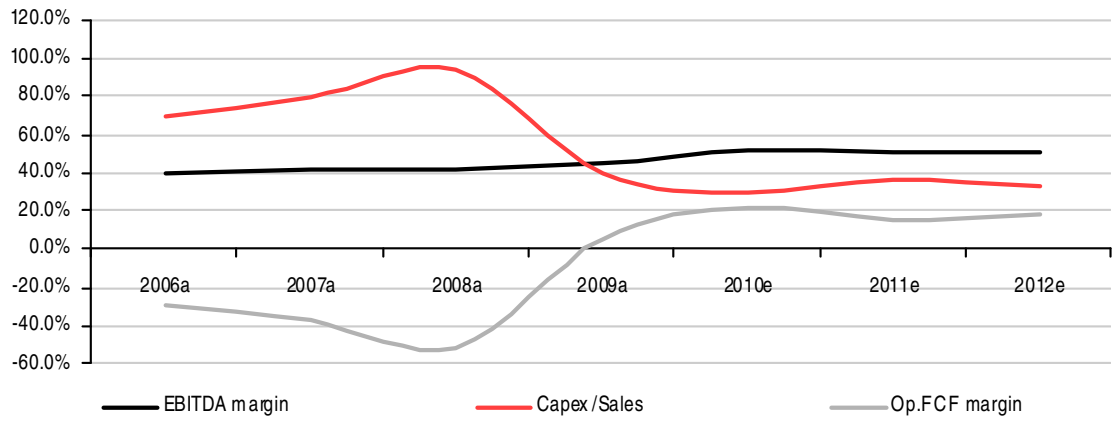
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: XL Axiata

Overweight (V)

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (IDRb)				
Revenue	13,880	17,675	20,119	21,994
EBITDA	6,205	9,055	10,153	11,148
Depreciation & amortisation	-3,741	-4,037	-4,312	-4,395
Operating profit/EBIT	2,464	5,018	5,841	6,752
Net interest	-1,218	-785	-688	-682
PBT	2,350	3,764	5,157	6,070
HSBC PBT	1,792	3,858	5,154	6,070
Taxation	-641	-874	-1,071	-1,300
Net profit	1,709	2,890	4,086	4,770
HSBC net profit	1,151	2,984	4,083	4,770
Cash flow summary (IDRb)				
Cash flow from operations	2,992	7,551	8,654	9,423
Capex	-5,502	-5,201	-7,096	-7,256
Cash flow from investment	-4,097	-4,412	-7,096	-7,256
Dividends	0	-128	-643	-547
Change in net debt	-4,835	-3,624	-838	-1,639
FCF equity	-2,510	2,350	1,558	2,166
Balance sheet summary (IDRb)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	25,261	25,676	28,460	31,321
Current assets	2,007	5,173	3,856	3,326
Cash & others	748	4,127	2,700	2,000
Total assets	27,380	30,900	32,366	34,697
Operating liabilities	3,930	4,713	5,126	7,391
Gross debt	13,464	13,219	10,954	8,615
Net debt	12,716	9,092	8,254	6,615
Shareholders funds	8,803	11,580	14,979	17,364
Invested capital	22,590	22,009	24,489	25,255

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	14.2	27.3	13.8	9.3
EBITDA	20.9	45.9	12.1	9.8
Operating profit	40.6	103.7	16.4	15.6
PBT		60.2	37.0	17.7
HSBC EPS	382.4	119.1	35.9	16.7
Ratios (%)				
Revenue/IC (x)	0.6	0.8	0.9	0.9
ROIC	8.2	17.4	20.0	21.5
ROE	17.6	29.3	30.7	29.5
ROA	9.5	12.1	15.0	15.9
EBITDA margin	44.7	51.2	50.5	50.7
Operating profit margin	17.8	28.4	29.0	30.7
EBITDA/net interest (x)	5.1	11.5	14.8	16.3
Net debt/equity	144.4	78.5	55.1	38.1
Net debt/EBITDA (x)	2.0	1.0	0.8	0.6
CF from operations/net debt	23.5	83.1	104.9	142.4
Per share data (IDR)				
EPS Rep (fully diluted)	237.08	338.87	475.63	554.59
HSBC EPS (fully diluted)	159.63	349.82	475.27	554.59
DPS	0.00	15.00	80.00	277.29
Book value	1220.89	1357.79	1743.66	2018.96

Key forecast drivers

Year to	12/2009a	12/2010e	12/2011e	12/2012e
ARPU ('000)	36	37	37	38
Mobile Subscribers ('000)	33,130	40,464	43,134	45,479
Revenue (IDR bn)	13,880	17,675	20,119	21,994
EBITDA margin (%)	45	51	50	51
Capex/Sales (%)	40	29	35	33

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	4.5	3.4	2.9	2.6
EV/EBITDA	10.1	6.5	5.8	5.1
EV/IC	2.8	2.7	2.4	2.2
PE*	37.0	16.9	12.4	10.6
P/Book value	4.8	4.3	3.4	2.9
FCF yield (%)	-5.0	4.7	3.1	4.3
Dividend yield (%)	0.0	0.3	1.4	4.7

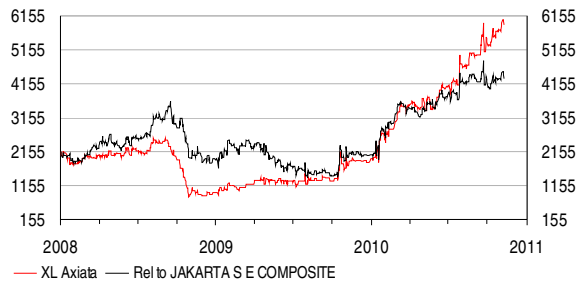
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (IDR)	5,900	Target price (IDR)	7,700	Potent'l return (%)	30.5

Reuters (Equity)	EXCL.JK	Bloomberg (Equity)	EXCL IJ
Market cap (USDm)	5,637	Market cap (IDRb)	50,197
Free float (%)	20	Enterprise value (IDRb)	59,238
Country	Indonesia	Sector	Diversified Telecoms
Analyst	Luis Hilado	Contact	+65 6239 0656

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

Japan

- We have become more positive on the large-cap Japanese telcos, upgrading KDDI to Overweight and DoCoMo to Neutral
- Despite the most advanced data services in the world, the data growth outlook is sluggish, while voice is in structural decline
- We look for improving smartphone trends at DoCoMo, expecting SoftBank's momentum to decline.

Market view

We are more positive on the growth outlook for the Japanese telecoms sector, on reducing regulatory risk, and improving smartphone momentum. Japan has moved very far very fast, but now is struggling to overcome limited growth in both wireline and wireless data, while voice revenues continue to tumble. This contrasts with North Asian neighbour Korea, which we argue is at the sweet spot when fast networks, and attractive tariffs and services and services are coupled with strong smartphone demand.

Market size and structure

The Japanese market has moved further and faster than any other in the development of both wireline and wireless data services. 35% of the 50m Japanese households take a fibre or equivalent connection with speeds in excess of 100Mbps. c50% of wireless accounts subscribe to a tiered data tariff, and SoftBank was the among the first operators globally to take a higher proportion of service revenues from data than voice in the quarter ending March 2010.

Data growth outlook

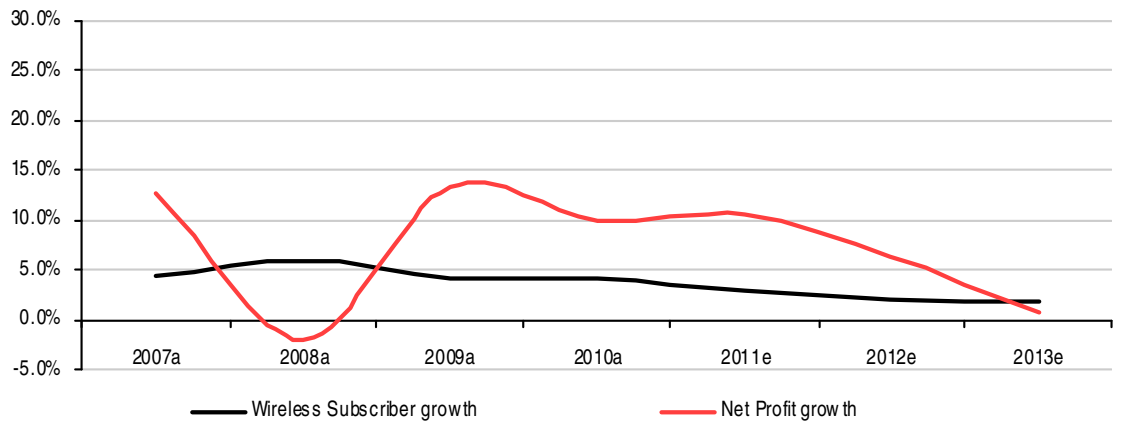
Striking in the guidance for FY11 from both NTT DoCoMo and KDDI is the continued slump expected in voice revenues. DoCoMo expects a decline in voice ARPU of 12%, and KDDI 14.6%. This is (still) the result of the shift to a lower-subsidy, lower-monthly-fee model initiated by SoftBank in 2007. SoftBank voice ARPU declines should moderate after a 25% fall in FY09 to c9% in FY11. Yet data growth does not offset this: NTT DoCoMo is targeting a 4.5% data ARPU growth in FY 2010, and KDDI (formerly the poster child of the wireless internet) just 2.9%. Market structure has been relatively stable, although we note the current debate regarding the possible breakup of NTT, which we expect to continue for the next 6-12 months.

In the next several months, we expect NTT DoCoMo and KDDI to show better subscriber momentum: we argue that SoftBank's iPhone driven momentum will be hard to maintain, with network issues resulting in a weaker ability to attract high-value customers from its peers.

HSBC

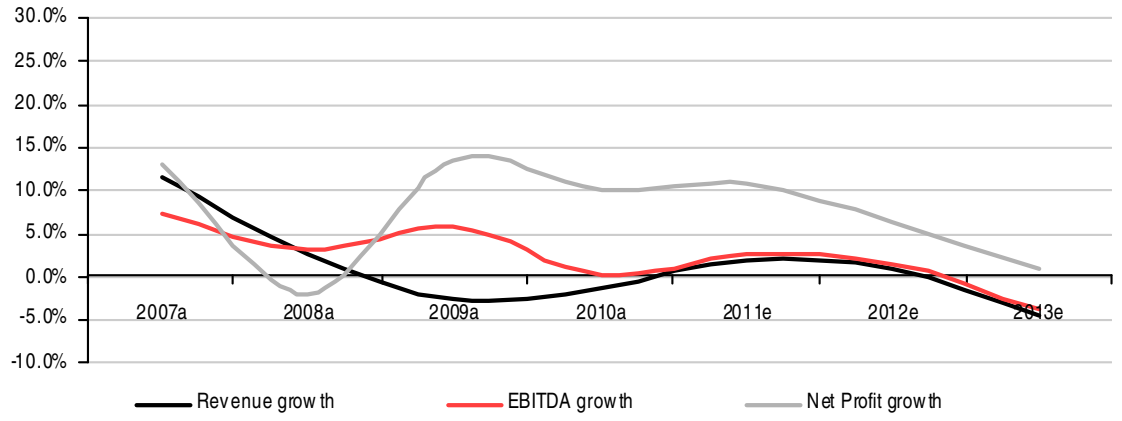
Japan: Market charts

Market position: Wireless subscriber growth vs. net profit growth



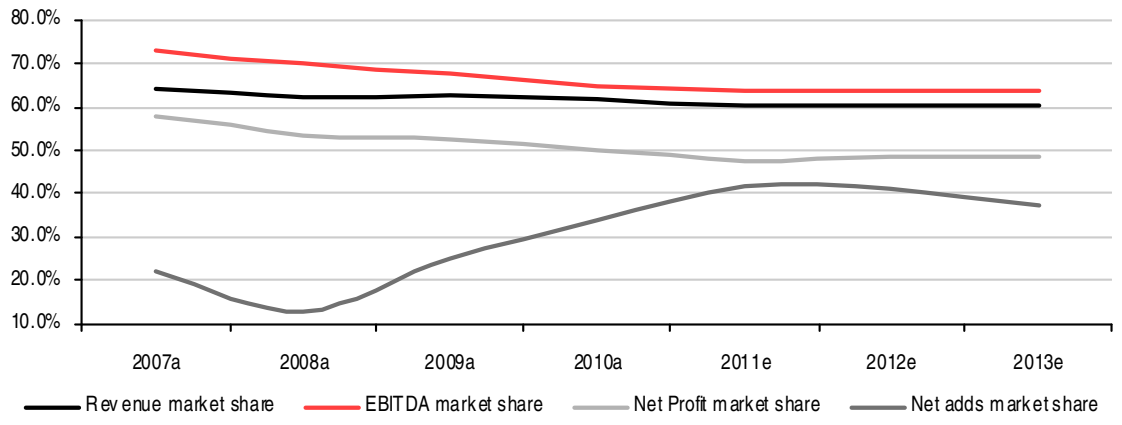
Source: Company reports, HSBC estimates. Data for fiscal year ending March.

Market growth: Revenue, EBITDA and net profit (YoY change)



Source: Company reports, HSBC estimates. Data for fiscal year ending March.

Market structure: DoCoMo's revenue, EBITDA, net profit and wireless net adds market shares (%)



Source: Company reports, HSBC estimates. Data for fiscal year ending March.

HSBC

NTT (9432)

- Improved outlook at NTT East/West; weaker performance at NTT Communications
- Regulatory risk reduced, and business transformation on-track, but progress in offsetting legacy declines to remain slow
- Neutral: Target price of JPY4,000 derived from 11x 2011e EPS

Investment thesis

Regulatory risk at NTT is falling, with public comments from the task force suggesting that it was against breaking NTT up (into wholesale and retail divisions), and Communications Minister Haraguchi being replaced in the September 2010 Cabinet reshuffle. Its primary strategic focus is on expanding its footprint overseas, with a cJPY286bn acquisition of Dimension Data (based in South Africa) set to conclude by October 2010. Dimension has a strong footprint at or near the premises of 6,000 corporate customers in 49 countries, which NTT believes offers a strategic fit with its international telecoms and IT services presence. Regarding the payout ratio, it has acknowledged the possibility for an increase in the past as capex levels come down. We note that this is likely not a near-term event, with group capex remaining high at c19% of sales in FY Mar-11. NTT is also still seeking overseas M&A opportunities, particularly via NTT Data.

Forecasts, business outlook

Performance at NTT East and West is improving, with revenues expected to flatten in FY10 at East (down 0.4%) and decline 2.2% at West. Management believes that NTT West will remain about a year behind NTT East, due to heavier competition in the Kansai region. NTT also benefited from a better-than-expected interconnect rate decision in March 2010. At NTT Communications, voice revenues remain under pressure.

Data growth outlook

IPTV subscription is picking up as the coverage area of the terrestrial programming re-transmission service on the Hikari TV IPTV platform expands, but the full-year target of 2.2m subscribers is likely to be a stretch, implying an increase from quarterly net adds of 154,000 in Q1 to c260,000 per quarter.

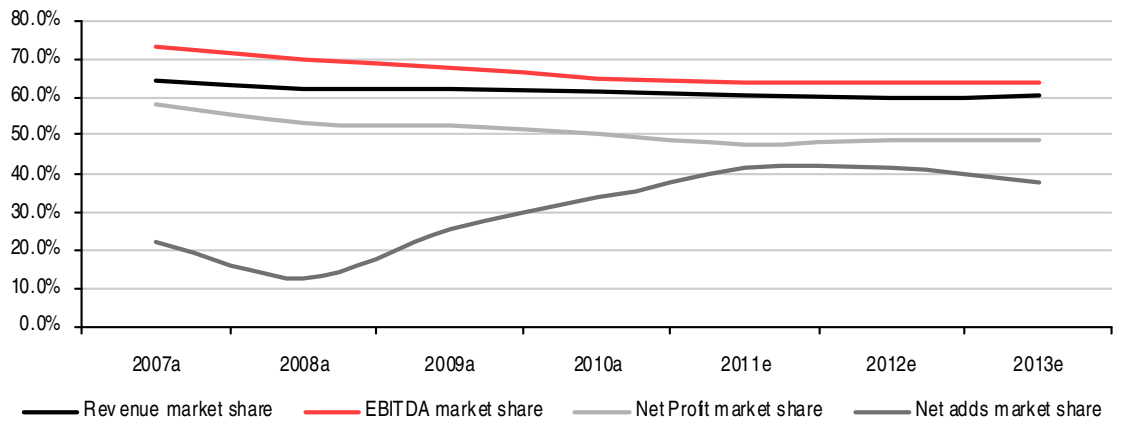
Valuation and risks

Our primary valuation methodology is PE-based, as we believe a relative valuation better reflects market priorities. We apply a multiple of 11x 2011e earnings to derive our target price. Risks to our rating include a better (or worse) outcome in the current regulatory debate; a significant change in the operating outlook or shareholder return policy, and a change in NTT's overseas expansion program.

HSBC

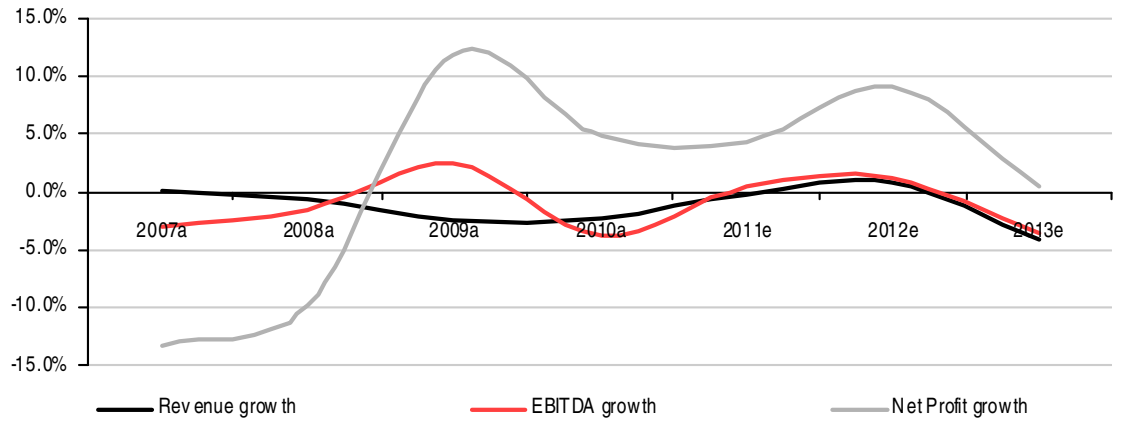
NTT: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



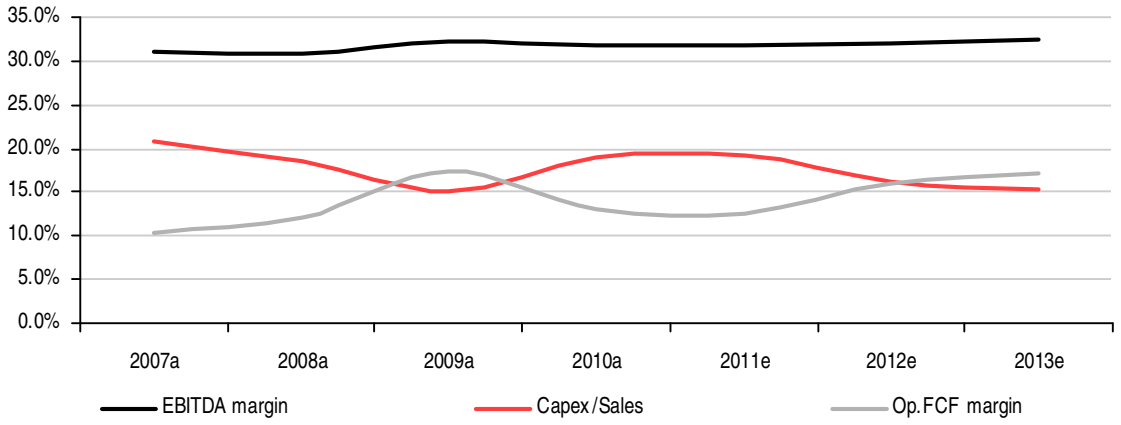
Source: Company reports, HSBC estimates. . Data for fiscal year ending March.

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates. . Data for fiscal year ending March.

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates. . Data for fiscal year ending March.

HSBC

Financials & valuation: NTT

Neutral

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (JPYb)				
Revenue	10,181	10,152	10,212	10,281
EBITDA	3,241	3,255	3,293	3,343
Depreciation & amortisation	-2,123	-2,103	-2,086	-2,015
Operating profit/EBIT	1,118	1,152	1,207	1,328
Net interest	-31	-39	-38	-23
PBT	1,129	1,128	1,178	1,315
HSBC PBT	1,095	1,118	1,169	1,305
Taxation	-447	-446	-471	-528
Net profit	492	501	527	597
HSBC net profit	460	481	510	579
Cash flow summary (JPYb)				
Cash flow from operations	2,818	2,817	2,825	2,875
Capex	-1,924	-1,921	-1,645	-1,568
Cash flow from investment	-2,309	-1,953	-1,645	-1,568
Dividends	-152	-159	-159	-185
Change in net debt	-441	-667	-1,021	-1,122
FCF equity	827	852	1,130	1,207
Balance sheet summary (JPYb)				
Intangible fixed assets	1,954	1,951	1,951	1,951
Tangible fixed assets	10,058	9,766	9,325	8,878
Current assets	4,246	4,703	5,733	6,866
Cash & others	1,293	1,801	2,822	3,944
Total assets	18,939	19,047	19,636	20,321
Operating liabilities	2,496	2,373	2,872	3,418
Gross debt	4,510	4,350	4,350	4,350
Net debt	3,216	2,549	1,528	406
Shareholders funds	7,788	8,096	8,437	8,822
Invested capital	12,467	12,246	11,316	10,333

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	-2.3	-0.3	0.6	0.7
EBITDA	-3.8	0.4	1.1	1.5
Operating profit	0.7	3.1	4.8	10.1
PBT	2.3	-0.1	4.5	11.6
HSBC EPS	7.1	4.6	6.0	13.6
Ratios (%)				
Revenue/IC (x)	0.8	0.8	0.9	0.9
ROIC	5.3	5.5	6.0	7.2
ROE	6.1	6.1	6.2	6.7
ROA	3.8	3.8	3.9	4.1
EBITDA margin	31.8	32.1	32.2	32.5
Operating profit margin	11.0	11.3	11.8	12.9
EBITDA/net interest (x)	104.1	83.7	86.1	145.9
Net debt/equity	32.9	25.0	14.2	3.6
Net debt/EBITDA (x)	1.0	0.8	0.5	0.1
CF from operations/net debt	87.6	110.5	184.8	708.7
Per share data (JPY)				
EPS Rep (fully diluted)	372	379	398	451
HSBC EPS (fully diluted)	348	364	385	438
DPS	120	120	140	160
Book value	5,885	6,118	6,376	6,667

Key forecast drivers

Year to	03/2010a	03/2011e	03/2012e	03/2013e
NTT Revenue (JPY bn)	10,181	10,152	10,212	10,281
NTT EBITDA (JPY bn)	3,241	3,255	3,293	3,343
NTT EBIT Adjusted (JPY bn)	1,118	1,152	1,207	1,328
NTT PBT Adjusted (JPY bn)	1,095	1,118	1,169	1,305
NTT EPS Adjusted (JPY)	348	364	385	438
NTT FCF Definition (JPY bn)	1,254	1,334	1,648	1,776

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	1.2	1.1	1.0	0.9
EV/EBITDA	3.7	3.5	3.2	2.8
EV/IC	1.0	0.9	0.9	0.9
PE*	10.8	10.3	9.7	8.6
P/Book value	0.6	0.6	0.6	0.6
FCF yield (%)	9.4	9.6	12.6	13.4
Dividend yield (%)	3.2	3.2	3.7	4.3

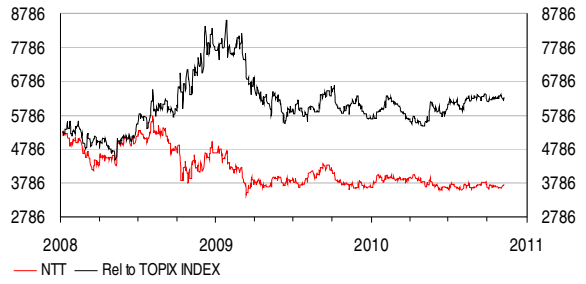
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (JPY)	3750	Target price (JPY)	4000	Potent'l return (%)	6.7

Reuters (Equity)	9432.T	Bloomberg (Equity)	9432 JP
Market cap (USDm)	73,043	Market cap (JPYb)	5,903
Free float (%)	54	Enterprise value (JPYb)	11,471
Country	Japan	Sector	Diversified Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

NTT DoCoMo (9437)

- Better data growth than KDDI from smartphones and data cards in FY11, but limited network capacity
- We expect December 2010 LTE launch to offer limited benefit, and expect additional investment in Tata to fund 3G deployment
- Neutral: TP of JPY141,000 based on target PE multiple of 12x

Investment thesis

Japan has seen a performance delta rare in telecoms, with SoftBank's status as sole supplier of the iPhone enabling it to take high value subscriber share from both NTT DoCoMo and KDDI over the past 18 months. We expect this to change: handset portfolios are approaching parity (particularly with DoCoMo's launch of the Samsung Galaxy on 28 October), and SoftBank's network continues to struggle under the huge volumes of data its iPhone customers are generating.

Forecasts, business outlook

NTT DoCoMo 1H results were in-line: revenues were up slightly by 0.4% (helped by strong growth in packet data and stronger handset sales) while OP continued to decline (-4.5% relative to 1H FY March 2010). The key driver here remained the transition to the Value Plan, which reduced voice revenues by JPY41.4bn in the half. Packet revenues rose by JPY23.7bn, while 'other expenses' (including loyalty program costs of JPY24.9bn) rose by JPY45.9bn.

Data growth outlook

At the launch of the Samsung Galaxy on 28 October, CEO Yamada noted that smartphone sales are expected to be c30% above the initial 1m target for the year. Our estimates are in line with this figure, at 1.37m. Much depends on sales of the Galaxy – as we pointed out in our 5 October 2010 report, *Network Effects*, take-up of DoCoMo Android phones apart from the Sony Ericsson Xperia has been quite weak. This said, the Galaxy has been the most successful competitor to the iPhone in markets as diverse as Korea and the US.

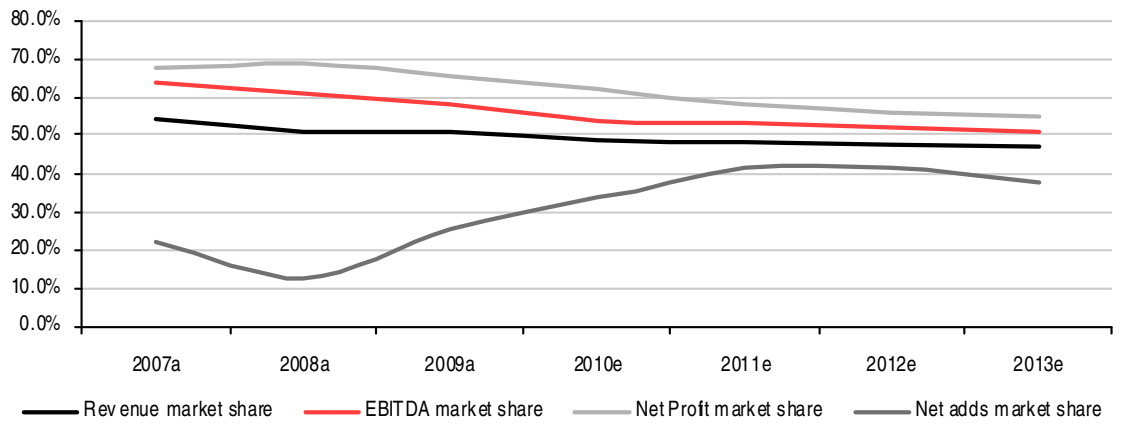
Valuation and risks

Our primary valuation methodology for NTT DoCoMo is PE-based, as we believe this best reflects the way investors view the stock relative to domestic peers and sectors. Since the sector de-rated in November 2007, NTT DoCoMo has traded at a forward multiple of c12x. Applied to our FY Mar-11 EPS estimate of JPY11,771 this returns our target price of JPY141,000. Risks to our rating include a significant change in the operating outlook (particularly for smartphones), and a change in DoCoMo's overseas investment strategy.

HSBC

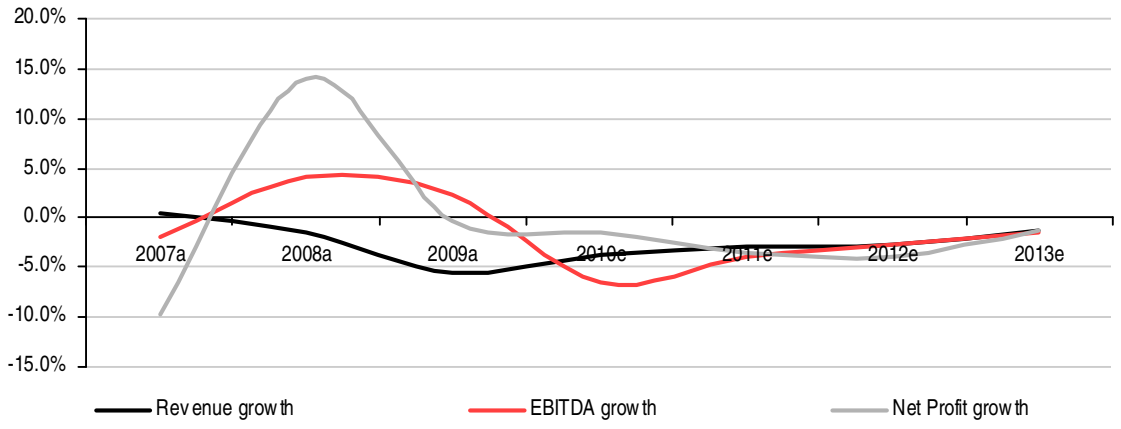
NTT DoCoMo: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



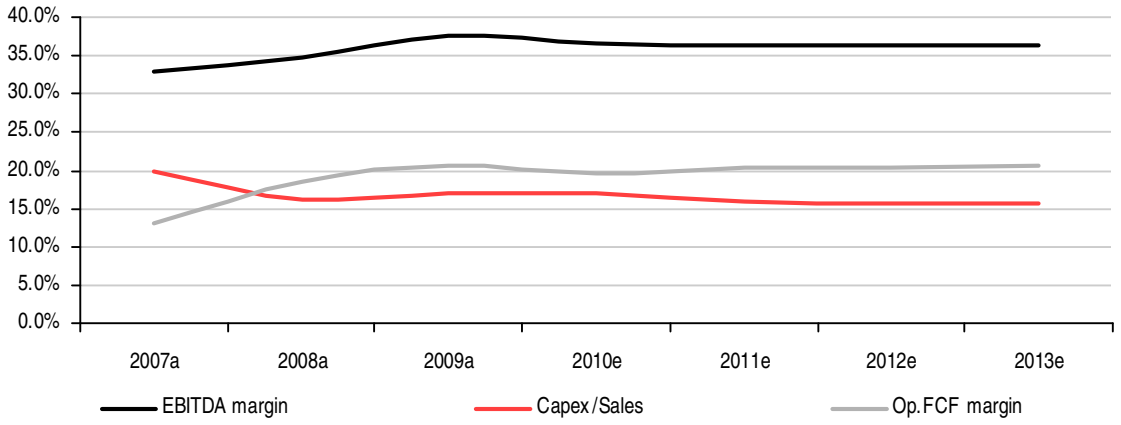
Source: Company reports, HSBC estimates. Data for fiscal year ending March

Financial performance: Growth (YoY) in Revenue, EBITDA and Net Profit



Source: Company reports, HSBC estimates. Data for fiscal year ending March

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates. Data for fiscal year ending March

HSBC

Financials & valuation: NTT DoCoMo

Neutral

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (JPYb)				
Revenue	4,284	4,245	4,298	4,353
EBITDA	1,569	1,557	1,547	1,563
Depreciation & amortisation	-735	-719	-702	-667
Operating profit/EBIT	834	838	845	895
Net interest	-4	-5	-6	-5
PBT	835	830	837	888
HSBC PBT	863	870	869	890
Taxation	-338	-339	-344	-365
Net profit	495	489	491	521
HSBC net profit	507	511	511	523
Cash flow summary (JPYb)				
Cash flow from operations	1,183	1,128	1,173	1,211
Capex	-726	-705	-675	-678
Cash flow from investment	-1,164	-713	-675	-678
Dividends	-209	-216	-216	-224
Change in net debt	-36	-132	-281	-309
FCF equity	484	512	522	512
Balance sheet summary (JPYb)				
Intangible fixed assets	198	197	197	197
Tangible fixed assets	3,236	3,226	3,229	3,239
Current assets	2,061	2,194	2,484	2,800
Cash & others	761	942	1,223	1,532
Total assets	6,757	6,858	7,149	7,476
Operating liabilities	1,007	837	859	893
Gross debt	762	812	812	812
Net debt	1	-131	-412	-720
Shareholders funds	4,636	4,877	5,143	5,432
Invested capital	3,728	3,838	3,827	3,811

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	-3.7	-0.9	1.3	1.3
EBITDA	-6.5	-0.8	-0.6	1.0
Operating profit	0.4	0.4	0.9	5.9
PBT	7.1	-0.7	0.8	6.1
HSBC EPS	6.4	-0.7	0.3	6.2
Ratios (%)				
Revenue/IC (x)	1.2	1.1	1.1	1.1
ROIC	14.1	13.7	13.5	13.8
ROE	11.3	10.8	10.2	9.9
ROA	7.6	7.3	7.1	7.2
EBITDA margin	36.6	36.7	36.0	35.9
Operating profit margin	19.5	19.7	19.7	20.6
EBITDA/net interest (x)	416.0	330.3	268.7	309.0
Net debt/equity	0.0	-2.7	-8.0	-13.2
Net debt/EBITDA (x)	0.0	-0.1	-0.3	-0.5
CF from operations/net debt	94625.4			
Per share data (JPY)				
EPS Rep (fully diluted)	11,854	11,771	11,806	12,539
HSBC EPS (fully diluted)	11,854	11,771	11,806	12,539
DPS	5,200	5,200	5,400	5,600
Book value	111,063	117,317	123,723	130,663

Key forecast drivers

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Mobile market share (%)	48	47	46	46
Wireless Voice ARPU, JPY	2,950	2,660	2,530	2,420
Wireless Data ARPU, JPY	2,450	2,550	2,610	2,670
Churn Rate Wireless (%)	0	0	-1	-1
LTE Capex,JPY bn	-20	-35	-100	-115
Capex/Sales (%)	16	16	16	16

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	1.3	1.3	1.2	1.1
EV/EBITDA	3.5	3.4	3.3	3.0
EV/IC	1.5	1.4	1.3	1.2
PE*	11.5	11.6	11.6	10.9
P/Book value	1.2	1.2	1.1	1.0
FCF yield (%)	8.9	9.4	9.6	9.4
Dividend yield (%)	3.8	3.8	3.9	4.1

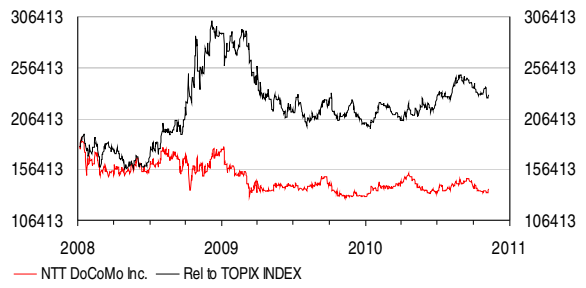
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (JPY)	136900	Target price (JPY)	141000	Potent'l return (%)	3.0

Reuters (Equity)	9437.T	Bloomberg (Equity)	9437 JP
Market cap (USDm)	74,180	Market cap (JPYb)	5,995
Free float (%)	35	Enterprise value (JPYb)	5,322
Country	Japan	Sector	Wireless Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

KDDI (9433)

- Management change welcome, but CDMA technology platform to limit rapid expansion of smartphone portfolio
- Lesser outflow of high-value subscribers to SoftBank a positive
- OW: JPY528,000 based on 9x March 2011e EPS

Investment thesis

In September 2010, KDDI announced that the departure of long-term CEO Tadashi Onodera to the Chairman's role (he currently holds both) would be accelerated, to allow incoming CEO Tanaka more time to prepare his strategy. While the change is welcome, Tanaka (who becomes CEO on 1 December 2010) faces several challenges. CDMA technology means KDDI lacks the capability to tap into global handset trends. As for LG U+ in Korea, it is harder for KDDI to source Android handsets: its October announcement of the ISO-3, the first Android phone to feature the Japanese mobile payment system, is an indication that it is starting to address this shortfall. We see limited near-term synergies from its partnership with J:COM, with cross-selling likely to result in declines in revenue in the near-term, in exchange for higher levels of subscriber growth in the future.

Forecasts, business outlook

We are above guidance for KDDI mobile revenues and EBITDA, reflecting our belief that (like DoCoMo) the company should see relatively little outflows of high-value subscribers to SoftBank after the initial iPhone 4 effect has played out.

We are slightly above corporate guidance for JPY3.44trn of revenues in FY Mar-11, primarily due to our forecasts in the mobile business, which comprises 75% of revenues.

Data growth outlook

KDDI is planning to deploy CDMA Revision A multi-carrier in its network at the end of FY10. Like DoCoMo, it has been relatively consistent in upgrading its network, and cost efficiencies have been aided by its use of 800MHz spectrum in rural Japan. Its smartphone portfolio should improve from end 2010 onwards.

Valuation and risks

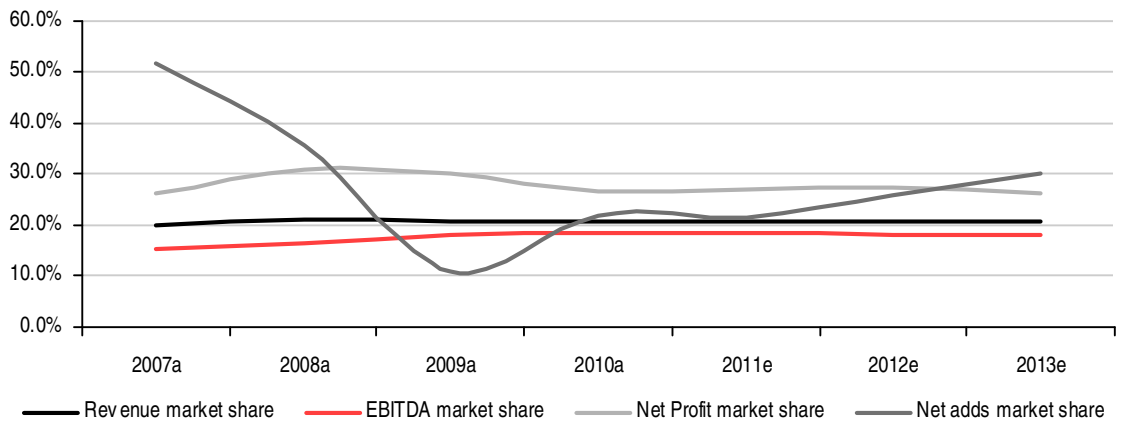
As with NTT DoCoMo, our primary valuation methodology for KDDI stock is PE-based, reflecting near-term concerns. Based on the average of two-year forward trading history since the sector de-rated in November 2007, we continue to use a target multiple of 9x.

The primary catalyst for KDDI is better performance at the monthly subscriber number releases, as it (and NTT DoCoMo) do better against SoftBank. Risks to our view include weaker than expected operating performance (particularly in smartphones) and slower than expected benefits from its partnership with J:COM.

HSBC

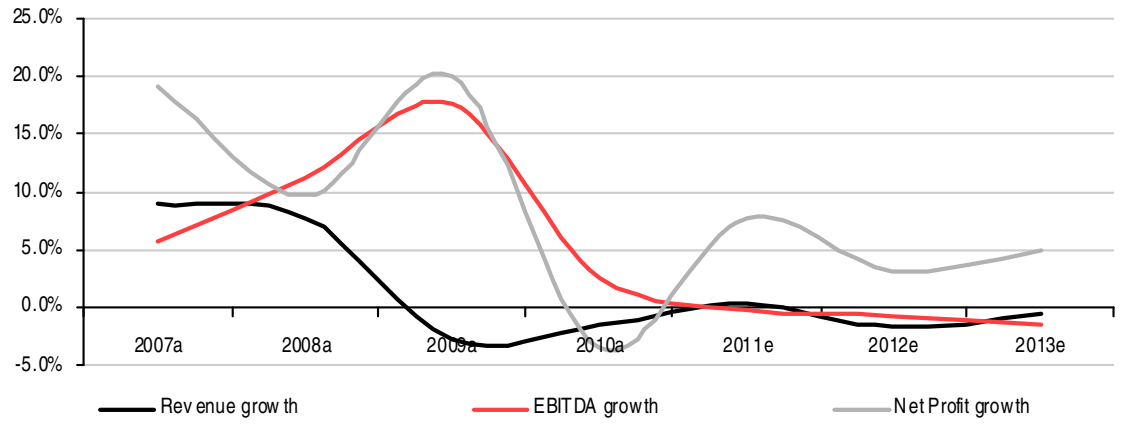
KDDI: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



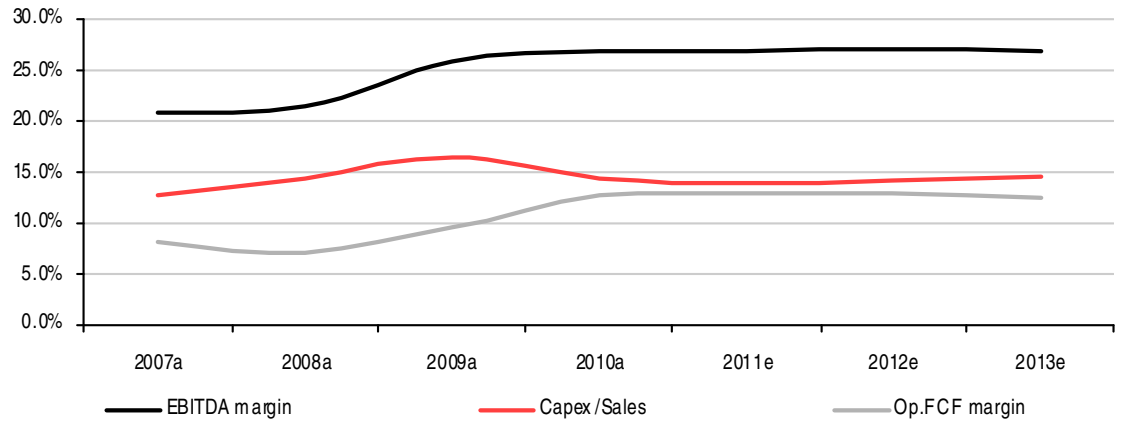
Source: Company reports, HSBC estimates. Data for fiscal year ending March

Financial performance: Growth (YoY) in Revenue, EBITDA and Net Profit



Source: Company reports, HSBC estimates. Data for fiscal year ending March

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates. Data for fiscal year ending March

HSBC

Financials & valuation: KDDI

Overweight

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (JPYb)				
Revenue	3,442	3,454	3,392	3,410
EBITDA	927	925	919	953
Depreciation & amortisation	-483	-457	-443	-433
Operating profit/EBIT	444	468	476	520
Net interest	-12	-14	-13	-11
PBT	369	456	464	510
HSBC PBT	422	459	473	519
Taxation	-150	-189	-195	-214
Net profit	213	258	260	288
HSBC net profit	244	263	271	298
Cash flow summary (JPYb)				
Cash flow from operations	740	693	715	741
Capex	-495	-479	-481	-486
Cash flow from investment	-924	-476	-481	-486
Dividends	-53	-58	-56	-55
Change in net debt	151	46	-178	-201
FCF equity	266	239	228	236
Balance sheet summary (JPYb)				
Intangible fixed assets	24	16	7	-2
Tangible fixed assets	2,239	2,263	2,311	2,372
Current assets	869	691	732	735
Cash & others	167	0	50	50
Total assets	3,820	3,637	3,718	3,774
Operating liabilities	625	458	451	471
Gross debt	985	864	736	536
Net debt	818	864	686	486
Shareholders funds	2,019	2,111	2,317	2,546
Invested capital	2,341	2,512	2,548	2,584

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	-1.6	0.3	-1.8	0.5
EBITDA	2.6	-0.2	-0.7	3.7
Operating profit	0.1	5.4	1.8	9.2
PBT	-6.6	23.8	1.8	9.9
HSBC EPS	-3.2	10.2	6.8	10.0
Ratios (%)				
Revenue/IC (x)	1.5	1.4	1.3	1.3
ROIC	11.7	11.6	11.3	12.2
ROE	12.6	12.7	12.3	12.3
ROA	6.2	7.4	7.5	8.1
EBITDA margin	26.9	26.8	27.1	28.0
Operating profit margin	12.9	13.5	14.0	15.3
EBITDA/net interest (x)	76.0	67.3	70.9	88.3
Net debt/equity	39.3	39.6	28.7	18.5
Net debt/EBITDA (x)	0.9	0.9	0.7	0.5
CF from operations/net debt	90.5	80.2	104.2	152.6
Per share data (JPY)				
EPS Rep (fully diluted)	47,686	59,132	61,802	68,242
HSBC EPS (fully diluted)	54,696	60,272	64,393	70,833
DPS	13,000	13,000	13,000	14,000
Book value	452,564	483,855	549,953	604,195

Key forecast drivers

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Mobile market share (%)	27	27	26	26
Wireless Voice ARPU, JPY	3,208	2,795	2,500	2,290
Wireless Data ARPU, JPY	2,281	2,322	2,380	2,440
Churn Rate Wireless (%)	-1	-1	-1	-1
LTE Capex,JPY bn	-211	-50	-90	-125
Capex/Sales (%)	14	14	14	14

Valuation data

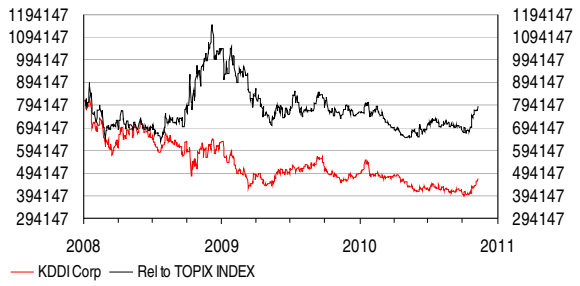
Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	0.7	0.7	0.7	0.7
EV/EBITDA	2.7	2.8	2.6	2.3
EV/IC	1.1	1.0	0.9	0.9
PE*	8.6	7.8	7.3	6.6
P/Book value	1.0	1.0	0.9	0.8
FCF yield (%)	15.7	14.2	13.3	13.6
Dividend yield (%)	2.8	2.8	2.8	3.0

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (JPY)	469000	Target price (JPY)	528000
Potent'l return (%)	12.6		
Reuters (Equity)	9433.T	Bloomberg (Equity)	9433 JP
Market cap (USDm)	26,027	Market cap (JPYb)	2,103
Free float (%)	64	Enterprise value (JPYb)	2,549
Country	Japan	Sector	Diversified Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

SoftBank (9984)

- Stock has outperformed peers over past two years on mobile data gains, primarily from the iPhone
- Expect network congestion to create increasing problems, only partly mitigated by femtocell/WiFi router distribution and use of the Willcom network
- UW: TP of JPY2,400 based on SOTP DCF valuation

Investment thesis

Our research suggests that this outperformance will begin to fade in the second half. The reason for this is the ongoing weakness of SoftBank's network, which we believe will constrain its ability to keep adding high value customers: network expansion taking time to complete.

Forecasts, business outlook

SoftBank again published strong results, exceeding expectations: sales were up 8.6% YoY compared to 1H FY 2010, and OP rose 36.8%. Net income was up 8.6% YoY. SoftBank Mobile remained the primary driver of growth in the first half.

Data growth outlook

At September 2010, 30k new cell-sites had been approved, but the overall number of sites at 70k is relatively unchanged from 60k at March 2010 when the network expansion plans were announced. The company stated that mobile network capex is likely to stay high at cJPY400bn – a change from the previous stance that it would reduce. This implies a run-rate of c25% of sales. 1.5GHz network will add capacity for local handsets, but not the iPhone. SoftBank plans to spend JPY70bn in FY March 2011 building out coverage at 1.5GHz (the former PDC spectrum). However, this will not improve iPhone reception (or that of most international handsets) as 1.5GHz is not supported. Capacity remains an issue. SoftBank noted that 3% of users are using 40% of capacity, and that 15% of iPhone/iPad users generate over 870MB of data at September 2010. It stated that 54k applications for femtocells had been received by end-September 2010, although it gave no indication of shipment/installation levels. 92% of 1,276 users surveyed reported improved coverage.

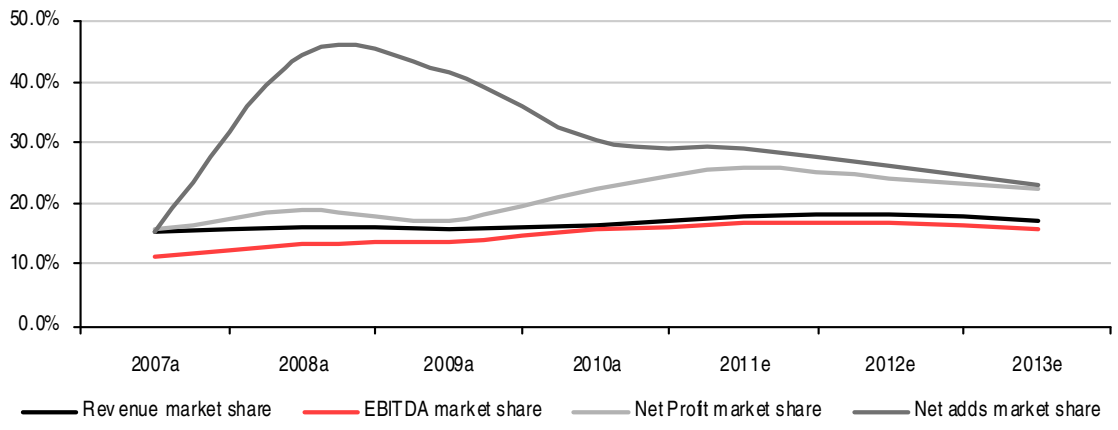
Valuation and risks

We continue to use a sum-of-the-parts, DCF valuation methodology for SoftBank. We apply a levered cost of equity of 13.1% and cost of debt of 4.3% to generate a WACC of 7.4%. This returns our fair value of JPY2,400. The primary catalyst is weaker performance revealed in the monthly subscriber numbers. The primary risks to our view are better than expected operational performance, and a potential listing of SoftBank's Chinese Internet investments.

HSBC

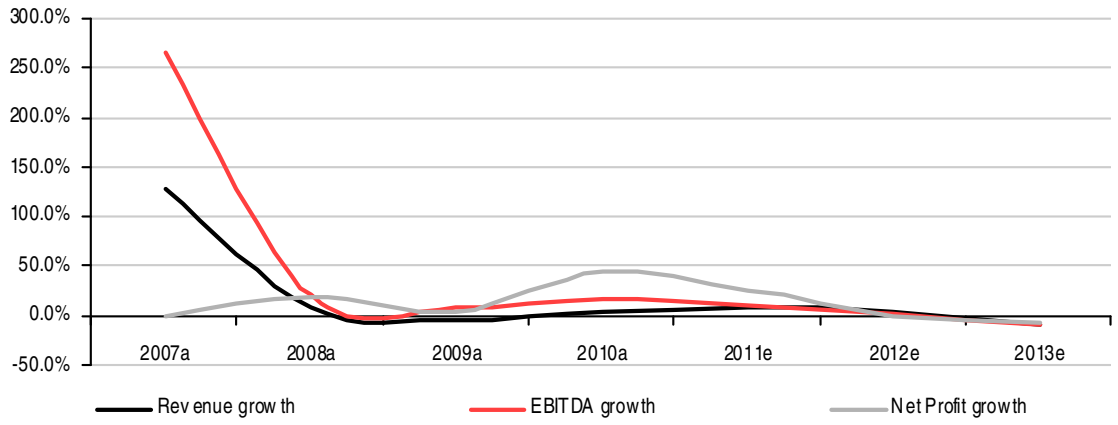
Softbank: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



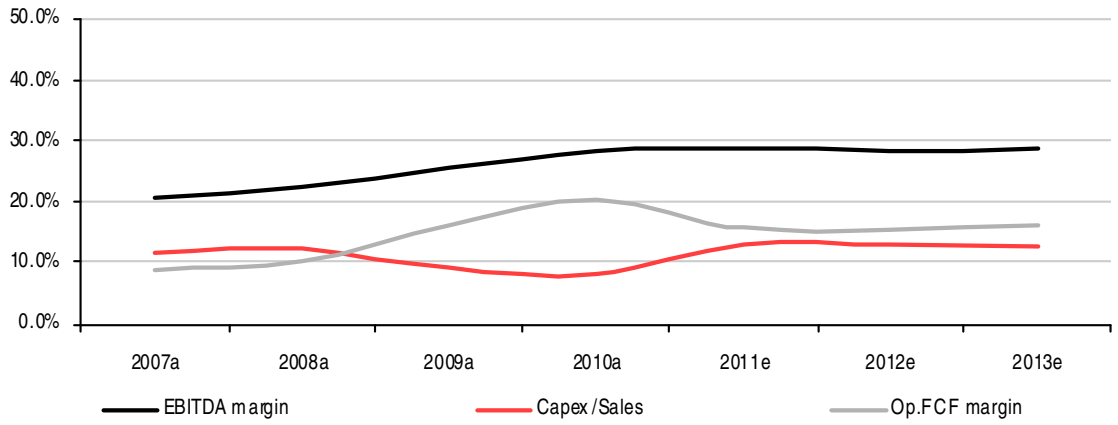
Source: Company reports, HSBC estimates. Data for fiscal year ending March

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates. Data for fiscal year ending March

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates. Data for fiscal year ending March

HSBC

Financials & valuation: SoftBank

Underweight

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (JPYb)				
Revenue	2,763	3,006	3,111	3,203
EBITDA	787	868	884	892
Depreciation & amortisation	-322	-299	-297	-311
Operating profit/EBIT	466	569	587	581
Net interest	-110	-106	-108	-101
PBT	289	445	476	477
HSBC PBT	430	532	536	537
Taxation	-145	-237	-218	-218
Net profit	97	154	203	203
HSBC net profit	207	261	263	263
Cash flow summary (JPYb)				
Cash flow from operations	668	618	584	581
Capex	-224	-396	-409	-364
Cash flow from investment	-277	-413	-426	-381
Dividends	-3	-5	-5	-6
Change in net debt	-530	-46	-152	-193
FCF equity	363	241	158	200
Balance sheet summary (JPYb)				
Intangible fixed assets	901	840	780	720
Tangible fixed assets	1,202	1,383	1,555	1,668
Current assets	1,694	1,490	1,491	1,484
Cash & others	694	570	570	570
Total assets	4,463	4,274	4,397	4,455
Operating liabilities	777	776	786	771
Gross debt	2,395	2,224	2,072	1,879
Net debt	1,701	1,654	1,502	1,309
Shareholders funds	471	589	785	980
Invested capital	2,326	2,366	2,469	2,532

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	3.4	8.8	3.5	3.0
EBITDA	16.0	10.3	1.8	0.9
Operating profit	29.8	22.2	3.2	-1.1
PBT	181.9	54.0	6.8	0.2
HSBC EPS	43.6	26.2	0.6	0.0
Ratios (%)				
Revenue/IC (x)	1.1	1.3	1.3	1.3
ROIC	13.2	16.2	15.9	15.2
ROE	48.9	49.3	38.2	29.8
ROA	4.8	6.3	7.5	7.2
EBITDA margin	28.5	28.9	28.4	27.8
Operating profit margin	16.9	18.9	18.9	18.1
EBITDA/net interest (x)	7.1	8.2	8.2	8.9
Net debt/equity	176.4	144.7	107.7	79.6
Net debt/EBITDA (x)	2.2	1.9	1.7	1.5
CF from operations/net debt	39.3	37.3	38.9	44.3
Per share data (JPY)				
EPS Rep (fully diluted)	89.48	142.69	187.49	187.50
HSBC EPS (fully diluted)	191.38	241.61	242.96	242.96
DPS	5.00	5.00	6.00	7.00
Book value	435.78	544.77	726.27	906.77

Key forecast drivers

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Mobile market share (%)	19	20	21	22
Wireless Voice ARPU, JPY	2,274	2,256	2,190	2,130
Wireless Data ARPU, JPY	2,142	2,311	2,360	2,400
Churn Rate Wireless (%)	-1	-1	-1	-1
LTE Capex,JPY bn	0	0	-328	-253
Capex/Sales (%)	11	18	17	14

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	1.8	1.7	1.6	1.4
EV/EBITDA	6.4	5.8	5.5	5.2
EV/IC	2.2	2.1	2.0	1.8
PE*	14.7	11.6	11.5	11.5
P/Book value	6.4	5.1	3.9	3.1
FCF yield (%)	10.8	7.2	4.7	6.0
Dividend yield (%)	0.2	0.2	0.2	0.2

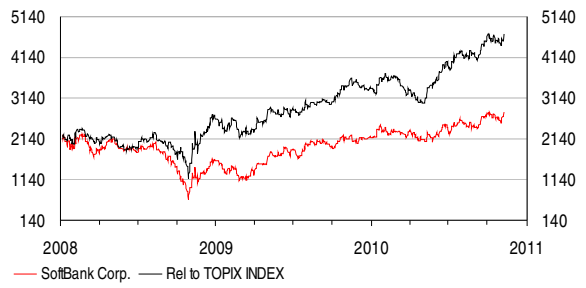
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (JPY)	2804	Target price (JPY)	2400	Potent'l return (%)	-14.4

Reuters (Equity)	9984.T	Bloomberg (Equity)	9984 JP
Market cap (USDm)	37,560	Market cap (JPYb)	3,035
Free float (%)	68	Enterprise value (JPYb)	5,002
Country	Japan	Sector	Diversified Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

eAccess (9427)

- Competition concerns from DoCoMo are overdone
- Introduction of 42Mbps (peak) speeds and new Pocket WiFi likely to drive 2H performance — top telco pick in Japan
- OW(V): TP of JPY88,000 based on PE based valuation

Investment thesis

Since the completion of the 'business combination' between eAccess and eMobile at end-June 2010, the key investor concern has been competition levels. eMobile, which previously had the market to itself, suddenly seemed to face more pressure from NTT DoCoMo and UQ Communications. In our view, these fears are overdone: we expect wireless data card net additions at DoCoMo to continue to trend at c50,000 per month (both the recent run-rate, and the required level to hit its March 2011 target of 1.5m users). We do not expect its LTE deployment to represent a significant new threat: DoCoMo's aims to present Xi as a premium brand, and not load its limited spectral resources with lots of data card subscribers generating 2GB of data traffic per month for cJPY4,000.

Forecasts, business outlook

With cost control at the eAccess fixed-line business remaining steady, the main variant here is Subscriber and Acquisition Costs (SACs) at eMobile. Conservatively, we expect per customer SACs of cJPY30,000 in FY11. We see potential upside from lower distribution costs. eMobile has saved commission costs by moving from big electronics distributors to more low-cost outlets; and lower data card procurement costs. At cJPY10,000, eMobile data card procurement costs are high, reflecting its move to launch new iterations of HSDPA technology as soon as it becomes available. While eMobile will launch 42Mbps services later in 2010, we see potential for lower costs.

Data growth outlook

Offsetting this, eMobile will launch its new 42Mbps (peak speed) network upgrade in 3Q, in an industry first in Japan. This represents a dramatic improvement in speed from the 21Mbps offered currently, and should boost sales. It is also working on a new iteration of the Pocket WiFi device which – while it has sold well and still represents c50% of gross additions – has weaker battery-life than the DoCoMo model, made by Buffalo.

Valuation and risks

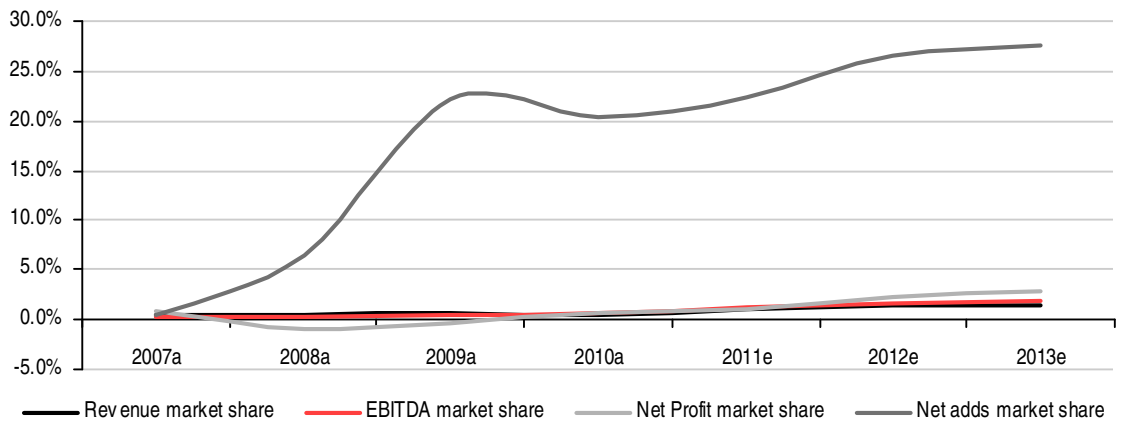
We value eAccess using target PE multiple based methodology, in line with the peer group. We apply PE multiple of 9x to 2012e EPS. This returns our target price of JPY88,000.

The primary catalyst is better performance at the monthly subscriber numbers. The primary risks to our view are higher than expected competition in wireless broadband leading to greater expenditure on marketing and subscriber acquisition.

HSBC

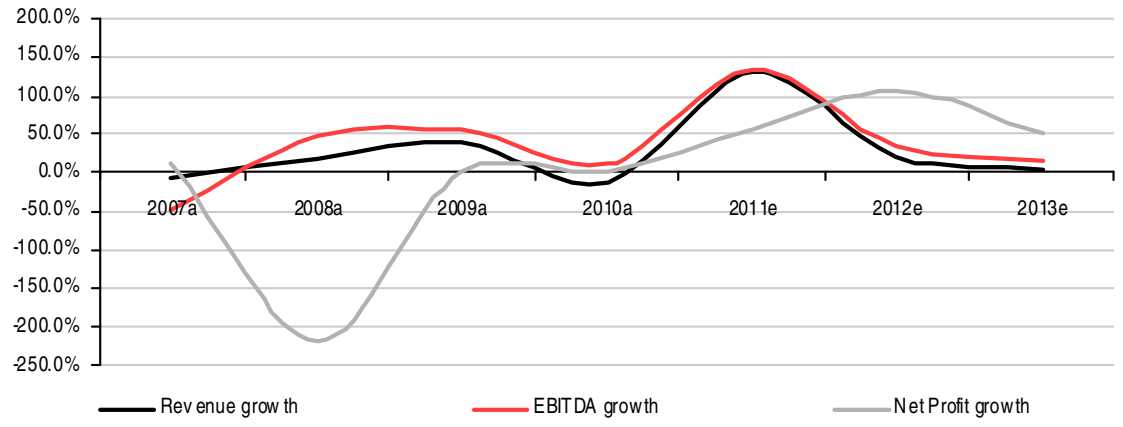
eAccess: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



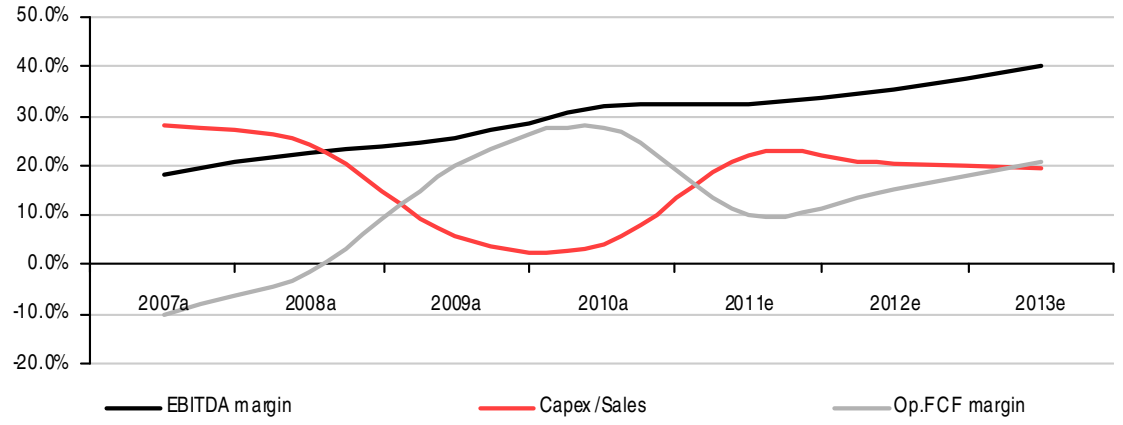
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: eAccess

Overweight (V)

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (JPYb)				
Revenue	83	186	229	252
EBITDA	27	59	84	100
Depreciation & amortisation	-7	-33	-38	-37
Operating profit/EBIT	19	25	46	62
Net interest	-2	-7	-5	-5
PBT	11	18	41	58
HSBC PBT	11	20	42	58
Taxation	-7	-7	-7	-7
Net profit	4	11	34	51
HSBC net profit	6	12	25	34
Cash flow summary (JPYb)				
Cash flow from operations	15	54	77	92
Capex	-3	-46	-57	-62
Cash flow from investment	-4	-48	-57	-62
Dividends	-4	-4	-2	-2
Change in net debt	-5	139	-19	-27
FCF equity	14	0	14	25
Balance sheet summary (JPYb)				
Intangible fixed assets	3	10	9	9
Tangible fixed assets	16	194	213	238
Current assets	46	178	181	183
Cash & others	26	100	100	100
Total assets	87	403	425	452
Operating liabilities	17	43	47	48
Gross debt	55	268	250	222
Net debt	29	168	150	122
Shareholders funds	13	78	110	159
Invested capital	21	238	256	282

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	-12.1	124.0	22.9	10.2
EBITDA	10.6	120.3	43.1	19.1
Operating profit	14.1	33.6	79.3	36.6
PBT		64.0	128.1	42.1
HSBC EPS		-16.5	89.0	38.9
Ratios (%)				
Revenue/IC (x)	3.4	1.4	0.9	0.9
ROIC	46.5	12.0	11.1	13.7
ROE	57.4	25.9	26.2	25.4
ROA	5.0	6.2	9.0	12.4
EBITDA margin	32.0	31.4	36.6	39.6
Operating profit margin	22.9	13.7	20.0	24.7
EBITDA/net interest (x)	12.5	8.8	16.6	21.6
Net debt/equity	220.0	215.7	136.4	77.1
Net debt/EBITDA (x)	1.1	2.9	1.8	1.2
CF from operations/net debt	51.2	32.4	51.7	75.1
Per share data (JPY)				
EPS Rep (fully diluted)	2,864	3,756	9,757	14,745
HSBC EPS (fully diluted)	4,496	3,756	7,100	9,858
DPS	2,400	600	600	600
Book value	8,929	26,327	31,697	45,842

Key forecast drivers

Year to	03/2010a	03/2011e	03/2012e	03/2013e
ADSL Revenue (JPY bn)	71	61	55	52
Mobile Revenue (JPY bn)	113	149	184	213
ADSL EBITDA (JPY bn)	26	23	20	18
Mobile EBITDA (JPY bn)	18	43	64	82
Total Operating Profit (JPY bn	19	27	46	62
Total Capex (JPY bn)	3	46	57	62

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	3.0	2.1	1.6	1.4
EV/EBITDA	9.4	6.6	4.4	3.4
EV/IC	11.7	1.6	1.4	1.2
PE*	14.1	16.9	8.9	6.4
P/Book value	7.1	2.4	2.0	1.4
FCF yield (%)	6.5	-0.2	6.5	11.3
Dividend yield (%)	3.8	0.9	0.9	0.9

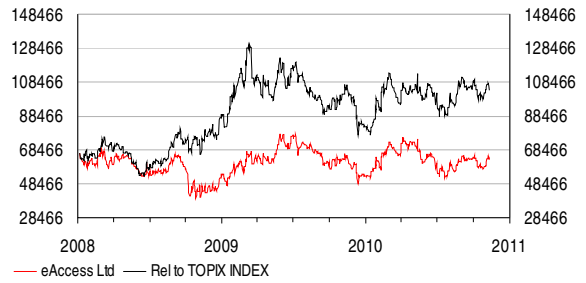
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (JPY)	63500	Target price (JPY)	88000	Potent'l return (%)	38.6

Reuters (Equity)	9427.T	Bloomberg (Equity)	9427 JP
Market cap (USDm)	2,756	Market cap (JPYb)	223
Free float (%)	54	Enterprise value (JPYb)	388
Country	Japan	Sector	DIVERSIFIED TELECOMS
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

Korea

- The Korean telecom stocks are an attractive combination of top-line growth, margin expansion, and improving shareholder returns
- Sector consolidation post LG merger is slowly changing market dynamics: wireline competition much reduced
- Dividends fairly high relative to region with some upside potential

Market view

Korea remains our top pick for telecoms service providers in Asia. Industry wireless data revenue continues to grow strongly in 2011. Booming smartphone sales (we estimate 7.8m in 2010) and strong consumer demand are the drivers, and KT is the clear winner: we expect KT data revenues to grow 25% in 2011, offsetting fixed-line declines.

Churn and marketing costs should come down. Irrespective of short-term marketing expenditure on smartphones, we believe the greater focus on integrated services can bring down churn levels that are very high relative to peers. On its 3Q10 results call, KT noted that churn levels of c1.9% at end 2009 were now down to c1% in its internet business.

Market size and structure

While advanced in the provision of wireline broadband services, Korea has been (surprisingly) behind in wireless data services adoption, with 5m of Korea's 48m accounts owning a smartphone at end-September 2010. Smartphone growth is accelerating, with domestic vendors following the lead of the iPhone, amidst considerable consumer demand. We expect wireless data to remain the key differentiator over the next 1-2 years, with market share changes in the broadband market evolving more slowly.

Data growth outlook

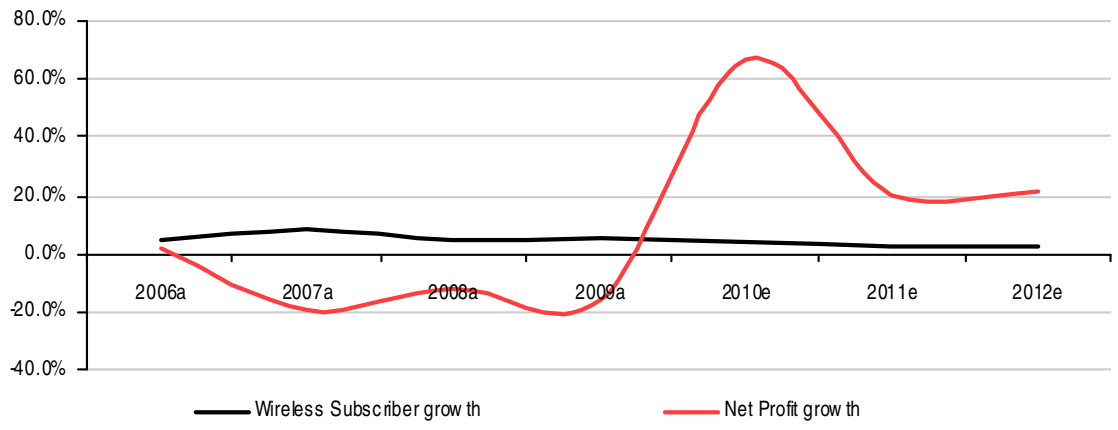
Consistent in the Korean telco earnings calls through 2010 has been the higher ARPU of smartphone users. This has survived the transition from early adopters into the early mass-market, and is very encouraging. 'Flat-rate' data plans start at cKRW55,000 per month, and an increasing number of users are upgrading their tariff along with their new smartphone, to take advantage of larger data allowances.

The past two years has seen considerable consolidation in the Korean telco market, first with the merger of KT and KTF (June 09) and then with the merger of LG Telecom, LG Dacom and LG Powercom (January 2010). SK Telecom, in turn is working more closely with SK Broadband, although it has said it has no intention of raising its 50.2% equity stake. We expect this consolidation to drive lower competition in the market.

HSBC

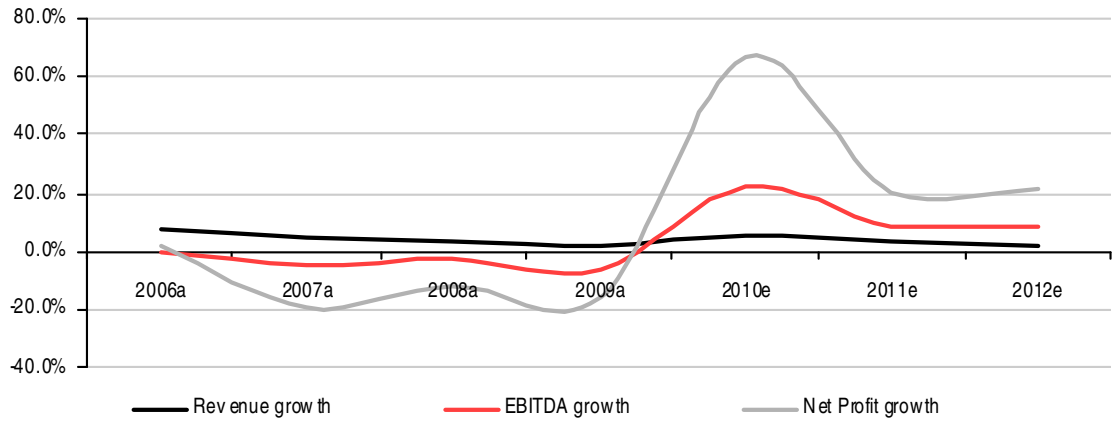
Korea: Market charts

Market position: Wireless subscriber growth vs. net profit growth



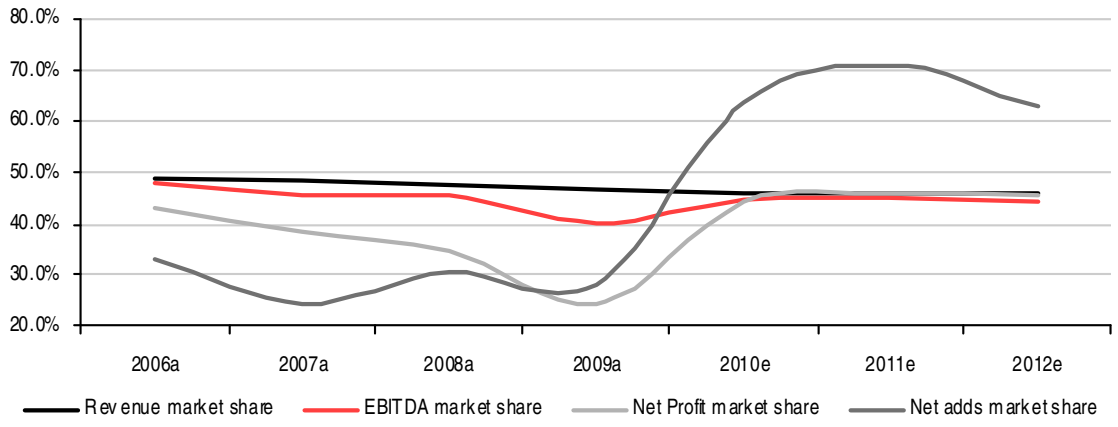
Source: Company reports, HSBC estimates

Market growth: Revenue, EBITDA and net profit (YoY change)



Source: Company reports, HSBC estimates

Market structure: KT's revenue, EBITDA, net profit and wireless net adds market shares (%)



Source: Company reports, HSBC estimates

HSBC

KT Corp (030200)

- Best wireless network positioning amongst operators in Asia
- Able to pursue wireless data growth at little incremental cost
- OW: KRW67,000 TP, based on 8x 2011e EPS

Investment thesis

KT continues to execute well across its businesses. Similar to SK Telecom and LG U+, KT benefited from strong demand for smartphones in 3Q 2010 – particularly the iPhone 4, which launched on 10 September. While this resulted in an 8% QoQ increase in marketing costs, smartphone ARPU remained high. Elsewhere, substantial labour cost reductions (down 12% QoQ) and lower churn in broadband as a result of increased take-up of bundled services were positives. Wireless data revenue growth remained strong: we expect 25% growth y-o-y in 2011, and we believe that KT has the best network in Asia.

Forecasts, business outlook

KT's strategy continues to focus on leveraging its network strengths. It will continue to invest in wireless (in all areas – WiFi, WiBro, WCDMA and femtocells) but overall capex is likely to come in lower than original 2010 guidance for KRW3.2trn. We estimate 2.8m smartphone users by end 2010, relative to the company target of 2.5m..

Data growth outlook

Wireless data revenue growth remained strong: we expect 25% growth y-o-y in 2011, and we believe that KT has the best network in Asia. A 2-3 month delay before shipping the iPhone 4 coupled with delays in other handsets limited KT's growth in 3Q 2010. However, a trend of 45% of new smartphone users taking a tariff plan over KRW55,000 per month increased to more than 70% for the iPhone 4 in September – we expect the benefits from this to come through in 4Q and 2011. We are encouraged by the diversification of KT's smartphone base at end October: c700k subscribers of the 2.1m smartphone base were non-iPhone customers, implying strong growth for mid-range phones such as the Optimus One (which sold 45k handsets in September). KT plans a total of 7-8 smartphone launches in the 4Q, including the Desire HD from HTC.

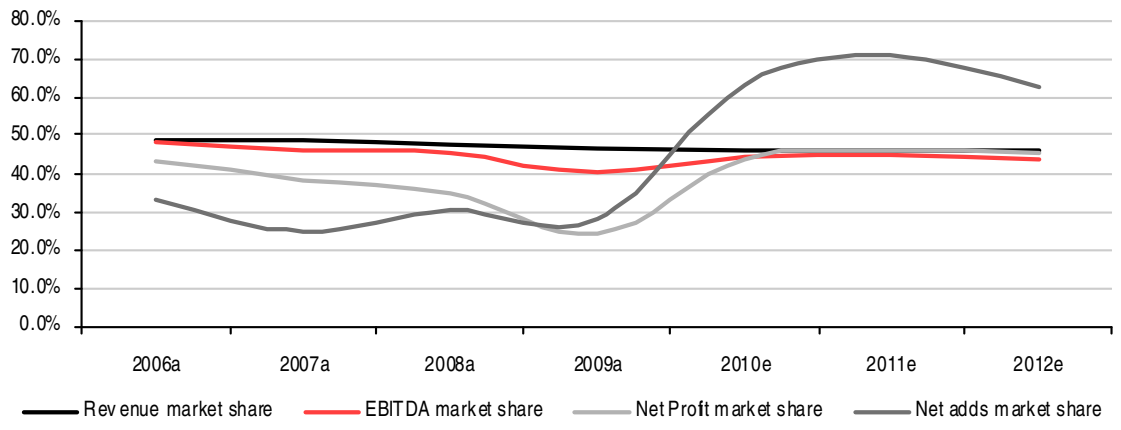
Valuation and risks

Valuations for KT are compelling: the stock trades at 5.5x 2011e; dividend yield of 5.5%. We apply a multiple of 8x to 2011e EPS, based on recent trading history. Our target price implies a target multiple of 7.8x 2011e.KT combines elements of both growth and yield. The commitment to a 50% payout ratio implies potential upside to our dividend forecasts (based on a dividend equivalent to 40% of net profit) if the foreign ownership quota of 49% remains filled. The key risks to our view are higher than expected competition, and a change in shareholder return policy.

HSBC

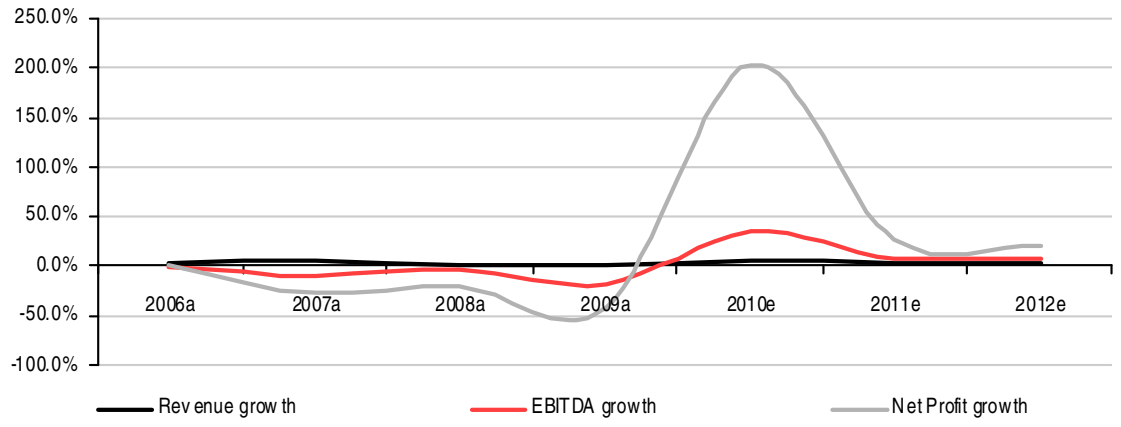
KT Corp: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



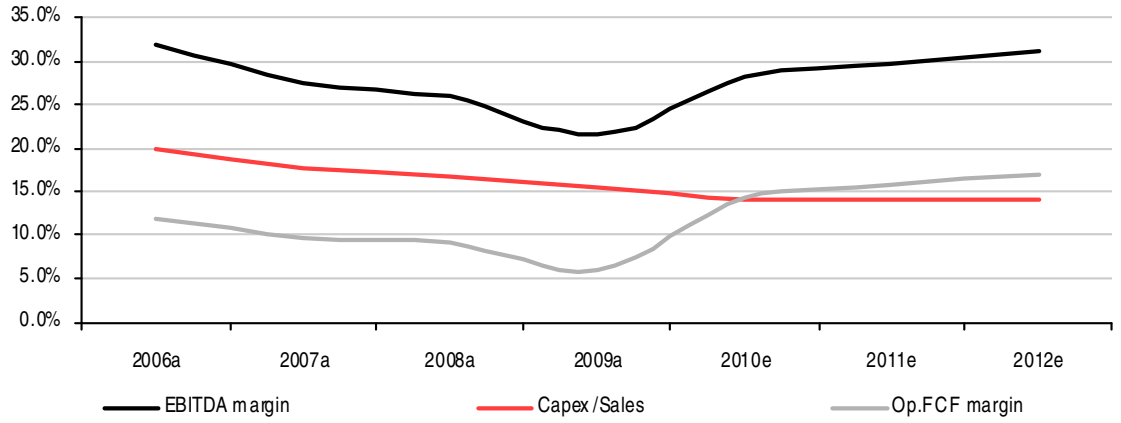
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: KT Corp

Overweight

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (KRWb)				
Revenue	18,956	20,544	21,454	21,686
EBITDA	4,065	5,367	5,790	6,300
Depreciation & amortisation	-3,120	-2,993	-2,947	-2,915
Operating profit/EBIT	945	2,374	2,843	3,385
Net interest	-319	-389	-355	-290
PBT	709	1,903	2,488	3,095
HSBC PBT	632	2,032	2,488	3,095
Taxation	-103	-414	-526	-673
Net profit	606	1,489	1,962	2,422
HSBC net profit	529	1,618	1,962	2,422
Cash flow summary (KRWb)				
Cash flow from operations	3,562	4,572	4,566	5,338
Capex	-2,959	-2,670	-2,787	-2,888
Cash flow from investment	-2,959	-2,695	-2,897	-2,998
Dividends	-226	-258	-595	-786
Change in net debt	-313	-350	-1,074	-1,554
FCF equity	603	1,902	1,779	2,450
Balance sheet summary (KRWb)				
Intangible fixed assets	1,207	1,036	1,036	1,036
Tangible fixed assets	14,204	13,699	13,539	13,512
Current assets	6,475	7,432	8,559	10,100
Cash & others	1,575	2,282	3,357	4,911
Total assets	24,343	24,936	25,903	27,417
Operating liabilities	5,859	5,372	4,971	4,850
Gross debt	7,827	8,184	8,184	8,184
Net debt	6,252	5,902	4,827	3,273
Shareholders funds	10,398	10,785	11,961	13,412
Invested capital	14,451	14,513	14,806	14,887

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	0.1	8.4	4.4	1.1
EBITDA	-16.9	32.0	7.9	8.8
Operating profit	-34.5	151.2	19.7	19.1
PBT	7.4	168.5	30.7	24.4
HSBC EPS	-32.3	220.3	21.2	23.4
Ratios (%)				
Revenue/IC (x)	1.3	1.4	1.5	1.5
ROIC	5.5	12.8	15.3	17.8
ROE	5.0	15.3	17.3	19.1
ROA	4.3	7.6	9.2	10.5
EBITDA margin	21.4	26.1	27.0	29.1
Operating profit margin	5.0	11.6	13.3	15.6
EBITDA/net interest (x)	12.7	13.8	16.3	21.7
Net debt/equity	60.1	54.7	40.4	24.4
Net debt/EBITDA (x)	1.5	1.1	0.8	0.5
CF from operations/net debt	57.0	77.5	94.6	163.1
Per share data (KRW)				
EPS Rep (fully diluted)	2,451	6,311	8,315	10,263
HSBC EPS (fully diluted)	2,141	6,858	8,315	10,263
DPS	2,000	2,520	3,330	4,110
Book value	42,078	45,708	50,693	56,846

Key forecast drivers

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Mobile market share (%)	31	32	33	32
Wireless Voice ARPU (KRW)	23,670	24,292	23,810	23,210
Wireless Data ARPU (KRW)	6,724	7,932	9,120	10,290
Churn Rate Wireless (%)	-3	-3	-3	-3
VoIP revenue, KRW bn	261	376	489	551
IPTV revenue, KRW bn	0	0	0	0

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	1.0	0.9	0.8	0.7
EV/EBITDA	4.5	3.4	2.9	2.4
EV/IC	1.3	1.2	1.1	1.0
PE*	21.6	6.8	5.6	4.5
P/Book value	1.1	1.0	0.9	0.8
FCF yield (%)	5.0	15.7	14.7	20.3
Dividend yield (%)	4.3	5.4	7.2	8.9

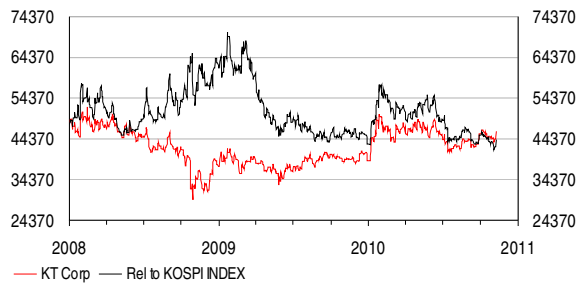
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (KRW)	46300	Target price (KRW)	67000	Potent'l return (%)	44.7

Reuters (Equity)	030200.KS	Bloomberg (Equity)	030200 KS
Market cap (USDm)	10,876	Market cap (KRWb)	12,089
Free float (%)	78	Enterprise value (KRWb)	17,991
Country	Korea	Sector	Diversified Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

SK Telecom (017670)

- Smartphone demand high, but other costs creeping up
- SK Telecom has moved quickly to improve its smartphone positioning, and has aggressively marketed new tariff plans
- Neutral: TP of KRW179,000 based on 8x 2011e EPS

Investment thesis

SK Telecom has recovered well from its weaker position relative to KT in the first half of the year. It has aggressively pushed the Samsung Galaxy S smartphone, and has sought to diversify its portfolio as quickly as possible. It has also been aggressive on price. However, we continue to see better cost saving potential at KT and LG U+, and remain concerned that SKT may re-start its overseas investment campaign.

Forecasts, business outlook

SKT spent heavily on marketing in September 2010, to counter KT's iPhone 4 launch. It still plans to meet the KCC marketing expenditure target of 22% of service revenues: as its 9m expenditure was 25.3%, it needs to halve marketing costs in the final quarter to hit the target. Other one-off cost items and seasonally higher depreciation also depressed profits in the quarter.

Data growth outlook

Smartphone trends remain very positive. Previously to the third quarter, SKT had pointed out that it would take several quarters for the impact of smartphones to become meaningful. 2Q and 3Q wireless internet revenue QoQ growth of 7% and 8% respectively suggests that these benefits are now starting to come through.

Smartphone ARPU increased to KRW57,000 in the quarter (KRW62,000 for Galaxy S users), after the impact of special discounts – a substantial increase over overall ARPU of KRW36,000.

Valuation and risks

We apply a PE multiple of 8x to our 2011 EPS estimates to value SKT, based on a discount to its average trading range over the past two years of 10x. This reflects its decreased ability to command a premium, and heightened overseas investment risk, as outlined above.

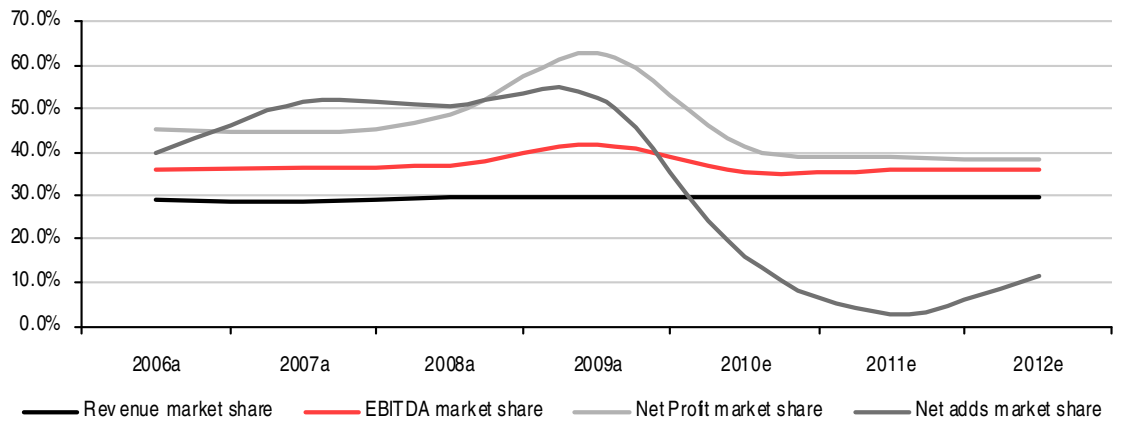
While SKT yield is relatively attractive at 5.7%, management has thus far preferred investment in growth to dividend increases.

Potential upside risks are a reduction in marketing activity after the significant launches of Galaxy S and iPhone 4; the key downside risk is a return to large overseas investments.

HSBC

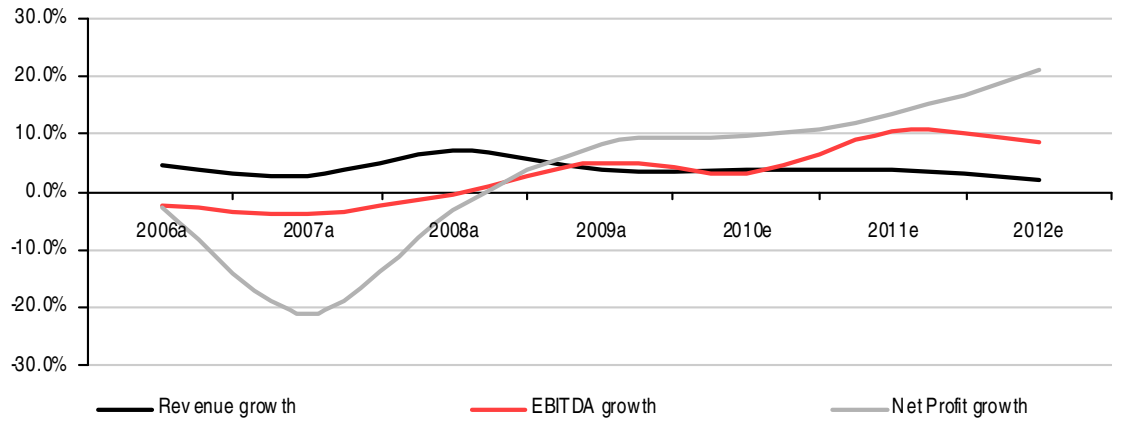
SK Telecom: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



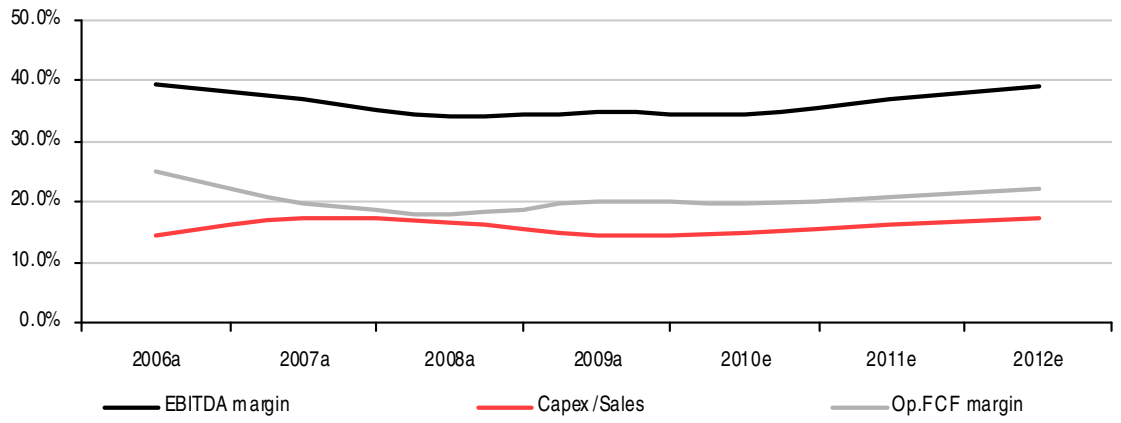
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: SK Telecom

Neutral

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (KRWb)				
Revenue	12,099	12,556	13,012	13,284
EBITDA	4,206	4,338	4,786	5,204
Depreciation & amortisation	-2,026	-2,152	-2,182	-2,205
Operating profit/EBIT	2,179	2,186	2,603	3,000
Net interest	-147	-133	-319	-258
PBT	1,658	1,876	2,144	2,620
HSBC PBT	1,805	1,979	2,247	2,723
Taxation	-369	-452	-519	-634
Net profit	1,289	1,424	1,625	1,986
HSBC net profit	1,368	1,500	1,703	2,064
Cash flow summary (KRWb)				
Cash flow from operations	3,030	2,058	3,831	4,331
Capex	-1,769	-1,841	-2,082	-2,258
Cash flow from investment	31	-1,894	-2,135	-2,258
Dividends	-682	-682	-761	-887
Change in net debt	38	739	-935	-1,186
FCF equity	1,155	163	1,677	1,988
Balance sheet summary (KRWb)				
Intangible fixed assets	2,666	2,461	2,514	2,514
Tangible fixed assets	5,197	5,196	5,096	5,150
Current assets	4,983	6,397	6,581	6,831
Cash & others	969	1,000	1,000	1,203
Total assets	19,298	20,485	20,585	20,870
Operating liabilities	3,377	3,237	3,408	3,578
Gross debt	4,679	5,449	4,514	3,531
Net debt	3,710	4,449	3,514	2,328
Shareholders funds	11,241	11,799	12,663	13,762
Invested capital	8,500	9,817	9,783	9,714

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	3.6	3.8	3.6	2.1
EBITDA	5.0	3.1	10.3	8.7
Operating profit	5.8	0.3	19.1	15.2
PBT	10.2	13.1	14.3	22.2
HSBC EPS	8.1	9.7	13.5	21.2
Ratios (%)				
Revenue/IC (x)	1.5	1.4	1.3	1.4
ROIC	21.3	18.1	20.1	23.3
ROE	12.5	13.0	13.9	15.6
ROA	8.0	8.2	9.2	10.7
EBITDA margin	34.8	34.5	36.8	39.2
Operating profit margin	18.0	17.4	20.0	22.6
EBITDA/net interest (x)	28.7	32.6	15.0	20.1
Net debt/equity	33.0	37.7	27.7	16.9
Net debt/EBITDA (x)	0.9	1.0	0.7	0.4
CF from operations/net debt	81.7	46.3	109.0	186.0
Per share data (KRW)				
EPS Rep (fully diluted)	17,777	19,633	22,406	27,377
HSBC EPS (fully diluted)	18,862	20,686	23,484	28,456
DPS	9,400	9,400	10,887	13,478
Book value	154,988	162,674	174,591	189,733

Key forecast drivers

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Mobile market share (%)	51	50	50	50
Wireless Voice ARPU, KRW	26,150	24,580	23,250	22,110
Wireless Data ARPU, KRW	10,760	11,850	12,560	13,240
Churn Rate Wireless (%)	-3	-3	-3	-2
Marketing expenses/Sales (%)	27	26	25	22
Capex/Sales (%)	15	15	16	17

Valuation data

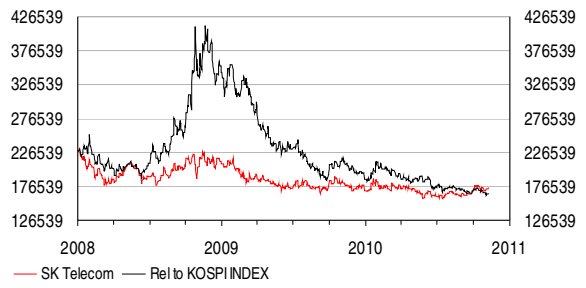
Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	1.5	1.5	1.4	1.2
EV/EBITDA	4.2	4.3	3.7	3.2
EV/IC	2.1	1.9	1.8	1.7
PE*	9.3	8.4	7.4	6.1
P/Book value	1.1	1.1	1.0	0.9
FCF yield (%)	8.2	1.2	11.9	14.1
Dividend yield (%)	5.4	5.4	6.2	7.7

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (KRW)	174500	Target price (KRW) 179000	Potent'l return (%) 2.6
Reuters (Equity)	017670.KS	Bloomberg (Equity)	017670 KS
Market cap (USDm)	12,676	Market cap (KRWb)	14,090
Free float (%)	72	Enterprise value (KRWb)	18,539
Country	Korea	Sector	Wireless Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

LG Uplus (032640)

- 3Q results weak on smartphone shipment delays; marketing expenses higher from defence of existing customer base
- Smartphone benefits and cost savings delayed, but expected to come through in 2011
- OW: KRW8,700 TP based on 8x 2011e EPS

Investment thesis

LG U+ management is, in our view, the furthest ahead in recognising the potential in converged networks and services: it will convert a disadvantage to an advantage in moving early from its capacity-constrained CDMA network to deploy LTE in early 2011, targeting nationwide coverage by mid-2013. With its fibre-based fixed network, this will give it a strong, all-IP platform. We expect capex to rise in 2011 to 19% of sales (from 16% in 2010). Its cloud initiative and strategic partnership is the first of several moves aimed at monetising this advantage. The LG U+ box and cloud service will enable users to access their services from a variety of devices. The company continues to build out its WiFi network. While we see KT as the clear leader in this segment, the LG U+ deployment target of 16,000 WiFi hotspots (from 11,000 previously) in 2010 will help it attract smartphone users, as well as 'offload' traffic quickly from wireless to wireline.

Forecasts, business outlook

LG U+ beat consensus sales expectations (from handset sales) at the expense of profits in 3Q. EBITDA of KRW340bn was 19% lower than consensus and HSBC forecasts, and down 17% QoQ. The primary driver was a delay in shipment of smartphones, resulting in LG U+ spending more on feature phone SACs to defend existing customers. This trend should improve in 4Q, with the sale of the Optimus Prime handsets beginning in October.

Data growth outlook

LG U+ struggled in 3Q as a result of a delay in smartphone shipments. This led to increased spending on feature phones, which (due to lower vendor subsidies) cost LG U+ more, but typically results in lower ARPU than smartphone customers. This trend should improve in 4Q, with a full quarter's benefit of the Optimus Prime handset, which launched in October. LG U+ is also focused on tablet PCs, and is building out a 16,000 WiFi hotspot network in 2010, higher than its original plan.

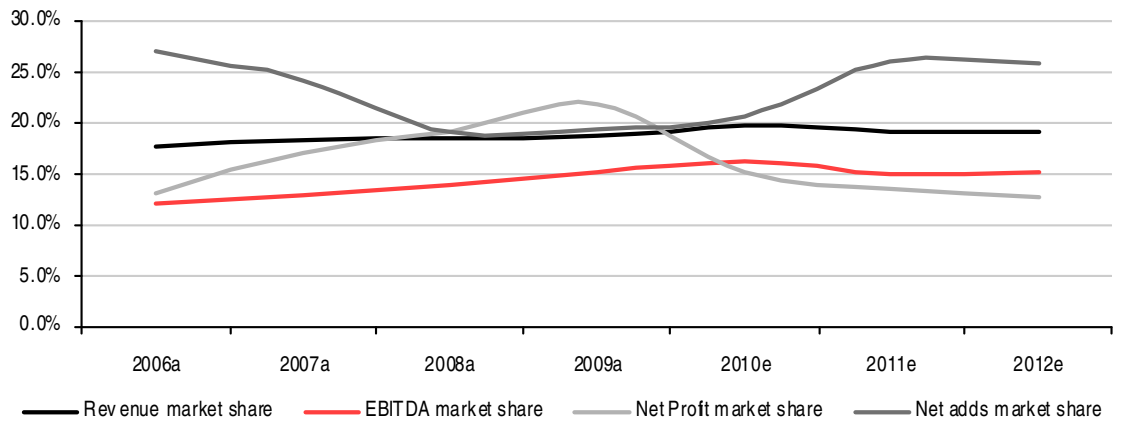
Valuation and risks

We use a multiple of 8x 2011e EPS, based on a 3-year average trading range. This returns our target price of KRW8,700. Our DCF fair value estimate remains KRW10,000. Catalysts are improved smartphone trends and better cost trends. Downside risks are greater than expected competition and weaker realization of cost savings.

HSBC

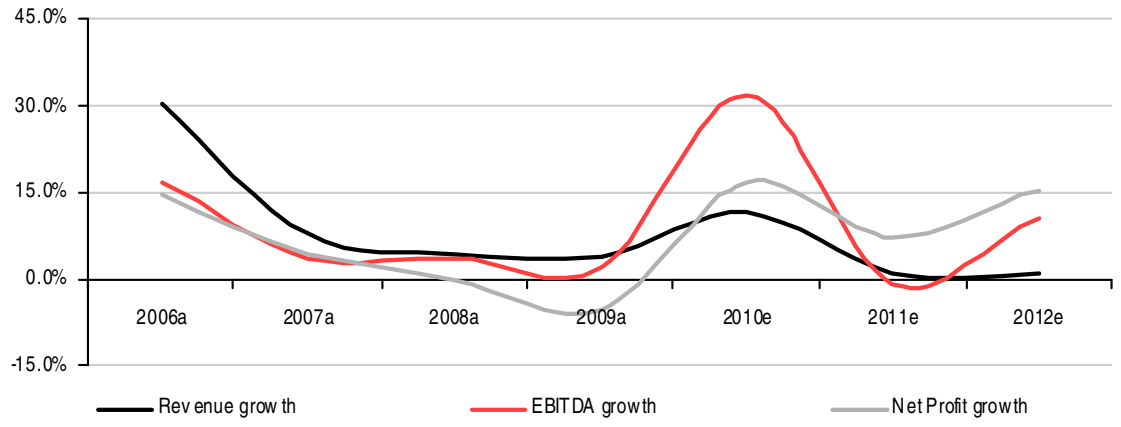
LG Uplus: Key company charts

Exhibit 1: Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



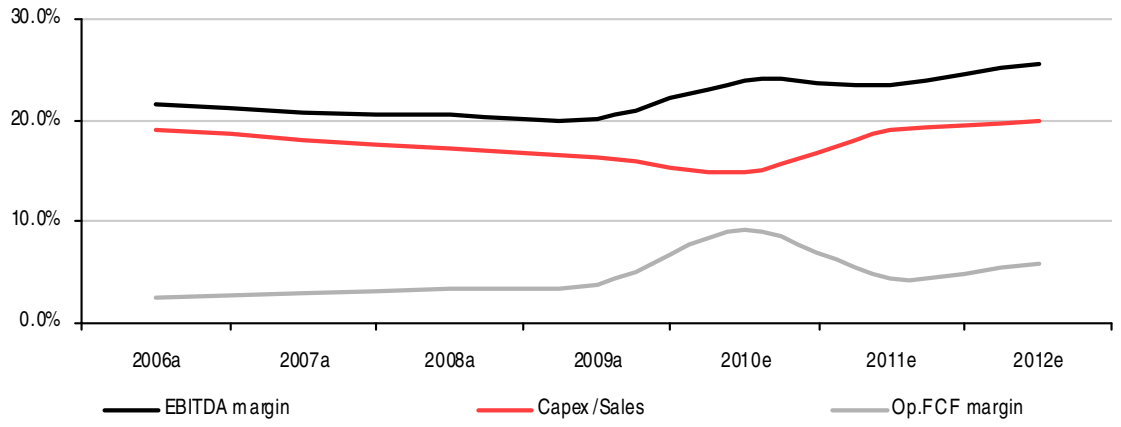
Source: Company reports, HSBC estimates

Exhibit 2: Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Exhibit 3: Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: LG Uplus

Overweight

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (KRWb)				
Revenue	7,587	8,452	8,537	8,596
EBITDA	1,531	2,017	2,001	2,212
Depreciation & amortisation	-851	-1,229	-1,171	-1,261
Operating profit/EBIT	680	788	830	951
Net interest	-73	-79	-71	-75
PBT	552	698	719	836
HSBC PBT	607	708	759	876
Taxation	-129	-35	-160	-186
Net profit	422	663	559	651
HSBC net profit	473	553	592	684
Cash flow summary (KRWb)				
Cash flow from operations	2,105	1,879	1,853	1,923
Capex	-1,248	-1,255	-1,622	-1,719
Cash flow from investment	-1,248	-1,285	-1,742	-1,769
Dividends	-407	-180	-180	-175
Change in net debt	325	210	69	22
FCF equity	929	657	146	218
Balance sheet summary (KRWb)				
Intangible fixed assets	748	542	496	413
Tangible fixed assets	4,782	5,024	5,641	6,232
Current assets	1,813	2,554	2,562	2,568
Cash & others	339	1,000	1,000	1,000
Total assets	8,170	9,025	9,604	10,118
Operating liabilities	2,365	2,428	2,555	2,608
Gross debt	1,750	2,621	2,691	2,712
Net debt	1,411	1,621	1,691	1,712
Shareholders funds	3,970	3,859	4,243	4,682
Invested capital	4,639	4,692	5,145	5,606

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue		11.4	1.0	0.7
EBITDA	3.4	31.8	-0.8	10.6
Operating profit	-0.8	15.9	5.4	14.6
PBT	-0.3	26.5	3.0	16.3
HSBC EPS	-4.8	16.7	7.1	15.5
Ratios (%)				
Revenue/IC (x)	1.7	1.8	1.7	1.6
ROIC	12.2	17.2	15.8	15.7
ROE	11.9	14.1	14.6	15.3
ROA	6.7	8.8	7.1	7.7
EBITDA margin	20.2	23.9	23.4	25.7
Operating profit margin	9.0	9.3	9.7	11.1
EBITDA/net interest (x)	20.9	25.4	28.2	29.7
Net debt/equity	35.5	42.0	39.8	36.6
Net debt/EBITDA (x)	0.9	0.8	0.8	0.8
CF from operations/net debt	149.2	115.9	109.6	112.3
Per share data (KRW)				
EPS Rep (fully diluted)	820	1,288	1,086	1,264
HSBC EPS (fully diluted)	920	1,073	1,150	1,328
DPS	0	350	340	410
Book value	7,711	7,496	8,241	9,095

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	0.6	0.5	0.5	0.5
EV/EBITDA	2.8	2.2	2.2	2.0
EV/IC	0.9	0.9	0.9	0.8
PE*	7.8	6.7	6.2	5.4
P/Book value	0.9	1.0	0.9	0.8
FCF yield (%)	32.6	23.3	5.2	7.8
Dividend yield (%)	0.0	4.9	4.8	5.7

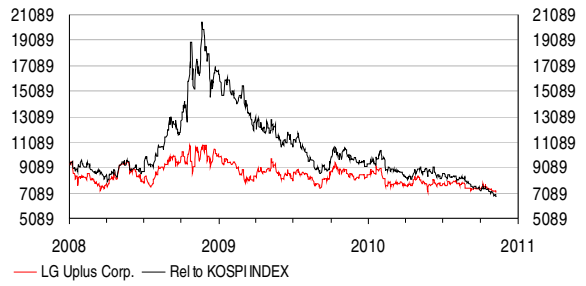
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (KRW)	7150	Target price (KRW)	8700	Potent'l return (%)	21.7

Reuters (Equity)	032640.KS	Bloomberg (Equity)	032640 KS
Market cap (USDm)	3,311	Market cap (KRWb)	3,681
Free float (%)	70	Enterprise value (KRWb)	4,441
Country	Korea	Sector	Diversified Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

SK Broadband (033630)

- Merger speculation overdone, in our view
- Operational outlook improving – expect net profit for 2011
- Neutral (V): KRW6,200 target price based on a PB and DCF blend

Investment thesis

SK Broadband stock periodically appreciates on reports in the Korean media that SK Telecom will increase its equity stake (it currently holds 50.56% of the equity, and consolidates it in its US GAAP reporting). We believe this speculation is overdone, but note the benefits from increased co-operation with SK Telecom, particularly the 'TB' bundled services launched in April 2010.

Forecasts, business outlook

A KRW2trn business, SK Broadband derives 56% of its revenues from broadband (80% of which is fiber LAN), 29% from voice, and 10% from leased line.

SK Broadband posted OP of KRW5.3bn (HSBCe KRW3.6bn) despite incurring a one-time KRW28bn charge in the quarter for redundancy costs incurred in the Early Retirement Program, which saw c15% of staff leave the company. Key elements of the results include: broadband and voice revenues, which make up 80% of total revenues, declined slightly, in line with expectations. However, the IDC and solution business grew 43.3% QoQ to KRW38.4bn. We estimate B2B revenues for 2010 at cKRW683bn, compared to the company target of KRW600bn.

Q3 saw a 29.4% QoQ reduction in marketing expenditures, as a result of greater efficiencies from the resale partnership with SK Telecom. This is encouraging, representing both an industry-wide shift away from value-destructive commissions, and a company shift to working more closely with SKT.

Valuation and risks

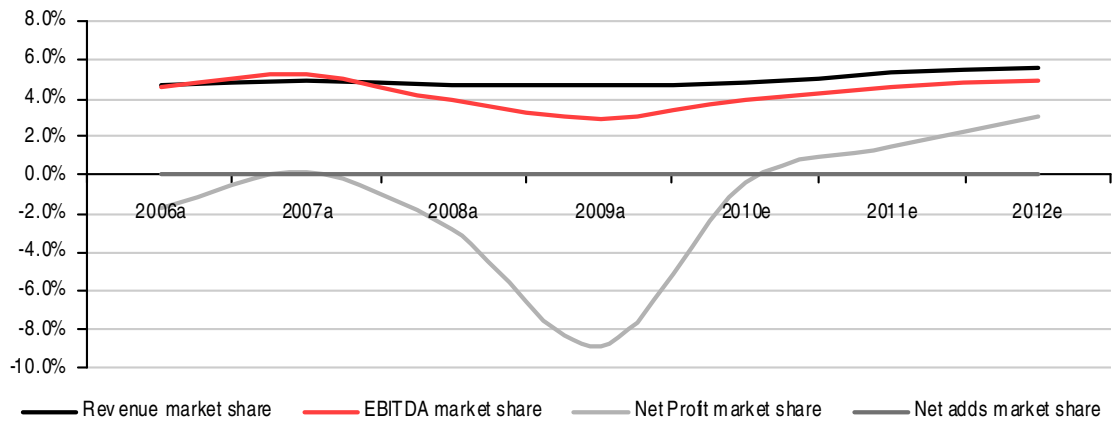
We continue to derive our target price by taking an average of PB and DCF-based valuations. We roll forward our PB-based fair value to 2011, taking a value of KRW4,900 (up from the KRW4,600 2010 estimate previously). Our multiple of 1x PB value is unchanged. Our DCF-based fair value declines from KRW7,800 to KRW7,400 as we roll forward our start year to 2011. This implies an unchanged blended target price of KRW6,200 per share for SKB shares.

The key upside risk to our valuation is a more rapid move to profitability than we currently forecast. We also note the possibility of closer ties with SK Telecom after a faster-than-expected move to profitability. Conversely, the key downside risk to our Neutral rating is that the KCC mishandles the implementation of the cap on marketing costs, and the fixed-line operators return to mutually value-destructive competition.

HSBC

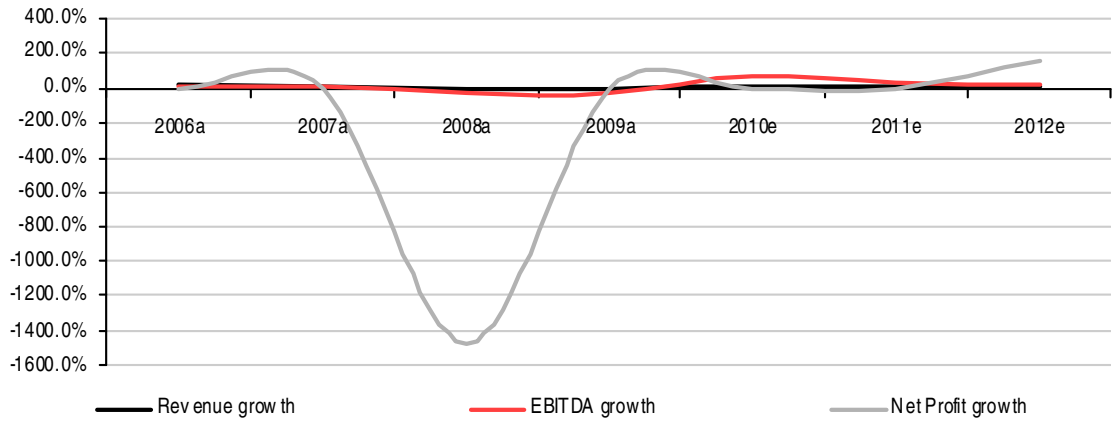
SK Broadband: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



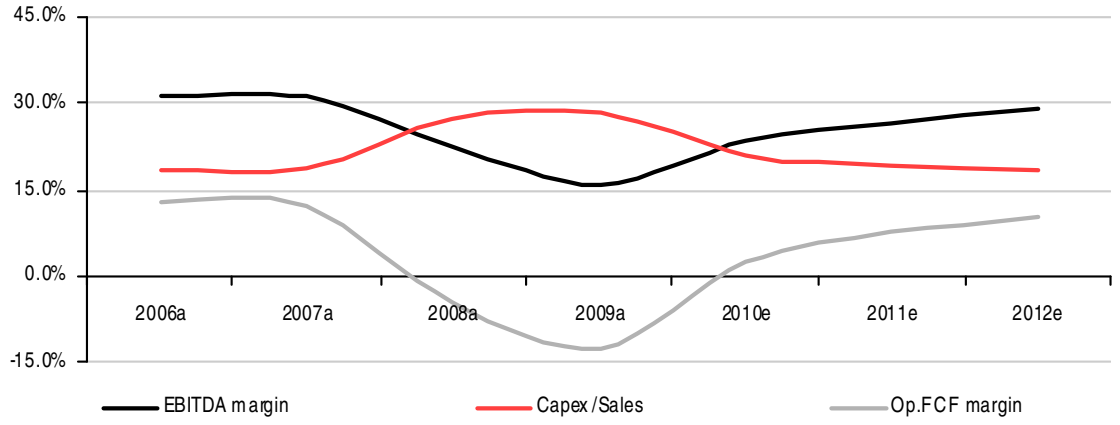
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: SK Broadband Co Ltd

Neutral (V)

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (KRWb)				
Revenue	1,894	2,112	2,442	2,659
EBITDA	300	458	642	741
Depreciation & amortisation	-409	-412	-444	-439
Operating profit/EBIT	-109	47	198	302
Net interest	-81	-75	-102	-85
PBT	-191	-26	98	219
HSBC PBT	-193	-27	97	219
Taxation	0	0	0	-27
Net profit	-191	-26	98	192
HSBC net profit	-193	-27	97	192
Cash flow summary (KRWb)				
Cash flow from operations	437	100	672	597
Capex	-540	-404	-464	-489
Cash flow from investment	-540	-404	-464	-489
Dividends	0	0	-5	-59
Change in net debt	-247	383	-203	-48
FCF equity	-40	-304	208	108
Balance sheet summary (KRWb)				
Intangible fixed assets	126	112	112	112
Tangible fixed assets	2,207	2,221	2,240	2,290
Current assets	550	715	618	706
Cash & others	221	125	156	204
Total assets	3,147	3,322	3,247	3,387
Operating liabilities	664	606	610	617
Gross debt	1,018	1,306	1,133	1,133
Net debt	798	1,181	978	929
Shareholders funds	1,400	1,363	1,456	1,589
Invested capital	1,998	2,317	2,205	2,288

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	1.8	11.5	15.6	8.9
EBITDA	-28.3	52.9	40.0	15.5
Operating profit			323.8	53.0
PBT				124.2
HSBC EPS				96.9
Ratios (%)				
Revenue/IC (x)	0.9	1.0	1.1	1.2
ROIC	-5.1	2.2	8.7	11.8
ROE	-13.7	-1.9	6.9	12.6
ROA	-3.1	1.8	6.3	8.2
EBITDA margin	15.8	21.7	26.3	27.9
Operating profit margin	-5.7	2.2	8.1	11.4
EBITDA/net interest (x)	3.7	6.1	6.3	8.7
Net debt/equity	57.0	86.6	67.2	58.5
Net debt/EBITDA (x)	2.7	2.6	1.5	1.3
CF from operations/net debt	54.8	8.5	68.7	64.2
Per share data (KRW)				
EPS Rep (fully diluted)	-721.42	-89.38	331.69	651.91
HSBC EPS (fully diluted)	-726.70	-90.74	330.33	650.55
DPS	0.00	0.00	165.16	364.31
Book value	5285.49	4621.44	4936.61	5386.92

Key forecast drivers

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Broadband ARPU (KRW)	23,081	22,261	22,081	22,188
EBITDA Margin (%)	16	22	26	28
Capex to Sales (%)	28	19	19	18

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	1.3	1.3	1.0	0.9
EV/EBITDA	7.9	6.0	4.0	3.4
EV/IC	1.2	1.2	1.2	1.1
PE*			16.2	8.2
P/Book value	1.0	1.2	1.1	1.0
FCF yield (%)	-2.5	-19.2	13.2	6.8
Dividend yield (%)	0.0	0.0	3.1	6.8

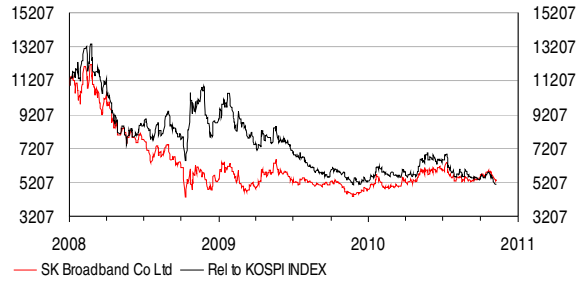
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (KRW)	5340	Target price (KRW)	6200	Potent'l return (%)	16.1

Reuters (Equity)	033630.KQ	Bloomberg (Equity)	033630 KS
Market cap (USDm)	1,422	Market cap (KRWb)	1,580
Free float (%)	52	Enterprise value (KRWb)	2,761
Country	Korea	Sector	Diversified Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

Singapore

- Rational market competition to prevail while operating and regulatory developments are not major game changers
- Capital management policies to continue despite new environment
- NBN – field of dreams for now

Market view

The Singapore telco sector is changing. Incumbent positions in iPhone supply, pay TV content and fixed broadband (BB) are being challenged and we think this will result in 2011e industry revenue growth slowing to 1% from 9% in 2010e. But the balance sheets of the three telcos are strong enough to continue to support capex and dividend payouts. Nonetheless, we believe free cash flow (FCF) generation and capital management commitments will not be jeopardised as rational competition will prevail.

Market size and structure

Given a lengthy lead time, we believe that incumbents SingTel and StarHub have strategies to handle increased competition from M1 and any new entrants. We forecast that M1 will take market share in mobile and broadband but the pace should not be disruptive, especially as the company has its own healthy capital management policy and profitability to maintain. At the same time, while SingTel and StarHub are strong rivals we do not believe they will engage in a long-term, value destructive price war across multiple service platforms. Although heated at times, the Singapore telecom market is relatively rational compared to some other Southeast Asian markets.

Data outlook

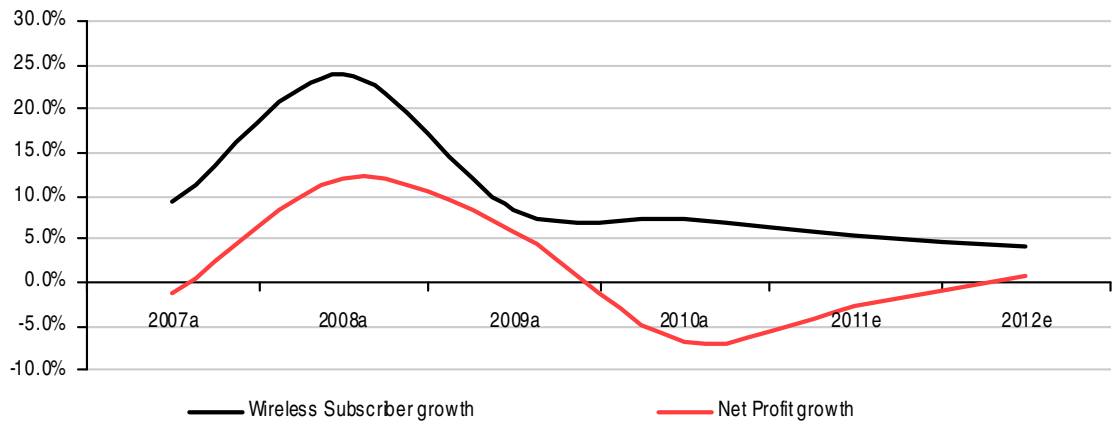
Although surveys by the Singapore regulator, the Infocomm Development Authority (IDA), found that only 12% of households used mobile phones for internet access in 2009, the recent smartphone boom is likely to raise those levels. The high levels of per capita GDP (cUSD36.5,000 in 2009), household computer penetration (83% in 2009), mobile penetration (140% in 2Q10) set the stage for higher fee smartphone plans and illustrate a populace accustomed to high speed internet access.

As smartphones proliferate and subscribers increasingly use wireless broadband (BB) tethers to laptops, the capacity crunch risk could in theory stretch capacity and, in turn, lead to risk of higher capex. While subsidy-based competition and the launch of the national broadband network (NBN) represent opex and cash flow pressures, we believe this will not reach debilitating levels. The three telcos have room on their balance sheets to support capex and we remain confident that cash dividend payouts are secure and subject to future upside.

HSBC

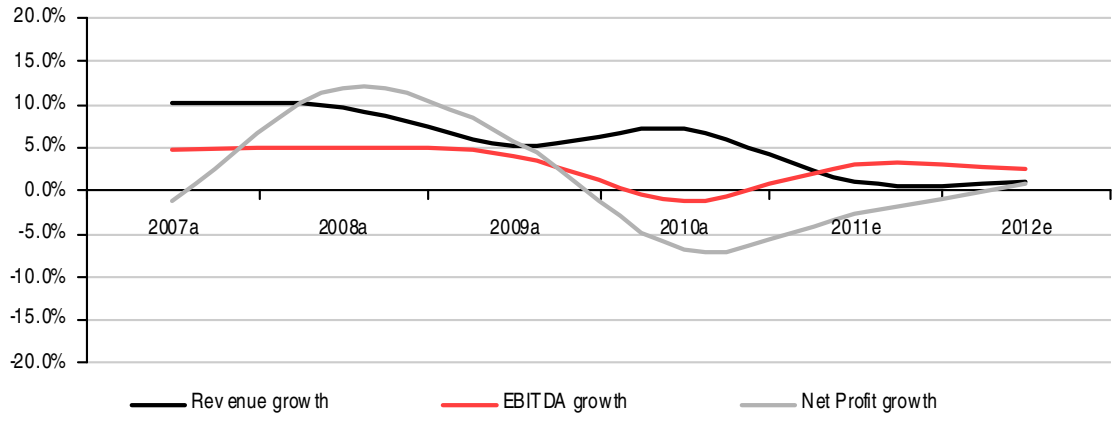
Singapore: Market charts

Market position: Wireless subscriber growth vs. net profit growth



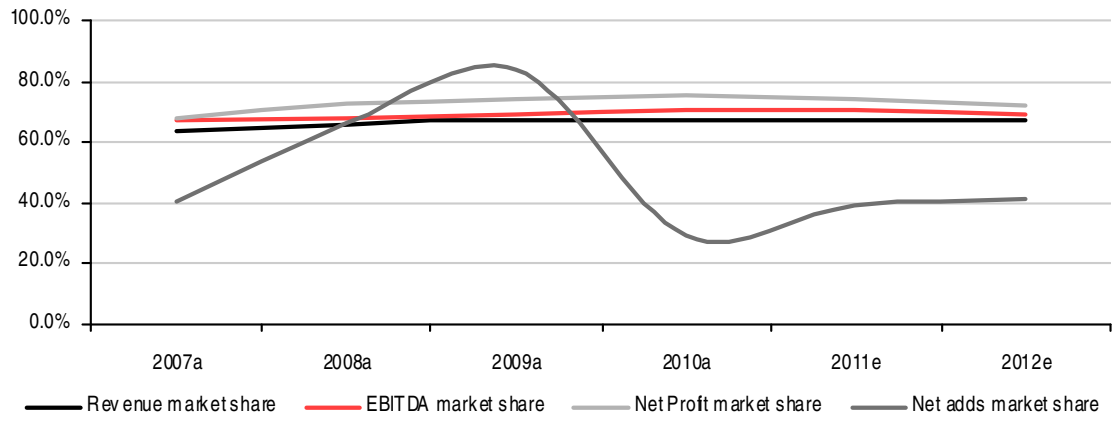
Source: Company reports, HSBC estimates

Market growth: Revenue, EBITDA and net profit (YoY change)



Source: Company reports, HSBC estimates

Market structure: Telkom's revenue, EBITDA, net profit and wireless net adds market shares (%)



Source: Company reports, HSBC estimates

HSBC

SingTel (ST SP)

- Concerns on the timing of value creation at Bharti and Telkomsel will continue to weigh down relative performance
- SingTel's diversified business structure will likely enable it to continue to outperform its more volatile parts
- Neutral with TP of SGD3.26 based on SOTP methodology

Investment thesis

SingTel's regionally diversified portfolio of market leaders provides a solid core of earnings and cash flow that is relatively defensive. However, the advanced stage of the growth cycle for all but India and Indonesia creates a significant hurdle for achieving double digit growth. With 32%-owned Bharti in the early days of digesting Zain and 35%-owned Telkomsel still challenged by XL Axiata, the potential upside from any positive developments for Optus are being washed out. This has caused the stock to underperform the broad Singapore market.

Forecasts, business outlook

We forecast the SingTel group to have a consolidated revenue and underlying profit CAGR of c2% and c8% over 2011-14, respectively. Our 2011e forecasts are in line with management guidance over the period apart from the Singapore EBITDA margin outlook, where we are below management guidance on costs related to the iPhone 4.0 launch and Barclays Premier League (BPL) content costs.

We expect StarHub and M1 to offer better yields than SingTel which has traditionally kept the payout lower, keeping its powder dry for increasing overseas exposure. However, recent payout revisions to the 55%-70% range announced in the 2QFY11 results is a positive step in our view. But given the pure Singapore focus of the smaller players, high cash flow businesses operating in a rational competitive environment, they are more likely to deliver higher yields for at least the medium term.

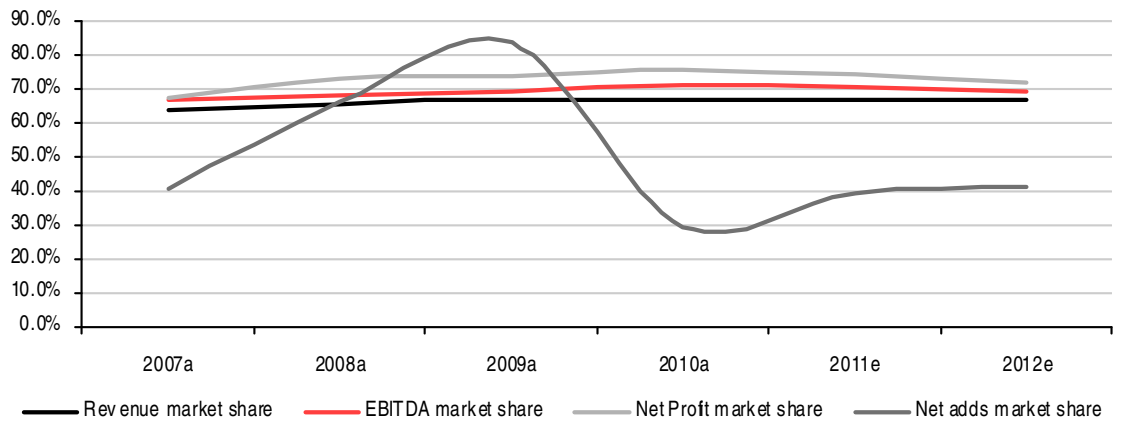
Valuation and risks

We are Neutral on SingTel with a SGD3.26 target price. We use a sum-of-the-parts (SOTP) methodology where the ex-growth parts are valued on DDM and growth parts are valued on a mix of DCF and PE. We apply a control discount of 20% to associates as although SingTel has more rights than a normal minority investor, it is not in majority control. The risk to our target price is worse than expected competitive heat in the major markets, and/or an extreme movement of the Singapore dollar against subsidiary or associate foreign exchange rates.

HSBC

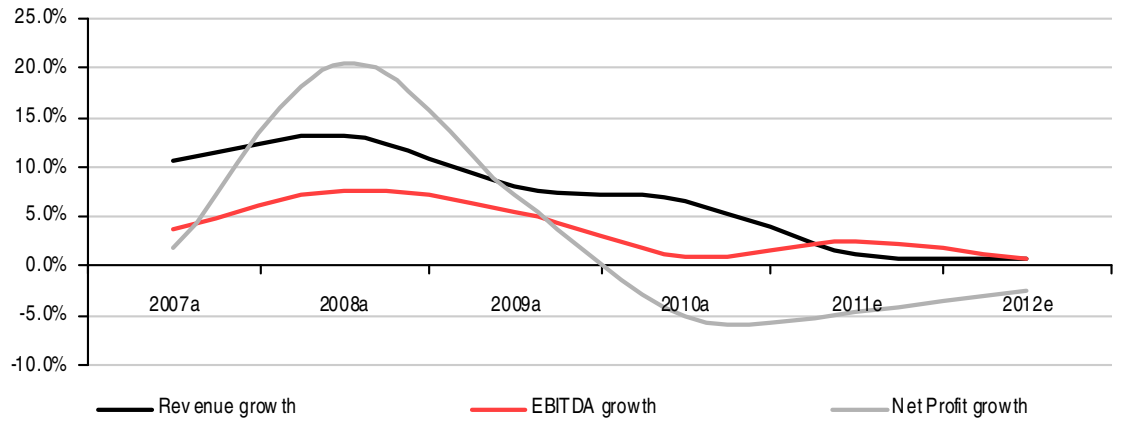
SingTel: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



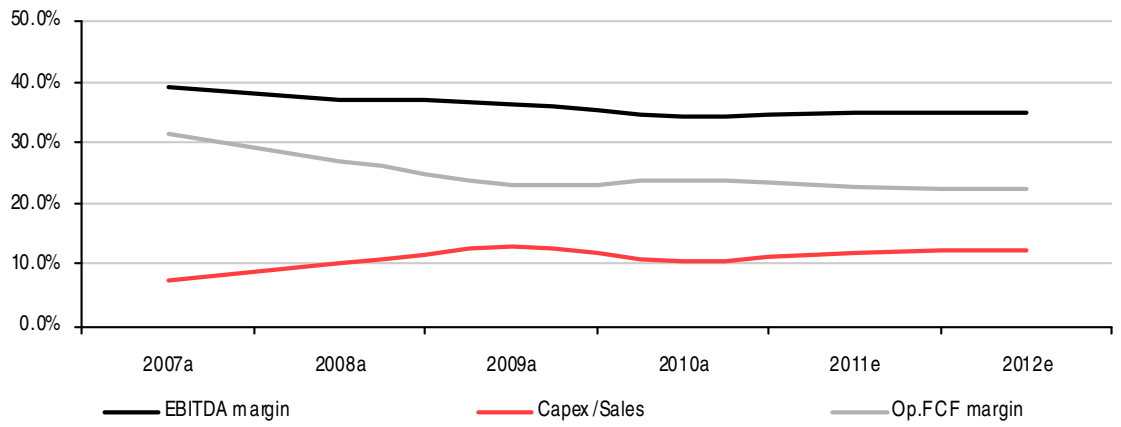
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: Singapore Telecom

Neutral

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (SGDm)				
Revenue	16,872	18,004	18,588	18,989
EBITDA	4,751	4,990	5,239	5,360
Depreciation & amortisation	-1,879	-1,926	-1,992	-2,070
Operating profit/EBIT	2,872	3,064	3,247	3,290
Net interest	-334	-346	-328	-307
PBT	5,041	5,041	5,551	6,229
HSBC PBT	4,996	4,947	5,457	6,137
Taxation	-1,138	-1,270	-1,638	-1,956
Net profit	3,905	3,773	3,913	4,273
HSBC net profit	3,855	3,679	3,819	4,181
Cash flow summary (SGDm)				
Cash flow from operations	5,003	5,444	5,520	5,286
Capex	-1,926	-2,195	-2,406	-2,426
Cash flow from investment	-2,193	-2,249	-2,406	-2,426
Dividends	-2,084	-2,357	-2,391	-2,600
Change in net debt	-252	-900	-723	-260
FCF equity	1,209	990	820	638
Balance sheet summary (SGDm)				
Intangible fixed assets	10,085	10,147	10,075	10,003
Tangible fixed assets	10,750	10,782	11,268	11,696
Current assets	5,145	7,256	7,531	7,307
Cash & others	1,614	3,179	3,457	3,256
Total assets	37,952	40,205	42,401	44,254
Operating liabilities	6,550	7,358	8,672	9,490
Gross debt	7,886	8,552	8,106	7,645
Net debt	6,272	5,372	4,649	4,389
Shareholders funds	23,493	24,273	25,600	27,096
Invested capital	17,816	17,648	16,746	16,260

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	13.0	6.7	3.2	2.2
EBITDA	8.4	5.0	5.0	2.3
Operating profit	8.3	6.7	6.0	1.3
PBT	15.0	0.0	10.1	12.2
HSBC EPS	13.7	-4.6	3.8	9.5
Ratios (%)				
Revenue/IC (x)	1.0	1.0	1.1	1.2
ROIC	13.2	13.2	13.6	14.0
ROE	17.5	15.4	15.3	15.9
ROA	11.7	10.4	10.1	10.5
EBITDA margin	28.2	27.7	28.2	28.2
Operating profit margin	17.0	17.0	17.5	17.3
EBITDA/net interest (x)	14.2	14.4	16.0	17.5
Net debt/equity	26.7	22.1	18.1	16.2
Net debt/EBITDA (x)	1.3	1.1	0.9	0.8
CF from operations/net debt	79.8	101.3	118.7	120.4
Per share data (SGD)				
EPS Rep (fully diluted)	0.25	0.24	0.25	0.27
HSBC EPS (fully diluted)	0.24	0.23	0.24	0.26
DPS	0.14	0.15	0.16	0.17
Book value	1.48	1.52	1.61	1.70

Key forecast drivers

Year to	03/2010a	03/2011e	03/2012e	03/2013e
SingTel Domestic Revenue	5,996	6,419	6,521	6,569
Optus Revenue	10,876	11,585	12,067	12,420
SingTel Domestic EBITDA	2,179	2,173	2,268	2,277
Optus EBITDA	2,572	2,817	2,970	3,083
Associate pre-tax profit	2,411	2,223	2,538	3,154
Capex	-1,955	-2,195	-2,406	-2,426

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	2.2	2.1	2.0	1.9
EV/EBITDA	7.9	7.4	6.9	6.7
EV/IC	2.1	2.1	2.2	2.2
PE*	13.7	14.3	13.8	12.6
P/Book value	2.2	2.2	2.1	1.9
FCF yield (%)	3.9	3.1	2.6	2.0
Dividend yield (%)	4.3	4.5	4.7	5.3

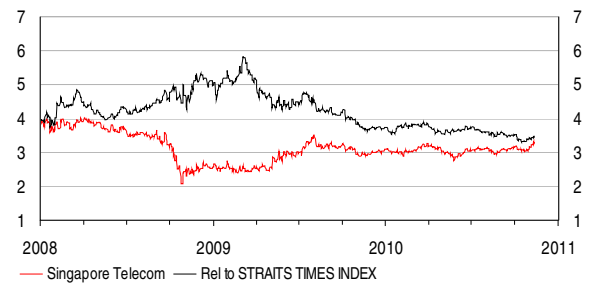
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (SGD)	3.31	Target price (SGD)	3.26	Potent'l return (%)	-1.5

Reuters (Equity)	STEL.SI	Bloomberg (Equity)	ST SP
Market cap (USDm)	40,910	Market cap (SGDm)	52,743
Free float (%)	45	Enterprise value (SGDm)	36972
Country	Singapore	Sector	DIVERSIFIED TELECOMS
Analyst	Luis Hilado	Contact	+65 6239 0656

Price relative



Source: HSBC

Note: price at close of 11 Nov 2010

HSBC

StarHub (STH)

- Although incumbent positions are being challenged, "hubbing" strategy remains a good defensive measure
- Commitment to capital management remains strong; we forecast DPS to increase 10% to SGD0.22 in FY11
- Neutral: TP of SGD2.91 based on DDM valuation methodology

Investment thesis

After losing its primary pay TV sports content to SingTel and with the upcoming NBN putting its broadband position at risk, StarHub has de-rated. We have factored in ARPU weakness in the two business lines rather than churn as we believe StarHub's bundling strategy ("hubbing") for its mobile (No. 2 market position), broadband (No. 2) and pay TV (No. 1) businesses is an effective retention tool. Although heated at times, the Singapore telecom market is relatively rational vs the extremes in other Southeast Asia markets.

Forecasts, business outlook

StarHub's recent 3Q10 results were slightly short of our estimates and significantly beat consensus. We think the strong recovery from the previous two quarters' doldrums was a good indicator of momentum. Although the dividend payout for the quarter remained at SGD0.05, we continue to believe that a healthy balance sheet (1.1x net debt to EBITDA in FY11e against management pain threshold of 2x), an adequate level of retained earnings at the company level, and a strong management conviction to return excess cash to shareholders provide impetus for future dividend increases. Although some 4G capex and cash tax payments are on the horizon, we believe StarHub can take on additional leverage to fund this.

Valuation and risks

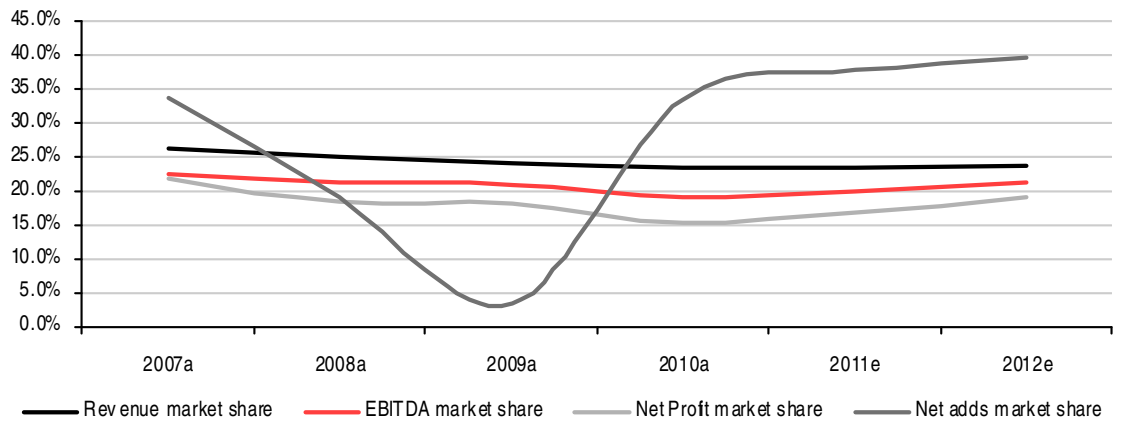
The risks to our outlook are irrational competition in any of StarHub's three main lines of business and/or capex running significantly higher than forecasted. On the other hand, we have not factored in StarHub generating additional revenue share in the non-residential market traditionally dominated by SingTel. Post-NBN, StarHub has indicated it will gain access to 20,000 non-residential buildings that previously generated SGD800m in telco revenues annually.

We value StarHub using a DDM methodology as the business has achieved the level of maturity that provides sustainable, healthy free cash flows that are in turn returned to investors. We base the DDM on 8% COE and a 0% terminal growth rate. Upside and downside risks to our valuation are reliant on the prospects for the dividend payout and FCF.

HSBC

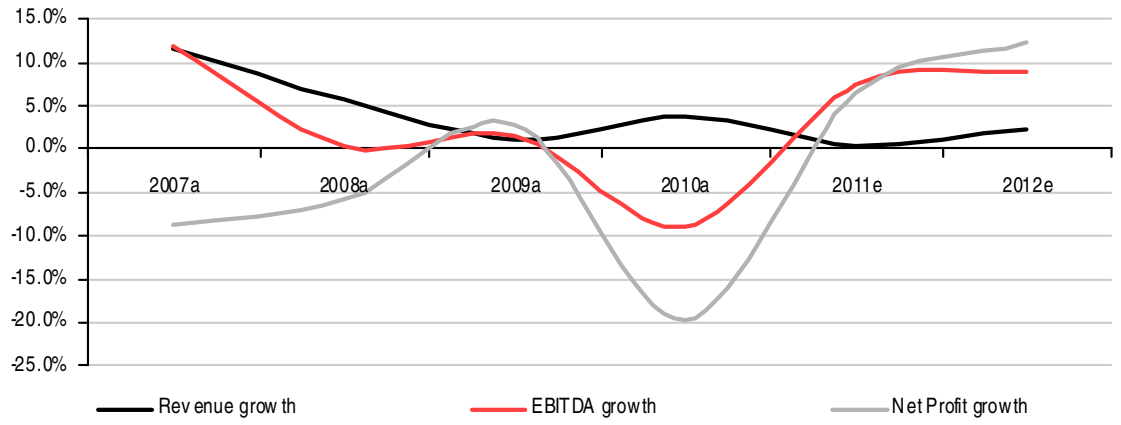
StarHub: Key company charts

Market position: revenue share, EBITDA share, net profit share and wireless net adds market share



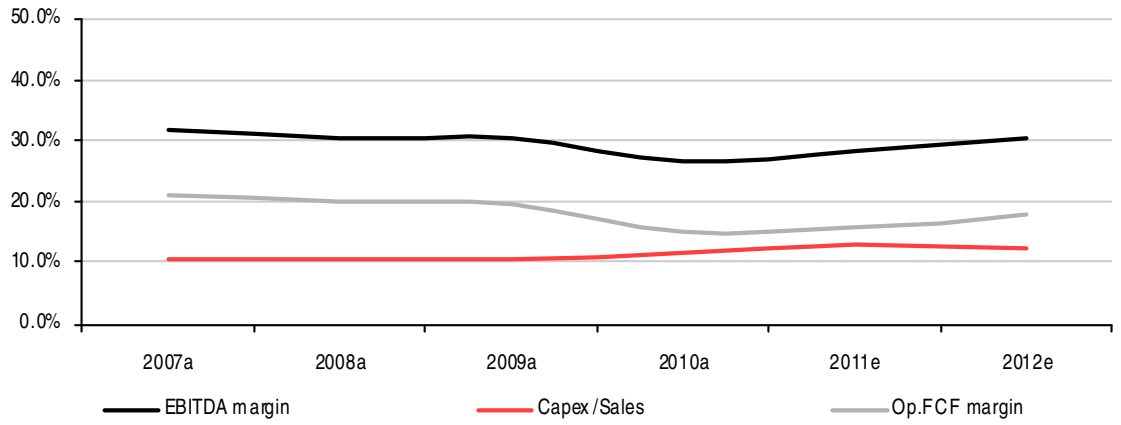
Source: Company reports, HSBC estimates

Financial performance: growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: StarHub

Neutral

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (SGDm)				
Revenue	2,150	2,230	2,235	2,286
EBITDA	654	595	639	695
Depreciation & amortisation	-245	-253	-270	-292
Operating profit/EBIT	409	342	369	403
Net interest	-23	-24	-27	-28
PBT	385	317	341	375
HSBC PBT	385	317	341	375
Taxation	-65	-60	-67	-67
Net profit	320	257	274	307
HSBC net profit	320	257	274	307
Cash flow summary (SGDm)				
Cash flow from operations	669	613	556	610
Capex	-231	-259	-289	-282
Cash flow from investment	-231	-257	-289	-282
Dividends	-317	-343	-377	-377
Change in net debt	-124	-8	110	49
FCF equity	360	290	250	325
Balance sheet summary (SGDm)				
Intangible fixed assets	416	431	418	407
Tangible fixed assets	785	791	824	825
Current assets	527	676	498	487
Cash & others	234	311	150	150
Total assets	1,733	1,913	1,740	1,720
Operating liabilities	711	914	896	896
Gross debt	896	965	914	964
Net debt	662	654	764	814
Shareholders funds	126	34	-70	-140
Invested capital	782	673	694	673

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	1.1	3.7	0.2	2.3
EBITDA	1.5	-9.0	7.3	8.8
Operating profit	-0.1	-16.4	7.9	9.2
PBT	0.8	-17.7	7.6	9.7
HSBC EPS	2.8	-19.7	6.5	12.1
Ratios (%)				
Revenue/IC (x)	2.6	3.1	3.3	3.3
ROIC	42.8	39.8	45.0	49.8
ROE	273.7	322.6	-1508.2	-292.2
ROA	20.0	15.3	16.3	19.2
EBITDA margin	30.4	26.7	28.6	30.4
Operating profit margin	19.0	15.3	16.5	17.6
EBITDA/net interest (x)	28.2	24.4	23.4	24.8
Net debt/equity	525.9	1944.8	0.0	0.0
Net debt/EBITDA (x)	1.0	1.1	1.2	1.2
CF from operations/net debt	101.1	93.7	72.8	75.0
Per share data (SGD)				
EPS Rep (fully diluted)	0.19	0.15	0.16	0.18
HSBC EPS (fully diluted)	0.19	0.15	0.16	0.18
DPS	0.19	0.21	0.22	0.22
Book value	0.07	0.02	-0.04	-0.08

Key forecast drivers

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Mobile revenue	1,094	1,189	1,272	1,310
Pay TV revenue	405	392	349	349
Broadband Revenue	241	230	203	207
Fixed network revenue	318	328	335	340
Capex	231	259	289	282
EBITDA	654	595	639	695

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	2.5	2.4	2.5	2.5
EV/EBITDA	8.4	9.2	8.7	8.1
EV/IC	7.0	8.1	8.0	8.3
PE*	15.0	18.7	17.5	15.6
P/Book value	38.1	142.8		
FCF yield (%)	7.5	6.1	5.2	6.8
Dividend yield (%)	6.8	7.3	7.9	7.9

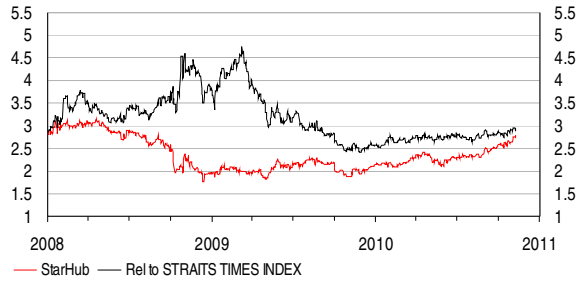
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (SGD)	2.80	Target price (SGD)	2.91	Potent'l return (%)	3.9

Reuters (Equity)	STAR.SI	Bloomberg (Equity)	STH SP
Market cap (USDm)	3,743	Market cap (SGDm)	4,804
Free float (%)	40	Enterprise value (SGDm)	5,444
Country	Singapore	Sector	Diversified Telecoms
Analyst	Luis Hilado	Contact	+65 6239 0656

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

M1 LTD (M1)

- We believe the shares have already anticipated M1 taking market share in the broadband space
- A higher, sustained payout policy could provide upside to our target and outlook
- Neutral: TP of SGD2.31 based on DDM valuation methodology

Investment thesis

M1 stands to benefit most from the NBN project. Gaining access to the fixed broadband (BB) retail service provider (RSP) market and potentially pay TV in the long term will enable M1 to compete with triple play incumbents StarHub and SingTel. We have assumed M1 will defend its 25-26% mobile market share and build a 22% share of the fixed BB market by 2015.

Forecasts, business outlook

We forecast a long-term postpaid and overall market share of 27% and 28%, respectively, for M1 by 2015e. Management recently unveiled plans to launch their own operating company (OpCo) to service corporate customers under the NBN but capex remains under study. This was also the case with plans to upgrade the network to LTE to address future data capacity and opportunities.

Valuation and risks

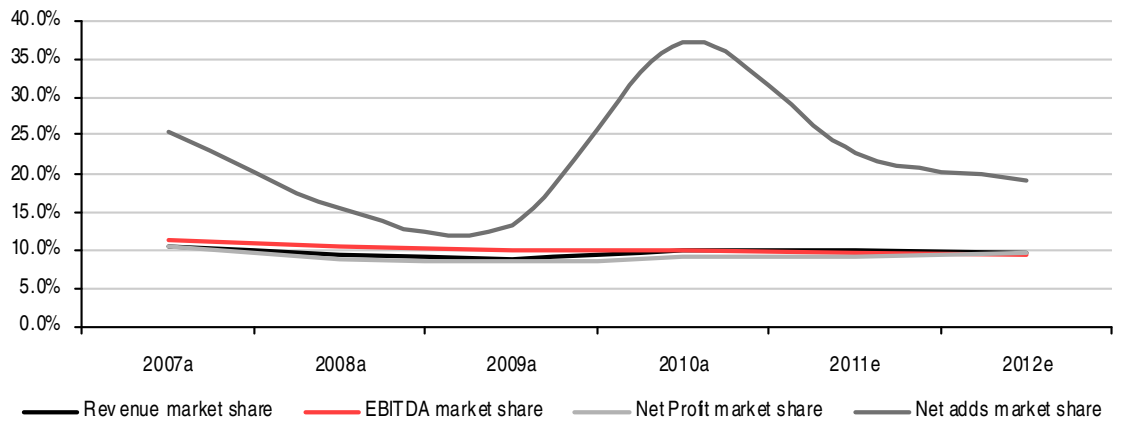
We value M1 on a DDM methodology as the business is now at the mature stage, providing sustainable, healthy free cash flows that are in turn returned to investors. We based the DDM on a 10-year average payout of 90%, a terminal growth rate of 0.5% and a COE of 8%. M1 has the FCF and balance sheet to increase cash dividend payout to shareholders even if medium-term capex is pressured by 4G rollout and/or by 3G due to strong demand for mobile BB. However, given the imminent launch of the BB RSP business, our payout forecasts for 2010e are in line with management's minimum commitment of 80%

The downside risks to our target price and outlook are irrational competition in M1's primary mobile business and/or capex running significantly higher than forecast. Meanwhile, an earlier, better-than-expected dividend payout would raise our DDM valuation on the stock.

HSBC

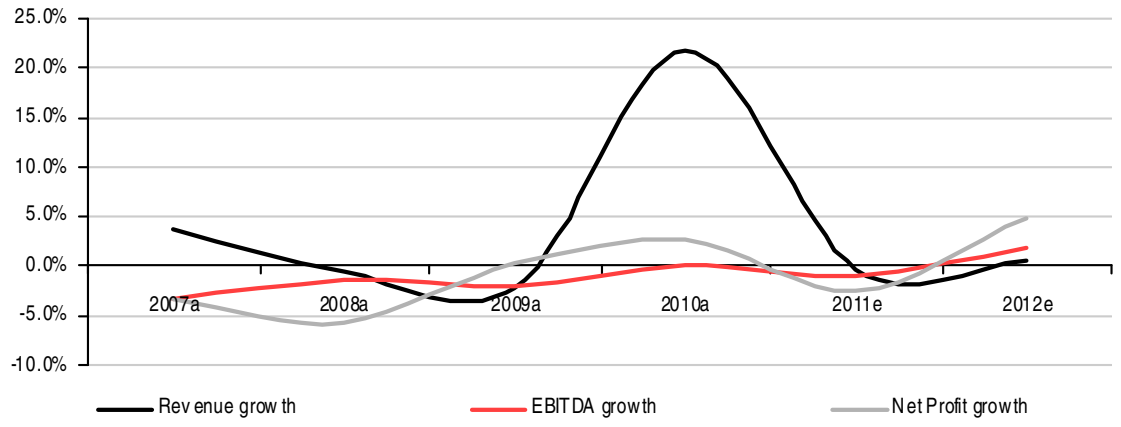
M1: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



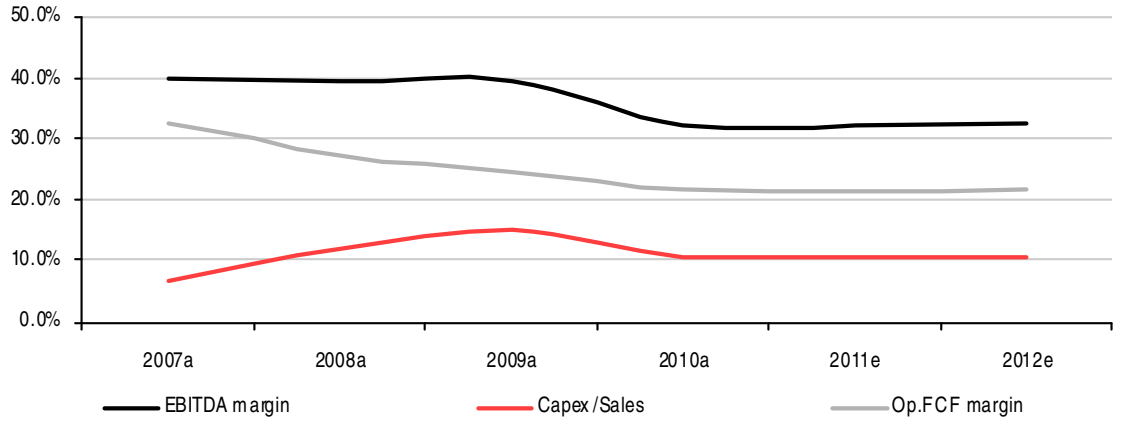
Source: Company reports, HSBC estimates

Financial performance: Growth (YoY) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and op. FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: M1

Neutral

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (SGDm)				
Revenue	783	955	952	955
EBITDA	310	310	307	312
Depreciation & amortisation	-128	-116	-117	-114
Operating profit/EBIT	182	194	189	198
Net interest	-7	-6	-6	-6
PBT	175	188	184	192
HSBC PBT	175	188	184	192
Taxation	-25	-33	-33	-35
Net profit	150	154	151	158
HSBC net profit	150	154	151	158
Cash flow summary (SGDm)				
Cash flow from operations	222	226	282	290
Capex	-119	-102	-101	-102
Cash flow from investment	-132	-102	-101	-102
Dividends	-120	-121	-117	-138
Change in net debt	29	-9	-64	-49
FCF equity	119	133	179	186
Balance sheet summary (SGDm)				
Intangible fixed assets	85	79	73	68
Tangible fixed assets	612	604	593	587
Current assets	141	243	243	283
Cash & others	7	50	62	111
Total assets	838	926	909	937
Operating liabilities	225	242	244	250
Gross debt	269	302	250	250
Net debt	262	252	188	139
Shareholders funds	256	231	246	262
Invested capital	605	633	604	576

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	-2.2	21.9	-0.3	0.4
EBITDA	-2.0	0.0	-1.0	1.9
Operating profit	-5.7	6.5	-2.2	4.6
PBT	-5.3	7.0	-2.1	4.8
HSBC EPS	0.2	2.3	-2.6	4.8
Ratios (%)				
Revenue/IC (x)	1.3	1.5	1.5	1.6
ROIC	27.8	26.5	25.8	28.3
ROE	62.7	63.3	63.0	62.1
ROA	19.0	18.1	16.9	17.6
EBITDA margin	39.5	32.5	32.2	32.7
Operating profit margin	23.2	20.3	19.9	20.7
EBITDA/net interest (x)	47.7	51.9	54.3	55.3
Net debt/equity	102.1	109.1	76.5	53.1
Net debt/EBITDA (x)	0.8	0.8	0.6	0.4
CF from operations/net debt	85.0	89.5	149.6	208.2
Per share data (SGD)				
EPS Rep (fully diluted)	0.17	0.17	0.17	0.18
HSBC EPS (fully diluted)	0.17	0.17	0.17	0.18
DPS	0.13	0.14	0.15	0.16
Book value	0.29	0.26	0.27	0.29

Key forecast drivers

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Mobile Subscribers ('000)	1,758	1,929	2,070	2,191
Blended ARPU (SGD)	40	40	38	36
Operating Expenses	602	761	762	757
EBITDA	310	310	307	312
Capex	119	102	101	102
DPS (SG Cents)	13	14	15	16

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	2.9	2.4	2.3	2.2
EV/EBITDA	7.3	7.3	7.1	6.8
EV/IC	3.7	3.5	3.6	3.7
PE*	13.2	12.9	13.3	12.6
P/Book value	7.8	8.6	8.1	7.6
FCF yield (%)	5.9	6.7	9.0	9.3
Dividend yield (%)	6.0	6.2	6.8	7.1

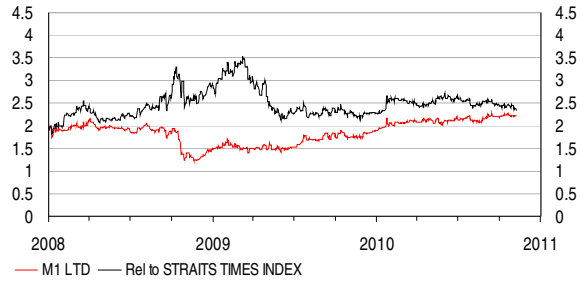
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (SGD)	2.22	Target price (SGD)	2.31	Potent'l return (%)	3.8

Reuters (Equity)	MONE.SI	Bloomberg (Equity)	M1 SP
Market cap (USDm)	1,555	Market cap (SGDm)	1,996
Free float (%)	36	Enterprise value (SGDm)	2,248
Country	Singapore	Sector	Diversified Telecoms
Analyst	Luis Hilado	Contact	+65 6239 0656

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

Taiwan

- Taiwan telco stocks have rallied on increased investor appetite for yield: we remain cautious, believing stocks to be fully valued
- Downside risks to Chunghwa include greater pressure to conserve its capital; wireless data growth is a sector positive
- Neutral on Chunghwa and Taiwan Mobile, and Underweight Far EasTone: cable deregulation a potential catalyst

Market view

Our bearish view of the Taiwanese telco market over the past 18 months was driven by CHT's weakness as an ex-incumbent, with 97% PSTN market share and c77% broadband market share. We saw it as vulnerable to cable deregulation, which would enable CHT's telco competitors to partner with cable providers to offer bundled services. In the wireless market, we saw risk from price competition driven by the success of off-net discounts offered by the smaller telcos, VIBO Telecom in particular. In wireline, CHT's line losses have been limited (chart below). Further, cable competition to CHT has yet to materialise: the rejection of Taiwan Mobile's bid to acquire cable operator kbro was rejected, and deregulation is set to take time. In wireless, data revenues have started to pick up, helping offset the impact of mandatory price controls introduced by the NCC in March 2010.

Market size and structure

In our focus on operational risk, we failed to recognise the importance of yield, and the extreme decline in performance that it would take to materially alter this yield. The telco sector has the highest dividend yield of the main equity sectors in Taiwan. It also compares well with regional peers: total yields of 6-9% are matched only by Telstra (10.4%) in our Asian telco coverage. CHT's total yield of 9% compares to the sovereign benchmark yield in Taiwan of 1.2%.

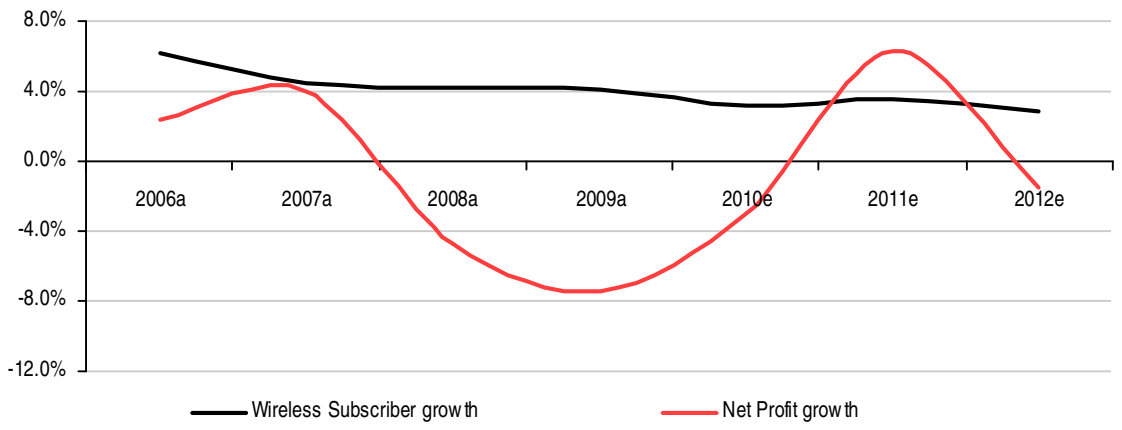
Data growth outlook

Compared to North Asian peers, data is a low percentage of service revenues in Taiwan: c14-15% compared to 20-25% in Korea, and 45-50% in Japan. Low data service demand has been followed by low data service supply, with operators only recently upgrading networks to support higher speeds. The strong demand for smartphones, then, is very encouraging: this promises a more broad-based revenue stream than that provided by data cards. As in other markets, we see subscribers moving to higher value tariffs when upgrading to smartphones, helping to offset the impact of the NCC-mandated tariff declines introduced in February 2010. However, we expect the telcos to struggle to differentiate their smartphone services relative to peers. For this reason, we expect smartphone adoption to be a secular positive.

HSBC

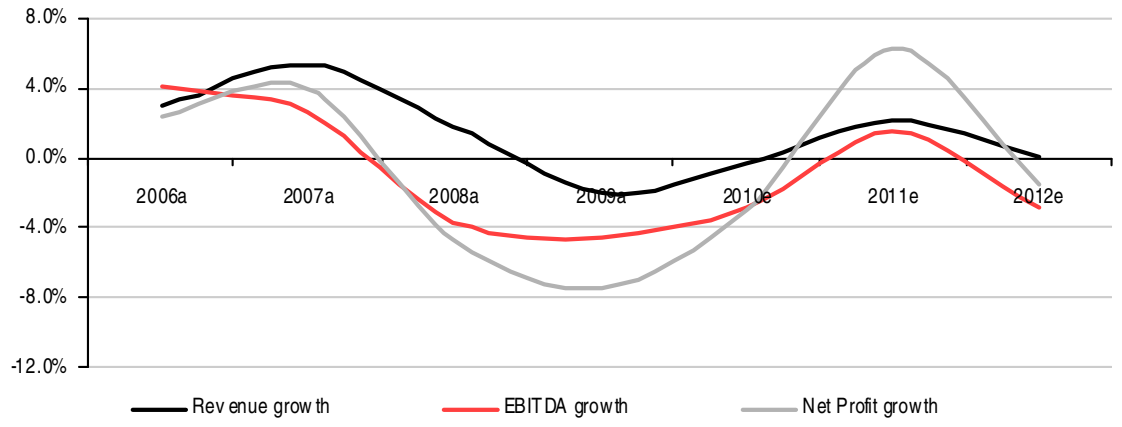
Taiwan: Market charts

Market position: Wireless subscriber growth vs net profit growth



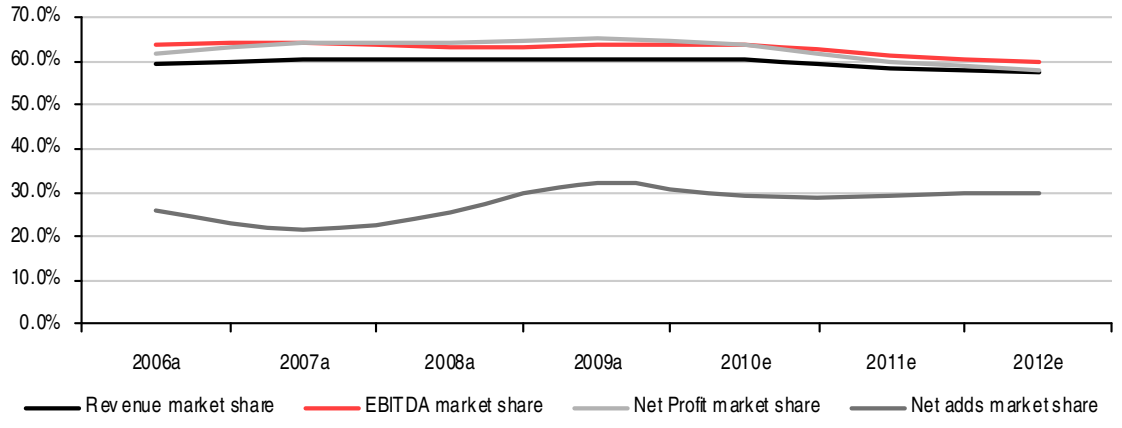
Source: Company reports, HSBC estimates

Market growth: Revenue, EBITDA and net profit (y-o-y change)



Source: Company reports, HSBC estimates

Market structure: Chunghwa Telecom's revenue, EBITDA, net profit and wireless net adds market share (%)



Source: Company reports, HSBC estimates

HSBC

Chunghwa (2412)

- Operating trends improving: wireless and wireline data growth offsetting mandatory price controls
- Reduced threat from regulation – particularly cable deregulation
- Neutral: TWD75 target price based on 15x 2011e EPS

Investment thesis

CHT remains popular as the largest, most liquid Taiwan telco stock, with a strong track record of high shareholder returns. While we see limited near-term risk, the potential for political pressure regarding its capital management policy is a concern. We also note the potential negative effect of cable deregulation (long planned, not yet enacted) which would likely impact CHT's c80% broadband market share.

Forecasts, business outlook

In wireline, CHT has shown a significant improvement in 2010. Even after incorporating the regulatory tariff cuts, wireline revenues are stable. With cable deregulation unlikely in the near-term, we expect CHT to maintain this trajectory. FTTx subscriber net addition trends also remain solid. We forecast an average 2010-12 annual revenue decline in the domestic wireline business of 0.9% and flat revenues in the Internet & Data business. In the wireless business we forecast a 2010-12 CAGR of 1.6%, with data revenue growth (CAGR of 18.7%) offsetting the impacts of the mandatory tariff reductions.

Data growth outlook

Smartphones currently form a small proportion of the overall subscriber base in Taiwan. At FET, smartphone accounts were just 6% of the total at 1H – but contributed c9% of the total service revenue, due to higher ARPU. The potential for rapid smartphone growth is significant: Chunghwa notes that smartphone ARPU stands at 1.8x of the normal 3G user. With each of the Taiwan telcos offering the iPhone and other key handsets, we expect this trend to be a sector positive, rather than favouring one operator.

Valuation and risks

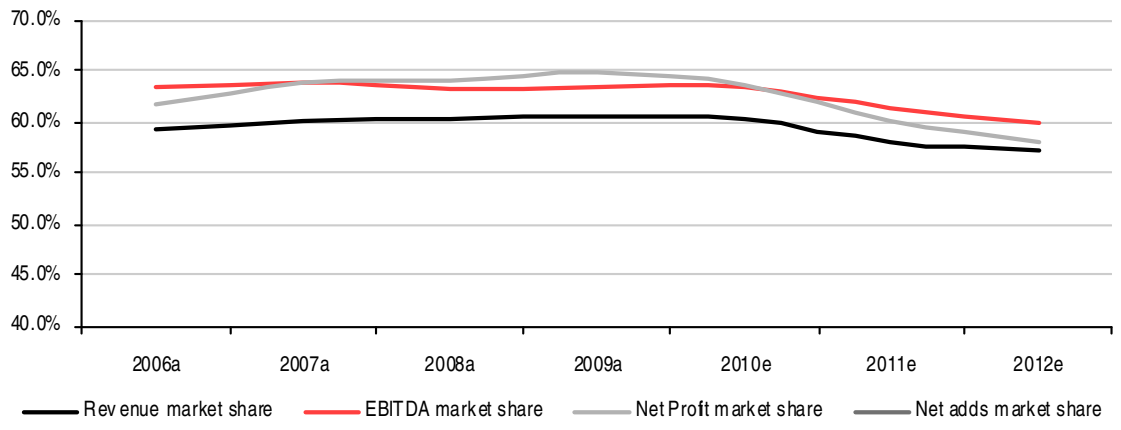
We use a straight PE-based model to value CHT, to facilitate easier comparison with domestic and international peers. CHT trades at 14.5x 2011e EPS, and 6.7x 2011e EBITDA. We forecast a total yield in 2011e of 8.9%. Our DDM-derived target price is TWD67, lower than our PE-based target price. Our DCF-derived target price is TWD71, also lower than our PE-derived target price.

The shareholder return outlook remains the largest potential catalyst, and the biggest risk to our Neutral rating: maintenance of the return at current levels would be a positive, while a reduction (possibly as a result of political pressure) a significant negative for the stock.

HSBC

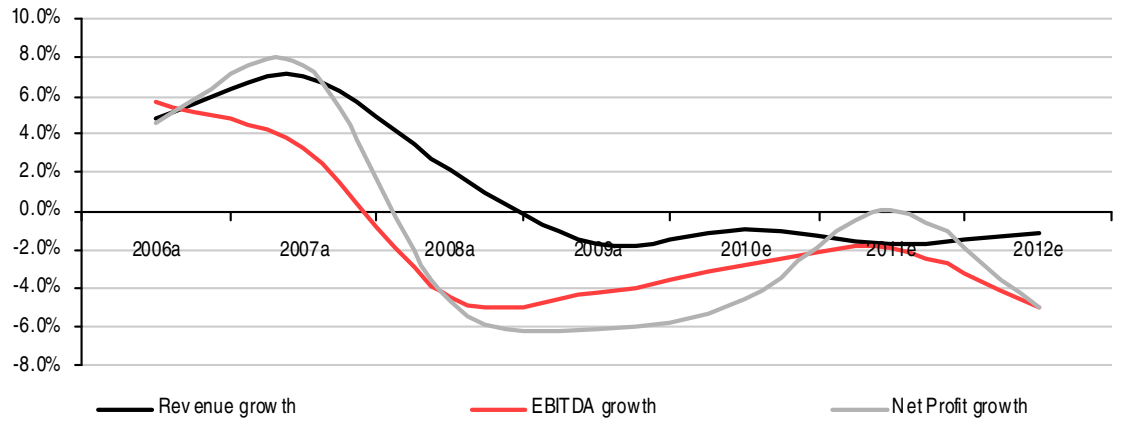
Chunghwa Telecom: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



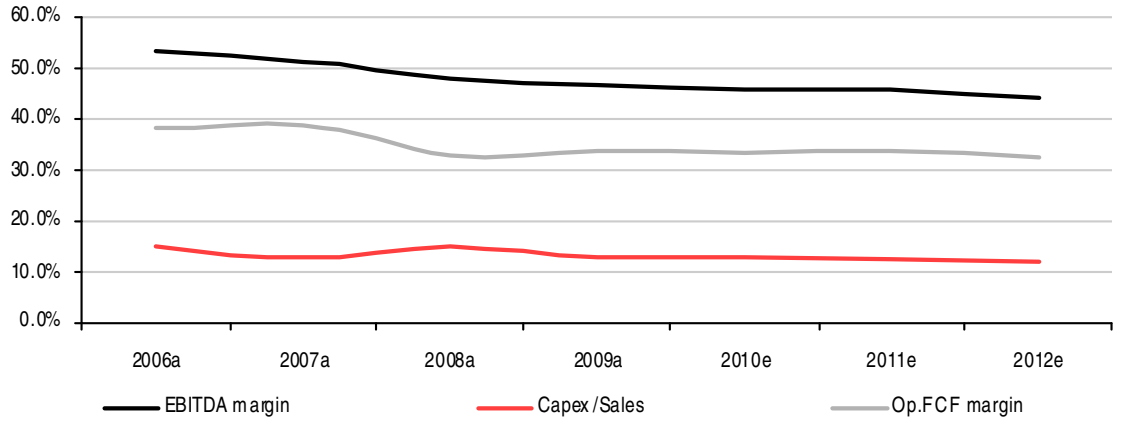
Source: Company reports, HSBC estimates

Financial performance: Growth (y-o-y) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and operating FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: Chunghwa Telecom

Neutral

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (TWDm)				
Revenue	198,361	201,447	202,810	202,664
EBITDA	92,714	93,161	93,643	93,528
Depreciation & amortisation	-36,320	-35,146	-34,070	-33,867
Operating profit/EBIT	56,394	58,016	59,573	59,661
Net interest	463	298	367	338
PBT	57,238	58,848	60,241	60,294
HSBC PBT	57,583	59,254	60,688	60,748
Taxation	-12,743	-9,476	-10,617	-10,627
Net profit	43,757	48,398	48,640	48,674
HSBC net profit	45,329	47,296	49,388	49,427
Cash flow summary (TWDm)				
Cash flow from operations	77,286	73,618	84,602	83,281
Capex	-25,478	-24,592	-28,026	-27,729
Cash flow from investment	-29,471	-17,655	-28,026	-27,729
Dividends	-37,836	-39,369	-43,558	-43,776
Change in net debt	5,754	10,013	6,382	7,624
FCF equity	53,553	56,130	55,133	55,497
Balance sheet summary (TWDm)				
Intangible fixed assets	7,617	6,790	6,041	5,293
Tangible fixed assets	313,022	304,800	299,505	294,115
Current assets	114,492	107,228	101,051	93,405
Cash & others	93,776	83,166	76,784	69,160
Total assets	448,997	438,159	425,937	412,153
Operating liabilities	58,820	85,076	86,406	86,186
Gross debt	1,101	505	505	505
Net debt	-92,675	-82,662	-76,279	-68,655
Shareholders funds	375,211	340,778	326,242	311,685
Invested capital	282,535	250,577	243,407	237,467

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	-1.6	1.6	0.7	-0.1
EBITDA	-4.3	0.5	0.5	-0.1
Operating profit	-3.8	2.9	2.7	0.1
PBT	-4.1	2.8	2.4	0.1
HSBC EPS	-6.1	4.3	4.4	0.1
Ratios (%)				
Revenue/IC (x)	0.7	0.8	0.8	0.8
ROIC	16.2	18.0	20.3	20.9
ROE	12.1	13.2	14.8	15.5
ROA	9.8	11.2	11.5	11.9
EBITDA margin	46.7	46.2	46.2	46.1
Operating profit margin	28.4	28.8	29.4	29.4
EBITDA/net interest (x)				
Net debt/equity	-24.5	-24.0	-23.0	-21.6
Net debt/EBITDA (x)	-1.0	-0.9	-0.8	-0.7
CF from operations/net debt				
Per share data (TWD)				
EPS Rep (fully diluted)	4.51	4.99	5.02	5.02
HSBC EPS (fully diluted)	4.67	4.88	5.09	5.10
DPS	4.06	4.49	4.51	4.49
Book value	38.69	35.14	33.64	32.14

Valuation data

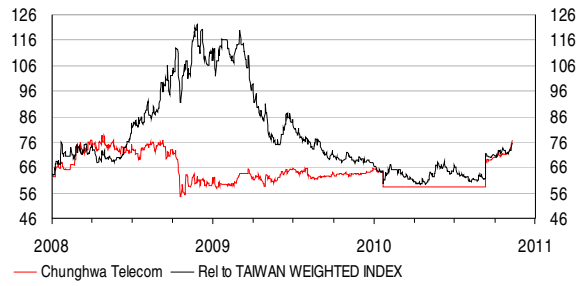
Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	3.2	3.2	3.2	3.3
EV/EBITDA	6.9	6.9	7.0	7.1
EV/IC	2.3	2.6	2.7	2.8
PE*	16.4	15.7	15.1	15.0
P/Book value	2.0	2.2	2.3	2.4
FCF yield (%)	7.3	7.7	7.6	7.6
Dividend yield (%)	5.3	5.9	5.9	5.9

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (TWD)	76.70	Target price (TWD)	75.00
Potent'l return (%)	-2.2		
Reuters (Equity)	2412.TW	Bloomberg (Equity)	2412 TT
Market cap (USDm)	24,681	Market cap (TWDm)	743,745
Free float (%)	64	Enterprise value (TWDm)	646,766
Country	Taiwan	Sector	Diversified Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

Taiwan Mobile (3045)

- Steady performance, but inability to expand cable-bundling strategy via kbro acquisition a setback
- Return to capital reduction, but on a smaller scale: cTWD1/share
- Neutral: TWD69 TP based on roll forward valuation to 2011e EPS

Investment thesis

The rejection of Taiwan Mobile's application to purchase cable operator kbro in September 2010 was a blow for the operator. The acquisition of kbro by the Tsai family (who own a stake in Taiwan Mobile) is contingent on there being no co-operation with Taiwan Mobile. Consequently, Taiwan Mobile has abandoned plans for an acquisition in the near term, and returned to capital reductions.

Forecasts, business outlook

We estimate a slight decline in Consumer Business Group revenues from 2010-12 (CAGR of -0.3%). This is where the consumer of the wireless business sits, and contributes c78% of overall revenue. The cable-focused Household Business Group (HBG) contributes c8% of revenues, and the Enterprise Business Group the remaining c14%. We estimate a 2010-12 revenue CAGR for the Household and Enterprise groups respectively of 3.1% and 1.3%.

The impact of mandatory tariff controls means we expect margin pressure in all business units except the HBG, where we look for a 2010-12 CAGR of c1%.

Data growth outlook

Smartphones currently form a small proportion of the overall subscriber base in Taiwan. At FET, smartphone accounts were just 6% of the total at 1H – but contributed c9% of the total service revenue, due to higher ARPU. The potential for rapid smartphone growth is significant: Chunghwa notes that smartphone ARPU stands at 1.8x of the normal 3G user. With each of the Taiwan telcos offering the iPhone and other key handsets, we expect this trend to be a sector positive, rather than favouring one operator.

Valuation and risks

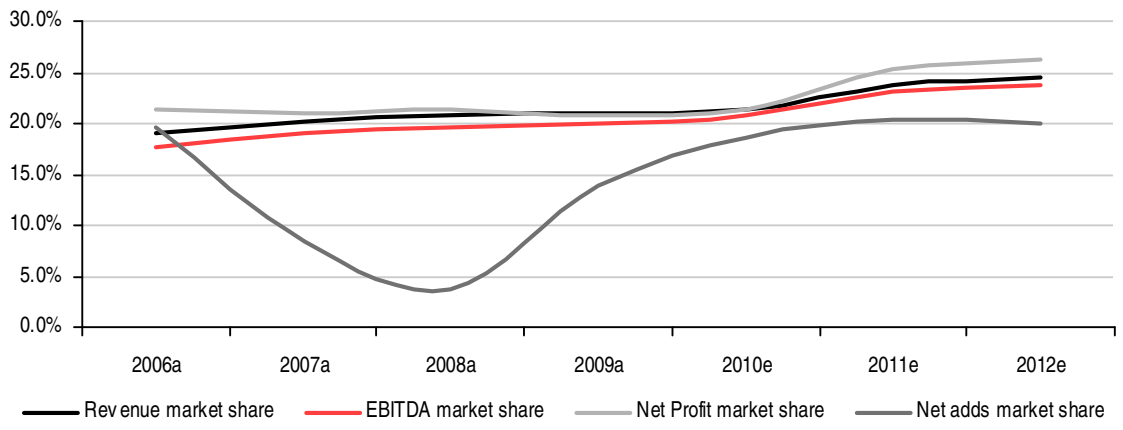
Our primary valuation methodology is a straight PE multiple. We apply a multiple of 14x to 2011e EPS. TWM trades at 13.8x 2011e EPS, and 7.6x 2011e EBITDA. We forecast a total yield in 2011e of 9.1%. Our DDM-derived target price is TWD72, lower than our PE-based target price. Our DCF-derived target price is TWD62, lower than our PE-derived target price.

As for CHT, the key upside and downside risks to our rating relate to the shareholder return outlook. The capital reduction for 2011e is cTWD1 per share: an increase to this level would be a significant positive.

HSBC

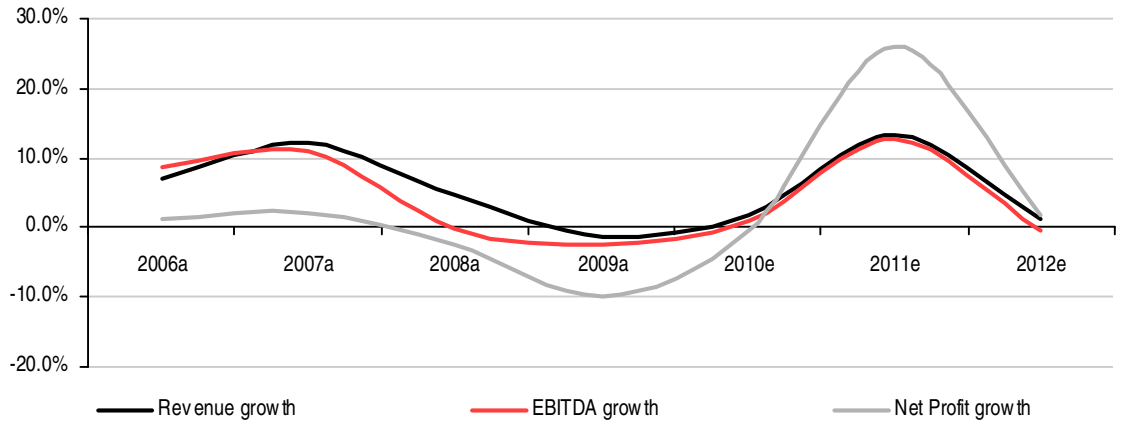
Taiwan Mobile: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



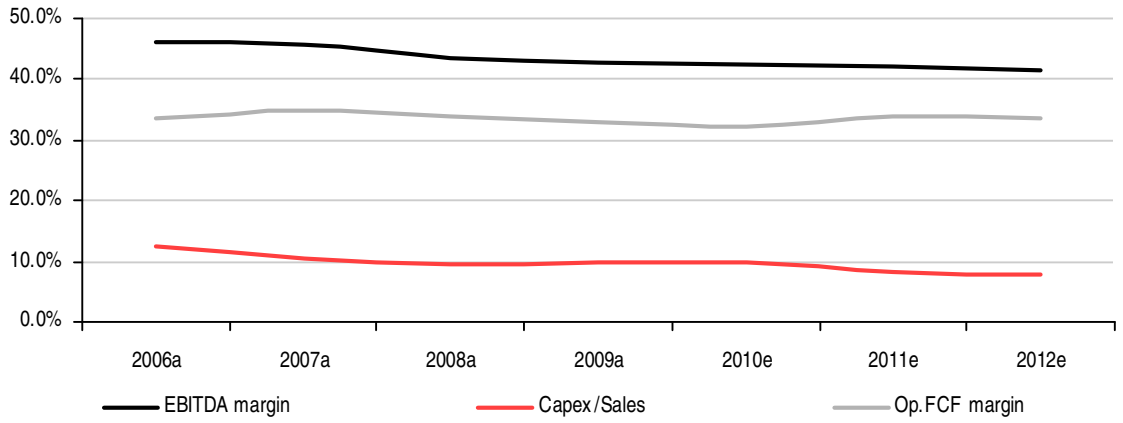
Source: Company reports, HSBC estimates

Financial performance: Growth (y-o-y) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and operating FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: Taiwan Mobile

Neutral

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (TWDm)				
Revenue	68,470	69,798	69,840	70,095
EBITDA	29,292	28,434	28,214	28,191
Depreciation & amortisation	-8,844	-9,089	-8,947	-8,419
Operating profit/EBIT	20,448	19,345	19,267	19,772
Net interest	-545	-355	-233	-254
PBT	18,733	17,451	17,795	18,579
HSBC PBT	19,403	18,810	19,033	19,518
Taxation	-4,756	-3,202	-3,037	-3,168
Net profit	13,977	14,249	14,756	15,411
HSBC net profit	14,552	15,612	15,797	16,199
Cash flow summary (TWDm)				
Cash flow from operations	23,951	24,092	23,180	23,620
Capex	-6,674	-6,363	-6,533	-6,414
Cash flow from investment	-6,743	-6,398	-6,533	-6,414
Dividends	-13,969	-15,005	-15,411	-16,141
Change in net debt	-5,000	-1,170	1,754	1,924
FCF equity	17,837	18,144	18,049	18,015
Balance sheet summary (TWDm)				
Intangible fixed assets	21,214	20,372	19,625	18,877
Tangible fixed assets	46,544	44,476	42,810	41,552
Current assets	11,600	13,683	11,046	11,349
Cash & others	3,209	5,000	2,011	2,011
Total assets	85,900	85,268	80,217	78,515
Operating liabilities	17,961	32,906	33,463	34,305
Gross debt	14,800	15,421	14,186	16,109
Net debt	11,591	10,421	12,175	14,098
Shareholders funds	52,073	35,868	31,495	27,027
Invested capital	58,187	40,626	38,006	35,463

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	-1.2	1.9	0.1	0.4
EBITDA	-2.6	-2.9	-0.8	-0.1
Operating profit	-6.1	-5.4	-0.4	2.6
PBT	-8.8	-6.8	2.0	4.4
HSBC EPS	-11.1	7.3	1.2	2.5
Ratios (%)				
Revenue/IC (x)	1.1	1.4	1.8	1.9
ROIC	26.0	33.5	42.3	46.4
ROE	28.3	35.5	46.9	55.4
ROA	16.2	17.0	18.1	19.7
EBITDA margin	42.8	40.7	40.4	40.2
Operating profit margin	29.9	27.7	27.6	28.2
EBITDA/net interest (x)	53.8	80.2	120.9	111.2
Net debt/equity	22.3	29.0	38.6	52.2
Net debt/EBITDA (x)	0.4	0.4	0.4	0.5
CF from operations/net debt	206.6	231.2	190.4	167.5
Per share data (TWD)				
EPS Rep (fully diluted)	4.68	4.77	4.94	5.16
HSBC EPS (fully diluted)	4.87	5.22	5.29	5.42
DPS	5.02	5.16	5.40	5.65
Book value	17.42	12.00	10.54	9.04

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	3.9	3.8	3.8	3.8
EV/EBITDA	9.0	9.3	9.4	9.5
EV/IC	4.5	6.5	7.0	7.5
PE*	14.0	13.1	12.9	12.6
P/Book value	3.9	5.7	6.5	7.6
FCF yield (%)	7.1	7.2	7.1	7.1
Dividend yield (%)	7.3	7.5	7.9	8.3

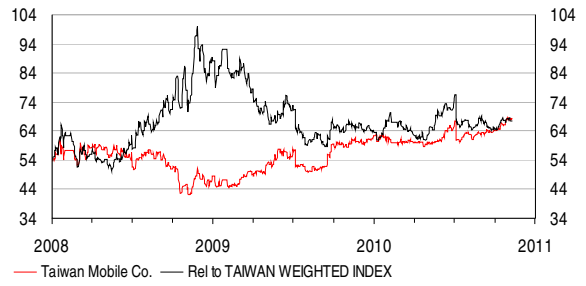
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (TWD)	68.30	Target price (TWD)	69.00	Potent'l return (%)	1.0

Reuters (Equity)	3045.TW	Bloomberg (Equity)	3045 TT
Market cap (USDm)	8,615	Market cap (TWDm)	259,603
Free float (%)	83	Enterprise value (TWDm)	263,330
Country	Taiwan	Sector	Wireless Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

Far Eastone (4904)

- Wireless business performance steady; NCIC consolidation to help reduce backhaul costs from strong wireless traffic growth
- China Mobile application to buy 12% equity stake likely to remain on hold in the near term
- UW: TWD39 TP based on 14x 2011e EPS

Investment thesis

Far EasTone aims to continue to invest to maintain its technology leadership in Taiwan. We expect it to remain ahead of its peers in moving to new software/hardware releases, as it was with HSPA. At the corporate level, the pending application by China Mobile to purchase a 12% equity stake in the company is a key driver. The company is unlikely to either make an acquisition or return to a stock dividend while this is still pending. However, we expect that the application continues to remain on hold for political reasons.

Forecasts, business outlook

We expect FET to continue to remain the wireless data leader in Taiwan, although all operators will benefit from this trend, and competition will increase. Opex increases from the growth in data traffic will in part be offset by its full consolidation of former equity affiliate NCIC, which will enable it to reduce its dependence on CHT for backhaul transmission to its wireless base stations. We expect revenues to grow at a 2010-12 CAGR of 2.1%, with data revenue (CAGR of 20.4%) offsetting declines in voice revenues (CAGR of -1.9%).

Data growth outlook

Smartphones currently form a small proportion of the overall subscriber base in Taiwan. At FET, smartphone accounts were just 6% of the total at 1H – but contributed c9% of the total service revenue, due to higher ARPU. The potential for rapid smartphone growth is significant: Chunghwa notes that smartphone ARPU stands at 1.8x of the normal 3G user. With each of the Taiwan telcos offering the iPhone and other key handsets, we expect this trend to be a sector positive, rather than favouring one operator.

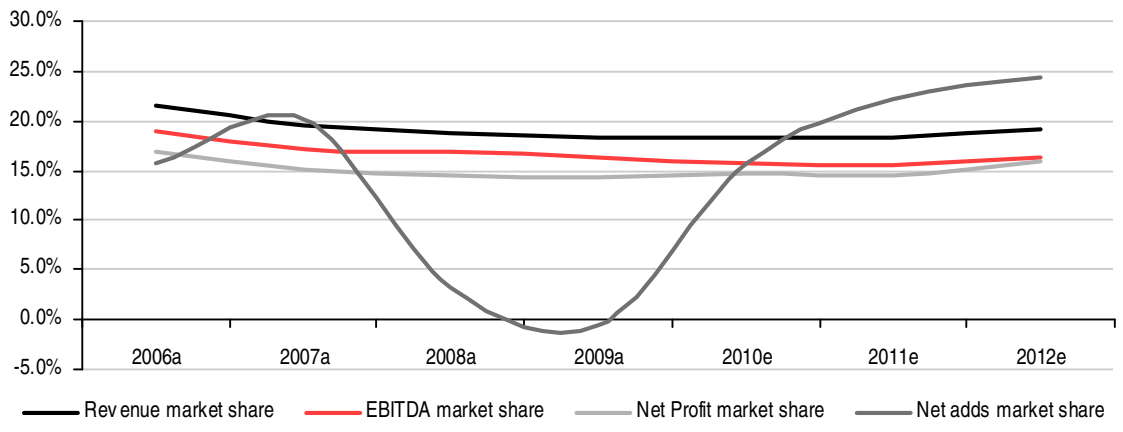
Valuation and risks

Applying a multiple of 14x to our new 2011 EPS estimate of TWD2.78 returns our price target of TWD39, and consequently our Underweight rating. The key risk to our rating is clarity around the China Mobile application to acquire a 12% equity stake, resulting in a return to capital reduction and thus an improved shareholder return. In the meantime, we see the company as restricted: valuations are more expensive than peers, and the total yield lower.

HSBC

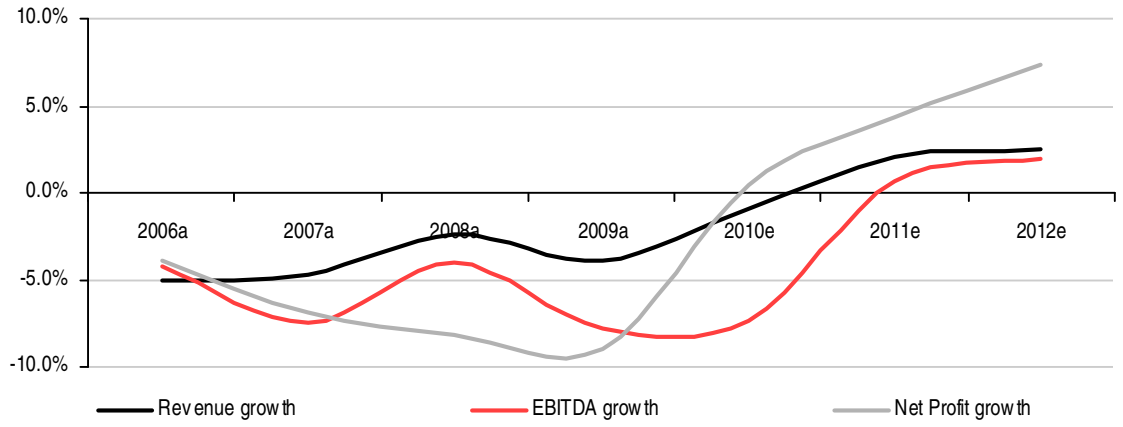
Far EasTone: Key company charts

Market position: Revenue share, EBITDA share, net profit share and wireless net adds market share



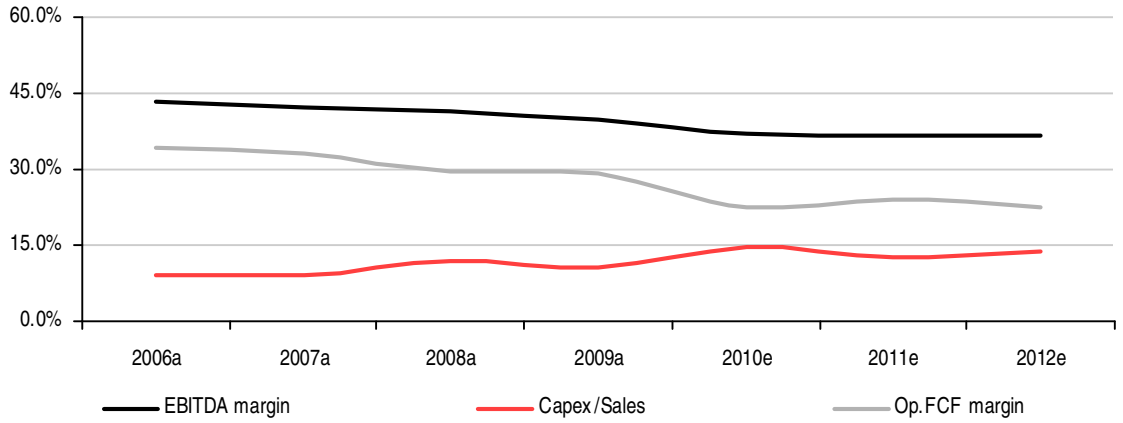
Source: Company reports, HSBC estimates

Financial performance: Growth (y-o-y) in revenue, EBITDA and net profit



Source: Company reports, HSBC estimates

Value generation: EBITDA margin, capex to sales and operating FCF margin



Source: Company reports, HSBC estimates

HSBC

Financials & valuation: Far Eastone

Underweight

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (TWDm)				
Revenue	60,062	61,105	61,219	62,241
EBITDA	23,944	22,130	22,043	22,176
Depreciation & amortisation	-11,514	-10,713	-10,753	-10,504
Operating profit/EBIT	12,430	11,417	11,290	11,673
Net interest	24	57	88	103
PBT	12,148	11,100	11,025	11,433
HSBC PBT	13,169	12,187	12,112	12,520
Taxation	-3,015	-2,214	-2,039	-2,108
Net profit	9,228	8,951	9,056	9,384
HSBC net profit	9,952	9,874	10,053	10,392
Cash flow summary (TWDm)				
Cash flow from operations	19,689	19,482	19,581	19,828
Capex	-6,411	-8,801	-7,652	-8,714
Cash flow from investment	-7,718	-8,801	-7,652	-8,714
Dividends	-9,124	-9,125	-8,906	-8,151
Change in net debt	-4,240	-8,452	-3,022	-2,963
FCF equity	15,045	11,216	12,458	11,400
Balance sheet summary (TWDm)				
Intangible fixed assets	18,402	16,366	15,634	14,902
Tangible fixed assets	40,308	38,453	36,108	35,072
Current assets	21,067	32,541	35,580	38,697
Cash & others	12,217	20,465	23,487	26,451
Total assets	86,469	95,260	95,201	96,541
Operating liabilities	11,632	29,819	28,925	29,213
Gross debt	936	732	732	732
Net debt	-11,281	-19,733	-22,756	-25,719
Shareholders funds	71,542	62,465	63,370	64,482
Invested capital	55,928	37,076	34,910	33,008

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	-3.9	1.7	0.2	1.7
EBITDA	-7.8	-7.6	-0.4	0.6
Operating profit	-13.3	-8.2	-1.1	3.4
PBT	-8.8	-8.6	-0.7	3.7
HSBC EPS	-9.1	-0.8	1.8	3.4
Ratios (%)				
Revenue/IC (x)	1.0	1.3	1.7	1.8
ROIC	17.2	21.2	27.8	30.4
ROE	13.9	14.7	16.0	16.3
ROA	10.5	9.8	9.4	9.7
EBITDA margin	39.9	36.2	36.0	35.6
Operating profit margin	20.7	18.7	18.4	18.8
EBITDA/net interest (x)				
Net debt/equity	-15.6	-31.2	-35.5	-39.5
Net debt/EBITDA (x)	-0.5	-0.9	-1.0	-1.2
CF from operations/net debt				
Per share data (TWD)				
EPS Rep (fully diluted)	2.83	2.75	2.78	2.88
HSBC EPS (fully diluted)	3.05	3.03	3.08	3.19
DPS	2.80	2.73	2.50	2.54
Book value	21.95	19.17	19.44	19.79

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	2.1	1.9	1.9	1.8
EV/EBITDA	5.3	5.3	5.2	5.1
EV/IC	2.2	3.2	3.3	3.4
PE*	14.5	14.7	14.4	13.9
P/Book value	2.0	2.3	2.3	2.2
FCF yield (%)	11.0	8.2	9.0	8.3
Dividend yield (%)	6.3	6.2	5.6	5.7

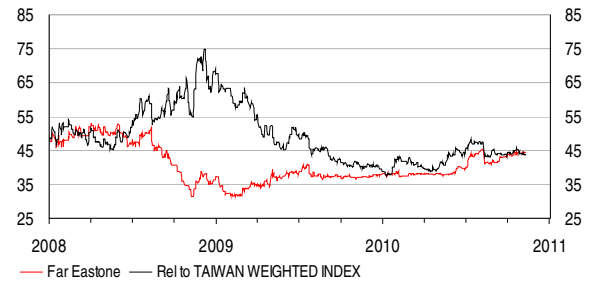
Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (TWD)	44.40	Target price (TWD)	39.00	Potent'l return (%)	-12.2

Reuters (Equity)	4904.TW	Bloomberg (Equity)	4904 TT
Market cap (USDm)	4,801	Market cap (TWDm)	144,677
Free float (%)	62	Enterprise value (TWDm)	117,795
Country	Taiwan	Sector	Wireless Telecoms
Analyst	Neale Anderson	Contact	+852 2996 6716

Price relative



Source: HSBC

Note: price at close of 09 Nov 2010

HSBC

Appendix

HSBC

Valuations & risks for Internet / tech stocks

Tencent – 0700.HK, OW(V)

Our target price of HKD240 is based on a 2010-11e PE multiple of 43x. Our PE is based on a 1.1 PEG ratio derived from a 2009-12e earnings CAGR of 39%. Key risks are related to operation execution and include delays in new game launches, lower monetisation rates and weaker advertising revenues.

NetEase – NTES.O, OW(V)

Our USD54 target price is based on a 17x PE multiple on a blend of 2H10e and 1H11e EPS. We use a PEG of 0.7x, as the NetEase business model relies on a blend of both the licensing-distribution of third-party content (such as Blizzard's WoW) and creation-distribution of inhouse content (such as Fantasy Westward Journey).

We argue that platform companies, such as Tencent and Baidu, should trade at a much higher PEG (1.1x) while pure-play content companies such as Perfect World should trade at 0.5x PEG. We have opted to use a midpoint 0.7x PEG to try to capture NetEase's business model. Traditionally, the Chinese WoW distributor has traded at a significant premium, reflecting the value of content exclusivity (see chart below on PEG multiple for The9). The key downside risks to our rating and estimates are potential regulatory risks on foreign game licensing and uncertainty about the performance of new games.

PerfectWorld – PWRD.O, N(V)

Our multiples-based target price of USD33 is based on a PE ratio of 10x derived from a 0.5x PEG (estimated 21% CAGR for 2009-12) applied to blended 2010-11e EPS. The key downside risks include new games performing poorly. The upside risk is better than expected sales of new games.

NCsoft – 036570 KS, OW(V)

Our target price is based on an unchanged 3-year PEG of 1.0 (implies 2011e PE of 25x), which is the average of its annual historical high valuations during the past 10 years. We expect NCsoft shares to approach our target price as the market prices in the company's ability to develop and service quality massive multi-player online role-playing games (MMORPGs).

Downside risks to our Overweight (V) rating include: (1) launch delays for B&S and GW2, or the launches being less successful than expected; (2) more competition from new MMORPG/RPGs, especially Tera, Diablo III and Archeage; and (3) greater-than-expected cannibalisation of existing revenue by new games.

Daum Communications – 035720.KQ, OW

Our target price of KRW113,000 is based on a three-year PEG of 0.65 (25% discount to NHN, the lowest average seen since 2007), which we believe is appropriate because the discount to NHN should narrow on Daum's growing PC

search query share, the company's greater gearing to mobile ad services, and PC ad market recovery (discount increased during recession, trend to reverse on economic recovery). Downside risks include 1) greater-than-expected marketing expenditure needed to gain market share in the PC ad market, 2) greater-than-expected negative impact on PPC of Daum's outsourced ads managed by Overture if Overture loses NHN as its media, 3) policy changes in the mobile industry or adoption of a new regulation for mobile Internet business that could limit the company's ability to monetize its mobile traffic.

Comba Telecom Systems – 2342.HK, OW(V)

We value Comba based on DCF, with a WACC of 7.5% and a terminal growth rate of 1% after 2013. Our target price is HKD11.09 after we adjust for the bonus share issue. Management may revise upward its guidance after there is more clarity on the position of its orders for 2011. Further news flow related to network convergence in China can also be a potential catalyst. A major downside risk is limited visibility on orders for 2011 and beyond.

ZTE – 0763.HK, N(V)

Our target price of HKD32 is based on 3x 2011e book value, derived from ZTE's historical average (January 2005-June 2010). We believe this ratio is appropriate, when we look at historical PB band charts. Before the China 3G capex wave (early 2005-08), ZTE's H shares were trading in a PB band of 2-3x and at an average 3.8x in the past year. With revenue and earnings becoming more volatile following China 3G capex, we focus on the PB ratio. Key downside risks include lower-than-expected domestic market share margins (competition from Huawei), a continued slowdown in global capex and margin compression due to the shift in revenue mix towards handsets. Key upside risks include potential upside from China capex and margin expansion.

HSBC

Notes

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Neale Anderson, Tucker Grinnan, Luis Hilado, Rajiv Sharma and Howon Rim

Important disclosures

Stock ratings and basis for financial analysis

HSBC believes that investors utilise various disciplines and investment horizons when making investment decisions, which depend largely on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations. Given these differences, HSBC has two principal aims in its equity research: 1) to identify long-term investment opportunities based on particular themes or ideas that may affect the future earnings or cash flows of companies on a 12 month time horizon; and 2) from time to time to identify short-term investment opportunities that are derived from fundamental, quantitative, technical or event-driven techniques on a 0-3 month time horizon and which may differ from our long-term investment rating. HSBC has assigned ratings for its long-term investment opportunities as described below.

This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings and other considerations. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations. Investors should carefully read the definitions of the ratings used in each research report. In addition, because research reports contain more complete information concerning the analysts' views, investors should carefully read the entire research report and should not infer its contents from the rating. In any case, ratings should not be used or relied on in isolation as investment advice.

Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

As of 12 November 2010, the distribution of all ratings published is as follows:

Overweight (Buy)	47%	(22% of these provided with Investment Banking Services)
Neutral (Hold)	38%	(19% of these provided with Investment Banking Services)
Underweight (Sell)	15%	(19% of these provided with Investment Banking Services)

Information regarding company share price performance and history of HSBC ratings and price targets in respect of its long-term investment opportunities for the companies the subject of this report,is available from www.hsbcnet.com/research.

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
BHARTI AIRTEL	BRTI.NS	316.75	12-Nov-2010	4, 5, 6, 7
CHINA MOBILE	0941.HK	80.85	11-Nov-2010	6, 7, 11
CHINA TELECOM CORPORATION	0728.HK	4.08	11-Nov-2010	4, 7, 11
CHINA UNICOM	0762.HK	11.44	11-Nov-2010	7, 11
COMBA TELECOM SYSTEMS	2342.HK	8.62	11-Nov-2010	4, 6, 7, 11
IDEA CELLULAR LTD	IDEA.BO	68.85	12-Nov-2010	2, 4, 5
INDOSAT	ISAT.JK	5650.00	11-Nov-2010	1, 5, 11
KDDI CORP	9433.T	465500.00	11-Nov-2010	7
KT CORP	030200.KS	45500.00	11-Nov-2010	6, 7, 11
MTNL	MTNLd.BO	65.00	12-Nov-2010	6, 7
NIPPON TELEGRAPH AND TELE	9432.T	3830.00	11-Nov-2010	7, 11
NTT DOCOMO INC.	9437.T	138300.00	11-Nov-2010	6
RELIANCE COMMUNICATIONS	RLCM.NS	176.10	12-Nov-2010	2, 5, 7
SINGAPORE TELECOM	STEL.SI	3.31	11-Nov-2010	1, 2, 5, 6, 7, 11
SK BROADBAND CO LTD	033630.KQ	5290.00	11-Nov-2010	7, 11
SK TELECOM	017670.KS	168500.00	11-Nov-2010	1, 4, 5, 11
SOFTBANK CORP.	9984.T	2877.00	11-Nov-2010	11
TAIWAN MOBILE CO.	3045.TW	68.50	11-Nov-2010	7
TELSTRA CORP	TLS.AX	2.64	11-Nov-2010	1, 2, 5, 7, 11
TENCENT	0700.HK	181.50	11-Nov-2010	11
ZTE CORPORATION	0763.HK	29.25	11-Nov-2010	4, 7, 11

Source: HSBC

1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
4 As of 31 October 2010 HSBC beneficially owned 1% or more of a class of common equity securities of this company.
5 As of 30 September 2010, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of investment banking services.
6 As of 30 September 2010, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-investment banking-securities related services.
7 As of 30 September 2010, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-securities services.
8 A covering analyst/s has received compensation from this company in the past 12 months.
9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.
11 At the time of publication of this report, HSBC is a non-US Market Maker in securities issued by this company and/or in securities in respect of this company

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at www.hsbcnet.com/research.

** HSBC Legal Entities are listed in the Disclaimer below.*

Additional disclosures

1 This report is dated as at 12 November 2010.
2 All market data included in this report are dated as at close 09 November 2010, unless otherwise indicated in the report.
3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.
4 As of 31 October 2010, HSBC and/or its affiliates (including the funds, portfolios and investment clubs in securities managed by such entities) either, directly or indirectly, own or are involved in the acquisition, sale or intermediation of, 1% or more of the total capital of the subject companies securities in the market for the following Company(ies) : SK TELECOM , ZTE CORPORATION , COMBA TELECOM SYSTEMS , CHINA TELECOM CORPORATION , BHARTI AIRTEL , IDEA CELLULAR LTD
5 As of 22 October 2010, HSBC owned a significant interest in the debt securities of the following company(ies) : SK TELECOM , KT CORP

HSBC

Disclaimer

** Legal entities as at 31 January 2010*
'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Securities (Canada) Inc, Toronto; HSBC Bank, Paris branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Dusseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt S.A.E., Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; 'GR' HSBC Pantelakis Securities S.A., Athens; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv, 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler A.S., Istanbul; HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC, HSBC Bank Brasil S.A. - Banco Múltiplo, HSBC Bank Australia Limited, HSBC Bank Argentina S.A., HSBC Saudi Arabia Limited.

Issuer of report
The Hongkong and Shanghai Banking Corporation Limited
Level 19, 1 Queen's Road Central
Hong Kong SAR
Telephone: +852 2843 9111
Telex: 75100 CAPEL HX
Fax: +852 2596 0200
Website: www.research.hsbc.com

This document has been issued by The Hongkong and Shanghai Banking Corporation Limited ("HSBC") in the conduct of its Hong Kong regulated business for the information of its institutional and professional customers; it is not intended for and should not be distributed to retail customers in Hong Kong. The Hongkong and Shanghai Banking Corporation Limited is regulated by the Securities and Futures Commission. All enquires by recipients in Hong Kong must be directed to your HSBC contact in Hong Kong. If it is received by a customer of an affiliate of HSBC, its provision to the recipient is subject to the terms of business in place between the recipient and such affiliate. This document is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. HSBC has based this document on information obtained from sources it believes to be reliable but which it has not independently verified; HSBC makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion are those of the Research Division of HSBC only and are subject to change without notice. HSBC and its affiliates and/or their officers, directors and employees may have positions in any securities mentioned in this document (or in any related investment) and may from time to time add to or dispose of any such securities (or investment). HSBC and its affiliates may act as market maker or have assumed an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform investment banking or underwriting services for or relating to those companies.
HSBC Securities (USA) Inc. accepts responsibility for the content of this research report prepared by its non-US foreign affiliate. All U.S. persons receiving and/or accessing this report and wishing to effect transactions in any security discussed herein should do so with HSBC Securities (USA) Inc. in the United States and not with its non-US foreign affiliate, the issuer of this report.
In the UK this report may only be distributed to persons of a kind described in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001. The protections afforded by the UK regulatory regime are available only to those dealing with a representative of HSBC Bank plc in the UK. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. Recipients in Singapore should contact a "Hongkong and Shanghai Banking Corporation Limited, Singapore Branch" representative in respect of any matters arising from, or in connection with this report.
In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient.
In Japan, this publication has been distributed by HSBC Securities (Japan) Limited. It may not be further distributed in whole or in part for any purpose. In Korea, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. HBAP SLS is regulated by the Financial Services Commission and the Financial Supervisory Service of Korea.

[283234]

HSBC

Global Telecoms, Media & Technology Research Team

Global

Stephen Howard
Analyst, Global Sector Head
+44 20 7991 6820 stephen.howard@hsbcib.com

Europe

Dominik Klarmann, CFA
Analyst
+49 211 910 2769 dominik.klarmann@hsbc.de

Nicolas Cote-Colisson
Analyst
+44 20 7991 6826 nicolas.cote-colisson@hsbcib.com

Luigi Minerva
Analyst
+44 20 7991 6928 luigi.minerva@hsbcib.com

Manish Beria, CFA
Analyst
+91 80 3001 3796 manishberia@hsbc.co.in

Amit Sachdeva
Analyst
+91 80 3001 3795 amit1sachdeva@hsbc.co.in

Dhiraj Saraf, CFA
Analyst
+91 80 3001 3773 dhirajsaraf@hsbc.co.in

Sunil Rajgopal
Analyst
+91 80 3001 3794 sunilrajgopal@hsbc.co.in

Americas

Richard Dineen
Analyst
+1 212 525 6707 richard.dineen@us.hsbc.com

Sean Glickenhaus
Analyst
+1 212 525 4131 sean.x.glickenhaus@us.hsbc.com

Anthony McCutcheon
Credit Strategist
+1 212 525 4198 anthony.c.mccutcheon@us.hsbc.com

Sub-Saharan Africa

Umulinga Karangwa
Analyst
+44 20 7992 3685 umulinga.karangwa@hsbcib.com

Global Emerging Markets (GEMs)

Hervé Drouet
Analyst
+44 20 7991 6827 herve.drouet@hsbcib.com

Emerging Europe, Middle East & Africa (EMEA)

Kunal Bajaj
Analyst
+971 4 507 7200 kunalbajaj@hsbc.com

Vangelis Karanikas
Analyst
+30 210 696 5211 vangelis.karanikas@hsbc.com

Avshalom Shimei
Analyst
+972 3 710 1197 avshalomshimei@hsbc.com

Bülent Yurdagül
Analyst
+90 212 376 46 12 bulentyurdagul@hsbc.com.tr

Sergey Fedoseev
Analyst
+44 20 7991 6831 sergey.fedoseev@hsbcib.com

Specialist Sales

Timothy Maunder-Taylor
+44 20 7991 5006 tim.maunder-taylor@hsbcib.com

Thomas Koenen
+49 211 910 4402 thomas.koenen@trinkaus.de

Myles McMahon
+852 2822 4676 mylesmacmahon@hsbc.com.hk

Asia

Steven C Pelayo
Analyst
+852 2822 4391 stevenpelayo@hsbc.com.hk

Tse-yong Yao
Analyst
+852 2822 4397 tse-yongyao@hsbc.com.hk

Nam Park
Analyst
+852 2996 6591 nampark@hsbc.com.hk

Carolyn Poon
Analyst
+852 2996 6586 carolynpoon@hsbc.com.hk

Tucker Grinnan
Analyst
+852 2822 4686 tuckergrinnan@hsbc.com.hk

Neale Anderson
Analyst
+852 2996 6716 neale.anderson@hsbc.com.hk

Henry Lee
Associate
+813 5203 4412 henry.lee@hsbc.co.jp

Wanli Wang
Analyst
+8862 8725 6020 wanliwang@hsbc.com.tw

Shishir Singh
Analyst
+852 2822 4292 shishirkumarsingh@hsbc.com.hk

Frank Su
Analyst
+8862 8725 6025 frankkssu@hsbc.com.tw

Jerry Tsai
Analyst
+8862 8725 6023 jerrycytsai@hsbc.com.tw

Percy Panthaki
Analyst
+91 22 2268 1240 percypanthaki@hsbc.co.in

Rajiv Sharma
Analyst
+91 22 2268 1239 rajivsharma@hsbc.co.in

Yogesh Aggarwal
Analyst
+91 22 2268 1246 yogeshaggarwal@hsbc.co.in

Anil Kumar T
Analyst
+91 80 3001 3749 anil.kumar.tulsiram@hsbc.co.in

Yolanda Wang
Analyst
+8862 8725 6027 yolandayywang@hsbc.com.tw

Brian Sohn
Analyst
+822 3706 8765 briansohn@kr.hsbc.com

Howon Rim
Analyst
+822 37068767 howonrim@kr.hsbc.com

Luis Hilado
Analyst
+65 6239 0656 luishilado@hsbc.com.sg

Joyce Chen
Associate
+8862 8725 6022 joycechchen@hsbc.com.tw

Soyun Shin
Associate Analyst
+822 3706 8774 soyunshin@kr.hsbc.com

Tucker Grinnan*
Analyst
The Hongkong and Shanghai Banking Corporation Limited
+852 2822 4686
tuckergrinnan@hsbc.com.hk

Tucker joined HSBC in November 2005 and has 15 years of experience as an analyst in the telecommunications, media and technology industries. Prior to joining HSBC, he spent five years as a head of regional telecoms for Asia and Latin America. Tucker also spent five years with the management consulting firm servicing clients in telecommunications and media. He holds degrees from the University of Virginia and George Washington University.

Neale Anderson*
Analyst
The Hongkong and Shanghai Banking Corporation Limited
+852 2996 6716
neale.anderson@hsbc.com.hk

Neale Anderson joined HSBC in March 2007. Previously he spent seven years at the specialist consultancy Ovum, where he was Research Director for Asia-Pacific telecommunications markets. He holds a BA from Oxford University and an MA in Advanced Japanese Studies from Sheffield University.

Rajiv Sharma*
Analyst
HSBC Securities and Capital Markets (India) Private Limited
9122 22681239
rajivsharma@hsbc.co.in

Rajiv joined HSBC in 2006. Before covering Indian telecoms , he was a member of HSBC's Asian telecoms team, working on North Asian telcos. Rajiv is a Chartered Accountant and has an PGDBA in finance.

Luis Hilado*
Analyst
The Hong Kong and Shanghai Banking Corporation Limited, Singapore Branch
+65 6239 0656
luishilado@hsbc.com.sg

Luis Hilado joined HSBC in 2010 from a US investment bank, where he covered the SE Asia telecom sector. He has over 15 years of equity research experience primarily covering SE Asia telecoms. Luis held a number of positions on the sell-side including Head of Research, Philippines for a European stock brockerage. He holds a BA in Economics and a BS in Commerce and Business Management from De La Salle University.

Howon Rim*
Analyst
The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch
+822 37068767
howonrim@kr.hsbc.com

Howon Rim joined HSBC in April 2010. He previously covered the Internet, telecom, and banking sectors for a leading brokerage in Seoul. He has degrees in electrical engineering and business administration from Seoul National University and an MBA from KAIST Graduate School of Management.

Anand Pattara*
Associate
Bangalore

* Employed by a non-US affiliate of HSBC Securities (USA) Inc, and is not registered/qualified pursuant to FINRA regulations.

HSBC
Global Research