China Mobile Limited (CHL)

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Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

China Mobile Limited - business

- Provides mobile telecommunications and related services in the Mainland China:
    - local calls, domestic and international long distance calls, intra-provincial roaming, inter-provincial roaming, and international roaming services
    - voice value-added services, including caller identity display, caller restrictions, call waiting, call forwarding, call holding, voice mail, and conference calls
    - data businesses: short message services, wireless application protocol, and multimedia messaging services, as well as color ring services
    - data products: Java applications, IVR, and PIM, agricultural information services
    - telecommunications network planning, design, and consulting services
- February 2011 served approximately 595 million customers, ~12% annual growth
- http://www.chinamobileltd.com/

China Mobile Limited - business (cont'd)

- Competition:

China Mobile Limited – Misc thoughts

- What can go wrong?
  - 75% government owned
  - 20% investment in Shanghai Pudong bank
- Opportunities:
  - Still growing China mobile penetration?
  - Increased data and services
  - APAC opportunities?

Strategic considerations

- Moat (*switching costs, habit, low cost*):
  - What are the moats? Brand. Coverage somewhat. Somewhat switching costs, Habit.
  - What does it take to sustain the moats? Brand?
  - Bargaining power of suppliers/customers? Not big
- Is it a low risk business? Somewhat.
- Is there high uncertainty? No
- How capital intensive is the business? Network upgrades somewhat expensive
- Future growth – unknown
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Not clear

Management

- I don't usually do management analysis. Included for template completeness
- No dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV

Piotroski Score

1. Net Income: Bottom line. Score 1 if last year net income is positive. 1
2. Operating Cash Flow: Better earnings gauge. Score 1 if last year cash flow is positive. 1
3. Return On Assets: Measures Profitability. Score 1 if last year ROA exceeds prior-year ROA. 20.7 < 22.7 0
4. Quality of Earnings: Warns of Accounting Tricks. Score 1 if last year operating cash flow exceeds net income. 1
5. Long-Term Debt vs. Assets: Is Debt decreasing? Score 1 if the ratio of long-term debt to assets is down from the year-ago value. (If LTD is zero but assets are increasing, score 1 anyway.) 1
6. Current Ratio: Measures increasing working capital. Score 1 if CR has increased from the prior year. 0 (I am very sceptical that current ratio is relevant)
7. Shares Outstanding: A Measure of potential dilution. Score 1 if the number of shares outstanding is no greater than the year-ago figure. 1 (very minor increase)
8. Gross Margin: A measure of improving competitive position. Score 1 if full-year GM exceeds the prior-year GM. 31% vs 32.5% 0
9. Asset Turnover: Measures productivity. Score 1 if the percentage increase in sales exceeds the percentage increase in total assets. 7% sales – 1%

- Total: 6 / 9

Is it a good business?

- >10 year history of profits
- ROE:
  - 2008: 25.5 2009:22.8 2010:20.7
- Margins
  - 2008: 27.4 2009:25.5 2010:24.7
- Growing earnings: 3 year sales growth 14%, earnings growth 15%
- No dilution
- Strong balance sheet
  - Debt << cash/short term investments
- ROIC = Earnings / (Equity + Debt – Cash) = Earnings / (Assets – non-debt liabilities - Cash)
  - ~= ROE

Is it a good business? Cash flow

- Strong cash flow
  - 2010 18B earnings, 34.7B operating cash flow, 10.7B FCF (FCF = OCF – capital expenditures)
  - Free Cash Flow/Share higher than dividends paid (barely)

Is business cheap? – Buffettology calculations

- ROE 20%
- Earnings in 10 years = ROE*Equity*$(1+ROE)^9$ = $84B
- Equity in 10 years = Equity*$(1+ROE)^9$ = $418B
- Market cap = 84B x P/E (15) = $1.2T
- Rate of return = 18.5% after tax (calculations omitted)

- 9 year earnings growth: 24%. Assuming 24% earnings growth: 28% share price growth. Assuming 15% earnings growth: 18% share price growth.
- Not clear if the recent performance can be repeated for 10 years either in equity or earnings

Is business cheap? DCF

- Discounted cash flow
  - Current earnings of 18B
  - 10% growth for 5 years, leveling after that
    - 15% discount -> $175B current valuation (if you buy company at <$175B, you will get 15% return or higher)
  - 5% growth for 10 years, leveling after that
    - 15% discount -> $161B current valuation
  - 10% growth for 10 years, leveling after that
    - 15% discount -> $219B current valuation
- Owner's yield = earnings / (market cap + debt - cash) = earnings/EV
  - 18B / (190B-38B) = 11.7%

- What makes up the margin of safety? Strong market position, strong current earnings yield, strong balance sheet
- Is there a sufficient margin of safety? Maybe

Is business cheap? – Graham investment considerations

- N/A for CHL – included for completeness
- 2.3 P/Book – not a net net
- Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)