

# Comba Telecom Systems (2342.HK)

Wireless enhancement business brought prosperous performance in 1H15

## Hong Kong | TMT | Company report

30 JUL 2015

Comba Telecom recently announced their positive profit alert, expecting a mid-year net profit recorded in 1H15 increases no less than 40% as compared to the same period in last year, which is mainly due to the advantage that China is entering an initial construction cycle of 4G network, more effort on enhancing wireless network construction is needed. In 2015, not only China Mobile has changed its goal of constructing 4G base stations to one million and FDD license is also released throughout the whole country. Investment on 4G by China Telecom and China Unicom is also experiencing speedy expansion. It is anticipated that yearly 4G clients will be increased over 300 million and this will support the Company's wireless enhancement business to keep booming in medium term.

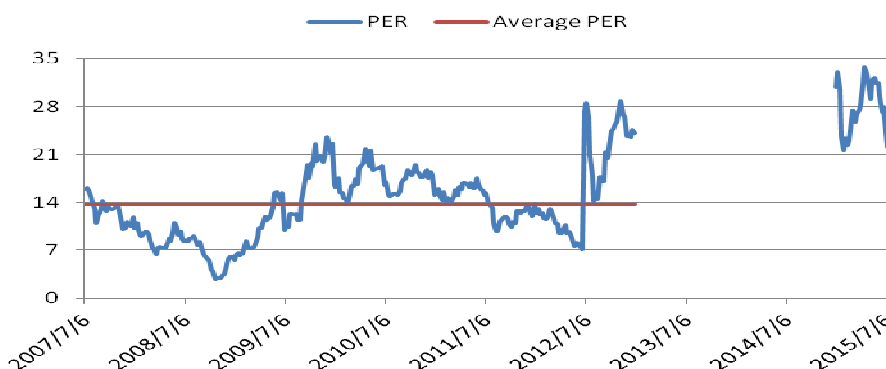
The wireless enhancement segment will also optimize the product mix of the Company and push up profitability. Moreover, with the advantages induced by economies of scale, in addition to effective cost control measures, the opex ratio of the Company declined nearly 5 percentage points as compared to the peak recorded in 2012. This also strongly pushed up the profitability of the Company. Looking forward, the Company will continue to be benefitted from economies of scale, and the drop in interest rate also helps saving financial costs. Rules and regulations for operators will assist to control expenses including marketing expenses. The opex ratio of the Company will probably keep declining.

In June, Comba entered an agreement with Guangzhou Zainar Info Tech Limited and Mapout Info Tech (HK) Limited, under which a joint-venture located in Beijing would be established. This joint-venture mainly works on indoor location-based service system throughout the whole country (including indoor mobile internet positioning system and indoor location-based big-data and map system). Comba possesses 20% of the equity of this joint-venture. Currently, operators in the market focus on 4G indoor coverage and mobile internet. Comba's Smallcell product is in line with the strategies of the operators. It is expected to help the joint-venture grow toward to leading provider of solutions concerning indoor location-based service system and brought new growth of profit for the Company.

### Safe valuation with high margins

Benefitted from the emerging peak of 4G infrastructure investment, Comba Telecom started to earn profit, getting away from previous loss. It even demonstrated more speedy growth in 2015. It is worth to note that the Company occupies the leading position in the domestic Chinese market of wireless enhancement. Telecom operators accelerated on the construction of 4G network and boosted up the demand in this aspect, probably leading to rise in both its revenue and profit.

### Historical P/E valuation



Source: Bloomberg, Phillip Securities (HK) Research

### Buy (Upgrade)

CMP: HKD 1.83  
(Closing price as at 28 July 2015)  
TARGET: HKD 2.54 (+39%)

#### COMPANY DATA

O/S SHARES (MN) :	1,849
MARKET CAP (HKDMN) :	3,384
52 - WK HI/LO (HKD):	3.47/ 1.3

#### SHARE HOLDING PATTERN, %

Huo Dongling :	32.98
----------------	-------

#### PRICE PERFORMANCE, %

	1M	3M	1Y
Comba	-15.91	-26.44	-3.75
HSI	-7.24	-12.06	-3.43

#### PRICE VS. HSI



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

HKD mn	FY13	FY14	FY15E	FY16E
Net Sales	5721	6733	7737	8136
Net Profit	-241	151	313	387
EPS, HKD	-0.14	0.09	0.17	0.21
PER, x	-	20.3	10.8	8.8
BVPS, HKD	2.19	2.21	2.33	2.48
P/BV, x	0.8	0.8	0.8	0.7
ROE, %	-6.4	4.0	8.1	9.3
Debt/Equity (%)	176.8	169.1	166.7	166.7

Source: Company reports, Phillip Securities Est.

Research Analyst  
**Fan Guohe**  
(+ 86 21 51699400-110)  
fanguohe@phillip.com.cn

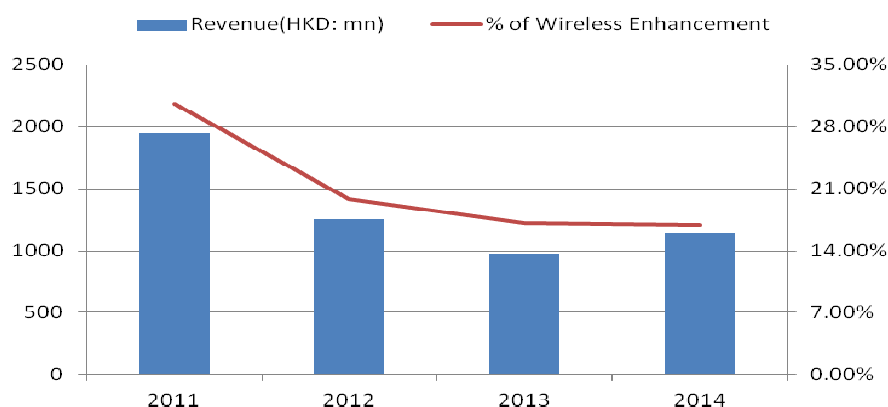
As the Company has regained growth, we take reference to P/E ratio. In the era of 3G, the Company was traded between 15x to 20x of P/E. However, after the recent slump of the stock market, the valuation of the Company is only about 10x of P/E, which is apparently being undervalued. We grant a valuation of 15x of EPS in 2015 and set the target price as HK\$2.54, with the rating upgraded to “Buy”. (Closing price as at 28 July 2015)

### Wireless enhancement business brought prosperous performance in 1H15

Comba Telecom recently announced their positive profit alert, expecting a mid-year net profit recorded in 1H15 increases no less than 40% as compared to the same period in last year, which is mainly due to the advantage that China is entering an initial construction cycle of 4G network, more effort on enhancing wireless network construction is needed. Since the award of TD LTE license in the year-end of 2013, the development of 4G has been far faster than 3G. New 4G clients recorded approximately 100 million in 2014. The construction target of the 4G base stations of China Mobile was also raised to 700,000 from the initial plan of 500,000. As the frequency of 4G is higher than 3G, worsening 4G radio wave’s diffraction capability, and thus greater demands for its depth coverage and network optimization are required compared to 3G. In 2015, the 4G network which initially arranged by China Mobile would advance into that stage.

Previously, in the mid and later stage of 3G network construction, the Company’s wireless enhancement business weighted more than 30%. However, after the peak of 3G network construction, demand dropped continually. It weighted only 17% in 2014. With the current development of 4G network, that business regained momentum and moved toward another boom, with the hope that its contribution to revenue would rebound to previous peak level. It is worth to mention that not only China Mobile has changed its goal of constructing 4G base stations to one million in 2015, and FDD license is also released throughout the whole country. Investment on 4G by China Telecom and China Unicom is also experiencing speedy expansion. It is anticipated that yearly 4G clients will be increased over 300 million and this will support the Company’s wireless enhancement business to keep booming in medium term.

### Sales by Wireless Enhancement Business of Comba



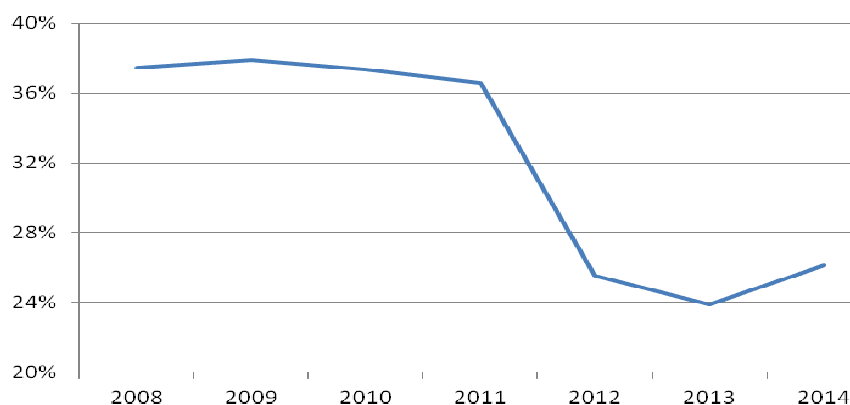
Source: Company reports, Phillip Securities (HK) Research

### Profitability keeps improving

The wireless enhancement segment will also optimize the product mix of the Company and push up profitability. The mid and later stage of 3G network construction is key stage for contribution by the segment of wireless enhancement: profitability of the Company is strong, with gross profit margin recorded as high as

around 37%. Subsequently, with the decline in the weighting of wireless enhancement, the gross profit margin significantly shrunk by around 10 percentage points and fell to 26% in 2014. We anticipate that, with the growth of business in wireless enhancement in the future, the profitability of the Company would keep improving.

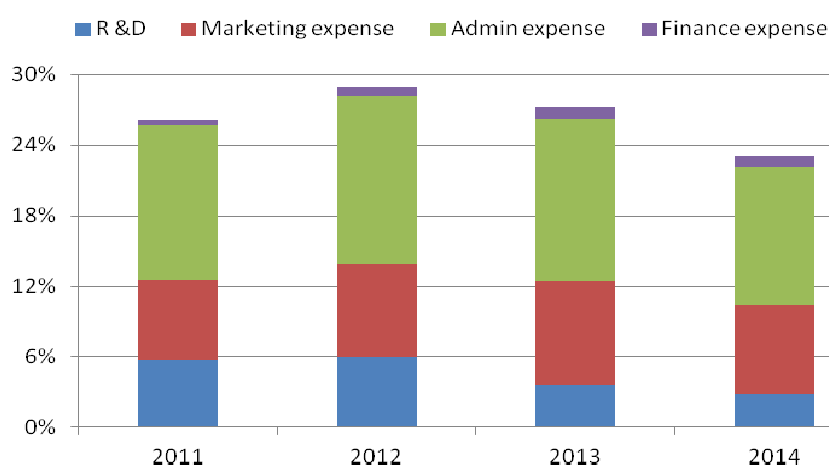
### Gross margin of Comba



Source: Company reports, Phillip Securities (HK) Research

It is worth to note that, with the advantages induced by economies of scale, in addition to effective cost control measures, the opex ratio of the Company declined over 3 percentage points in recent years, and it even declined nearly 5 percentage points as compared to the peak recorded in 2012. This also strongly pushed up the profitability of the Company. Looking forward, the Company will continue to be benefitted from economies of scale, and the drop in interest rate also helps saving financial costs. Rules and regulations for operators will assist to control expenses including marketing expenses. The opex ratio of the Company will probably keep declining.

### Opex ratio of Comba



Source: Company reports, Phillip Securities (HK) Research

### Layout location-based services brought new growth of profit

In June, Comba entered an agreement with Guangzhou Zainar Info Tech Limited and Mapout Info Tech (HK) Limited, under which a joint-venture located in Beijing would be established. This joint-venture mainly works on indoor location-based service system throughout the whole country (including indoor mobile internet positioning system and indoor location-based big-data and map system). Comba possesses 20% of the equity of this joint-venture.

Currently, operators in the market focus on 4G indoor coverage and mobile internet. Comba's Smallcell product is in line with the strategies of the operators. It is expected to help the joint-venture grow toward to leading provider of solutions concerning indoor location-based service system and brought new growth of profit for the Company.

### **Catalyst**

4G construction progress is beyond expectation;  
Better-than-expected development of overseas market.

### **Risk**

More fierce competition leads to market loss.

## Financials

FYE	2012	2013	2014	2015F	2016F
<b>Valuation Ratios</b>					
Price Earnings	-	-	20.3x	10.8x	8.8x
Price to Book	0.8x	0.8x	0.8x	0.8x	0.7x
Dividend Yield	0.0%	0.0%	1.5%	2.8%	3.4%
<b>Per share data(HK\$)</b>					
EPS Adjusted	-0.12	-0.14	0.09	0.17	0.21
Book Value Per Share	2.27	2.19	2.21	2.33	2.48
Dividends Per Share	0.00	0.00	0.03	0.05	0.06
<b>Growth &amp; Margin</b>					
Revenue growth	-	-9.7%	17.7%	14.9%	5.2%
Gross Profit growth	-	-15.5%	28.9%	22.2%	6.7%
Net Profit growth	-	-	-	-	23.3%
<b>Profitability Ratios</b>					
Gross Margin	25.5%	23.9%	26.1%	27.8%	28.2%
Net Profit Margin	-3.2%	-4.2%	2.2%	4.1%	4.8%
Dividend Payout Ratio %	0.0%	0.0%	30.0%	30.0%	30.0%
<b>Key Ratios</b>					
Return on Assets	-2.1%	-2.4%	1.5%	3.0%	3.5%
Return on Equity	-5.2%	-6.4%	4.0%	8.1%	9.3%
Effective Tax Rate	0.0%	0.0%	23.8%	22.5%	22.5%
Liability ratio	61.7%	63.9%	62.8%	62.5%	62.5%
<b>Income Statement(HK\$: mn)</b>					
<b>Revenue</b>	<b>6,333</b>	<b>5,721</b>	<b>6,733</b>	<b>7,737</b>	<b>8,136</b>
- Cost of Goods Sold	4,717	4,355	4,973	5,586	5,842
<b>Gross Income</b>	<b>1,616</b>	<b>1,366</b>	<b>1,760</b>	<b>2,151</b>	<b>2,294</b>
- Selling, General & Admin Expe	1,775	1,487	1,502	1,687	1,749
<b>Operating Income</b>	<b>-98</b>	<b>-63</b>	<b>309</b>	<b>522</b>	<b>609</b>
- Interest Expense	43	55	61	65	65
<b>Pretax Income</b>	<b>-148</b>	<b>-160</b>	<b>202</b>	<b>412</b>	<b>509</b>
- Income Tax Expense	68	85	48	93	115
<b>Income Before XO Items</b>	<b>-216</b>	<b>-245</b>	<b>154</b>	<b>319</b>	<b>395</b>
- Minority Interests	-13	-4	3	6	8
<b>Net Profit</b>	<b>-202</b>	<b>-241</b>	<b>151</b>	<b>313</b>	<b>387</b>

Source: Company, Phillip Securities (HK) Research Estimates  
(Financial figures as at 28 July 2015)

**PHILLIP RESEARCH STOCK SELECTION SYSTEMS**

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

**GENERAL DISCLAIMER**

This publication is prepared by Phillip Securities (Hong Kong) Ltd ("Phillip Securities"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively the "Research") contained in this publication are based on such information and are expressions of belief only. Phillip Securities has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities shall not have any responsibility to maintain the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the information or Research made available, even if it has been advised of the possibility of such damages.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a financial adviser regarding the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

**Disclosure of Interest**

Analyst Disclosure: Neither the analyst(s) preparing this report nor his associate has any financial interest in or serves as an officer of the listed corporation covered in this report.

Firm's Disclosure: Phillip Securities does not have any investment banking relationship with the listed corporation covered in this report nor any financial interest of 1% or more of the market capitalization in the listed corporation. In addition, no executive staff of Phillip Securities serves as an officer of the listed corporation.

**Availability**

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Information contained herein is based on sources that Phillip Securities (Hong Kong) Limited ("PSHK") believed to be accurate. PSHK does not bear responsibility for any loss occasioned by reliance placed upon the contents hereof. PSHK (or its affiliates or employees) may have positions in relevant investment products. For details of different product's risks, please visit the Risk Disclosures Statement on <http://www.phillip.com.hk>.

© 2015 Phillip Securities (Hong Kong) Limited

**Contact Information (Regional Member Companies)**

**SINGAPORE**

**Phillip Securities Pte Ltd**  
Raffles City Tower  
250, North Bridge Road #06-00  
Singapore 179101  
Tel : (65) 6533 6001  
Fax : (65) 6535 6631  
Website: [www.poems.com.sg](http://www.poems.com.sg)

**HONG KONG**

**Phillip Securities (HK) Ltd**  
Exchange Participant of the Stock Exchange of Hong Kong  
11/F United Centre 95 Queensway  
Hong Kong  
Tel (852) 22776600  
Fax (852) 28685307  
Websites: [www.phillip.com.hk](http://www.phillip.com.hk)

**INDONESIA**

**PT Phillip Securities Indonesia**  
ANZ Tower Level 23B,  
Jl Jend Sudirman Kav 33A  
Jakarta 10220 – Indonesia  
Tel (62-21) 57900800  
Fax (62-21) 57900809  
Website: [www.phillip.co.id](http://www.phillip.co.id)

**THAILAND**

**Phillip Securities (Thailand) Public Co. Ltd**  
15th Floor, Vorawat Building,  
849 Silom Road, Silom, Bangrak,  
Bangkok 10500 Thailand  
Tel (66-2) 6351700 / 22680999  
Fax (66-2) 22680921  
Website: [www.phillip.co.th](http://www.phillip.co.th)

**UNITED KINGDOM**

**King & Shaxson Capital Limited**  
6th Floor, Candlewick House,  
120 Cannon Street,  
London, EC4N 6AS  
Tel (44-20) 7426 5950  
Fax (44-20) 7626 1757  
Website: [www.kingandshaxson.com](http://www.kingandshaxson.com)

**AUSTRALIA**

**PhillipCapital Australia**  
Level 12, 15 William Street,  
Melbourne, Victoria 3000, Australia  
Tel (613) 96188238  
Fax (613) 92002272  
Website: [www.phillipcapital.com.au](http://www.phillipcapital.com.au)

**MALAYSIA**

**Phillip Capital Management Sdn Bhd**  
B-3-6 Block B Level 3 Megan Avenue II,  
No. 12, Jalan Yap Kwan Seng, 50450  
Kuala Lumpur  
Tel (603) 21628841  
Fax (603) 21665099  
Website: [www.poems.com.my](http://www.poems.com.my)

**JAPAN**

**PhillipCapital Japan K.K.**  
Nagata-cho Bldg.,  
8F, 2-4-3 Nagata-cho,  
Chiyoda-ku, Tokyo 100-0014  
Tel (81-3) 35953631  
Fax (81-3) 35953630  
Website: [www.phillip.co.jp](http://www.phillip.co.jp)

**CHINA**

**Phillip Financial Advisory (Shanghai) Co. Ltd**  
No 436 Hengfeng Road,  
Greentech Unit 604,  
Postal code 200070  
Tel (86-21) 51699400  
Fax (86-21) 63532643  
Website: [www.phillip.com.cn](http://www.phillip.com.cn)

**FRANCE**

**King & Shaxson Capital Limited**  
3rd Floor, 35 Rue de la Bienfaisance 75008  
Paris France  
Tel (33-1) 45633100  
Fax (33-1) 45636017  
Website: [www.kingandshaxson.com](http://www.kingandshaxson.com)

**UNITED STATES**

**Phillip Futures Inc**  
141 W Jackson Blvd Ste 3050  
The Chicago Board of Trade Building  
Chicago, IL 60604 USA  
Tel +1.312.356.9000  
Fax +1.312.356.9005