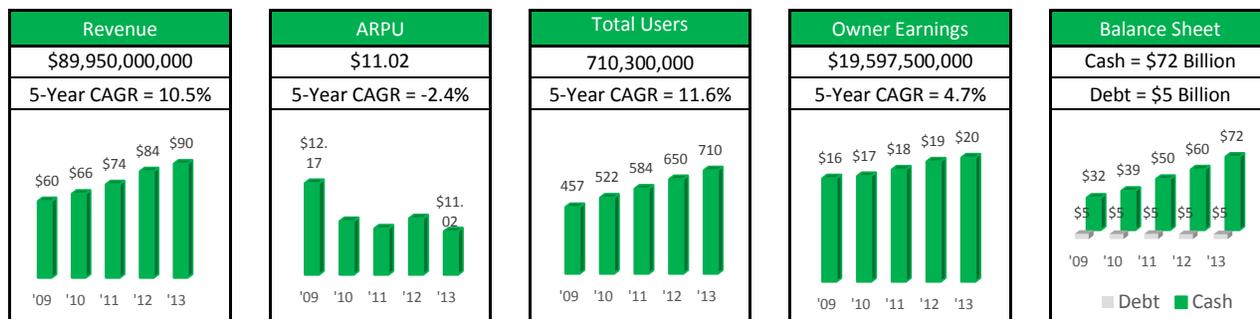




China Mobile Ltd.
March 7, 2014

General Overview

China Mobile LTD is the world's largest cell phone and data plan provider with more than 700 million customers in Mainland China. The company's extensive network spans all 31 provinces in Mainland China providing the best coverage in the nation.



In the last 10 years the company has benefited greatly as a quasi-government entity with the PRC holding a 70% stake. The key metrics; Revenue, Average Revenue Per User (ARPU), Total Users, and Owner Earnings have all benefited during this time period to establish China Mobile as the most dominate Wireless carrier in China. In the last five years the government has encouraged increased competition and prices are slowly coming down as a result. Despite these headwinds China Mobile is a safe investment due to the incredible strength of the company's balance sheet with more than \$72 billion USD in cash and only \$5 billion in debt.

Purchase Logic

We purchased China Mobile at \$45.07 per share which equates to a total market capitalization of \$188 billion. With more than \$68 billion in net cash the enterprise value at purchase was roughly \$120 billion. Our effective purchase price was less than 7x TTM earnings. This purchase represents one of the cheapest purchases we've made throughout 2014. With a strong dividend of more than 4% we elected to make this purchase as a superior alternative to cash.

Future Expectations

We expect China Mobile to earn roughly \$18 billion or more going forward with very little growth. The company has publically stated their intention to payout 43% of their profits as a dividend which would equate to a 4.1% dividend yield. Due to the substantial cash position, low purchase price, and negligible debt we believe this investment will protect principle and is superior to cash. Due to the mature nature of the company and the risk in a continued decline in ARPU from increasing competition we would be content selling this position for a modest gain.

Financial Highlights

Historical Growth

China Mobile has grown tremendously during the last 10 years growing from 140 million users to more than 740 million today. During this same time frame net income has increased from \$4 billion to more than \$20 billion. However, the cell phone market in China is now mature and regulatory pressure will likely stunt growth in the future. We are anticipating a net income of \$18 billion that is constant for several years. Growth is not required for this investment to be successful.

Table 1: Performance Measures

Year	'09	'10	'11	'12	'13
Total Revenue	\$ 60,356,000,000	\$ 66,223,000,000	\$ 73,635,000,000	\$ 83,889,000,000	\$ 89,950,000,000
ARPU	\$12.17	\$11.27	\$11.09	\$11.33	\$11.02
Total Users	457,300,000	522,300,000	584,000,000	649,600,000	710,300,000
Minutes Provided	2,441,300,000,000	2,918,700,000,000	3,461,600,000,000	3,887,200,000,000	4,192,300,000,000
Owner Earnings	\$16,312,500,000	\$16,665,750,000	\$17,699,250,000	\$18,964,500,000	\$19,597,500,000
YOY Earnings Growth	24%	2%	6%	7%	3%
Cash	\$31,989,000,000	\$38,745,000,000	\$50,462,000,000	\$59,863,000,000	\$72,428,000,000
Debt	\$5,237,000,000	\$5,018,000,000	\$5,184,000,000	\$4,815,000,000	\$4,791,000,000

Divisions

China Mobile operates in two primary divisions: Voice and Data. The voice business enables customers to make and receive phone calls with a mobile phone. The data business includes text messaging (SMS) and wireless data traffic.

Problem & Solution

Problem

Individuals want to be able to communicate anytime, anywhere; as well as access the internet and information at any time.

Solution

China Mobile provides the network for their users to communicate and access the internet from anywhere. The company has built a network of 'base stations' throughout the country to route phone calls from one subscriber to another.

Products & Services

The company offers telecommunication services for phone calls, Wi-Fi for internet access at various locations, and TD-LTE. All of these services empower smart phones to surf the web and communicate with each other over wireless broadband networks. This is the same service AT&T and Verizon provide in the United States.

Technical Overview

In order for users to communicate using their cellular phones data is transmitted over radio waves at a specific frequency. The problem with this form of communication is that there are only so many frequencies, or spectrums, available to transmit data. In the old days powerful radio transmitters were used that covered very large

areas (50+ square miles). The problem with these powerful transmitters was that once all the frequencies were used in that 50+ square miles there were no more channels available to transmit data.

Cell phones are brilliant in that they divide a city in very small areas, called cells, which are typically 10 square miles. Each cell has a certain number of radio frequencies available to transmit data, but because the cells are small the number of frequencies is enough to service everything in that specific area. Data is transmitted from cell to cell which allows the same frequency to be used over and over as the information is passed from cell to cell. By dividing areas into smaller cells the number of users can increase dramatically and frequencies become less limiting.

Base stations are built inside each cell to transmit the data from cell to cell. If there is no base station inside a specific cell then there is no cell phone reception. The best telecommunication companies have base stations everywhere – allowing high quality communication at any location.

Customers

Individuals and enterprises both subscribe to cell phone services. The ability to communicate at anytime from anywhere has become an essential part of society and life. China Mobile's customers include 740 million subscribers and roughly 64% of the addressable market in China. In all countries cell phones play a critical role in our daily lives. Individuals typically select their cell phone provider based on price and service. Service includes good reception from anywhere. Frequently dropped calls or areas that are not serviced can cause customers to switch providers even if the monthly payment is more. If the service and coverage is equivalent between two providers the major deciding factor is price. This creates a commodity type service, but given the exceptionally low purchase price and outstanding balance sheet we believe the risk is minimal.

Sales & Marketing

Customers are reached through traditional advertising and then sold the service through retail stores. Traditional advertising includes billboards, radio commercials, television ads, etc. These advertising efforts are intend to help brand "China Mobile" and the company has been incredibly successful in this respect. The company has been voted the most respected brand in China for several years running.

The advertising and branding helps to drive customer traffic into their extensive network of stores and various other channels. The retail sales environment is the primary way to distribute their product. The company also distribute through electronic channels, such as being able to purchase plans online or adding additional minutes over the phone.

China Mobile's marketing strategy is geared toward retaining medium and high-end customers. The company advertises specifically to 3.46 million businesses that account for 34.5% of their overall customer base. The three brands the company promotes include "GoTone" for high to middle-end customers, "Easy own" for the mass market, and "M-Zone" for young user groups.

Revenue Creation

China Mobile generates revenue primarily through cell phone and data plans. The company charges customers in a variety of ways; which includes usage charges, monthly fees, and service fees for data services. The various packages are very similar in structure to cell and data plans in the United States.

China Mobile's average monthly payment per user is \$10.55. With more than 740 million customers their annual revenue is in excess of \$90 billion dollars.

Geographically revenue is earned across all 31 provinces in Mainland China. The service is price competitive, but network coverage also plays an important role. Unlike the United States, there is not coverage nationwide provided by multiple carriers and the outstanding network has given China Mobile some pricing power. However, the average monthly payment per user has been dropping year-over-year and we expect this trend to continue. As the ARPU drops and the customer base reaches market saturation the overall revenue will decline. It is our expectation that the ARPU will drop slowly due to the addition of data packages.

The long-term slope of the pricing will be negative and place pressure on the long-term ROE. As it currently stands the ROE of the business is exceptional at +25% with no debt. Even with a saturated customer base and declining ARPU the ROE is sufficiently high that this investment was prudent.

Expenses

The expenses for China Mobile are broken down into several categories. As of December 2012 they had 182,487 employees. The employees have the following classifications:

Management	33,983
Technical	55,205
Marketing	60,188
General affairs	33,111
Total	182,487

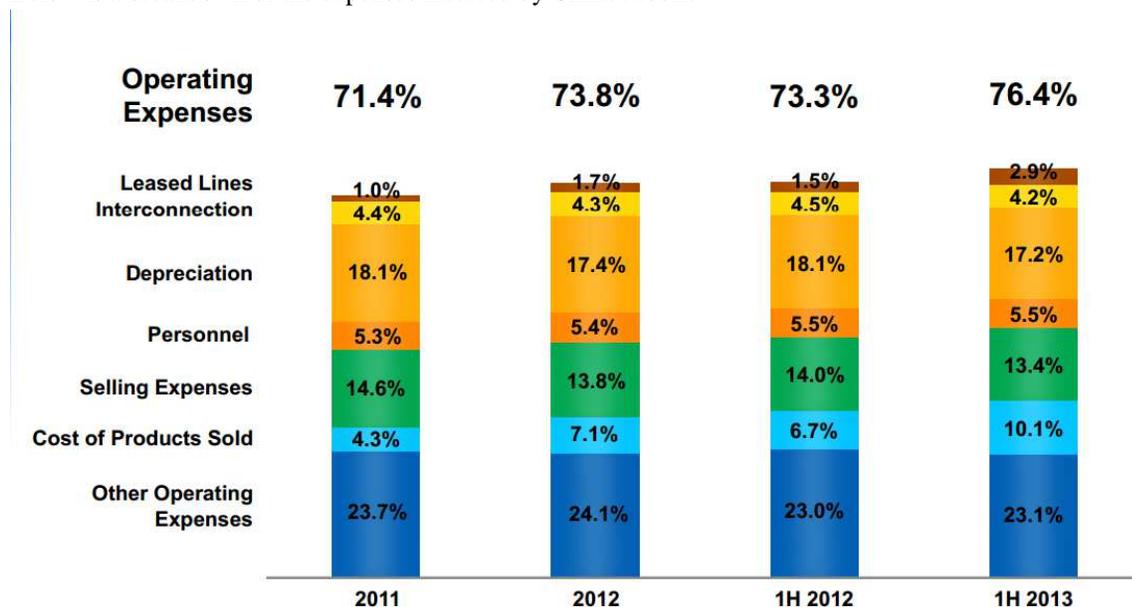
Most employees participate in a labor association (or union). This could be problematic in the future as collective bargaining power puts wage pressure on business owners.

In addition to the work performed by the employees of China Mobile the network is also quite expensive. A typically base station, depending on the technology, can cost anywhere from \$25,000 to \$55,000. With each new generation of technology the price is slowly dropping. The rapid changes in base station technology make 'upgrading' the network a routine occurrence, and therefore, the depreciation charge for the base stations is a very real expense.

A 4G LTE base station costs roughly \$33,000. China Mobile will be building 200,000 of these base stations in 2014 and is a major expense for them (\$6.75 billion). A single base station was as much as \$75,000 5 years ago and now the newest generation are being installed for only \$33,000. This will help them to drop the ARPU while simultaneously maintaining profit margins.

On top of personnel and equipment telecommunication providers also must purchase frequency bands. In the United States the radio frequencies are divided into regions and businesses must purchase specific frequencies, known as spectrum, for each area. The same frequency may be purchased many times in different areas of the country. This is a huge expense for US telecommunication companies and appears as an intangible asset on their balance sheets. The same frequencies are assigned in China and do not appear on the balance sheet as intangible assets. As it currently stands the PRC government is attempting to promote competition and assigning more mobile players frequencies in several regions. This initiative was started in 2008 and thus far China Mobile continues its domination.

Below is a breakdown of the expenses incurred by China Mobile.



Real Income

The Real Income adds back phantom expenses and one-time charges that are not recurring in nature. For China Mobile their real income is as stated with no adjustments. The depreciation expense is a very real expense for their network and the capital expenditures has outpaced the depreciation expense as they have grown. With the company reaching maturity I'd expect the capital expenditures and depreciation expenses to nearly offset in the upcoming years. China Mobile's income in 2013 was \$20 billion USD. Our purchase price was roughly \$180 billion dollars for the business.

The net income margin for China Mobile is sensational at 23%. This compares very favorably to their two largest competitors, China Unicom and China Telecom.

Net Income Margin

	2012	2011	2010	2009	2008	2007	2006	2005
China Mobile	23.1%	23.9%	24.7%	25.5%	27.4%	24.3%	22.4%	22.0%
China Unicom	2.9%	2.0%	2.2%	6.1%	18.7%	10.6%	4.0%	5.6%
China Telecom	5.3%	6.8%	7.0%	6.8%	0.5%	13.4%	15.6%	16.4%

Growth

In the last decade the company has experienced substantial growth, but it is certain that this growth has come to an end. The penetration rate for cell phone users in China has matured and new customers will not be added. Additionally, more competition will reduce their overall market share, absolute customer count, and ARPU. While all of these elements make the prospects of the company sound poor the opposite is true. Who needs their service? Everyone. Who has their service? Everyone. They provide an incredible service very efficiently to everyone and therefore cannot grow their customer count. It is a good problem to have. Our expectation is that the decline in customer count will be very slow and China Mobile will maintain more than 650 million customers for many years.

The ARPU is the most important element to our investment thesis. It is our expectation that the ARPU will be stable or decline very slow. A rapid decline in ARPU would be a surprise and very detrimental to the profitability of the business. The reason we anticipate flat ARPU is due to a decline in APRU from voice and an increase in ARPU from data. The data element, in the short-term, may actually increase the ARPU since many Chinese consumers do not currently have data plans, want data plans, and are gradually able to afford these plans. The growth in the middle class should help stabilize the ARPU over time.

Growth plans in the near-term are based on the roll-out of 4G technology. The company intends to build 200,000 TD-LTE based stations in 2013 and offer 4G services for additional data plans. Data usage over LTE networks went from \$0 per year to \$90 billion in the United States in the last 5 years. We believe the insatiable desire for data and bandwidth will continue to grow in China.

Some facts on the general market conditions on China: Mainland China has reached an 82.6% penetration rate for mobile users. This is a very mature market. The total population in China is 1.351 billion which indicates China Mobile services 52% of the entire population. It is estimated they have 64% of the addressable market in China.

In general the GDP for the PRC economy grew by 7.8% in 2012 and is slated for continued growth into the future. We believe that the country has a bright economic future ahead of it which will help China Mobile continue to earn billions of dollars long into the future.

Competition

China Mobile competes against two, much smaller and much less profitable, companies in China: China Unicom and China Telecom. The Chinese government has been implement changes to attempt to increase the competition and reduce the monopolistic market share China Mobile currently holds. The PRC government implement minimum monthly charges that China Mobile must pay and allows their competitors to charge *less* than the forced monthly charges on China Mobile. Despite these changes and pressure for competition China Mobile continues to dominant.

Their market share decreased from 66.5% to 63.9% with all the attempts to increase competition and absolute customer count continues to rise.

The most appropriate figure to monitor the competition is the 'churn rate'. The churn rate is defined as the number of customers that disconnected their service from China Mobile (whether voluntary or involuntarily) divided by the total number of customers during that period. The monthly churn rate has been very stable for China Mobile at 3.2% since 2008 (when the government attempted to increase competition) and it does not appear that customer attrition is accelerating.

Monthly Churn

Year	2012	2011	2010	2009	2008
Monthly Churn	3.25%	3.21%	3.22%	3.30%	2.71%

We also believe the churn rate is artificially overstated compared to US counterparts (which have churn rates of roughly 1% - 2.5%). A churn rate of 3.2% implies that more than 36% of the customer base disconnects their service annually. If these customers did not return China Mobile would lose 273 million customers annually.

China Mobile Customer Changes

Year	2012	2011	2010	2009	2008
Total Customers	710,300,000	649,600,000	584,000,000	522,300,000	457,300,000
Monthly Churn	3.25%	3.21%	3.22%	3.30%	2.71%
Annual Customers Lost	253,344,000	224,956,800	201,816,720	181,090,800	120,096,360
Annual Customers Added	314,044,000	290,556,800	263,516,720	246,090,800	208,096,360
Net Change	+60,700,000	+65,700,000	+61,700,000	+65,000,000	+88,000,000

In the last 5 years China Mobile has added a *net* of 253,000,000 customers as their customer base has grown. The reported churn indicates they have ‘lost’ 981,304,680 customers in the last 5 years, but simultaneously added 1,322,304,680 customers. The customers added is larger than the total population of China...so where are they coming from? We believe the answer is simple. Customers disconnect their service for brief periods and then reconnect their service. These customers are loyal China Mobile customers, but cannot afford cell phone minutes every month and periodically ‘disconnect’. These disconnects are included in the monthly churn, but do not actually represent lost customers. It is our belief that the churn for China Mobile is much lower than the reported figure and as income levels improve in China the ‘involuntary’ disconnects will greatly reduce and churn; as measured by customers lost to the competition, will drop dramatically.

There are some other regulatory changes notable that will heat up competition: MIIT has mandated that telecommunication operators must share existing transmission towers and masts and jointly construct future transmission towers and masts. CM, China Unicom, and China Telecom have entered an agreement to jointly construct relevant telecommunications infrastructure going forward.

Consolidated Balance Sheet

The balance sheet for China Mobile is a marvel to behold. The telecommunications industry is a very capital intensive business and most participants have substantial debt loads. Below is a table of telecommunication companies and their balance sheet strength.

Company	Revenue	Net Cash (Debt) Position
China Mobile	\$89.950 Billion	\$67.637 Billion Cash
China Telecom	\$45.435 Billion	(\$10.770) Billion Debt
China Unicom	\$33.233 Billion	(\$14.262) Billion Debt
Verizon	\$120.550 Billion	(\$39.462) Billion Debt
AT&T	\$128.752 Billion	(\$71.449) Billion Debt

This incredible balance sheet was a major reason we were very confident in this purchase. China Mobile has demonstrated outstanding profitability due to their incredible economies of scale with the largest customer base in the world and has demonstrated vastly superior ability to generate cash with no debt.

Accounting Quality

The accounting quality of the business is very sound.

Legal

The regulatory environment in the Chinese telecommunications industry is very complex. In 2008 there was a restricting of the telecommunications market that changed the competitive landscape allowing non-State-owned

telecommunication providers to enter the market. This has created additional pressure on China Mobile from other competitors, but it is evident they have been able to withstand this pressure.

The Ministry of Industry and Information Technology, or MIIT, controls the allocation of frequency spectrum to mobile telecommunications operators in Mainland China. They would be equivalent to the US version of the FCC. They have allocated 45x2 Mz of spectrum to be used for transmission and reception to China Mobile.

There is political risk associated with the investment. The PRC government may implement asymmetrical regulatory measures to allow competitors to compete against China Mobile more effectively. They have been attempting for a few years to increase competition in the telecommunications space and there is the possibility that further action will be taken.

One element of the Chinese telecommunication market that makes customers 'stickier' is the non-portability of cell phone numbers. In the United States if you want to switch cell phone providers your number can transfer with you. This increases competition. In China they are currently working on a system that will make cell phone numbers portable across networks – which will increase competition and likely decrease the earnings for China Mobile in the future. The decrease should be minor.

Market

The telecommunications market in China is mature, yet growing. It is mature in the sense that more than 82% of all individuals have cell phone plans of some type. This is a very high penetration rate and likely will not increase much further (at most an 18% increase :-P). In this sense the market is mature, but the ARPU is very low and the number of 3G users that utilize data plans is very low. The data market is likely to compound at exceptionally high rates of return of the next decade.

We've talked some about China Mobile's market share, but will add more detail here. They currently have 63.9% of the entire market, down from 66.5% in 2012. The decrease in market share is from more mobile users in China, not a drop in absolute customer count. It is our expectation that the market share for China Mobile will gradually drop over time, but anticipate them maintain at least 650 million customers for the next 5 years.

Corporate Governance

The majority shareholder is China Mobile Communications Corporation or CMCC. They own 74.08% of the outstanding shares. This makes China Mobile a State-Owned corporate entity. A state-owned corporate entity is a corporation that is formed for commercial purposes, in this case to provide cell phone services, with the government being a regular stockholder. There is definitely a conflict of interest with the PRC being the majority shareholder of a for-profit corporation. Interestingly enough, China has recently implemented policies to make non-State-owned telecommunication companies more competitive. The country is becoming more and more capitalistic with each passing day. This is in sharp contrast to the United States government that seems to be purchasing more for-profit entities each passing year (Fannie Mae, Freddie Mac, TARP program, AIG, etc.)

Allocation of Capital

Their capital allocation has been extremely predictable. They have paid out 43% of their profits for many years and retained the remainder for expansion. The sum of their dividend payouts and capital expenditures have been substantially less than their overall income which has led to a buildup of \$69 billion in cash. If \$40 billion of this cash position were paid out as a dividend it would equate to roughly \$10 per share (we paid \$46.89 per share). This scenario is unlikely, but is not required for this to be an excellent investment. The cash pile at least gives outstanding downside protection.

Based off of their 2014 earnings estimate a 43% dividend payout would equate to a 4.8% dividend yield. This is an exceptional yield when compared to cash.

Risks

The biggest risks comes from the regulatory environment. The changes in China, such as the regulatory prices set by the government, can create major problems for China Mobile in the future. It is difficult to gauge how these politics risk will pan out – especially considering the government is a major shareholder of the company. While it was very difficult to assess this regulatory risk we felt that the exceptional economic performance, very strong balance sheet, and extremely attractive purchase price merited a purchase.

Recently China imposed a Value Added Tax (VAT) of roughly 11% on telecommunication services. This tax will negatively impact China Mobile’s profitability in the future, but we do not consider this a risk. Tax environments change constantly and we do not consider changing tax situations a business ‘risk’ as long as all market participates are expected to pay the tax equally. The competitive position will be unaffected by changes in taxation.

Moat

China Mobile’s economic moat is the enormous customer base, outstanding network, and strong brand name. With 740 million customers China Mobile is able to increase the utilization rate of their network which lowers the capital expenditure costs per user. These savings can be passed on to customers while simultaneously maintaining profitability. This is the most important element of their competitive position.

The brand is the second most important element of their competitive position. The Chinese consumers view China Mobile’s brand very favorably and BrandZ recently ranked China Mobile the #1 most valuable Chinese Brand. China Telecom and China Unicom did not make the top 10.

Works Cited

- 1) *China Mobile LTD. Annual Report - SEC Filing 20-F*. EDGAR, 2013.

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