

# China Tower Corporation Ltd. (788 HK)

## Limited upside potential; downgrade to HOLD

- MIIT has allocated the 5G telecom operating licenses to the three major telecom operators and China Broadcasting Network Corporation earlier than expected. 5G commercial launch is feasible in 2H19.
- Sino-US tension concerning 5G may affect the sector's valuation
- We project the Group's tenancy ratio in 2019E-21E to be 1.55 to 1.83.
- Recent RMB depreciation has negatively impacted investment appetite
- We downgrade to **HOLD** due to the 35.7% rally YTD that reduces upside potential for share price to 2.9%, which is calculated based on our unchanged TP of HK\$2.00 that implies 8.2x/7.2x FY19E/20E EV/EBITDA..

**We expect China Tower's tower tenancy ratio to rise from 1.55 in 2018 to 1.83 in 2021E.** MIIT has allocated the official 5G operating licenses to the three major telecom operators (China Unicom [762 HK], China Telecom [728 HK], and China Mobile [941 HK]) and China Broadcasting Network Corporation earlier than expected. In our view, introduction of the 5G network in China will lift demand for telecom and 5G commercial usage may commence in 2H19.

**Intensifying Sino-US trade dispute may affect sector valuation.** The US government may impose more restrictions to China's export of 5G-related technologies, affecting the component procurement in the upstream. The telecom operators may restrain on 5G spending.

**Valuation.** We revise up FY19 revenue/ net profit by 1.2% and 2.0%, respectively, to reflect the faster than expected commercial launch of 5G network. We maintain the TP and valuation, but downgrade to **HOLD**. Our TP of HK\$ 2.00, implying 8.2x/7.2x FY19E/20E EV/EBITDA. The counter has rallied by 35.7% YTD, hence upside potential for share price is low at 2.9% based on our unchanged TP. Moreover, dividend yield at 0.9% is unattractive. Recommend **HOLD**.

**Risk factors:** (1) Markup margin may change; (2) Delay in 5G network launch; (3) Business relies heavily on three major telecom operators; (4) Failure or delay in collecting trade receivables; (5) Tenancy ratio may deviate from expectation.

### Results and Valuation

| FY ended Dec 31     | FY17A   | FY18A  | FY19E  | FY20E  | FY21E  |
|---------------------|---------|--------|--------|--------|--------|
| Revenue (RMB mn)    | 68,665  | 71,819 | 78,219 | 85,418 | 93,105 |
| Chg (% YoY)         | 22.6    | 4.6    | 8.9    | 9.2    | 9.0    |
| Net profit (RMB mn) | 1,943   | 2,650  | 5,525  | 8,360  | 9,482  |
| Chg (% YoY)         | 2,456.6 | 36.4   | 108.5  | 51.3   | 13.4   |
| EPS (RMB)           | 0.015   | 0.015  | 0.031  | 0.047  | 0.054  |
| Chg (% YoY)         | 2,456.6 | 0.2    | 108.5  | 51.3   | 13.4   |
| BPS (RMB)           | 0.99    | 1.03   | 1.05   | 1.09   | 1.12   |
| Chg (% YoY)         | 1.5     | 4.0    | 2.8    | 3.0    | 2.8    |
| P/E (x)             | 108.3   | 114.3  | 56.2   | 37.1   | 32.7   |
| P/B (x)             | 1.65    | 1.68   | 1.67   | 1.62   | 1.58   |
| ROAE (%)            | 1.5     | 1.7    | 3.0    | 4.4    | 4.9    |
| ROAA (%)            | 0.6     | 0.8    | 1.6    | 2.1    | 2.2    |
| DPS (HKD)           | 0.00    | 0.00   | 0.02   | 0.02   | 0.03   |
| Dividend Yield (%)  | N/A     | N/A    | 0.9    | 1.4    | 1.5    |

Source(s): Bloomberg, ABCI Securities estimates

\*Exchange rate assumption for FY19E-21E: 1HKD = 0.900RMB

\*Net profit = Net profit attributable to shareholders of the Company

## Company Report

Aug 9, 2019

Rating: **HOLD**  
TP: HK\$ 2.00

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|                         |              |
|-------------------------|--------------|
| Share price (HK\$)      | 1.96         |
| Est. share price return | 2.0%         |
| Est. dividend yield     | 0.9%         |
| Est. total return       | 2.9%         |
| Previous Rating & TP    | BUY/HK\$2.00 |
| Previous Report Date    | Jan 28, 2019 |

Source(s): Bloomberg, ABCI Securities

### Key Data

|                              |           |
|------------------------------|-----------|
| 52Wk H/L(HK\$)               | 2.24/0.99 |
| Issued shares (mn)           | 176,008   |
| Issued H-shares (mn)         | 46,664    |
| H-share market cap (HK\$ mn) | 91,461    |
| Avg daily turnover (HK\$ mn) | 1,395.8   |
| Major shareholder(s)         |           |
| China Mobile                 | 28.5%     |
| China Unicom                 | 21.1%     |
| China Telecom                | 20.9%     |

Source(s): Company, ABCI Securities

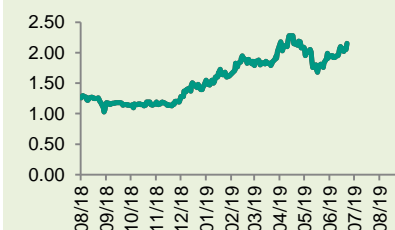
### Share Performance (%)

|       | Absolute | Relative* |
|-------|----------|-----------|
| 1-mth | 17.5     | 9.4       |
| 3-mth | 12.7     | 16.8      |
| 6-mth | 53.8     | 33.8      |

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

### Share performance (HK\$)



Source(s): Bloomberg, ABCI Securities

MIIT has allocated the official 5G operating licenses to the three major telecom operators (China Unicom [762 HK], China Telecom [728 HK], and China Mobile [941 HK]) and China Broadcasting Network Corporation earlier than expected. The launch of 5G network, whose commercial usage may occur in 2H19, will lift the demand of telecom towers. We expect the Group's tenancy ratio to rise from 1.55 in 2018 to 1.83 in 2021E.

According to the Broadband China strategy, telecom operators will expand their 4G network to attain a population coverage of 98%. Telecom operators have allocated CAPEX for 4G network improvement and maintenance and are generally rather prudent in their budgeting for 5G CAPEX in FY19. Since telecom operators enjoy discounts by sharing tower resources with others, we expect tower co-sharing ratio to rise. We project the Group's tower business revenue to grow by 5.1%/ 4.1%/ 3.3% in 2019E-21E.

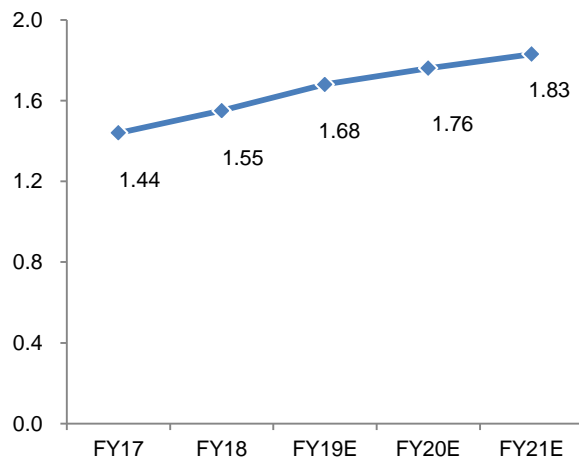
In 2019, telecom operators in China are expected to lower the mobile service tariff by 20% and fixed line broadband fee for SME customers by 30%. In FY19, telecom operators are launching small scale 5G network development with the construction of around 100 thousand 5G base stations. Based on the estimates of the individual operators, China Unicom's 5G CAPAEX will be RMB 6bn-8 bn, lower than China Telecom's RMB9 bn and China Mobile's RMB 15bn. CAPEX for FY20 will increase on the expansion of 5G network.

**Exhibit 1: Telecom operators' CAPEX in FY19:**

| RMB Bn     | China Mobile | China Telecom | China Unicom | Total |
|------------|--------------|---------------|--------------|-------|
| FY19 CAPEX | 149.9        | 78.0          | 58.0         | 285.9 |
| YoY        | -10.3%       | 4.1%          | 29.2%        | -0.4% |

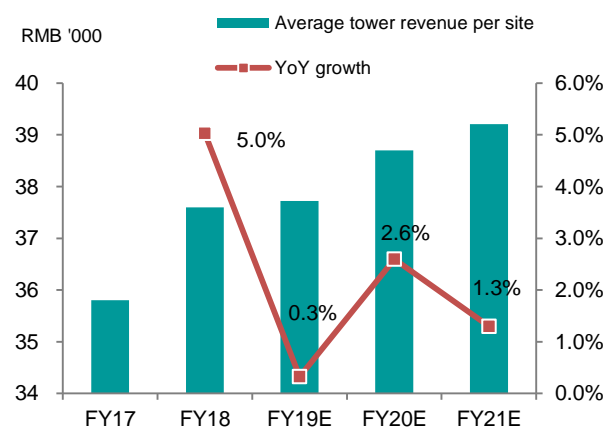
Source(s): Companies, ABCI Securities

**Exhibit 2: China Tower's tenancy ratio**



Source(s): Company, ABCI Securities estimates

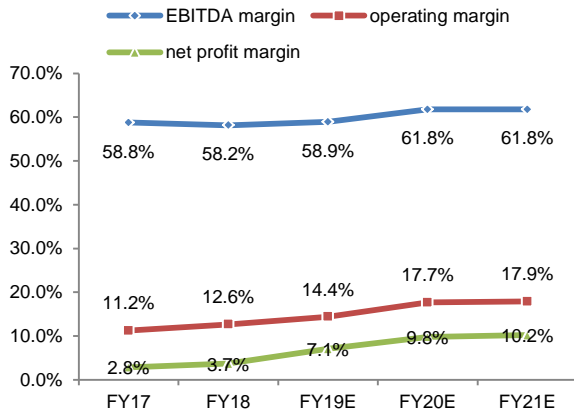
**Exhibit 3: China Tower's average tower revenue per site**



Source(s): Company, ABCI Securities estimates

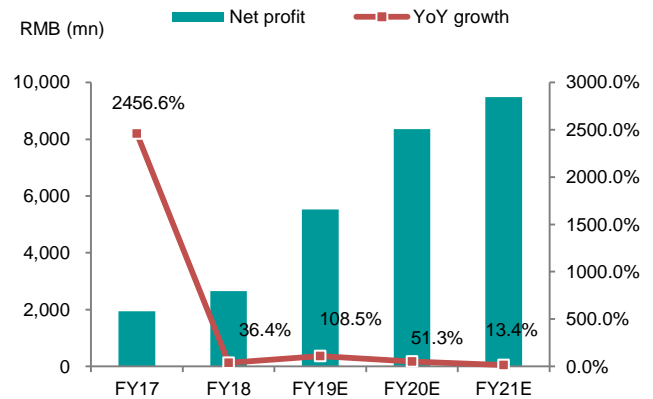


Exhibit 4: China Tower's profit margins



Source(s): Company, ABCI Securities estimates

Exhibit 5: China Tower's net profit and yoy growth



Source(s): Company, ABCI Securities estimates

Exhibit 6: Changes in financial:

|                          | OLD   | NEW   | CHANGE |
|--------------------------|-------|-------|--------|
| FY19 Revenue (RMB mn)    | 77.3  | 78.2  | 1.2%   |
| FY19 Net profit (RMB mn) | 5.4   | 5.5   | 2.0%   |
| FY19 EPS (RMB)           | 0.030 | 0.031 | 2.0%   |

Source(s): Companies, ABCI Securities

We revise up FY19 revenue/ net profit by 1.2% and 2.0%, respectively, to reflect the faster than expected commercial launch of 5G network.

Limited upside potential post-rally; recommend HOLD with TP at HK\$2.00

We maintain the TP and valuation, but downgrade to HOLD. Our TP of HK\$2.00, implying 8.2x/7.2x FY19E/20E EV/EBITDA based on DCF valuation (WACC: 13.0%; perpetuity growth rate: 2%). With our unchanged TP, share price upside is limited at current level after the 35.7% rally YTD, while the dividend yield at 0.9% is lackluster. Going forward, we expect share price to fluctuate on new developments in 5G rollout and trade war.



Exhibit 7: Peer comparison table

|                         | Ticker  | Price | P/E  |      |      |      | P/B |     |     |     | ROE   | ROA   | EV/<br>EBITDA |
|-------------------------|---------|-------|------|------|------|------|-----|-----|-----|-----|-------|-------|---------------|
|                         |         |       | 18A  | 19E  | 20E  | 21E  | 18A | 19E | 20E | 21E | 19E   | 19E   | 19E           |
| <b>China Market</b>     |         |       |      |      |      |      |     |     |     |     |       |       |               |
| China Unicom            | 762 HK  | 10.12 | 19.6 | 15.5 | 11.4 | 9.5  | 0.7 | 0.6 | 0.6 | 0.6 | 4.2   | 2.4   | 1.9           |
| China Mobile            | 941 HK  | 63.05 | 9.7  | 10.3 | 10.1 | 9.9  | 1.1 | 1.1 | 1.0 | 1.0 | 10.8  | 7.5   | 2.8           |
| China Telecom           | 728 HK  | 3.37  | 11.4 | 11.3 | 10.6 | 10.1 | 0.7 | 0.7 | 0.7 | 0.6 | 6.3   | 3.4   | 2.8           |
| China Tower             | 788 HK  | 1.96  | 89.0 | 54.0 | 33.8 | 23.6 | 1.6 | 1.6 | 1.6 | 1.5 | 3.1   | 1.7   | 8.0           |
| <b>Simple Average</b>   |         |       | 32.4 | 22.8 | 16.5 | 13.3 | 1.0 | 1.0 | 1.0 | 0.9 | 6.1   | 3.7   | 3.9           |
| <b>Weighted Average</b> |         |       | 23.4 | 17.8 | 14.0 | 12.0 | 1.1 | 1.1 | 1.0 | 1.0 | 8.3   | 5.5   | 3.5           |
| <b>US Market</b>        |         |       |      |      |      |      |     |     |     |     |       |       |               |
| AT&T                    | T US    | 8.91  | 12.0 | 9.6  | 9.4  | 9.4  | 1.4 | 1.4 | 1.4 | 1.3 | 12.2  | 4.2   | 6.9           |
| Verizon                 | VZ US   | 55.09 | 14.8 | 11.6 | 11.4 | 11.2 | 4.3 | 3.8 | 3.3 | 2.9 | 34.2  | 7.4   | 7.0           |
| Sprint                  | S US    | 6.73  | 3.7  | n.a. | n.a. | n.a. | 1.0 | 1.1 | 1.1 | 1.1 | (7.4) | (2.3) | 5.7           |
| T-Mobile                | TMUS US | 76.48 | 22.9 | 19.2 | 16.2 | 14.2 | 2.7 | 2.3 | 2.1 | 1.9 | 11.3  | 4.3   | 6.9           |
| American Tower          | AMT US  | 8.91  | 13.3 | 13.5 | 12.4 | 11.6 | 2.3 | 2.2 | 2.0 | 1.8 | 12.6  | 3.4   | 6.6           |
| <b>Simple Average</b>   |         |       | 14.0 | 11.6 | 11.1 | 10.7 | 2.7 | 2.5 | 2.2 | 2.0 | 20.0  | 5.1   | 6.9           |
| <b>Weighted Average</b> |         |       | 12.0 | 9.6  | 9.4  | 9.4  | 1.4 | 1.4 | 1.4 | 1.3 | 12.2  | 4.2   | 6.9           |

Note: Data priced on August 8, 2019

Source(s): Bloomberg



**Consolidated income statement (2017A-2021E)**

| <b>FY Ended Dec 31 (RMB mn)</b> | <b>2017A</b>  | <b>2018A</b>  | <b>2019E</b>  | <b>2020E</b>  | <b>2021E</b>  |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|
| Tower business revenue          | 67,085        | 68,597        | 72,118        | 75,101        | 77,584        |
| DAS revenue                     | 1,284         | 1,819         | 2,819         | 4,088         | 5,683         |
| TSSAI revenue                   | 169           | 1,222         | 3,055         | 5,957         | 9,532         |
| Others                          | 127           | 181           | 226           | 272           | 307           |
| <b>Total revenue</b>            | <b>68,665</b> | <b>71,819</b> | <b>78,219</b> | <b>85,418</b> | <b>93,105</b> |
| D&A expenses                    | (32,642)      | (32,692)      | (34,807)      | (37,670)      | (40,873)      |
| Site operating lease charges    | (11,336)      | (12,196)      | (13,062)      | (13,863)      | (15,111)      |
| Repairs and maintenance         | (6,156)       | (6,165)       | (6,649)       | (7,090)       | (7,728)       |
| Employee benefits and expenses  | (4,229)       | (4,917)       | (4,615)       | (4,869)       | (5,307)       |
| Other operating expenses        | (6,587)       | (6,768)       | (7,822)       | (6,833)       | (7,448)       |
| Other gains                     | 149           | 153           | 207           | 240           | 278           |
| Interest income                 | 104           | 248           | 29            | 134           | 278           |
| Finance costs                   | (5,283)       | (6,007)       | (4,277)       | (4,567)       | (4,832)       |
| Profit before tax               | 2,685         | 3,475         | 7,222         | 10,900        | 12,362        |
| Tax                             | (742)         | (825)         | (1,697)       | (2,540)       | (2,880)       |
| <b>Net profit</b>               | <b>1,943</b>  | <b>2,650</b>  | <b>5,525</b>  | <b>8,360</b>  | <b>9,482</b>  |
| <b>EBITDA</b>                   | <b>40,357</b> | <b>41,773</b> | <b>46,071</b> | <b>52,763</b> | <b>57,511</b> |
| <b>EPS (RMB)</b>                | <b>0.015</b>  | <b>0.015</b>  | <b>0.031</b>  | <b>0.047</b>  | <b>0.054</b>  |
| <b>DPS (RMB)</b>                | <b>0.000</b>  | <b>0.002</b>  | <b>0.016</b>  | <b>0.024</b>  | <b>0.027</b>  |
| <b>Payout ratio</b>             | <b>0.0%</b>   | <b>50.0%</b>  | <b>50.0%</b>  | <b>50.0%</b>  | <b>50.0%</b>  |

Source(s): Company, ABCI Securities estimates

\*Net profit = shareholders' profit



Consolidated balance sheet (2017A-2021E)

| As of Dec 31 (RMB mn)                             | 2017A          | 2018A          | 2019E          | 2020E          | 2021E          |
|---|----------------|----------------|----------------|----------------|----------------|
| PPE   | 258,138        | 249,055        | 259,402        | 258,319        | 264,224        |
| CIP   | 10,930         | 12,193         | 10,364         | 8,809          | 7,488          |
| Long term prepayments                             | 9,910          | 13,216         | 14,538         | 15,991         | 17,590         |
| Deferred income tax assets                        | 689            | 706            | 494            | 346            | 242            |
| Other non-current assets                          | 12,459         | 8,395          | 47,665         | 54,699         | 62,227         |
| <b>Total non-current assets</b>                   | <b>292,126</b> | <b>283,565</b> | <b>332,463</b> | <b>338,165</b> | <b>351,772</b> |
| Cash & cash equivalents                           | 7,852          | 4,836          | 22,286         | 46,363         | 76,540         |
| Trade and other receivables                       | 15,262         | 19,158         | 18,200         | 17,290         | 16,426         |
| Prepayments & other current assets                | 7,375          | 7,805          | 8,586          | 9,444          | 10,388         |
| Others  | 28             | -              | -              | -              | -              |
| <b>Total current assets</b>                       | <b>30,517</b>  | <b>31,799</b>  | <b>49,071</b>  | <b>73,097</b>  | <b>103,354</b> |
| <b>Total assets</b>                               | <b>322,643</b> | <b>315,364</b> | <b>381,534</b> | <b>411,262</b> | <b>455,126</b> |
| Interest bearing borrowings                       | 95,260         | 79,946         | 84,743         | 89,827         | 95,217         |
| Deferred consideration payables - current portion | 17,252         | 382            | -              | -              | -              |
| Accounts payable                                  | 31,906         | 30,591         | 29,061         | 27,608         | 26,228         |
| Others  | 5,623          | 3,840          | 60,142         | 79,641         | 113,140        |
| <b>Total current liabilities</b>                  | <b>150,041</b> | <b>114,759</b> | <b>173,946</b> | <b>197,077</b> | <b>234,585</b> |
| Borrowings  | 43,793         | 19,064         | 20,970         | 22,019         | 23,120         |
| Others  | 1,314          | 1,039          | 987            | 938            | 891            |
| <b>Total non-current liabilities</b>              | <b>45,107</b>  | <b>20,103</b>  | <b>21,957</b>  | <b>22,957</b>  | <b>24,011</b>  |
| <b>Total liabilities</b>                          | <b>195,148</b> | <b>134,862</b> | <b>195,904</b> | <b>220,033</b> | <b>258,596</b> |
| <b>Total equity</b>                               | <b>127,495</b> | <b>180,502</b> | <b>185,631</b> | <b>191,229</b> | <b>196,530</b> |

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2017A-2021E)

| As of Dec 31 (RMB mn)                                 | 2017A           | 2018A           | 2019E           | 2020E           | 2021E           |
|---|-----------------|-----------------|-----------------|-----------------|-----------------|
| Operating profit before tax                           | 2,685           | 3,475           | 7,222           | 10,900          | 12,362          |
| Others  | 32,250          | 42,065          | 35,956          | 39,439          | 42,901          |
| <b>Operating cash flow</b>                            | <b>34,935</b>   | <b>45,540</b>   | <b>43,178</b>   | <b>50,339</b>   | <b>55,263</b>   |
| CAPEX   | (51,837)        | (32,713)        | (29,442)        | (27,970)        | (26,571)        |
| Others  | (78)            | (210)           | (227)           | (245)           | (265)           |
| <b>Investing cash flow</b>                            | <b>(51,915)</b> | <b>(32,923)</b> | <b>(29,669)</b> | <b>(28,215)</b> | <b>(26,836)</b> |
| Change in borrowings                                  | 43,793          | 19,064          | 20,970          | 22,019          | 23,120          |
| Others  | (36,210)        | (34,698)        | (17,030)        | (20,066)        | (21,370)        |
| <b>Financing cash flow</b>                            | <b>7,583</b>    | <b>(15,634)</b> | <b>3,941</b>    | <b>1,953</b>    | <b>1,750</b>    |
| <b>Net increase in cash and cash equivalents</b>      | <b>(9,397)</b>  | <b>(3,017)</b>  | <b>17,450</b>   | <b>24,077</b>   | <b>30,177</b>   |
| <b>Cash and cash equivalents at beginning of year</b> | <b>17,249</b>   | <b>7,852</b>    | <b>4,836</b>    | <b>22,286</b>   | <b>46,363</b>   |
| <b>Cash and cash equivalents at end of year</b>       | <b>7,852</b>    | <b>4,836</b>    | <b>22,286</b>   | <b>46,363</b>   | <b>76,540</b>   |
| <b>Financial ratio:</b>                               |                 |                 |                 |                 |                 |
| <u>Growth rate:</u>                                   |                 |                 |                 |                 |                 |
| Revenue   | 22.6%           | 4.6%            | 8.9%            | 9.2%            | 9.0%            |
| Net profit  | 2,456.6%        | 36.4%           | 108.5%          | 51.3%           | 13.4%           |
| EBITDA  | 23.6%           | 3.5%            | 10.3%           | 14.5%           | 9.0%            |
| ROAE  | 1.5%            | 1.7%            | 3.0%            | 4.4%            | 4.9%            |
| ROAA  | 0.6%            | 0.8%            | 1.6%            | 2.1%            | 2.2%            |
| EBITDA margin   | 58.8%           | 58.2%           | 58.9%           | 61.8%           | 61.8%           |
| Operating profit margin                               | 11.2%           | 12.6%           | 14.4%           | 17.7%           | 17.9%           |
| Net profit margin                                     | 2.8%            | 3.7%            | 7.1%            | 9.8%            | 10.2%           |

Source(s): Company, ABCI Securities estimates



**Disclosures**

**Analyst Certification**

I, Lai Pak Kin, Ricky, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

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**Definition of equity rating**

| Rating | Definition   |
|--------|--|
| Buy    | Stock return rate $\geq$ Market return rate (10%)                                |
| Hold   | - Market return rate (-10%) $\leq$ Stock return rate < Market return rate (+10%) |
| Sell   | Stock return < - Market return (-10%)  |

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2005 (HSI total return index 2005-17 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

**Disclaimers**

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