

# China Unicom (762 HK)

## Slower mobile user growth in near term

- Speed Upgrade and Tariff Reduction will continue to impact China Unicom's mobile ARPU in FY19E-20E
- China Unicom is facing stiffer competition from other telecom operators due to resource constraints and marketing disadvantages
- We expect slower mobile user growth in 2019E-21E at 6.3%/ 4.5%/ 2.6% YoY
- Maintain **HOLD** with TP of HK\$8.0, which implies 2.6x/ 2.5x FY19E/ FY20E EV/EBITDA

**Further drag on mobile ARPU.** Due to the influence of Speed Upgrade and Tariff Reduction and market competition, we forecast China Unicom's mobile ARPU to lower by 3.0%/ 1.7%/ 0.5% to RMB44.3/ RMB43.6/ RMB63.4 in FY19-21E, respectively.

**We expect lower mobile user growth at (6.3%/ 4.5%/ 2.6% YoY) for FY19E-21E.** Due to market saturation and stiff competition, China Unicom's mobile user growth would slow in 2019.

**RMB 8bn for 40,000 5G base stations in 2019.** Management announced potential plans to share 5G network with China Mobile (941 HK) and China Telecom (728 HK), which can save over RMB 200bn in the long run. We expect limited contributions from the 5G network to the Group in 2020 given the high switching cost for users since new 5G smartphone devices will be required.

**Valuation.** We trim FY19E-20E net profit by 3.1/ 3.6% YoY to reflect policy impact on mobile ARPU and user saturation. We lower TP from HK\$ 9.5 to HK\$ 8.0, implying 2.6x/ 2.5x FY19E/ FY20E EV/EBITDA. Maintain **HOLD** on estimated share price upside of 3.2%.

**Risk factors:** 1) Delayed launch of 5G telecom network; 2) Further reduction in mobile data tariff by regulators; 3) Lower ROAA and ROAE than peers; 4) CAPEX change.

### Results and Valuation

FY ended Dec 31	FY17A	FY18A	FY19E	FY20E	FY20E
Revenue (RMB mn)	274,829	290,877	289,151	295,683	305,421
Chg (% YoY)	0.2	5.8	(0.6)	2.3	3.3
Net profit (RMB mn)	1,828	10,197	13,236	17,059	21,405
Chg (% YoY)	192.5	457.8	29.8	28.9	25.5
EPS (RMB)	0.074	0.333	0.433	0.558	0.700
Chg (% YoY)	185.1	347.9	29.8	28.9	25.5
BVPS (RMB)	12.39	10.27	10.57	10.95	11.43
Chg (% YoY)	30.3	(17.1)	2.9	3.6	4.3
P/E (x)	86.4	20.4	16.1	12.5	10.0
P/B (x)	0.52	0.66	0.66	0.64	0.61
ROAE (%)	0.7	3.3	4.2	5.2	6.3
ROAA (%)	0.3	1.8	2.4	3.0	3.7
DPS (RMB)	0.05	0.13	0.17	0.22	0.28
Dividend Yield (%)	0.81	1.97	2.50	3.22	4.04

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

\* Net profit = net profit attributable to shareholders

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

Sep 4, 2019  
 Rating: **HOLD**  
 TP: **HK\$8.00**

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Share price (HK\$)	7.75
Est. share price return	3.2%
Est. dividend yield	2.5%
Est. total return	5.7%
Previous Rating & TP	HOLD/HK\$9.5
Previous Report Date	Nov 14, 2018

Source(s): Bloomberg, ABCI Securities

### Key Data

52Wk H/L(HK\$)	10.7 / 7.0
Issued shares (mn)	30,598.1
Market cap (HK\$ mn)	237,135
Avg daily turnover (HK\$ mn)	279.4
Major shareholder(s)	
China Unicom Group	53.5%
Capital Group Cos Inc	1.3%
Blackrock	1.0%

Source(s): Company, ABCI Securities

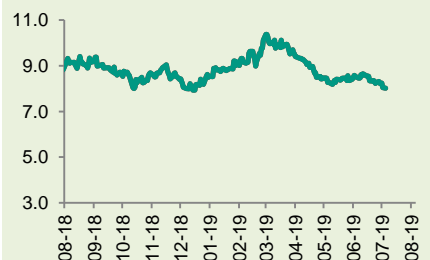
### Share Performance (%)

	Absolute	Relative*
1-mth	(4.4)	4.7
3-mth	(7.0)	(2.1)
6-mth	(14.0)	(7.3)

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

### Share performance (HK\$)



Source(s): Bloomberg, ABCI Securities

China Unicom added 22.8mn of 4G users in Jan-July 2019 (-28.5% YoY) while its aggregate mobile users reached over 324.5mn in July 2019, up 6.6% YoY. Its 4G user penetration rate reached 74.8%, up 6.9ppt YoY. The Group is phasing out its 2G telecom network and reallocating the frequency for 4G usage. Due to market saturation and competition, we forecast overall mobile users for the Group to grow 6.3%/ 4.5%/ 2.6% YoY to 335.0mn/ 350.0mn/ 359.0mn in FY19E-21E, respectively.

China Unicom plans to build 40,000 5G base stations with RMB8bn in 2019. Management announced potential plans to share 5G network with China Mobile and China Telecom, which can save over RMB 200bn in the long run. As the 5G frequency spectrums of China Telecom and China Unicom are similar to each other, the two companies are more likely to form a partnership before cooperating with other operators. However, we expect limited revenue contributions from the 5G network to the Group in 2020 given due to the high switching cost for users, who would need 5G smartphone devices to utilize the new network.

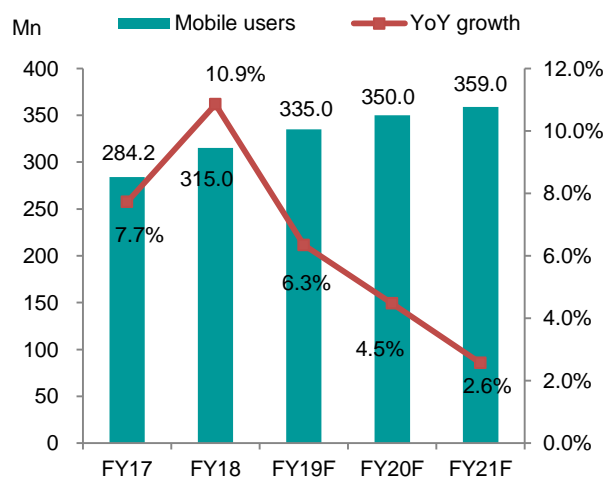
**Exhibit 1: Telecom operators' 1H19 operational data comparison table**

	China Mobile	China Unicom	China Telecom
ARPU (RMB)	52.2	40.8	46.9
YoY	-10.2%	-14.8%	-10.5%
Mobile users (mn)	935.1	324.4	323.5
YoY	3.2%	7.4%	20.5%

Source(s): Company

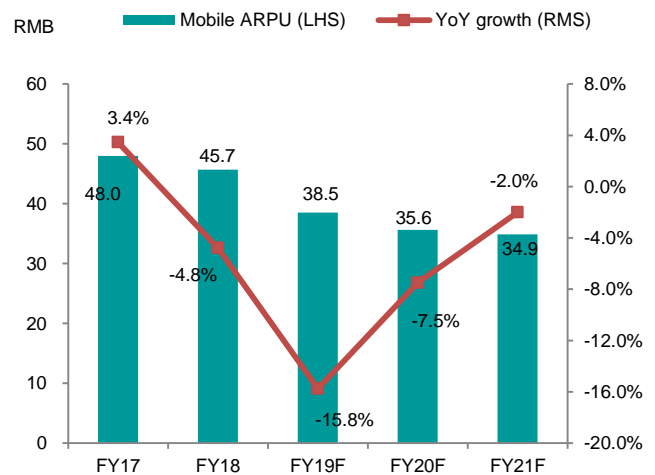
Compared to other telecom operators, the Group's mobile ARPU dropped the most by 14.8% YoY to RMB 40.8 in 1H19 due to the slashed mobile data tariff. Handset user DOU surged 45.1% YoY to 7.4GB. Affected by the "Speed Upgrade and Tariff Reduction" policy and market competition, we forecast its mobile ARPU to lower by 15.8%/ 7.5%/ 2.0% to RMB38.5/ RMB35.6/ RMB34.9 in FY19E-21E, respectively. We believe upside potential of its mobile ARPU is limited despite the introduction of 5G telecom services in 2H19.

**Exhibit 2: China Unicom's mobile users and growth**



Source(s): Company, ABCI Securities estimates

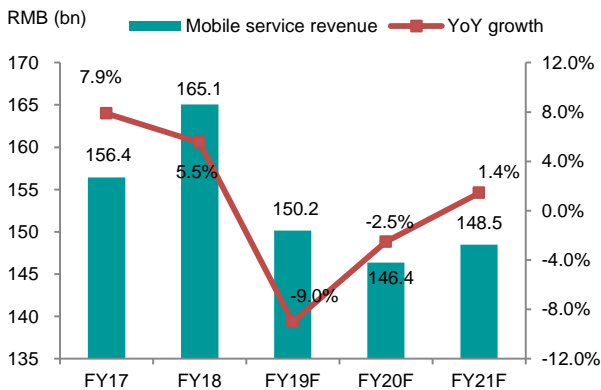
**Exhibit 3: China Unicom's mobile ARPU and growth**



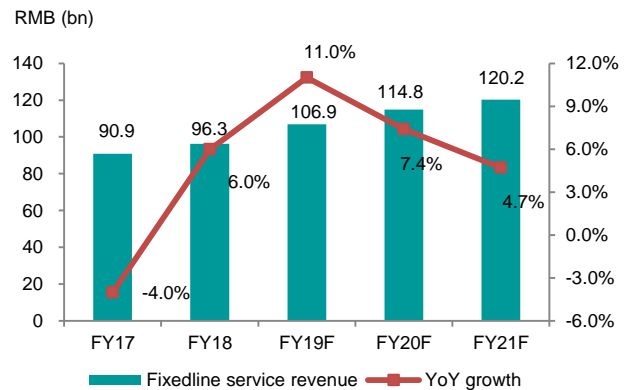
Source(s): Company, ABCI Securities estimates

Fixed-line broadband users reached 83.7mn in July 2019, up 5.2% YoY, with 2.8mn of net user additions in Jan-July 2019. China Unicom's fixed-line market share was affected by China Mobile's aggressive pricing scheme and we forecast user growth will continue to be affected by fierce competition in 2019.

The Group has introduced more value-added services including IPTV, 4K video content, cloud services and bundled packages. Concurrently, it has been partnering with internet corporations to develop the emerging business of industrial internet to capture the strong demand on cloud computing, big data, Internet of Things and artificial intelligence. Overall, we project fixed-line service revenue to grow by 11.0%/ 7.4%/ 4.7% YoY in FY19E-21E.

**Exhibit 4: China Unicom's mobile service revenue and growth**


Source(s): Company, ABCI Securities estimates

**Exhibit 5: China Unicom's fixed-line service revenue and growth**


Source(s): Company, ABCI Securities estimates

**Exhibit 6: Changes in our financial estimates**

(RMB Bn)	OLD			NEW			CHANGE		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	297,175	305,458	317,816	289,151	295,683	305,421	-2.7%	-3.2%	-3.9%
Operating profit	11,095	14,610	18,739	10,751	14,084	17,971	-3.1%	-3.6%	-4.1%
Net Profit	13,659	17,696	22,320	13,236	17,059	21,405	-3.1%	-3.6%	-4.1%

Source(s): Company, ABCI Securities estimates



**HOLD with TP of HK\$8.00**

We revise down FY19/FY20 net profits by 3.1/ 3.6% to reflect policy impacts on mobile ARPU and mobile user saturation. We lower TP from HK\$ 9.50 to HK\$ 8.0 based on our DCF model (WACC: 13.2%; perpetuity growth rate: 2%), which represents 2.6x/ 2.5x FY19E/ FY20E EV/EBITDA. Maintain **HOLD** on limited share price upside (3.2%).

**Exhibit 7: Peer comparison**

			P/E				P/B				ROE	ROA	EV/EBITDA
	Ticker	Price*	18A	19E	20E	21E	18A	19E	20E	21E	19E	19E	19E
<b>China Market</b>													
<b>China Unicom</b>	762 HK	7.75	19.8	16.6	12.1	10.1	0.7	0.6	0.6	0.6	5.4	2.2	2.2
<b>China Mobile</b>	941 HK	64.75	9.5	10.8	10.7	10.5	1.1	1.1	1.0	1.0	9.8	7.0	3.0
<b>China Telecom</b>	728 HK	3.52	11.4	11.7	10.9	10.5	0.7	0.7	0.7	0.7	6.6	3.5	2.9
<b>China Tower</b>	788 HK	1.78	83.9	53.9	35.6	25.8	1.5	1.6	1.5	1.5	4.3	1.8	7.7
Simple Avg.			31.1	23.2	17.3	14.2	1.0	1.0	1.0	0.9	6.5	3.6	3.9
Weighted Avg.			21.7	17.8	14.5	12.7	1.1	1.1	1.0	1.0	8.1	5.3	3.6
<b>US Market</b>													
<b>AT&amp;T</b>	T US	35.38	12.4	9.9	9.7	9.8	1.4	1.5	1.4	1.4	12.6	4.2	7.1
<b>Verizon</b>	VZ US	58.04	15.4	12.1	11.9	11.6	4.5	4.0	3.4	3.0	30.2	7.3	7.3
<b>Sprint</b>	S US	6.70	3.6	n.a.	n.a.	n.a.	1.0	1.0	1.1	1.0	0.3	(2.3)	5.7
<b>T-Mobile</b>	TMUS	77.13	22.7	19.3	16.1	n.a.	2.7	2.3	2.1	1.9	14.2	4.0	6.8
Simple Avg.			13.9	15.7	14.0	11.6	2.7	2.4	2.2	2.0	14.9	3.0	6.6
Weighted Avg.			15.9	13.6	12.8	11.6	3.9	3.4	3.0	2.6	24.5	5.9	7.1

\*Based on closing price on Sep 3, 2019

Source(s): Bloomberg



Consolidated income statement (2017A-2021E)

FY Ended Dec 31 (RMB mn)	2017A	2018A	2019E	2020E	2021E
Mobile service revenue	156,441	165,064	150,168	146,384	148,482
Fixed line service revenue	90,866	96,295	106,887	114,797	120,193
Others	27,522	29,518	32,096	34,501	36,746
<b>Total revenue</b>	<b>274,829</b>	<b>290,877</b>	<b>289,151</b>	<b>295,683</b>	<b>305,421</b>
Interconnection charges	(12,617)	(12,579)	(12,453)	(12,354)	(12,255)
D&A	(77,492)	(75,777)	(74,640)	(73,969)	(73,399)
Network operation & support	(54,507)	(55,077)	(49,556)	(48,307)	(49,623)
Employee benefit expenses	(42,471)	(48,143)	(46,264)	(47,309)	(48,867)
Cost of product sold	(26,643)	(27,604)	(29,798)	(31,343)	(32,940)
Other operating expenses	(57,166)	(62,561)	(65,689)	(68,317)	(70,366)
<b>Total operating expenses</b>	<b>(270,896)</b>	<b>(281,741)</b>	<b>(278,400)</b>	<b>(281,598)</b>	<b>(287,450)</b>
<b>Operating Profits</b>	<b>3,933</b>	<b>9,136</b>	<b>10,751</b>	<b>14,084</b>	<b>17,971</b>
Finance cost	(5,734)	(1,625)	(519)	(475)	(446)
Interest income	1,647	1,712	1,689	2,729	3,924
Others (including associates, JV & other income)	2,747	3,858	5,094	5,592	6,068
<b>Profit before tax</b>	<b>2,593</b>	<b>13,081</b>	<b>17,015</b>	<b>21,930</b>	<b>27,517</b>
Tax	(743)	(2,824)	(3,673)	(4,734)	(5,940)
<b>Profit after tax</b>	<b>1,850</b>	<b>10,257</b>	<b>13,342</b>	<b>17,196</b>	<b>21,576</b>
Minority interests	22	60	106	136	171
<b>Shareholders' net profit</b>	<b>1,828</b>	<b>10,197</b>	<b>13,236</b>	<b>17,059</b>	<b>21,405</b>
<b>EBITDA</b>	<b>81,425</b>	<b>84,910</b>	<b>85,392</b>	<b>88,053</b>	<b>91,370</b>
<b>EPS (RMB)</b>	<b>0.074</b>	<b>0.333</b>	<b>0.433</b>	<b>0.558</b>	<b>0.700</b>
<b>DPS (RMB)</b>	<b>0.052</b>	<b>0.134</b>	<b>0.174</b>	<b>0.225</b>	<b>0.282</b>

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2017A-2021E)

As of Dec 31 (RMB mn)	2017A	2018A	2019E	2020E	2021E
PPE	416,596	384,475	383,036	384,353	389,561
Interest in associates	33,233	35,758	36,473	37,203	37,947
Lease prepayments	9,313	9,290	9,383	9,477	9,571
Other non-current assets	36,119	34,888	34,570	30,130	26,568
<b>Total non-current assets</b>	<b>495,261</b>	<b>464,411</b>	<b>463,462</b>	<b>461,162</b>	<b>463,647</b>
Cash & cash equivalents	32,836	30,060	50,907	74,759	97,759
Accounts receivables	13,964	14,433	14,101	14,582	15,062
Short-term bank deposits	5,526	3,720	3,676	3,718	3,795
Others	24,396	27,696	24,594	23,964	23,265
<b>Total current assets</b>	<b>76,722</b>	<b>75,909</b>	<b>93,278</b>	<b>117,023</b>	<b>139,881</b>
<b>Total assets</b>	<b>571,983</b>	<b>540,320</b>	<b>556,740</b>	<b>578,185</b>	<b>603,528</b>
Accounts payable and accrued liabilities	125,260	122,458	126,302	87,122	97,864
Short-term bank loans	22,500	15,085	14,632	14,193	13,768
Commercial paper	8,991	0	0	0	0
Others	85,871	77,367	83,643	134,181	135,318
<b>Total current liabilities</b>	<b>242,622</b>	<b>214,910</b>	<b>224,577</b>	<b>235,496</b>	<b>246,950</b>
Promissory notes	17,981	999	599	360	216
Others	7,033	10,125	8,132	7,152	6,637
<b>Total non-current liabilities</b>	<b>25,014</b>	<b>11,124</b>	<b>8,731</b>	<b>7,512</b>	<b>6,853</b>
<b>Total liabilities</b>	<b>267,636</b>	<b>226,034</b>	<b>233,308</b>	<b>243,008</b>	<b>253,803</b>
<b>Shareholders' profit</b>	<b>304,050</b>	<b>313,922</b>	<b>323,058</b>	<b>334,784</b>	<b>349,315</b>
<b>Non-controlling interests</b>	<b>297</b>	<b>364</b>	<b>375</b>	<b>393</b>	<b>409</b>
<b>Total equity</b>	<b>304,347</b>	<b>314,286</b>	<b>323,432</b>	<b>335,177</b>	<b>349,725</b>
<b>Net debt</b>	<b>32,953</b>	<b>2,912</b>	<b>Net cash</b>	<b>Net cash</b>	<b>Net cash</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 change in working capital	2,593	13,081	17,015	21,930	27,517
Change in working capital	1,966	375	2,142	5,087	4,367
Others	87,767	82,114	75,679	74,910	74,253
Tax	(7,272)	(3,183)	(4,193)	(5,210)	(6,386)
<b>Operating cash flow</b>	<b>85,054</b>	<b>92,387</b>	<b>90,643</b>	<b>96,718</b>	<b>99,750</b>
CAPEX	(61,489)	(52,176)	(58,000)	(60,900)	(63,945)
Others	14,153	(9,003)	(2,954)	(2,902)	(2,750)
<b>Investing cash flow</b>	<b>(47,336)</b>	<b>(61,179)</b>	<b>(60,954)</b>	<b>(63,802)</b>	<b>(66,695)</b>
Dividend paid	0	(1,591)	(4,100)	(5,333)	(6,874)
Others	(28,414)	(32,467)	(4,809)	(3,790)	(3,235)
<b>Financing cash flow</b>	<b>(28,414)</b>	<b>(34,058)</b>	<b>(8,909)</b>	<b>(9,123)</b>	<b>(10,109)</b>
Net increase in cash & cash equivalents	9,304	(2,850)	20,780	23,792	22,946
Cash & cash equivalents at beginning of year	23,633	32,836	30,060	50,907	74,759
Effect of changes in foreign exchange rate	(101)	74	67	60	54
<b>Cash &amp; cash equivalents at end of year</b>	<b>32,836</b>	<b>30,060</b>	<b>50,907</b>	<b>74,759</b>	<b>97,759</b>
<b>Financial Ratios:</b>					
EBITDA / service revenue margin (%)	52.0%	51.4%	56.9%	60.2%	61.5%
Operating margin (%)	1.4%	3.1%	3.7%	4.8%	5.9%
Net profit margin (%)	0.7%	3.5%	4.6%	5.8%	7.0%
ROAA (%)	0.3%	1.8%	2.4%	3.0%	3.7%
ROAE (%)	0.7%	3.3%	4.2%	5.2%	6.3%
Net debt/ equity (%)	10.8%	0.9%	-11.6%	-18.7%	-24.8%
Liabilities/ assets (%)	46.8%	41.8%	41.9%	42.0%	42.1%
<b>YoY Growth:</b>					
EBITDA (%)	2.4%	4.3%	0.6%	3.1%	3.8%
Net profit (%)	192.5%	457.8%	29.8%	28.9%	25.5%

Source(s): Company, ABCI Securities estimates

**Disclosures****Analyst Certification**

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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.

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