

# China Telecom Corporation Ltd. (728 HK)

## Strong mobile user growth, upgrade to BUY

- Solid service revenue growth with strong mobile user addition
- Thanks to scale effect with strong mobile user growth, we estimate profit margin to improve in 2020.
- Team up with China Unicom to co-share and co-build 5G network
- Recommend **BUY** with TP of HK\$ 3.50, which implies 2.4x/ 2.3x FY19E/ FY20E EV/EBITDA.

**Robust mobile user growth.** We project China Telecom's mobile users to grow by 13.2%/ 8.2%/ 6.2% in FY19-21E, respectively. The Group has launched a larger variety of telecom service products, such as bundled services packages, smart home services, internet SIM cards, etc., than other operators.

**Strong mobile service revenue growth.** China Telecom was the only telecom operator to record a positive growth in mobile service revenue in 9M19 (+2.5% YoY, vs. -1.0% for China Mobile (941 HK) and -5.6% for China Unicom (762 HK)). We estimate China Telecom's service revenue to grow by 3.1%/ 3.5%/ 2.7% in FY19E-21E, respectively. Net margin is expected to edge up by 0.3ppt each in FY20 / 21E to 5.9% / 6.2%.

**Benefiting from co-shared and co-built 5G network with China Unicom.** China Telecom is expected to spend RMB 9bn to build 40,000 of 5G base stations in 2019. The Group has also teamed up with China Unicom to co-share and co-build 5G network, which will enable a more extensive network coverage.

**Valuation.** Upgrade to **BUY** rating on China Telecom with the TP of HK\$3.50, implying 2.4x/ 2.3x FY19E/ FY20E EV/EBITDA.

### Results and Valuation

FY ended Dec 31	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	366,229	377,124	382,528	393,749	402,776
Chg (% YoY)	3.9	3.0	1.4	2.9	2.3
Net profit (RMB mn)	18,617	21,210	21,374	23,308	24,878
Chg (% YoY)	3.3	13.9	0.8	9.0	6.7
EPS (RMB)	0.23	0.26	0.26	0.29	0.31
Chg (% YoY)	3.3	13.9	0.8	9.0	6.7
BPS (RMB)	4.03	4.24	4.40	4.58	4.77
Chg (% YoY)	3.3	5.3	3.7	4.1	4.2
P/E (x)	10.9	10.1	10.3	9.4	8.8
P/B (x)	0.62	0.62	0.62	0.59	0.57
ROE (%)	5.8	6.3	6.1	6.4	6.6
ROA (%)	2.8	3.2	3.2	3.5	3.6
DPS (RMB)	0.09	0.11	0.11	0.12	0.12
Dividend Yield (%)	2.6	3.2	3.2	3.5	3.7

\*Exchange rate assumption for FY19E-21E: HKD 1 = RMB 0.900  
Source(s): Bloomberg, ABCI Securities estimates

## Company Report

Dec 11, 2019  
Rating: **BUY**  
TP: HK\$ 3.50

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Share price (HK\$)	3.01
Est. share price return	16.3%
Est. dividend yield	3.2%
Est. total return	19.5%
Previous Rating & TP	HOLD/HK\$4.0
Previous Report Date	Jan 15, 2019

Source(s): Bloomberg, ABCI Securities

### Key Data

52Wk H/L(HK\$)	4.5/3.3
Issued shares (mn)	80,932.0
Market cap (HK\$ mn)	243,605
Avg daily turnover (HK\$ mn)	392
Major shareholder(s)	
China Telecom Cop.	70.9%
JP Morgan	12.0%
Citigroup	8.0%

Source(s): Company, ABCI Securities

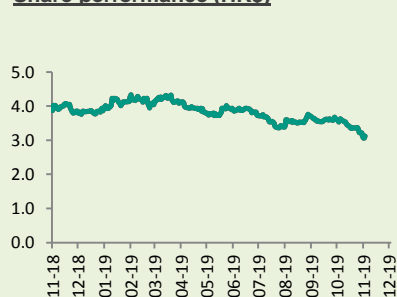
### Share Performance (%)

	Absolute	Relative*
1-mth	(14.0)	(13.9)
3-mth	(12.1)	(13.5)
6-mth	(17.4)	(13.9)

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

### Share performance (HK\$)



Source(s): Bloomberg, ABCI Securities

China Telecom's net profit in 9M19 was down 3.4% YoY on cancellation of data roaming fee and the lower mobile service tariff. Excluding the one-off disposal gain from China Tower (788 HK) in 3Q18, net profit would rise 2.5% YoY. EBITDA margin improved 3.4ppt YoY to 33.9% in 3Q19; mobile ARPU was RMB 46.6, similar to 2018.

Service revenue grew 2.5% YoY in 9M19, outpacing other telecom operators in China (China Mobile: -1.0%; China Unicom: -5.6%), mainly driven by strong mobile user growth. China Telecom added 27.4mn of mobile users in 9M19, the highest among telecom operators in China (China Mobile's:+17.0mn; China Unicom: +9.7mn), indicating the Group strong ability to retain mobile users.

**Exhibit 1: Telecom operators' 9M19 operational data comparison table**

	China Mobile	China Unicom	China Telecom
<b>Service revenue growth (YoY)</b>	-1.0%	-5.6%	2.5%
<b>EBITDA growth (YoY)</b>	5.3%	10.4%	13.8%
<b>EBITDA margin</b>	39.8%	36.8%	33.9%
<b>Net profit growth (YoY)</b>	-13.9%	11.9%	-3.4%
<b>Mobile user additions (mn)</b>	17.0	9.7	27.4
<b>4G user additions (mn)</b>	30.1	32.2	32.9
<b>ARPU (RMB)</b>	50.2	40.6	46.6

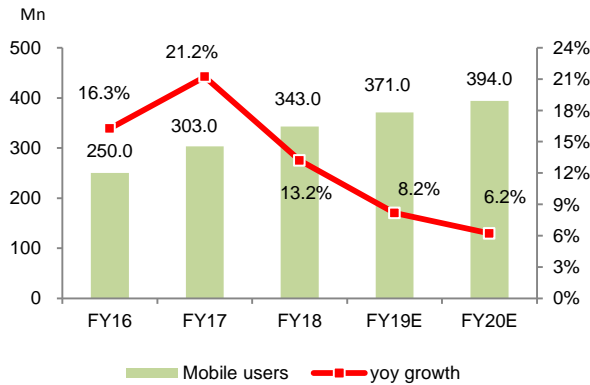
Source(s): the Companies

The Group's ability to gain mobile customers would remain strong in 2020, thanks to its cooperation with China Unicom and internet companies as well as the launch of telecom products. The Group has launched more telecom service products, which include bundled services packages, smart home services, internet SIM cards, etc., than other operators. We project its mobile users to grow by 13.2%/ 8.2%/ 6.2% to 343 mn/ 371mn/ 394mn in FY19-21E, respectively.

Teaming up with China Unicom to co-share and co-build 5G network would allow the Group to expedite its 5G network development with less investment capital. China Telecom plans to spend RMB 9bn for building 40,000 5G base stations in 2019; we estimate its total number of 5G base stations would surpass China Mobile's. Thanks to the large mobile user base, which enables the economies of scale, and robust user growth, we estimate China Telecom's net margin to grow 0.3ppt/ 0.3ppt to 5.9%/ 6.2% in FY20-21E, respectively.

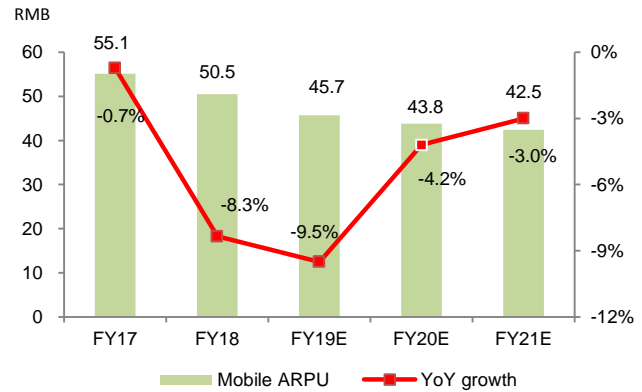
Based on our revision of mobile users forecast, we revise up net profit by 2.5%/3.0%/3.3% in FY19-21E, respectively.

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



Source(s): Company, ABCI Securities estimates

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



Source(s): Company, ABCI Securities estimates

**Exhibit 4: Changes in our financial estimates**

(RMB mn)	OLD			NEW			CHANGE		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
<b>Revenue</b>	371,386	380,618	387,657	382,528	393,749	402,776	3.0%	3.5%	3.9%
<b>Operating profit</b>	28,566	30,848	32,169	29,366	31,835	33,391	2.8%	3.2%	3.8%
<b>Net Profit</b>	20,853	22,629	24,083	21,374	23,308	24,878	2.5%	3.0%	3.3%

Source(s): Company, ABCI Securities estimates

## Upgrade to BUY with TP at HK\$3.50

We derive the Group's valuation (HK\$283.3 bn) based on DCF model analysis (WACC: 12.8%; D/ (D+E) =30.8%; perpetuity growth rate: 2%). We lower the TP from HK\$ 4.00 to HK\$ 3.50 in view of the present sector valuation. Due to the stock's potential return of 19.5%, we recommend **BUY** with TP at HK\$ 3.50, representing 2.4x/ 2.3x FY19E/ FY20E EV/EBITDA.

**Exhibit 5: Peer Comparison Table**

	Ticker	Price*	P/E				P/B				ROE	ROA	EV/EBITDA
			17A	18A	19E	20E	17A	18A	19E	20E	19E	19E	19E
<b>China Market</b>													
China Unicom	762 HK	6.86	105.2	26.3	16.7	12.3	0.7	0.7	0.7	0.6	4.2	2.2	2.2
China Mobile	941 HK	60.00	12.4	12.3	12.2	11.8	1.4	1.4	1.3	1.2	10.7	7.0	3.2
China Telecom	728 HK	3.01	15.3	14.0	12.9	11.8	0.8	0.8	0.8	0.8	6.4	3.5	3.0
China Tower	788 HK	1.62	n.a.	77.4	40.8	27.2	1.2	1.2	1.0	0.9	3.0	1.4	6.6
Simple Average			44.3	32.5	20.7	15.8	1.0	1.0	0.9	0.9	6.1	3.5	3.8
Weighted Average			23.5	20.7	15.8	13.4	1.2	1.2	1.1	1.1	8.7	5.5	3.4
<b>US Market</b>													
AT&T	T US	38.06	6.5	8.8	8.6	8.5	1.3	1.3	1.2	1.2	15.5	4.1	6.3
Verizon	VZ US	61.23	7.9	12.4	12.3	12.2	5.5	4.5	3.7	3.2	32.5	7.6	7.0
Sprint	S US	5.34	n.a.	3.4	167.6	113.8	1.3	1.0	0.9	0.9	0.8	0.1	5.1
T-Mobile	TMUS	75.02	12.8	20.6	17.5	14.7	2.6	2.3	2.0	1.9	12.4	5.9	6.3
Simple Average			9.0	11.3	51.5	37.3	2.7	2.3	2.0	1.8	15.3	4.4	6.2
Weighted Average			7.8	11.4	18.7	15.7	3.3	2.8	2.4	2.1	21.9	5.6	6.6

\*Based on closing price on Dec 10, 2019

Source(s): Bloomberg, ABCI Securities

## Financial Statements

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

FY Ended Dec 31 (RMB mn)	2017A	2018A	2019E	2020E	2021E
Service revenue	331,044	350,434	361,334	373,967	384,132
Sales of products and others	35,185	26,690	21,194	19,781	18,644
<b>Total revenue</b>	<b>366,229</b>	<b>377,124</b>	<b>382,528</b>	<b>393,749</b>	<b>402,776</b>
D&A	(74,951)	(75,493)	(76,964)	(79,281)	(84,202)
Network operation & support	(103,969)	(116,062)	(115,627)	(114,958)	(113,319)
Selling G&A	(58,434)	(59,422)	(61,204)	(62,291)	(63,155)
Personnel expenses	(56,043)	(59,736)	(61,427)	(62,378)	(63,766)
Other operating expenses	(45,612)	(37,697)	(37,940)	(43,006)	(44,943)
Total operating expenses	(339,009)	(348,410)	(353,162)	(361,914)	(369,386)
Operating Profits	27,220	28,714	29,366	31,835	33,391
Investment income	147	38	23	25	27
Share of profit from associates	877	2,104	1,473	1,546	1,624
Net finance costs	(3,291)	(2,708)	(2,496)	(2,474)	(2,026)
Profit before tax	24,953	28,148	28,365	30,932	33,016
Tax	(6,192)	(6,810)	(6,863)	(7,484)	(7,988)
Profit after tax	18,761	21,338	21,503	23,448	25,028
Minority interests	(144)	(128)	(129)	(141)	(150)
<b>Shareholders' net profit</b>	<b>18,617</b>	<b>21,210</b>	<b>21,374</b>	<b>23,308</b>	<b>24,878</b>
<b>EBITDA</b>	<b>102,169</b>	<b>104,204</b>	<b>106,326</b>	<b>111,116</b>	<b>117,593</b>
<b>EPS (RMB)</b>	<b>0.230</b>	<b>0.262</b>	<b>0.264</b>	<b>0.288</b>	<b>0.307</b>
<b>DPS (RMB)</b>	<b>0.093</b>	<b>0.107</b>	<b>0.106</b>	<b>0.116</b>	<b>0.124</b>

Source(s): Company, ABCI Securities estimates

**Consolidated balance sheet (2017A-2021E)**

As of Dec 31 (RMB mn)	2017A	2018A	2019E	2020E	2021E
PPE	406,257	407,795	417,599	424,145	422,950
CIP	73,106	66,644	63,312	53,815	45,743
Land lease prepayments	22,262	21,568	22,215	21,104	20,049
Goodwill	29,920	29,922	29,921	29,922	29,923
Intangible costs	12,391	14,161	15,011	15,761	16,549
Interest in associates	35,726	38,051	34,909	37,746	40,726
Other non-current assets	9,982	12,236	14,420	9,927	9,551
<b>Total non-current assets</b>	<b>589,644</b>	<b>590,377</b>	<b>597,386</b>	<b>592,421</b>	<b>585,490</b>
Cash & cash equivalents	19,410	16,666	14,345	25,026	42,508
Deposits in bank	3,100	6,814	6,610	6,411	6,219
Accounts receivables	22,096	20,475	20,885	21,302	21,728
Others	26,944	29,050	29,898	31,783	33,795
<b>Total current assets</b>	<b>71,550</b>	<b>73,005</b>	<b>71,737</b>	<b>84,522</b>	<b>104,249</b>
<b>Total assets</b>	<b>661,194</b>	<b>663,382</b>	<b>669,123</b>	<b>676,943</b>	<b>689,739</b>
Short term debt	54,558	49,537	34,676	27,741	22,193
Accounts payable	119,321	107,887	112,202	117,813	123,703
Accrued expenses and other payable	98,695	43,497	45,672	47,955	50,353
Others	2,834	57,999	53,175	49,354	46,253
<b>Total current liabilities</b>	<b>275,408</b>	<b>258,920</b>	<b>245,726</b>	<b>242,863</b>	<b>242,502</b>
Long term debt and payable	48,596	44,852	35,882	28,705	22,964
Deferred revenue	8,010	13,138	14,511	16,007	17,605
Others	2,483	2,373	16,317	17,953	19,708
<b>Total non-current liabilities</b>	<b>59,089</b>	<b>60,363</b>	<b>66,709</b>	<b>62,665</b>	<b>60,277</b>
<b>Total liabilities</b>	<b>334,497</b>	<b>319,283</b>	<b>312,435</b>	<b>305,528</b>	<b>302,779</b>
Equity attributable to shareholders	325,867	343,069	355,814	370,521	386,019
Non-controlling interests	830	1,030	874	894	941
<b>Total equity</b>	<b>326,697</b>	<b>344,099</b>	<b>356,688</b>	<b>371,415</b>	<b>386,960</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	106,236	102,794	108,433	113,162	119,583
Change in working capital	(1,897)	4,053	4,669	5,520	5,796
Others	(3,211)	(2,923)	(2,852)	(2,805)	(2,312)
Tax	(4,626)	(4,626)	(4,626)	(4,626)	(4,626)
<b>Operating cash flow</b>	<b>96,502</b>	<b>99,298</b>	<b>105,625</b>	<b>111,251</b>	<b>118,442</b>
CAPEX	(87,334)	(74,940)	(78,000)	(80,340)	(82,750)
Others	2,071	(11,014)	2,464	2,472	2,481
<b>Investing cash flow</b>	<b>(85,263)</b>	<b>(85,954)</b>	<b>(75,536)</b>	<b>(77,868)</b>	<b>(80,270)</b>
Dividend paid	(7,530)	(7,568)	(8,629)	(8,601)	(9,379)
Others	(8,617)	(8,715)	(23,929)	(14,213)	(11,396)
<b>Financing cash flow</b>	<b>(16,147)</b>	<b>(16,283)</b>	<b>(32,558)</b>	<b>(22,815)</b>	<b>(20,776)</b>
Net increase in cash & cash equivalents	(4,908)	(2,939)	(2,469)	10,568	17,396
Cash & cash equivalents at beginning of year	24,617	19,410	16,666	14,345	25,026
Effect of changes in foreign exchange rate	(299)	195	148	113	86
<b>Cash &amp; cash equivalents at end of year</b>	<b>19,410</b>	<b>16,666</b>	<b>14,345</b>	<b>25,026</b>	<b>42,508</b>
<b>Financial Ratios:</b>					
EBITDA margin (%)	30.9	29.7	29.4	29.7	30.6
Operating margin (%)	8.2	8.2	8.1	8.5	8.7
Net profit margin (%)	5.1	5.6	5.6	5.9	6.2
ROE (%)	5.8	6.3	6.1	6.4	6.6
ROA (%)	2.8	3.2	3.2	3.5	3.6
<b>YoY Growth:</b>					
Service revenue (%)	6.9	5.9	3.1	3.5	2.7
EBITDA (%)	7.4	2.0	2.0	4.5	5.8
Net profit (%)	3.3	13.9	0.8	9.0	6.7

Source(s): Company, ABCI Securities estimates

## Disclosures

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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.

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