

China Unicom (762 HK)

Mobile user loss in 5M20

- China Unicom recorded 9.7 mn net loss in mobile users in 5M20; the highest among telecom operators
- The Company's ARPU is expected to drop by 3.0% for FY20E due to Speed Upgrade and Tariff Reduction policy
- More challenges with drops in mobile users and mobile ARPU
- Recommend HOLD with TP of HK\$4.50, which implies 1.3x/1.2x FY20E/ FY21E EV/EBITDA

Mobile users to drop by 4.1% YoY for 2020E. China Unicom's recorded the largest net loss in mobile users of 9.7mn in 5M20. Its aggregate mobile users declined by 4.8% YoY to 308.7mn as of May 2020. The loss can be partially attributed to recent launch of mobile phone number portability scheme that allows users to transfer their mobile numbers to other telecom service providers. We lower our FY20E-22E mobile user estimates by 3.5%/ 4.8%/ 5.1%.

Market competition and user saturation affect mobile ARPU. Due to the Speed Upgrade and Tariff Reduction policy and market competition, we project mobile ARPU to decline by 3.0%/ 1.5%/ 0.3% in FY20E-22E.

We cut FY20E-22E revenue by 0.7%/ 1.4%/ 1.7% . We estimate the no. of mobile users to drop by 4.1%/1.6%/ 0.5% YoY in FY20E-22E.

Valuation. We trim FY20E-22E net profit by 1.6%/ 1.1%/ 3.1% YoY due to weaker-than-expected mobile user growth. We lower TP from HK\$ 4.80 to HK\$ 4.50, implying 1.3x/ 1.2x FY20E/ FY21E EV/EBITDA. Recommend **HOLD**.

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	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	290,877	290,515	291,159	293,729	298,744
Chg (% YoY)	5.8	(0.1)	0.2	0.9	1.7
Net profit (RMB mn)	10,197	11,330	12,231	13,985	16,629
Chg (% YoY)	457.8	11.1	8.0	14.3	18.9
EPS (RMB)	0.333	0.370	0.400	0.457	0.543
Chg (% YoY)	347.9	11.1	8.0	14.3	18.9
BVPS (RMB)	10.27	10.48	10.72	11.02	11.38
Chg (% YoY)	(17.1)	2.1	2.3	2.8	3.3
P/E (x)	12.1	11.2	10.4	9.1	7.6
P/B (x)	0.39	0.40	0.39	0.38	0.36
ROAE (%)	3.3	3.6	3.8	4.2	4.9
ROAA (%)	1.8	2.1	2.1	2.3	2.6
DPS (RMB)	0.13	0.15	0.16	0.18	0.22
Dividend Yield (%)	3.31	3.57	3.85	4.40	5.24

*Exchange rate assumption for FY20E-22E: 1RMB=0.900HKD

Source(s): Bloomberg, ABCI Securities estimates

Company Report

July 13, 2020
 Rating: HOLD
 TP: HK\$4.5

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Share price (HK\$)	4.61
Est. share price return	(2.39%)
Est. dividend yield	3.85%
Est. total return	(1.46%)
Previous Rating & TP	HOLD/HK\$4.8
Previous Report Date	Sept 4, 2019

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L(HK\$)	8.76/3.84
Issued shares (mn)	30,598
Market cap (HK\$ mn)	141,057
Avg daily turnover (HK\$ mn)	240.4
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	(1.3)	(6.4)
3-mth	2.5	(2.0)
6-mth	(38.4)	(29.2)

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

China Unicom recorded 9.7mn net loss in mobile users in 5M20, driving down its aggregate no. of mobile users by 4.8% YoY to 308.7mn as of May 2020. Compared to other telecom operators, China Unicom recorded the largest net loss in aggregate mobile users, which can be partially attributed to recent launch of mobile phone number portability scheme that allows users to transfer their mobile numbers to other telecom service providers. Market share of China Unicom's mobile user dropped from 33.5% in May 2019 to 19.3% in May 2020 - a critical signal of its weak business model with the drop in mobile user and market share. We lower the Company's mobile user estimates by 3.5%/ 4.8%/ 5.1% to 305.5mn/ 300.5mn/ 299.0mn for FY20-FY22E.

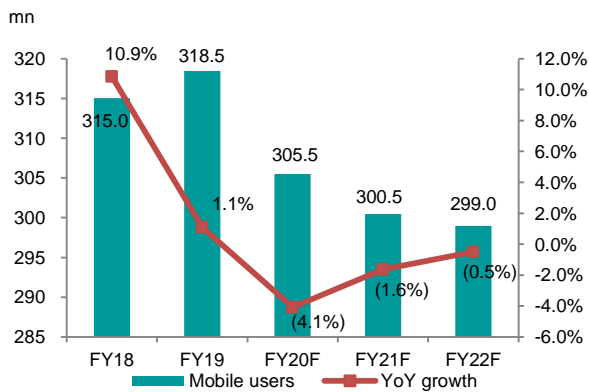
Exhibit 1: Telecom operators' operational data comparison table

	China Mobile (941 HK)	China Unicom (762 HK)	China Telecom (728 HK)
Aggregate mobile users in May 2020 (mn)	947.0	308.7	341.2
YoY	1.6%	(4.8%)	6.2%
Net additions of mobile users in 1-5M20 (mn)	(3.3)	(9.7)	5.6

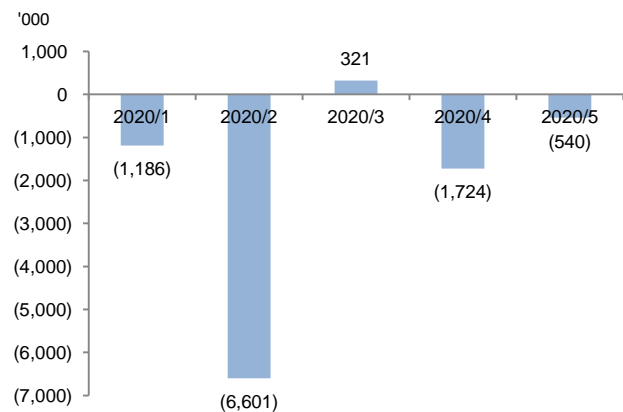
Source(s): Companies

China Mobile's cooperation with China Broadcasting Network Corporation will further improve its network coverage with the 700MHz advantage, posing threats to China Unicom.

We estimate China Unicom's no. of mobile users to drop by 4.1% YoY in 2020E. Due to the Speed Upgrade and Tariff Reduction policy and market competition, we project mobile ARPU to decline by 3.0%/ 1.5%/ 0.3% in 2020E-22E. Due to the revised estimates, we adjust down FY20E-22E net profits by 1.6%/ 1.1%/ 3.1%.

Exhibit 2: China Unicom's mobile users and growth


Source(s): Company, ABCI Securities estimates

Exhibit 3: China Unicom's monthly mobile user change in 1-5/2020


Source(s): Company



Exhibit 4: Changes in our financial estimates

(RMB Bn)	OLD			NEW			CHANGE		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	293,11	297,937	303,758	291,159	293,729	298,744	(0.7%)	(1.4%)	(1.7%)
Operating profit	12,574	13,656	16,573	12,359	13,515	15,944	(1.7%)	(1.0%)	(3.8%)
Net Profit	12,428	14,136	17,166	12,231	13,985	16,629	(1.6%)	(1.1%)	(3.1%)

Source(s): Company, ABCI Securities estimates

Exhibit 5: Major assumptions:

	FY20E	FY21E	FY22E
Overall mobile users (mn)	305.5	300.5	299.0
Mobile ARPU (RMB)	39.2	38.6	38.5
5G users (mn)	50.0	120.0	190.0
5G ARPU (RMB)	47.0	51.0	56.0
Non-5G mobile users (mn)	255.5	180.5	109.0
Non-5G ARPU (RMB)	34.5	32.0	30.0

Source(s): ABCI Securities estimates

HOLD with TP of HK\$4.50

We revise down FY20E-22E net profits by 1.6%/ 1.1%/ 3.1% to reflect the negative changes in mobile user growth. The Company's TP is lowered from HK\$ 4.80 to HK\$ 4.50 based on our DCF model (WACC: 11.9%; perpetuity growth rate: 2%), which represents 1.3x/1.2x FY20E/ FY21E EV/EBITDA. Recommend **HOLD**.

Exhibit 6: Peer comparison

	Ticker	Price*	P/E				P/B				ROE	ROA	EV/EBITDA
			19A	20E	21E	22E	19A	20E	21E	22E	20E	20E	20E
China Market													
China Unicom	762 HK	4.61	11.4	10.7	9.2	8.2	0.4	0.4	0.4	0.4	3.9	2.1	1.3
China Mobile	941 HK	54.90	9.6	9.9	9.6	9.2	0.9	0.9	0.9	0.9	9.6	6.4	2.4
China Telecom	728 HK	2.32	8.4	8.8	8.2	7.7	0.5	0.5	0.5	0.5	5.7	2.9	2.0
China Tower	788 HK	1.56	46.9	35.9	25.5	20.5	1.4	1.3	1.3	1.3	3.8	2.3	5.6
Simple Avg.			19.1	16.3	13.1	11.4	0.8	0.8	0.8	0.7	5.7	3.4	2.8
US Market													
AT&T	T US	30.32	16.0	9.4	9.1	8.7	1.2	1.2	1.1	1.1	11.6	3.9	6.8
Verizon	VZ US	55.04	11.8	11.6	11.2	11.0	3.7	3.4	3.0	2.7	29.7	6.5	7.2
T-Mobile	TMUS US	105.80	26.1	44.1	35.7	25.6	3.2	2.2	2.1	1.9	6.4	1.6	9.4
Simple Avg.			18.0	21.7	18.7	15.1	2.7	2.2	2.1	1.9	15.9	4.0	7.8

*Based on closing price on July 10, 2020

Source(s): Bloomberg's market consensus



Consolidated income statement (2018A-2022E)

FY Ended Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
Mobile service revenue	165,064	156,381	146,708	140,339	138,417
Fixed line service revenue	96,295	105,659	114,112	122,100	128,205
Others	29,518	28,475	30,339	31,290	32,123
Total revenue	290,877	290,515	291,159	293,729	298,744
Interconnection charges	(12,579)	(11,513)	(11,398)	(11,295)	(11,205)
D&A	(75,777)	(83,080)	(84,326)	(85,675)	(87,132)
Network operation & support	(55,077)	(43,236)	(41,078)	(39,435)	(38,480)
Employee benefit expenses	(48,143)	(50,516)	(48,915)	(49,346)	(50,189)
Cost of product sold	(27,604)	(26,412)	(27,958)	(28,881)	(29,689)
Other operating expenses	(62,561)	(64,480)	(65,125)	(65,581)	(66,105)
Total operating expenses	(281,741)	(279,237)	(278,800)	(280,214)	(282,800)
Operating Profits	9,136	11,278	12,359	13,515	15,944
Finance cost	(1,625)	(2,123)	(2,520)	(2,905)	(3,438)
Interest income	1,712	1,272	1,358	2,504	3,622
Others	3,858	3,740	4,097	4,374	4,665
Profit before tax	13,081	14,167	15,293	17,487	20,793
Tax	(2,824)	(2,795)	(3,017)	(3,450)	(4,102)
Profit after tax	10,257	11,372	12,276	14,037	16,691
Minority interests	60	42	45	52	62
Shareholders' net profit	10,197	11,330	12,231	13,985	16,629
EBITDA	84,910	94,358	96,685	99,190	103,076
EPS (RMB)	0.333	0.370	0.400	0.457	0.543
DPS (RMB)	0.134	0.148	0.160	0.183	0.217

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2018A-2022E)

As of Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
PPE	384,475	367,401	376,586	386,001	395,651
Interest in associates	35,758	36,445	37,174	37,917	38,676
Other non-current assets	44,178	75,058	70,978	67,732	65,159
Total non-current assets	464,411	478,904	484,738	491,650	499,485
Cash & cash equivalents	30,060	34,945	67,578	99,401	130,985
Accounts receivables	14,433	17,233	14,359	14,485	15,551
Others	31,416	31,417	28,975	28,120	28,181
Total current assets	75,909	83,595	110,911	142,007	174,716
Total assets	540,320	562,499	595,649	633,657	674,202
Accounts payable and accrued liabilities	122,458	121,564	85,895	94,692	96,601
Loans	15,085	14,559	10,794	8,473	7,021
Others	77,367	69,067	137,656	161,982	192,108
Total current liabilities	214,910	205,190	234,345	265,147	295,730
Promissory notes	999	2,998	1,799	1,079	648
Others	10,125	33,556	31,372	30,191	29,532
Total non-current liabilities	11,124	36,554	33,171	31,270	30,180
Total liabilities	226,034	241,744	267,516	296,417	325,910
Shareholders' profit	313,922	320,047	327,749	336,845	347,884
Non-controlling interests	364	708	384	395	408
Total equity	314,286	320,755	328,133	337,240	348,292

Source(s): Company, ABCI Securities estimates



Consolidated Cash Flow Statement (2018A-2022E)

As of Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
Operating profit before change in working capital	13,081	14,167	15,293	17,487	20,793
Change in working capital	375	(6,550)	8,247	4,620	2,241
Others	82,114	88,886	88,299	90,030	92,014
Tax	(3,183)	(2,825)	(5,537)	(6,355)	(7,540)
Operating cash flow	92,387	93,678	106,302	105,782	107,508
CAPEX	(52,176)	(56,187)	(58,996)	(61,946)	(65,043)
Others	(9,003)	(2,866)	(2,454)	(2,281)	(2,107)
Investing cash flow	(61,179)	(59,053)	(61,451)	(64,227)	(67,151)
Dividend paid	(1,591)	(4,100)	(4,529)	(4,889)	(5,590)
Others	(32,467)	(25,665)	(7,712)	(4,862)	(3,202)
Financing cash flow	(34,058)	(29,765)	(12,241)	(9,751)	(8,792)
Net increase in cash & cash equivalents	(2,850)	4,860	32,610	31,804	31,565
Cash & cash equivalents at beginning of year	32,836	30,060	34,945	67,578	99,401
Effect of changes in foreign exchange rate	74	25	23	20	18
Cash & cash equivalents at end of year	30,060	34,945	67,578	99,401	130,985

Source(s): Company, ABCI Securities estimates

Financial Ratios

As of Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
<u>Profit margins:</u>					
EBITDA / service revenue margin (%)	29.2%	32.5%	33.2%	33.8%	34.5%
Operating margin (%)	3.1%	3.9%	4.2%	4.6%	5.3%
Net profit margin (%)	3.5%	3.9%	4.2%	4.8%	5.6%
ROAA (%)	1.8%	2.1%	2.1%	2.3%	2.6%
ROAE (%)	3.3%	3.6%	3.8%	4.2%	4.9%
Net debt/ equity (%)	0.9%	8.3%	16.7%	12.5%	10.7%
Liabilities/ assets (%)	41.8%	43.0%	44.9%	46.8%	48.3%
<u>Costs ratio</u>					
<u>% to revenue</u>					
D&A expenses/ revenue	26.1%	28.6%	29.0%	29.2%	29.2%
Networks, operations and support expenses/ revenue	18.9%	14.9%	14.1%	13.4%	12.9%
Employee benefit expenses/revenue	16.6%	17.4%	16.8%	16.8%	16.8%
Other expenses/revenue	21.5%	22.2%	22.4%	22.3%	22.1%
<u>YoY Growth:</u>					
Revenue	5.8%	(0.1%)	0.2%	0.9%	1.7%
EBITDA (%)	4.3%	11.1%	2.5%	2.6%	3.9%
Net profit (%)	457.8%	11.1%	8.0%	14.3%	18.9%

Source(s): Company, ABCI Securities estimates



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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 2008 (HSI total return index 2008-19 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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