

China Tower Corporation Ltd. (788 HK)

Better sector valuation with 5G network

- MIIT has allocated the 5G trial network spectrum to the three major telecom operators. Telecom operators can expedite 5G network development with the clarification in spectrum usage
- We project the Group's tenancy ratio to improve from 1.44 to 1.52 in 2017-20E. Operating profit margin would improve by 2.5ppt/3.2ppt to 14.4%/17.6% in FY19E-20E on lower depreciation expenses supported by the extension of tower useful lives.
- We recommend **BUY** to China Tower with TP of HK\$ 2.0, implying 6.9x/6.6x FY19E/20E EV/EBITDA and 1.7x/ 1.6x FY19E/20E P/B.

Expedited 5G network development in China. Government official bodies including MIIT and NDRC have emphasized on 5G ramp-up in China. We forecast commercial launch of 5G network would expedite from 2020 to 2H19, which would raise demand for telecom equipment products and infrastructure in the short term.

We expect China Tower's tower tenancy ratio to rise from 1.44 in 2017 to 1.52 in 2020E. The 5G frequency spectrum is much higher than that of the 4G network and telecom operators are required to build a much denser base station network, meaning that more towers will be needed. Revenues from the three major telecom operators would increase.

Operating profit margin to improve with the adjustment of tower useful life. The Group has adjusted the useful life of ground towers from 10 years to 20 years in Jan 2018, which can lower the tower depreciation expenses and improve profit margin.

Valuation. We maintain a **BUY** rating and revise up TP to HK\$ 2.0 (previous: HK\$ 1.35) to reflect higher sector valuation driven by the earlier-than-expected launch of 5G network. The TP based on EV/EBITDA, implies 6.9x/6.6x FY19E/20E EV/EBITDA and 1.7x/ 1.6x FY19E/20E P/B.

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 could affect financial condition; (5) Tenancy ratio may increase faster or slower than expected

Results and Valuation

FY ended Dec 31	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue (RMB mn)	55,997	68,665	72,997	77,349	81,899
Chg (% YoY)	n.a.	22.6	6.3	6.0	5.9
Net profit (RMB mn)	76	1,943	2,678	4,618	6,869
Chg (% YoY)	n.a.	2,456.6	37.8	72.4	48.8
EPS (RMB)	0.00	0.015	0.015	0.026	0.039
Chg (% YoY)	n.a.	2,456.6	1.3	72.4	48.8
BPS (RMB)	0.97	0.99	1.03	1.04	1.07
Chg (% YoY)	0.1	1.5	4.0	1.8	2.5
P/E (x)	2,527.3	91.2	95.2	56.0	37.6
P/B (x)	1.5	1.4	1.4	1.4	1.4
ROAE (%)	0.1	1.5	1.7	2.5	3.7
ROAA (%)	0.0	0.6	0.8	1.2	1.7
DPS (HKD)	-	-	0.01	0.01	0.02
Dividend Yield (%)	N/A	N/A	0.5	0.9	1.3

Source(s): Bloomberg, ABCI Securities estimates

*Exchange rate assumption for FY19E-20E: 1 HKD = 0.890RMB

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

Company Report

Jan 28, 2019

Rating: **BUY**

TP: **HK\$ 2.0**

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Share price (HK\$)	1.65
Est. share price return	21.2%
Est. dividend yield	0.9%
Est. total return	22.1%
Previous Rating & TP	BUY/HK\$1.35
Previous Report Date	Oct 19, 2018

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L (HK\$)	1.76/1.03
Issued shares (mn)	176,008
Issued H-shares (mn)	46,664
H-share market cap (HK\$ mn)	76,995
Avg daily turnover (HK\$ mn)	491.5
Major shareholder(s)	
China Mobile	28.5%
China Unicom	21.1%
China Telecom	20.9%

Source(s): Company, ABCI Securities

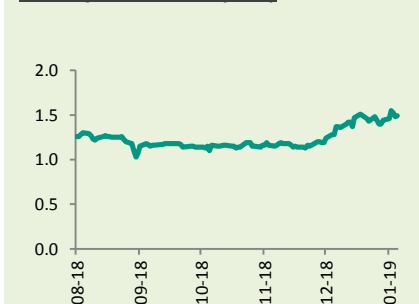
Share Performance (%)

	Absolute	Relative*
1-mth	0.1	0.1
3-mth	0.3	0.2
6-mth	N/A	N/A

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Share performance (HK\$)



Source(s): Bloomberg, ABCI Securities



Latest development of the China telecom industry

Telecom operators in China have recently obtained 5G frequency spectrum for testing until 2020. China Mobile (941 HK) was allocated the more favorable frequency bands of 2.52GHz-2.67GHz and 4.8GHz-4.9GHz; China Unicom (762 HK) and China Telecom (728 HK) obtained the 3.5GHz-3.6GHz and 3.4 GHz-3.5 GHz, respectively. According to MIIT, overall 5G telecom capital investment in China is estimated to be RMB 1.2tr, 1.5 times higher than that of the 4G network. The 5G infrastructure will take more than eight years to complete. The number of 5G base stations required and the average price of these stations will double that of the 4G network. Overall development and cycle of the 5G telecom network are expected to be longer than those of the 4G. Also, it will take a much longer period of time for 5G telecom network to mature.

Government official bodies including MIIT and NDRC have emphasized on the ramp-up of 5G network in China. We forecast the commercial launch of 5G network would start in 2H19 instead of 2020 as originally presumed, which would drive up demand for telecom equipment products and infrastructure in the short term.

The 5G frequency spectrum is much higher than that of the 4G network and telecom operators are required to build a much denser base station network, meaning that more towers will be needed. We expect the Group's tenancy ratio to rise from 1.44 in 2017 to 1.52 in 2020E. Recent adjustment of tower useful lives from 10 years to 20 years would help the Group lower depreciation expenses and improve profit margin.

We believe the commercial launch of 5G network would start in 2H19, which will spur a new round of large-scale network build-out by telecom operators. As the rate and frequency of 5G network are higher than those of 4G, transmission distance of 5G signals will reduce and the coverage radius of a single 5G base station will be shorter. Telecom operators would need to deploy a denser distribution of 5G network. The number of 5G base stations in the PRC market was estimated to be ~2.4mn units in 2020.

According to CAICT, it is estimated that between 2020 and 2025, China's 5G development will directly drive the total economic output of RMB 10.6tr, directly creating an economic added value of RMB 3.3tr.

Recommend BUY with TP at HK\$2.0

We maintain a **BUY** rating and revise up the TP from HK\$ 1.35 to HK\$ 2.00, thanks to better sector prospect with the earlier-than-expected launch of 5G network in China. The TP implies 6.9x/6.6x FY19E/20E EV/EBITDA and 1.7x/ 1.6x FY19E/20E P/B.

Our EBITDA is 28% higher than the market consensus, given that we expect lower operating costs growth with higher tenancy ratio by higher rate of co-sharing towers with lower rate of tower expansions.



Exhibit 1: Peer comparison table

	Ticker	Price	P/E				P/B				ROE	ROA	EV/ EBITDA
			17A	18E	19E	20E	17A	18E	19E	20E	19E	19E	
China Market													
China Unicom	762 HK	8.98	112.2	27.9	17.8	13.1	0.8	0.7	0.7	0.7	4.2	2.3	2.4
China Mobile	941 HK	82.40	12.6	12.4	12.3	11.8	1.4	1.4	1.3	1.2	10.8	7.0	3.3
China Telecom	728 HK	4.37	16.3	14.9	13.9	12.6	0.9	0.9	0.9	0.8	6.4	3.4	3.2
China Tower	788 HK	1.65	n.a.	87.9	46.4	29.8	1.4	1.4	1.4	1.4	3.0	1.4	7.9
Simple Average			47.1	35.8	22.6	16.8	1.1	1.1	1.1	1.0	6.1	3.5	4.0
Weighted Average			25.1	22.9	17.0	14.1	1.3	1.2	1.2	1.1	8.6	5.4	3.6
US Market													
AT&T	T US	30.66	6.4	8.7	8.5	8.4	1.3	1.3	1.2	1.2	15.5	4.1	6.3
Verizon	VZ US	56.40	7.7	12.1	11.9	11.7	5.3	4.4	3.6	3.1	32.5	7.6	6.9
Sprint	S US	6.18	n.a.	3.3	131.5	101.3	1.3	0.9	0.9	0.9	0.8	0.1	4.9
T-Mobile	TMUS US	68.48	12.7	20.4	17.3	14.6	2.6	2.3	2.0	1.9	12.6	5.9	6.3
American Tower	AMT US	167.41	62.2	57.3	48.5	41.7	11.5	13.5	14.4	19.3	29.5	5.4	21.5
Simple Average			22.3	20.4	43.6	35.5	4.4	4.5	4.4	5.3	18.2	4.6	9.2
Weighted Average			14.5	16.7	20.5	18.1	4.2	4.0	3.8	4.1	22.8	5.6	8.3

Note: Data priced on Jan 28, 2019

Source(s): Bloomberg



Consolidated income statement (2016A-2020E)

FY Ended Dec 31 (RMB mn)	2016A	2017A	2018E	2019E	2020E
Tower business revenue	55,552	67,085	69,694	72,180	74,384
DAS revenue	421	1,284	1,990	2,687	3,452
TSSAI revenue	19	169	1,014	1,876	3,001
Others	5	127	298	606	1,060
Total revenue	55,997	68,665	72,997	77,349	81,899
D&A expenses	(27,585)	(32,642)	(34,308)	(34,420)	(36,199)
Site operating lease charges	(9,121)	(11,336)	(12,117)	(12,917)	(13,292)
Repairs and maintenance	(5,750)	(6,156)	(6,351)	(6,575)	(6,798)
Employee benefits and expenses	(3,743)	(4,229)	(4,380)	(4,564)	(4,668)
Other operating expenses	(4,728)	(6,587)	(7,154)	(7,735)	(6,552)
Other gains	48	149	343	463	537
Interest income	65	104	47	402	431
Finance costs	(5,077)	(5,283)	(5,562)	(5,966)	(6,401)
Profit before tax	106	2,685	3,514	6,037	8,956
Tax	(30)	(742)	(836)	(1,419)	(2,087)
Net profit	76	1,943	2,678	4,618	6,869
EBITDA	32,655	40,357	42,995	45,559	50,589
EPS (RMB)	0.001	0.015	0.015	0.026	0.039
DPS (RMB)	0.000	0.000	0.008	0.013	0.020
Payout ratio	0.0%	0.0%	50.0%	50.0%	50.0%

Source(s): Company, ABCI Securities estimates

*Net profit = shareholders' profit



Consolidated balance sheet (2016A-2020E)

As of Dec 31 (RMB mn)	2016A	2017A	2018E	2019E	2020E
PPE	245,788	258,138	263,648	266,335	268,364
CIP	13,592	10,930	9,291	7,897	6,712
Long term prepayments	5,385	9,910	10,901	11,991	13,190
Deferred income tax assets	1,208	689	482	338	236
Other non-current assets	6,130	12,459	13,331	52,946	60,351
Total non-current assets	272,103	292,126	297,653	339,507	348,853
Cash & cash equivalents	17,249	7,852	66,924	71,836	82,433
Trade and other receivables	15,789	15,262	14,499	13,774	13,085
Prepayments & other current assets	6,524	7,375	8,113	8,924	9,816
Others	3	28	(3,262)	(37,537)	(42,753)
Total current assets	39,565	30,517	86,274	56,997	62,582
Total assets	311,668	322,643	383,927	396,504	411,435
Interest bearing borrowings	32,316	95,260	100,976	107,034	113,456
Deferred consideration payables - current portion	90,499	17,252	16,389	15,570	14,791
Accounts payable	39,840	31,906	30,311	28,795	27,355
Others	8,913	5,623	6,348	7,169	8,096
Total current liabilities	171,568	150,041	154,024	158,568	163,699
Borrowings	12,280	43,793	48,172	52,990	58,288
Others	2,268	1,314	1,248	1,186	1,127
Total non-current liabilities	14,548	45,107	49,421	54,175	59,415
Total liabilities	186,116	195,148	203,445	212,743	223,114
Total equity	125,552	127,495	180,482	183,761	188,321

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2016A-2020E)

As of Dec 31 (RMB mn)	2016A	2017A	2018E	2019E	2020E
Operating profit before tax	106	2,685	3,514	6,037	8,956
Others	27,488	32,250	32,820	33,267	35,389
Operating cash flow	27,594	34,935	36,334	39,303	44,346
CAPEX	(64,103)	(43,836)	(37,261)	(33,535)	(31,858)
Others	18,080	(8,079)	(8,725)	(9,423)	(10,177)
Investing cash flow	(46,023)	(51,915)	(45,986)	(42,958)	(42,035)
Change in borrowings	12,280	43,793	48,172	52,990	58,288
Others	9,745	(36,210)	20,552	(44,423)	(50,002)
Financing cash flow	22,025	7,583	68,724	8,567	8,286
Net increase in cash and cash equivalents	3,596	(9,397)	59,072	4,912	10,597
Cash and cash equivalents at beginning of year	13,653	17,249	7,852	66,924	71,836
Cash and cash equivalents at end of year	17,249	7,852	66,924	71,836	82,433
Financial ratio:					
<u>Growth rate:</u>					
Revenue	536.2%	22.6%	6.3%	6.0%	5.9%
Net profit	N/A	2456.6%	37.8%	72.4%	48.8%
EBITDA	3242.4%	23.6%	6.5%	6.0%	11.0%
ROAE	0.1%	1.5%	1.7%	2.5%	3.7%
ROAA	0.0%	0.6%	0.8%	1.2%	1.7%
EBITDA margin	58.3%	58.8%	58.9%	58.9%	61.8%
Operating profit margin	9.1%	11.2%	11.9%	14.4%	17.6%
Net profit margin	0.1%	2.8%	3.7%	6.0%	8.4%

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 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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