

# China Unicom (762 HK)

## In need of an edge; initiate with HOLD

- Mobile ARPU showed a downtrend due to speed upgrade, tariff reduction policy and fierce market competition
- Affected by China Mobile's (941 HK) aggressive pricing strategy and network advantage, China Unicom has lost its market share in the wireline and mobile businesses
- China Unicom's ROE and ROA are lower than peers
- Initiate **HOLD** with TP of HK\$9.5, which implies 16.5x/11.1x FY19E/20E P/E, and 3.1x/2.8x FY19E/ FY20E EV/EBITDA.

**Mobile service revenue to grow by 10.0%/ 8.7%/ 6.1% YoY in FY18E-20E.** We forecast China Unicom to add 33.0 mn/ 25.0 mn/ 20.0mn of mobile users in FY18E-20E, representing growth of 61.9%/ -24.2%/ -20.0% YoY. 9M18 mobile ARPU was RMB46.8, down 3.3% YoY, due to the cancellation of mobile data roaming tariff in July 2018.

**Diversify businesses with Mixed Ownership Reform.** The Group has strengthened its relationship with Internet enterprises after the Mixed Ownership Reform, which results in the launch of data SIM cards and accelerates development in the cloud computing, industrial Internet and Internet of Things businesses.

**EBITDA per service revenue ratio fell 1.1 ppt to 34.0% in 1H18 due to tower leasing, information and communication technology (ICT) costs, fixed asset disposals, and employee benefit expenses.** We expect EBITDA per service revenue ratio in FY18E-FY20E to be 30.6%/ 31.4%/ 32.8%. Our FY18E-20E net profit margins estimates are 3.1%/ 4.8%/ 6.8%.

**Valuation.** We initiate **HOLD** on China Unicom with TP at HK\$ 9.5, implying 16.5x/ 11.1x FY19E/ FY20E P/E, and 3.1x/ 2.8x FY19E/ FY20E EV/EBITDA.

**Risk factors:** 1) The launch of data SIM cards has already affected mobile ARPU; 2) 2H18 core net profit is expected to show YoY decline.

### Results and Valuation

FY ended Dec 31	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue (RMB mn)	274,197	274,829	286,404	300,272	311,618
Chg (% YoY)	(1.0)	0.2	4.2	4.8	3.8
Net profit (RMB mn)	625	1,828	8,852	14,998	22,214
Chg (% YoY)	(94.1)	192.5	384.3	69.4	48.1
EPS (RMB)	0.026	0.074	0.289	0.490	0.726
Chg (% YoY)	(94.1)	185.1	288.9	69.4	48.1
BVPS (RMB)	9.51	12.39	10.19	10.43	10.73
Chg (% YoY)	(1.5)	30.3	(17.8)	2.3	2.9
P/E (x)	293.8	95.0	25.0	14.8	10.0
P/B (x)	0.8	0.6	0.7	0.7	0.7
ROAE (%)	0.3	0.7	2.9	4.8	6.9
ROAA (%)	0.1	0.3	1.5	2.4	3.3
DPS (RMB)	N/A	0.05	0.25	0.42	0.63
Dividend Yield (%)	N/A	1.36	0.29	0.17	0.12

Source(s): Bloomberg, ABCI Securities estimates

\*Exchange rate assumption for FY18E-20E: 1RMB=0.850HKD

\* Net profit = net profit attributable to shareholders

## Company Report

### Initiation

Nov 14, 2018

Rating: Hold  
TP: HK\$9.50

Analyst : Ricky Lai  
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Share price (HK\$)	8.52
Est. share price return	11.5%
Est. dividend yield	0.2%
Est. total return	11.7%

Source(s): Bloomberg, ABCI Securities

#### Key Data

52Wk H/L (HK\$)	12.1 / 8.1
Issued shares (mn)	30,598.1
Market cap (HK\$ mn)	260,696
Avg daily turnover (HK\$ mn)	31.4
Major shareholder(s)	
China Unicom Group	53.5%
Capital Group Cos Inc.	1.3%
Blackrock	1.0%

Source(s): Company, ABCI Securities

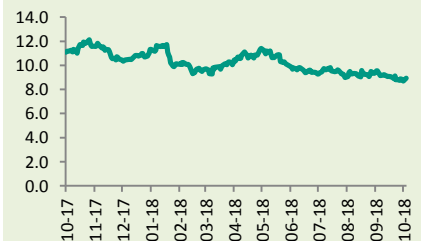
#### Share Performance (%)

	Absolute	Relative*
1-mth	-6.4	-4.1
3-mth	-9.9	-1.4
6-mth	-9.7	-0.6

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

#### Share performance (HK\$)



Source(s): Bloomberg, ABCI Securities



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## Industry analysis

According to China's 13<sup>th</sup> Five-Year Plan (2016-10), China will implement the Internet Plus action plan, the Internet speed upgrade, tariff reduction action, as well as starting the construction of next-generation Internet ahead of other countries and boosting Internet-based innovation. Complying with the regulatory plans, telecom operators have cancelled the domestic data roaming tariff and lower their handset service tariff by 30% in 2018 to boost mobile Internet penetration and stimulate domestic consumption.

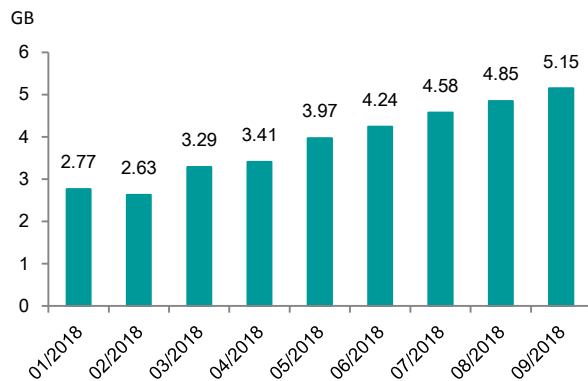
According to the Ministry of Industry and Information Technology (MIIT), mobile business of telecom operator took up 70.6% of total telecom revenue in 9M18; such high proportion was supported by the higher demand for data services and value-added services. Mobile users in China reached 1.55bn in Sep 2018, up 10.9% YoY, thanks to unlimited data packages launched by telecom operators,

China's mobile Internet users exceeded 1.29bn in Sep 2018, accounting for 83.7% of total mobile users. According to MIIT, as of Sep 2018, 4G users reached 1.15 bn, which represented 74.3% of total mobile users in China. In 2017, China Unicom, has issued the highest number of data SIM cards among the telecom operators through cooperation with Internet enterprises. Although the launch of data SIM cards has improved user growth, mobile ARPU was affected.

The average mobile data per user in China reached over 5.2GB in Sep 2018, up 162.6% YoY. We expect 4G penetration rate in China to further improve, driven by the migration of low-end users (from 2G/3G platforms), the introduction of dual SIM smartphones, and lower mobile service tariff.

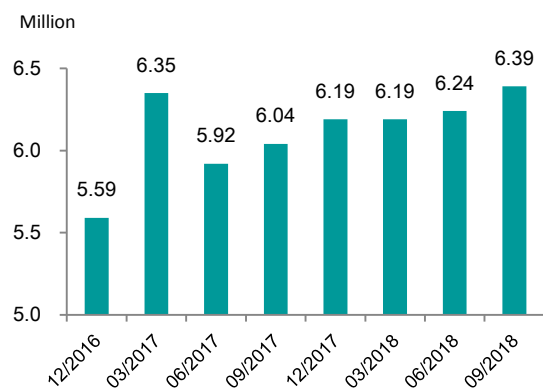
Average mobile data per user reached over 5.2GB in Sep 2018, up 162.6% YoY, signaling the robust demand for mobile data in China.

**Exhibit 1: China's average monthly data usage**



Source(s): MIIT

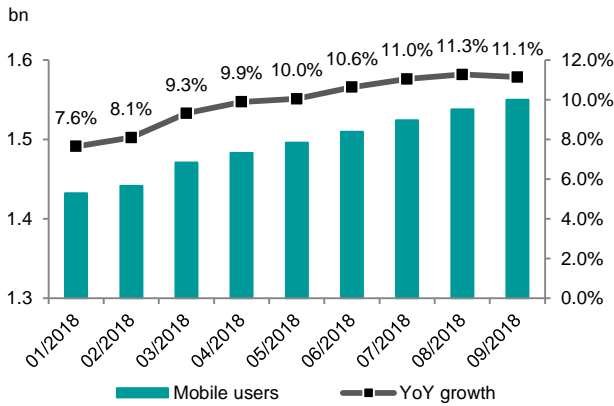
**Exhibit 2: China's mobile base stations**



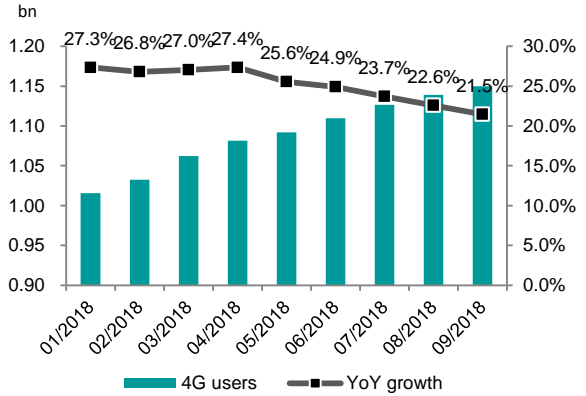
Source(s): MIIT

MIIT has scheduled to have the 4G network coverage reaching 98% of population by 2020. Aggregate telecom revenue in China grew 3% YoY in 9M18. Overall telecom volume usage surged 138% YoY, reflecting robust data consumption in China. The wireline broadband users with 100M transmission speed or above accounted for over 60% of total broadband users as of Sep 2018. The 200M and 500M speed broadband networks are becoming more popular. China Mobile (941 HK) surpassed China Telecom (728 HK) to become China's largest wireline broadband service provider in Oct 2018. The former recorded a strong growth in wireline broadband market thanks to lower service tariff than peers, network coverage improvement, and bundled service package offer. The telecom operators have launched different types of value

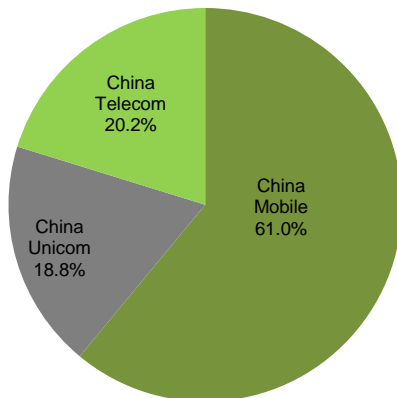
added services, IPTV, and video contents to improve user experience and boost adoption. We expect further expansion in China's wireline broadband market.

**Exhibit 3: China's overall mobile users**


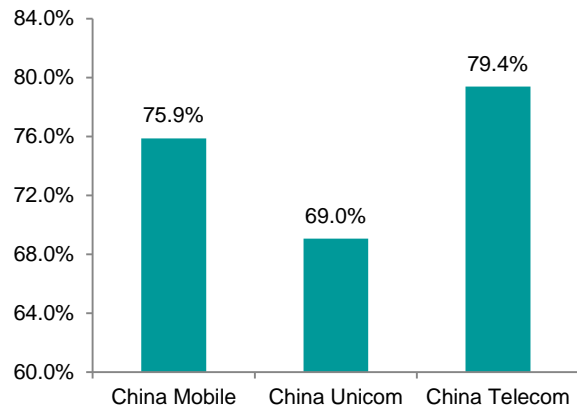
Source(s): MIIT

**Exhibit 4: China's 4G users and YoY growth**


Source(s): MIIT

**Exhibit 5: China's 4G user market share in Sep 2018**


Source(s): Companies, ABCI Securities

**Exhibit 6: Percentage of 4G users to mobile users in Sep 2018**


Source(s): Companies, ABCI Securities

According to MIIT, wireline broadband users reached 396mn in Sep 2018 and FTTH (fiber to the home) users reached 348mn, or 87.9% of total wireline users. China's IPTV users reached over 150mn as of Sep 2018, thanks to stronger demand for 4K TV program, online games, and high-definition video contents. The robust user growth in wireline network was driven by value-added services and quality video contents introduced by telecom operators.

Market share of China Mobile, China Unicom, China Telecom were 61.0%/ 18.8%/ 20.2% in Sep 2018. We expect stable growth in wireline broadband market in 2019, with better network speed and IPTV utilization rate. As of Sep 2018, 4G penetration rate of China Mobile, China Unicom, China Telecom were 75.9%/ 69.0%/ 79.4%. The highest penetration in China Telecom can be attributed to its frequency re-farm of 800MHz frequency spectrum for 4G network usage.

We believe telecom operators will roll out more bundled services packages as well as improving transmission speed to fight for more market share. They are offering free speed upgrade for old customers and improving fiber network coverage to boost adoption by high-end customers.



## Company introduction

China Unicom ( or “the Group”) provides full range and high-quality information and telecommunication services, including mobile broadband (WCDMA, LTE FDD, TD-LTE), wireline broadband, GSM, wireline local access, ICT, data communications and other related value-added services. As of Sep 2018, the Group had 309.8 mn of mobile billing subscribers, of which 4G users reached 213.9 mn, representing a 4G penetration rate of 69.0%.

In recent years, China Unicom has devoted to the development of emerging businesses including Cloud Computing, Big Data, and the Internet of Things ("IoT") by cooperating with Internet enterprises through the Mixed Ownership Reform. Mixed Ownership Reform is a restructure of state-owned enterprises SOE which introduces private capital for corporate reform.

### Exhibit 7: China Unicom’s milestones

Date	Events
2001	Included as a constituent stock of the Hang Seng Index
2008	China Unicom merged with China Netcome
Aug 2017	Carried out the Mixed Ownership Reform
Aug 2017	Partnered with Baidu in Internet of things, artificial intelligence, Big Data, etc.
Sep 2017	Cancelled domestic mobile voice long distance and roaming fees
Oct 2017	Co-operate with Alibaba to build cloud platform
Mar 2018	Launched e-SIM services in several cities
July 2018	Cancelled domestic mobile data roaming fees

Source(s): Companies, ABCI Securities

China Unicom’s 1H18 CAPEX was RMB 11.6bn; full-year figure is estimated to be RMB 50.0bn (+18.8% YoY). Major expenditure items include network maintenance, upgrades, and transmission improvement. The Group’s 4G base stations reached 910k in June 2018, with 60k additions in 1H18. The Group will allocate its CAPEX for 4G network coverage expansion, development of fiber optics network, maintenance, as well as preparation for the forthcoming 5G network. Of the RMB 50bn CAPEX for FY18E, 37% will be allocated for expansion in mobile network, 20% in fixed line broadband & data, and 43% in infrastructure, transmission & others. We expect FY19E-20E CAPEX to increase by 4.0%/ 8.0% YoY due to increased allocation for 5G network development. China Unicom is expected to add 110k 4G base stations in FY18, with its focus on capacity expansion and experience enhancement. The Group has also started trials for 5G telecom network in several cities in 2018.

## Mobile Business

China Unicom added 39.0mn of 4G users in 9M18, down 30.1% YoY compared to 25.7mn in 9M18 (+ 96.7% YoY) driven by the launch of data SIM cards. Since 2017, China Unicom has cooperated with many Internet corporations (such as JD.com, Baidu, Sunning, etc.) to launch more than 80 different data SIM cards to target different customers with various preferences of accessing online services. The Group has also strengthened its online distribution channels with increased focus on O2O sales. Its 4G user penetration rate reached 69% in Sep 2018, up 11.1ppt YoY.

Exhibit 8: Mobile revenue breakdown in 1H18

(RMB bn)	1H17	1H18	YoY
Voice	21.7	18.5	-14.4%
Data traffic	43.5	53.9	23.8%
Others	11.6	11.9	1.9%

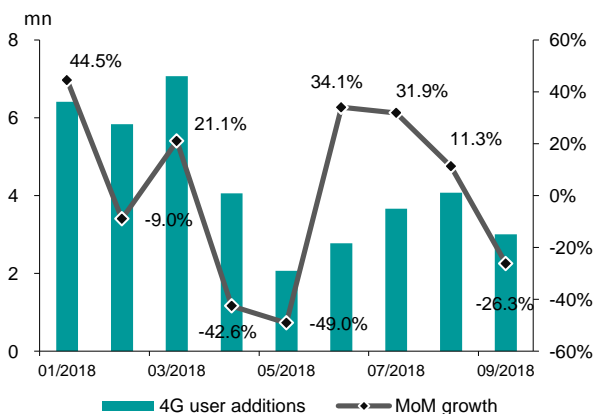
Source(s): Companies, ABCI Securities

We forecast China Unicom to add 33.0 mn/ 25.0 mn/ 20.0mn of mobile users in FY18E-20E, representing YoY growth of 61.9%/ -24.2%/ -20.0%. It is expected to benefit from the proliferation of multi-SIM handsets and data SIM cards offers.

Mobile ARPU was RMB 46.8 in 9M18, down 3.3% YoY, affected by the cancellation of mobile data roaming tariff in July 2018. Like other telecom operators, China Unicom is expected to lower its handset data tariff by 30% in 2018 to comply with the regulatory instructions. Average handset data usage surged 218% YoY to 5.1GB in 1H18, driven by lower data tariff. Handset data usage is estimated to be stimulated with the reduced service fee.

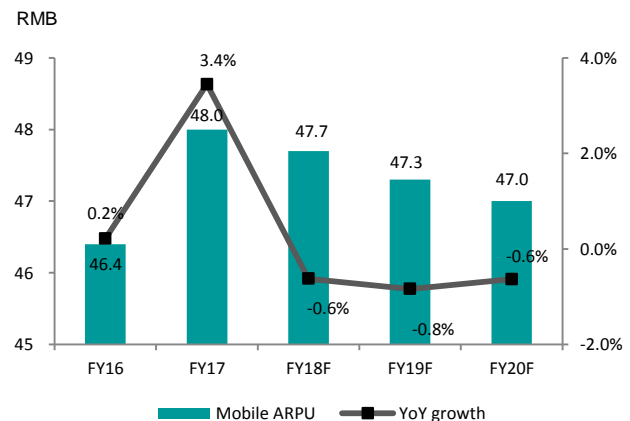
We expect mobile ARPU to be dragged down by the regulatory instructions, low-end data SIM cards and intensifying market competition. FY18E-20E mobile ARPU are estimated to decline by 0.6%/ 0.8%/ 0.6% YoY to RMB47.7/ RMB47.3/ RMB47.0. Based on our estimates of mobile user and ARPU, we project mobile service revenue to grow 10.0%/ 8.7%/ 6.1% in FY18E-20E.

Exhibit 9: China Unicom's 4G users and growth



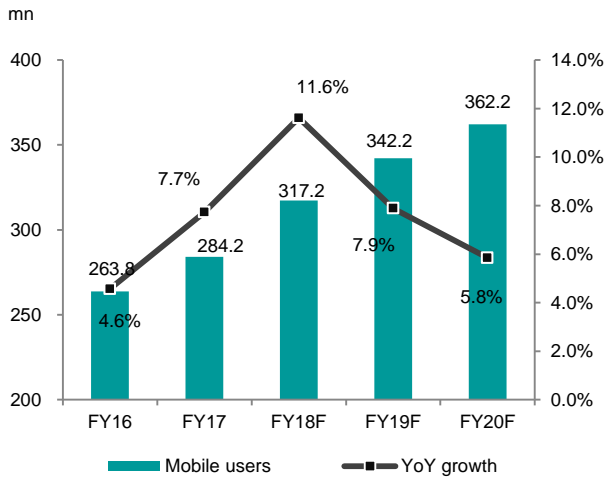
Source(s): Company

Exhibit 10: China Unicom's ARPU and growth



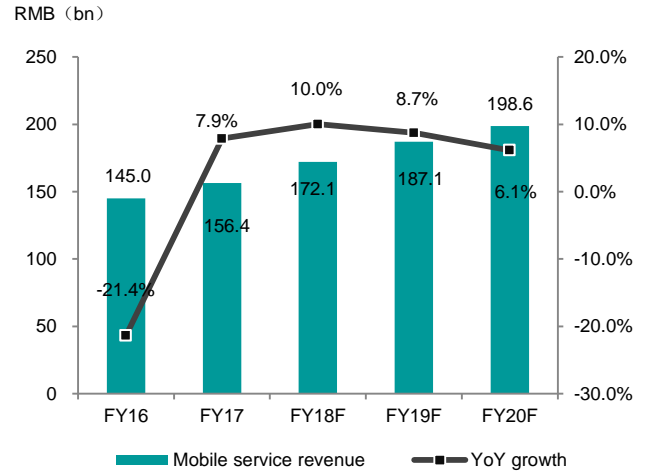
Source(s): Company, ABCI Securities estimates

**Exhibit 11: China Unicom's mobile user forecasts and growth**



Source(s): Company, ABCI Securities estimates

**Exhibit 12: China Unicom's mobile service revenue and growth**



Source(s): Company, ABCI Securities estimates



## Wireline business

China Unicom added 5.1 mn of wireline broadband users in 9M18, up 135.5% YoY. Its aggregate wireline broadband users reached 80.3 mn in Sep 2018, representing the lowest market share in the sector. We believe the disappointing result can be partly attributed to aggressive pricing strategies by competitors. Going forward, we forecast meager growth in the Group's wireline business. Compared to the Group, most major telecom players have launched a larger variety of value-added services including IPTV, video contents, and bundled packages at more competitive prices.

The smaller range of wireline service packages offered by the China Unicom could be due to the Group's strategy of focusing on emerging business and industrial usage. Wireline broadband ARPU was RMB46.1 in 1H18, down 1.9% YoY. The drop in wireline ARPU and weak user addition weighed on the Group's broadband access, which was down 0.1% YoY in 1H18.

China Unicom's aggregate wireline broadband users reached 80.3 mn in Sep 2018, representing the lowest market share in the sector

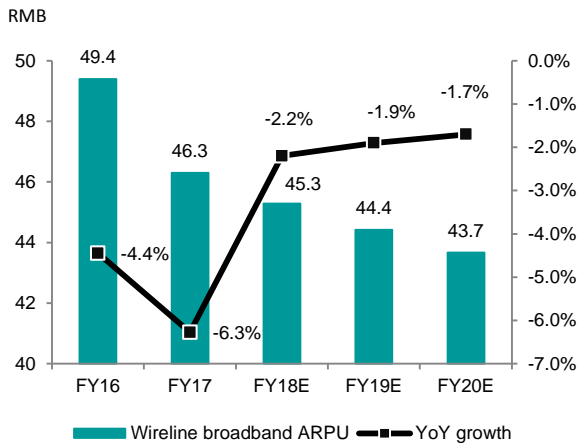
Exhibit 13: Wireline revenue breakdown in 1H18

(RMB bn)	1H17	1H18	YoY
Voice	6.3	5.5	-12.5%
Broadband access	21.6	21.5	-0.1%
Other Internet & data	9.2	10.2	10.7%
ICT (information and communication technology)	1.9	3.1	67.9%
Others	7.7	8.8	14.5%

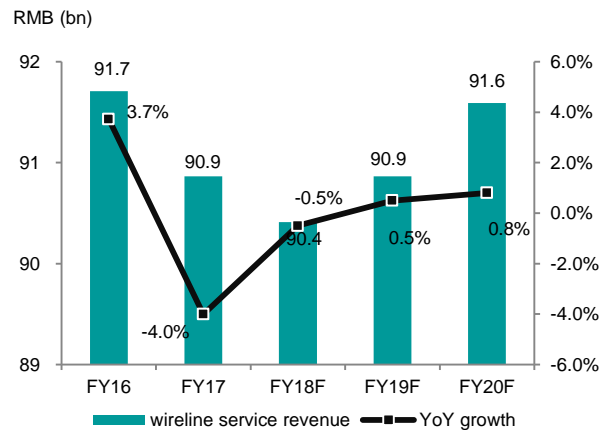
Source(s): Company

The Group's wireline service revenue was mostly driven by growth in cloud computing, big data, the Internet of Things, industrial Internet, and other emerging businesses. Corporate Internet, Internet of things, industrial cloud, and industrial Internet are expected to be the Group's major wireline revenue driver in 2019. Thanks to the Mixed Ownership Reform, the Group managed to build strong contacts with large enterprises to boost revenue growth in the industrial cloud and corporate Internet businesses. China Unicom has established a JV with Alibaba to jointly develop the cloud computing business for the enterprise and government markets. The Group also further develops in the area of video content with IPTV and home appliances services to boost value-added services revenue.



**Exhibit 14: China Unicom's wireline broadband ARPU and growth**


Source(s): Company, ABCI Securities estimates

**Exhibit 15: China Unicom's wireline service revenue and growth**


Source(s): Company, ABCI Securities estimates

**Exhibit 16: China Unicom's key operational metrics assumptions:**

(mn)	FY18E	FY19E	FY20E
Mobile user additions	33.0	25.0	20.0
YoY	61.9%	-24.2%	-20.0%
Mobile users	317.2	342.2	362.2
YoY	11.6%	7.9%	5.8%
Mobile ARPU (RMB)	47.7	47.3	47.0
YoY	-0.6%	-0.8%	-0.6%
Wireline broadband user additions	6.0	7.0	8.0
YoY	361.5%	16.7%	14.3%
Aggregate broadband users	82.5	89.5	97.5
YoY	7.8%	8.5%	8.9%
Wireline ARPU (RMB)	44.9	43.8	43.1
YoY	-3.0%	-2.5%	-1.5%

Source(s): Company, ABCI Securities estimates

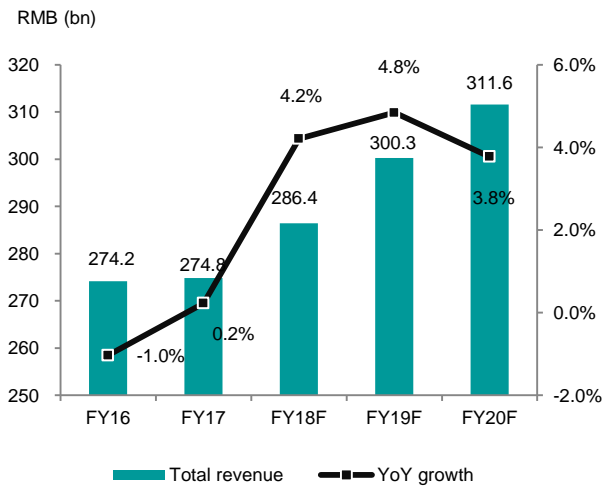
## Financial outlook

China Unicom is expected to develop cloud computing and industrial Internet through cooperation with Internet enterprises via the Mixed Ownership Reform. Mobile service revenue showed a moderate growth in 3Q18 (+2.4% YoY), supported by user growth and data usage improvement amid the reduced data service tariff. Through partnerships with Internet enterprises, China Unicom launched a number of data SIM cards which helped to boost growth in mobile user. Wireline service revenue grew 4.6% YoY in 3Q18 thanks to industrial Internet and cloud computing demand. The Group is expected to leverage its liaison with Internet enterprises to further develop its business. We expect price competition to increase in the mobile business.

The Group will continue to strengthen its cooperation with Internet enterprises and benefit from the rising demand of cloud computing, industrial Internet and government usage. Hence, we project total revenue to grow 4.2%/ 4.8%/ 3.8% in FY18E-FY20E. We have not factored potential revenue impacts of 5G network upgrade due to its preliminary stage and uncertain pricing.

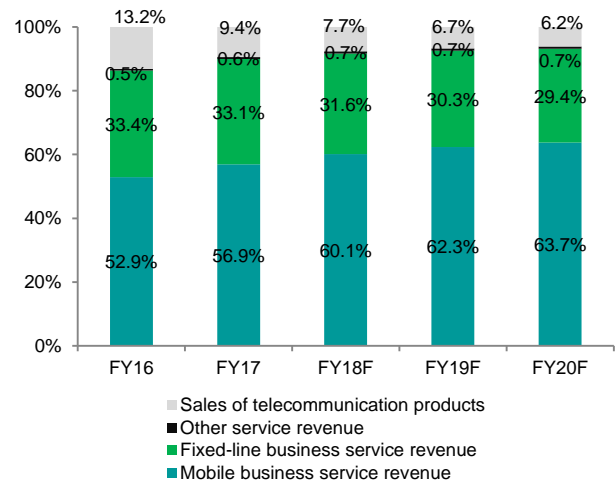
The Group's D&A expense was down 0.6% YoY in 1H18 on lower CAPEX. Due to a shift in marketing strategy, China Unicom lowered its handset subsidy by 52% in 1H18 but increased its selling expense by 2.4%. Tower leasing fee decreased by 5.9% YoY in 1H18, thanks to increasing tower-sharing ratio that resulted in greater tower-leasing discount on usage fee. We expect tower-leasing discount to improve further on increased sharing ratio.

**Exhibit 17: China Unicom's total revenue and growth**



Source(s): Company, ABCI Securities estimates

**Exhibit 18: China Unicom's revenue breakdown**



Source(s): Company, ABCI Securities estimates



Exhibit 19: 3Q18 results analysis:

(RMB Bn)	3Q18	3Q17	YoY
Overall service revenue	65.6	63.8	2.8%
Mobile service revenue	41.1	40.2	2.4%
Wireline service revenue	24.1	23.0	4.6%
Sales of telecom products	5.0	3.8	30.5%
Total revenue	70.6	67.6	4.4%
Net profit	2.9*	1.6	75.0%
EBITDA	20.6	21.8	-5.8%
Net profit margin	4.1%	2.4%	1.6ppt
EBITDA / service revenue margin	31.4%	34.2%	-2.9ppt

\*Including one-off gain of RMB1,474 mn on separate listing of China Tower during the period

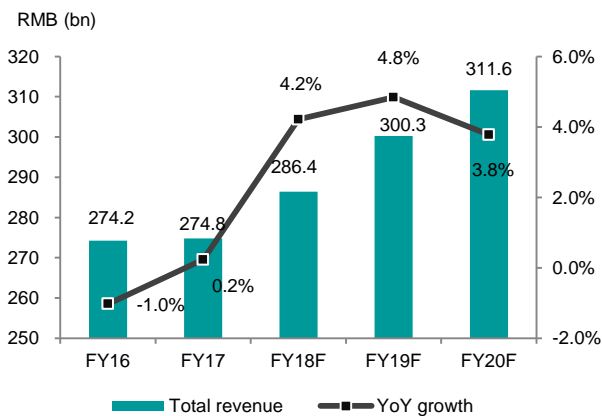
Source(s): Company, ABCI Securities estimates

Liabilities-to-assets ratio lowered by 16.1ppt YoY to 46.8% in FY17, thanks to the capital injection from Mixed Ownership Reform. We expect slight increase in Liabilities-to-assets ratio in FY19E-20E due to 5G network expansion.

EBITDA per service revenue ratio was down by 1.1ppt YoY to 34.0% in 1H18 due to tower leasing, ICT costs, fixed asset disposals and employee benefit expenses. China Unicom has shifted its marketing strategy –instead of relying on providing handset subsidy, it focuses on promoting through online distribution channels to help lower marketing expenses.

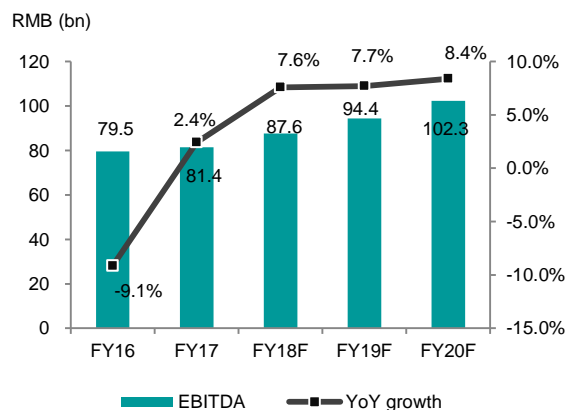
We project EBITDA per service revenue ratio in FY18E-20E to be 30.6%/ 31.4%/ 32.8%. China Unicom’s FY18E-20E net profit margins are estimated to be 3.1%/ 4.8%/ 6.8%.

Exhibit 20: China Unicom’s total revenue and growth

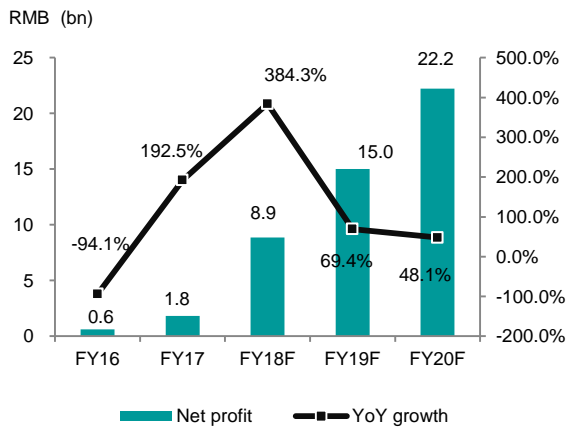


Source(s): Company, ABCI Securities estimates

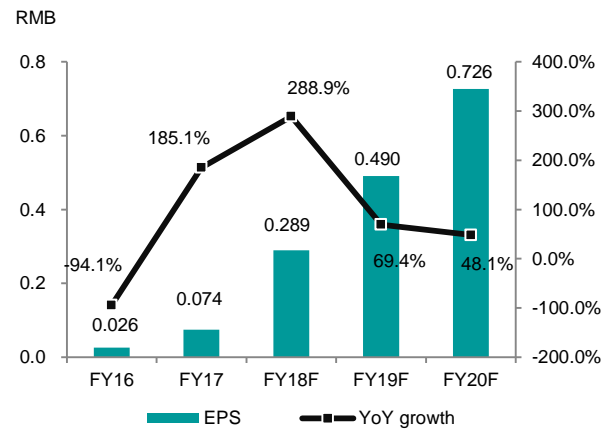
Exhibit 21: China Unicom’s EBITDA and growth



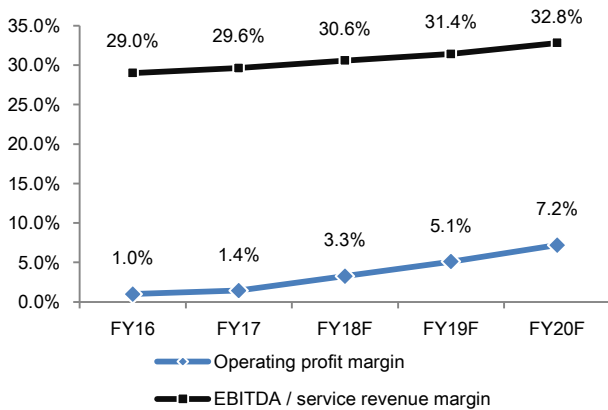
Source(s): Company, ABCI Securities estimates

**Exhibit 22: China Unicom's net profit and growth**


Source(s): Company, ABCI Securities estimates

**Exhibit 23: China Unicom's EPS and growth**


Source(s): company, ABCI Securities estimates

**Exhibit 24: Operating and EBITDA margin trends**


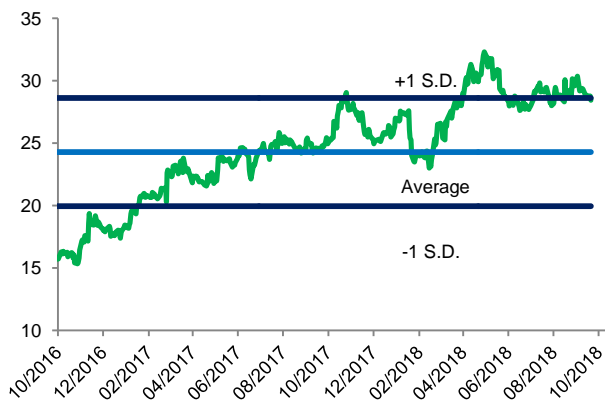
Source(s): Company, ABCI Securities estimates



**Recommend HOLD with TP of HK\$ 9.50**

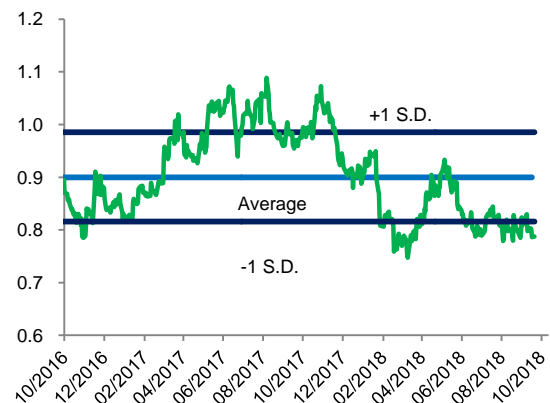
We derive the Group's valuation (RMB278.1 bn) based on the DCF model (WACC: 14.1%; D/ (D+E) =10.2%; perpetuity growth rate: 2%). We initiate HOLD on China Unicom with TP of HK\$ 9.50, which represents 16.5X/ 11.1x FY19E/ FY20E P/E, and 3.1x/ 2.8x FY19E/ FY20E EV/EBITDA. We have applied 9.1% discount to the DCF valuation to obtain the Group's TP. We set the Group's investment rating as HOLD based on its weakening mobile business with relatively low ROA and ROE ratios even though the TP has over 10% upside to the present stock price. There may be technical rebound in the short terms with news relating to the 5G network development in China. China Unicom has shown slowing growth in mobile and wireline business, which will affect its business outlook in 2019. Also, it has the lowest 4G user penetration rate in the sector. The Group is trading at 17.7X FY19E P/E which is not attractive compared to sector average of 12.6x FY19E P/E.

**Exhibit 25: China Unicom's P/E graph**



Source(s): Company, ABCI Securities estimates

**Exhibit 26: China Unicom's P/B Graph**



Source(s): Company, ABCI Securities estimates

**Exhibit 27: Peer Comparison Table**

	Ticker	Price*	P/E				P/B				ROE	ROA	EV/EBITDA
			17A	18E	19E	20E	17A	18E	19E	20E	19E	19E	19E
<b>China Market</b>													
China Unicom	762 HK	8.52	107.0	27.7	17.7	13.0	0.7	0.7	0.7	0.7	4.2	2.2	2.4
China Mobile	941 HK	75.10	11.6	11.8	11.7	11.2	1.3	1.3	1.2	1.2	10.8	7.1	3.0
China Telecom	728 HK	3.91	14.7	13.9	12.9	11.7	0.8	0.8	0.8	0.8	6.4	3.4	3.0
Simple Average			44.5	17.8	14.1	12.0	0.9	0.9	0.9	0.9	7.1	4.3	2.8
Weighted Average			24.0	14.1	12.6	11.5	1.2	1.2	1.1	1.0	9.3	5.9	2.9
<b>US Market</b>													
AT&T	T US	31.04	6.5	8.8	8.7	8.5	1.4	1.3	1.2	1.2	14.7	4.3	6.4
Verizon	VZ US	58.27	7.9	12.5	12.4	12.3	5.5	4.4	3.7	3.2	33.2	7.6	7.1
Sprint	S US	6.26	n.a.	3.4	118.1	106.1	1.3	1.0	0.9	0.9	0.4	0.1	4.9
T-Mobile	TMUS US	69.75	12.9	21.1	17.6	14.1	2.7	2.4	2.1	1.9	12.6	5.6	6.4
Simple Average			9.1	11.4	39.2	35.2	2.7	2.2	2.0	1.8	15.2	4.4	6.2
Weighted Average			7.9	11.5	16.3	15.3	3.3	2.7	2.4	2.1	21.9	5.7	6.6

\*Based on closing price on Nov 13, 2018

Source(s): Bloomberg



## Risk factors

### Data SIM cards may affect mobile ARPU

China Unicom has launched a large amount of low-price data SIM cards through cooperating with Internet enterprises. We project its mobile ARPU to decline by 0.6%/ 0.8%/ 0.6% in FY18E-FY20E.

### May receive less favorable 5G frequency spectrum

The 5G frequency spectrum has not been released and specified at the present stage, China Unicom may receive less favorable frequency spectrum than peers from the authority. If such is the case, the Group may need to allocate more CAPEX and resources to develop the 5G network. We predict CAPEX to increase by 4.0%/ 8.0% in FY19E/ FY20E in our forecast model. Our estimation may be under-estimated or over-estimated as government has not determined the 5G frequency spectrum to China Unicom.

### Lower ROAA and ROAE than peers

The Group's ROAA and ROAE are lower than China Mobile's and China Telecom's because of its lower net profit with weak user growth and ARPU. Its ROAE is projected in the range of 2.9% to 6.9% in FY18E-FY20E, which is lower than its WACC (14.1%). Its operation based on our financial projection is destroying shareholders' value, unless it manages to raise ROAE or lower WACC.

### 2H18 core net profit is expected to decline

China Unicom's core net profit is estimated to show a YoY decline in 2H18 due to the cancellation of mobile data roaming tariff in July 2018 and reduced handset service tariff (-30%) in 2018. We project its net profit to decline by 12% YoY in 2H18.



Consolidated income statement (2016A-2020E)

FY Ended Dec 31 (RMB mn)	2016A	2017A	2018E	2019E	2020E
Mobile service revenue	145,018	156,441	172,121	187,138	198,641
Wireline service revenue	91,710	90,866	90,412	90,864	91,591
Others	37,469	27,522	23,872	22,271	21,387
<b>Total revenue</b>	<b>274,197</b>	<b>274,829</b>	<b>286,404</b>	<b>300,272</b>	<b>311,618</b>
Interconnection charges	(12,739)	(12,617)	(12,365)	(12,117)	(11,875)
D&A	(76,805)	(77,492)	(78,267)	(79,050)	(79,840)
Network operation & support	(51,167)	(54,507)	(60,242)	(65,872)	(68,332)
Employee benefit expenses	(36,907)	(42,471)	(44,393)	(46,542)	(48,301)
Cost of product sold	(39,301)	(26,643)	(22,922)	(21,037)	(19,877)
Other operating expenses	(54,585)	(57,166)	(58,881)	(60,353)	(60,957)
<b>Total operating expenses</b>	<b>(271,504)</b>	<b>(270,896)</b>	<b>(277,069)</b>	<b>(284,971)</b>	<b>(289,182)</b>
<b>Operating Profits</b>	<b>2,693</b>	<b>3,933</b>	<b>9,335</b>	<b>15,301</b>	<b>22,436</b>
Finance cost	(5,017)	(5,734)	(2,010)	(1,201)	(722)
Interest income	1,160	1,647	1,918	3,343	5,373
Others (including associates, JV & other income)	1,948	2,747	3,031	3,351	3,713
<b>Profit before tax</b>	<b>784</b>	<b>2,593</b>	<b>12,274</b>	<b>20,795</b>	<b>30,801</b>
Tax	(154)	(743)	(3,351)	(5,677)	(8,409)
<b>Profit after tax</b>	<b>630</b>	<b>1,850</b>	<b>8,923</b>	<b>15,118</b>	<b>22,392</b>
Minority interests	5	22	71	120	178
<b>Shareholders' net profit</b>	<b>625</b>	<b>1,828</b>	<b>8,852</b>	<b>14,998</b>	<b>22,214</b>
<b>EBITDA</b>	<b>79,498</b>	<b>81,425</b>	<b>87,602</b>	<b>94,351</b>	<b>102,276</b>
<b>EPS (RMB)</b>	<b>0.026</b>	<b>0.074</b>	<b>0.289</b>	<b>0.490</b>	<b>0.726</b>
<b>DPS (RMB)</b>	<b>0.000</b>	<b>0.052</b>	<b>0.251</b>	<b>0.425</b>	<b>0.630</b>
<b>Payout ratio</b>	<b>0.0%</b>	<b>86.0%</b>	<b>86.0%</b>	<b>86.0%</b>	<b>86.0%</b>

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2016A-2020E)

As of Dec 31 (RMB mn)	2016A	2017A	2018E	2019E
PPE	451,115	416,596	423,472	433,572
Interest in associates	32,248	33,233	32,477	32,802
Lease prepayments	9,436	9,313	9,872	9,970
Other non-current assets	39,137	36,119	30,982	26,907
<b>Total non-current assets</b>	<b>531,936</b>	<b>495,261</b>	<b>496,803</b>	<b>503,252</b>
Cash & cash equivalents	23,633	32,836	61,204	101,654
Accounts receivables	13,622	13,964	16,478	18,099
Short-term bank deposits	1,754	5,526	5,652	5,813
Others	43,209	24,396	23,291	23,252
<b>Total current assets</b>	<b>82,218</b>	<b>76,722</b>	<b>106,625</b>	<b>148,818</b>
<b>Total assets</b>	<b>614,154</b>	<b>571,983</b>	<b>603,428</b>	<b>652,070</b>
Accounts payable and accrued liabilities	143,224	125,260	158,651	163,956
Short-term bank loans	76,994	22,500	18,000	10,800
Commercial paper	35,958	8,991	7,193	4,316
Others	86,479	85,871	87,109	140,175
<b>Total current liabilities</b>	<b>342,655</b>	<b>242,622</b>	<b>270,953</b>	<b>319,247</b>
Promissory notes	17,906	17,981	14,385	8,631
Others	25,911	7,033	6,394	5,171
<b>Total non-current liabilities</b>	<b>43,817</b>	<b>25,014</b>	<b>20,778</b>	<b>13,802</b>
<b>Total liabilities</b>	<b>386,472</b>	<b>267,636</b>	<b>291,731</b>	<b>333,049</b>
<b>Equity attributable to ordinary shareholders</b>	<b>227,407</b>	<b>304,050</b>	<b>311,311</b>	<b>318,635</b>
<b>Non-controlling interests</b>	<b>275</b>	<b>297</b>	<b>386</b>	<b>385</b>
<b>Total equity</b>	<b>227,682</b>	<b>304,347</b>	<b>311,697</b>	<b>319,020</b>

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 change in working capital	784	2,593	12,274	20,795	30,801
Change in working capital	(3,898)	1,966	5,130	6,134	5,073
Others	84,617	87,767	82,594	82,602	82,947
Tax	(6,910)	(7,272)	(5,361)	(6,878)	(9,130)
<b>Operating cash flow</b>	<b>74,593</b>	<b>85,054</b>	<b>94,637</b>	<b>102,653</b>	<b>109,690</b>
CAPEX	(98,293)	(61,489)	(50,000)	(52,250)	(56,430)
Others	2,544	14,153	19,098	20,083	21,206
<b>Investing cash flow</b>	<b>(95,749)</b>	<b>(47,336)</b>	<b>(30,902)</b>	<b>(32,167)</b>	<b>(35,224)</b>
Dividend paid	(4,071)	0	(1,591)	(7,674)	(13,001)
Others	26,948	(28,414)	(33,685)	(22,280)	(15,182)
<b>Financing cash flow</b>	<b>22,877</b>	<b>(28,414)</b>	<b>(35,276)</b>	<b>(29,954)</b>	<b>(28,183)</b>
Net increase in cash & cash equivalents	1,721	9,304	28,459	40,532	46,283
Cash & cash equivalents at beginning of year	21,755	23,633	32,836	61,204	101,654
Effect of changes in foreign exchange rate	157	(101)	(91)	(82)	(74)
<b>Cash &amp; cash equivalents at end of year</b>	<b>23,633</b>	<b>32,836</b>	<b>61,204</b>	<b>101,654</b>	<b>147,864</b>
<b>Financial Ratios:</b>					
EBITDA / service revenue margin (%)	29.0%	29.6%	30.6%	31.4%	32.8%
Operating margin (%)	1.0%	1.4%	3.3%	5.1%	7.2%
Net profit margin (%)	0.2%	0.7%	3.1%	5.0%	7.1%
ROAA (%)	0.1%	0.3%	1.5%	2.4%	3.3%
ROAE (%)	0.3%	0.7%	2.9%	4.8%	6.9%
<b>YoY Growth:</b>					
EBITDA (%)	-9.1%	2.4%	7.6%	7.7%	8.4%
Net profit (%)	-94.1%	192.5%	384.3%	69.4%	48.1%

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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