

China Telecom Corporation Ltd. (728 HK)

Outperformed mobile user growth

- 5G will benefit the Group with more high-end customers
- Thanks to scale effect with strong mobile user growth, we estimate EBITDA margin to rise 0.1ppt/ 0.4ppt/ 0.3ppt to 32.9%/ 33.3%/ 33.6% in 2020E22E.
- Teaming up with China Unicom (762 HK) to co-share and co-build 5G network
- Recommend **BUY** with TP of HK\$ 3.50, which implies 2.2x/ 2.1x FY20E/ FY21E EV/EBITDA.

Stellar mobile user growth. Thanks to quality services and higher network speed, the Group outperformed other operators in terms of mobile user addition (+0.98mn in 1Q20), compared to the reductions of 3.98mn and 7.47mn in China Mobile and China Unicom. We estimate China Telecom's to add a total of 15mn mobile users in 2020E.

EBITDA margin growth exceeded peers. China Telecom showed the slowest decline in EBITDA and EBITDA margin in 1Q20 among peers, thanks to its cost control measures and mobile user growth. We estimate EBITDA margin to be 32.9%/ 33.3%/ 33.6% in 2020-22E.

Net profit is expected to grow at a CAGR of 3.8% in 2019-22E. The Group has teamed up with China Unicom to co-share and co-build 5G network, which will enable more extensive network coverage. Driven by mobile user growth and 5G development, we estimate China Telecom's net profit to rebound in 2H20.

Valuation. Upgrade to **BUY** rating on China Telecom with the TP of HK\$3.50, implying 2.2x/ 2.1x FY20E/ FY21E EV/EBITDA.

Results and Valuation

FY ended Dec 31	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	377,124	375,734	379,615	384,661	391,999
Chg (% YoY)	3.0	(0.4)	1.0	1.3	1.9
Net profit (RMB mn)	21,210	20,517	20,950	21,934	22,949
Chg (% YoY)	13.9	(3.3)	2.1	4.7	4.6
EPS (RMB)	0.26	0.25	0.26	0.27	0.28
Chg (% YoY)	13.9	(3.3)	2.1	4.7	4.6
BPS (RMB)	4.24	4.36	4.50	4.67	4.84
Chg (% YoY)	5.3	2.8	3.4	3.7	3.7
P/E (x)	8.9	9.5	9.3	8.9	8.5
P/B (x)	0.55	0.55	0.53	0.51	0.50
ROAE (%)	6.3	5.9	5.8	5.9	6.0
ROAA (%)	3.2	3.0	2.9	2.9	3.1
DPS (RMB)	0.110	0.113	0.104	0.109	0.114
Dividend Yield (%)	3.7	3.8	3.5	3.7	3.8

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

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Apr 28, 2020
Rating: **BUY**
TP: **HK\$ 3.50**

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Share price (HK\$)	2.67
Est. share price return	31.1%
Est. dividend yield	3.5%
Est. total return	34.6%
Previous Rating & TP	BUY/HK\$3.5
Previous Report Date	Feb 13, 2020

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L(HK\$)	4.5/3.3
Issued shares (mn)	80,932.0
Market cap (HK\$ mn)	216,088
Avg daily turnover (HK\$ mn)	392
Major shareholder(s)	
China Telecommunications	70.9%
JP Morgan	12.0%
Citigroup	8.0%

Source(s): Bloomberg, ABCI Securities estimates

Share Performance (%)

	Absolute	Relative*
1-mth	15.1	11.2
3-mth	(15.5)	(2.8)
6-mth	(22.6)	(14.4)

*Relative to HSI

Source(s): Bloomberg



China Telecom's 1Q20 net profit met our expectations with a 2.2% YoY decline. As business in 1Q was affected by the Speed Upgrade and Tariff Reduction and COVID-19, 1Q20 revenue dropped 0.7% YoY on the 42% decrease in terminal sales. Its retail shops were mostly closed in 1Q20, resulting in the drop in handset sales and slower user growth. Mobile service revenue grew 2.9% YoY in 1Q20, driven by the 0.98mn net mobile user additions. In contrast, China Mobile and China Unicom lost 3.98mn and 7.47mn mobile users in 1Q20. The Group's overall mobile users reached 336.6mn (+ 6.8% YoY) with over 16.6 mn 5G users. Mobile ARPU was RMB 44.4 (- 5.3% YoY). The lowering in data tariff has stimulated volume usage.

China Telecom was the telecom operator to show the slowest decline EBITDA and EBITDA margin in 1Q20, thanks to its cost control effort and mobile user addition amid decrease in mobile ARPU. The Group is launching more stringent measures to monitor expenses to alleviate negative impacts from COVID-19 and stiffening market competitions in 2020.

Exhibit 1: Telecom operators' 1Q20 operational data comparison table

	China Mobile	China Unicom	China Telecom
Overall revenue growth (YoY)	-2.0%	0.9%	0.7%
Net profit growth (YoY)	-0.8%	-13.9%	-2.2%
EBITDA growth (YoY)	-5.8%	-5.8%	-0.3%
EBITDA margin	-1.5ppt	-2.3ppt	-0.4ppt
Net profit margin	0.2ppt	-0.7ppt	-0.1ppt
Mobile user additions (mn)	-3.98	-7.47	0.98

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 rolled out more telecom service products, which include bundled services packages, smart home services, internet SIM cards, etc., than other operators. Also, it will team up with China Unicom to co-build and co-share the 5G network in 2020. Overall, we project its mobile users to grow by 4.5%/2.3%/0.8% in FY20-22E, respectively. We cut FY20E/ FY21E net profit by 5.9%/7.8% to reflect the impact from COVID-19 and market competition, due to the adjustment of mobile ARPU and user growth.

Exhibit 2: Major assumptions:

	FY20E	FY21E	FY22E
Overall mobile users (mn)	350.6	358.6	361.6
Mobile ARPU (RMB)	44.0	43.1	43.3
5G users (mn)	70.0	140.0	200.0
5G ARPU (RMB)	80.0	75.0	73.5
Non-5G users (mn)	280.6	218.6	161.6
Non-5G ARPU (RMB)	40.0	38.0	36.2

Source(s): ABCI Securities estimates

Exhibit 3: Changes in our financial estimates

	OLD			NEW			CHANGE		
(RMB mn)	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	393,749	402,776	N/A	379,615	384,661	391,999	-2.3%	-2.7%	N/A
Operating profit	31,835	33,391	N/A	27,510	28,802	30,134	-7.1%	-8.4%	N/A
Net Profit	23,308	24,878	N/A	20,950	21,934	22,949	-5.9%	-7.8%	N/A

Source(s): Company, ABCI Securities estimates



Recommend BUY with TP at HK\$3.50

We derive the Group's TP at HK\$3.50 based on the DCF analysis (WACC: 9.5%; perpetuity growth rate: 2%), representing 2.2x/ 2.1x FY20E/ FY21E EV/EBITDA.

Exhibit 4: Peer Comparison Table

			P/E				P/B				ROE	ROA	EV/EBITDA
	Ticker	Price*	19A	20E	21E	22E	19A	20E	21E	22E	20E	20E	20E
China Market													
China Unicom	762 HK	6.86	12.2	11.5	10.1	9.0	0.4	0.4	0.4	0.4	3.9	2.1	1.4
China Mobile	941 HK	60.00	10.5	10.8	10.5	10.2	1.0	1.0	1.0	0.9	9.5	6.5	2.9
China Telecom	728 HK	2.67	9.3	9.7	9.1	8.5	0.5	0.5	0.5	0.5	5.7	3.0	1.9
China Tower	788 HK	1.62	50.8	36.4	28.0	22.8	1.5	1.5	1.4	1.4	3.9	2.2	5.9
Simple Average			20.7	17.1	14.4	12.6	0.9	0.9	0.8	0.8	5.7	3.5	3.1
US Market													
AT&T	T US	29.71	15.6	9.2	8.9	8.3	1.2	1.1	1.1	1.1	11.8	4.3	6.7
Verizon	VZ US	57.93	12.4	12.1	11.7	11.6	3.9	3.4	3.0	2.8	29.8	6.7	7.4
T-Mobile	TMUS US	90.80	22.4	26.4	23.9	28.4	2.7	1.6	1.6	1.5	7.3	2.3	6.9
Simple Average			16.8	15.9	14.8	16.1	2.3	1.9	1.8	1.7	12.1	3.5	7.0

*Based on closing price on Apr 27, 2020

Source(s): Bloomberg

Risk factors:

- 1) Expecting ARPU to decline in FY20E & FY21E.
- 2) Expecting low users growth.
- 3) Peers reported decline of mobile users, they may kick start price war to retain and boost users' volume.

Financial Statements

Consolidated income statement (2018A-2022E)

FY Ended Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
Service revenue	350,434	357,610	365,082	371,089	378,619
Sales of products and others	26,690	18,124	14,532	13,572	13,381
Total revenue	377,124	375,734	379,615	384,661	391,999
D&A	(75,493)	(88,145)	(91,271)	(93,885)	(96,548)
Network operation & support	(116,062)	(109,799)	(111,350)	(112,069)	(113,586)
Selling G&A	(59,422)	(57,361)	(61,118)	(61,546)	(61,936)
Personnel expenses	(59,736)	(63,567)	(64,985)	(65,312)	(66,637)
Other operating expenses	(37,697)	(27,792)	(21,905)	(22,265)	(22,717)
Total operating expenses	(348,410)	(346,664)	(350,628)	(355,077)	(361,423)
Operating Profit	28,714	29,070	28,987	29,584	30,576
Investment income	38	30	33	36	39
Share of profit from associates	2,104	1,573	1,652	1,734	1,821
Net finance costs	(2,708)	(3,639)	(3,161)	(2,552)	(2,302)
Profit before tax	28,148	27,034	27,510	28,802	30,134
Tax	(6,810)	(6,322)	(6,433)	(6,735)	(7,047)
Profit after tax	21,338	20,712	21,077	22,067	23,087
Minority interests	(128)	(195)	(126)	(132)	(138)
Shareholders' net profit	21,210	20,517	20,950	21,934	22,949
EBITDA	104,204	117,211	120,257	123,469	126,534
EPS (RMB)	0.262	0.254	0.259	0.271	0.284
DPS (RMB)	0.110	0.113	0.104	0.109	0.114

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2018A-2022E)

As of Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
PPE	407,795	410,008	434,288	477,150	353,475
CIP	66,644	59,206	53,285	45,293	38,499
Interest in associates	38,051	39,192	42,244	45,448	48,812
Others	77,887	121,543	121,288	57,192	159,406
Total non-current assets	590,377	629,949	651,105	625,083	600,192
Cash & cash equivalents	16,666	20,791	40,081	67,983	97,157
Deposits in bank	6,814	3,628	3,519	3,414	3,311
Accounts receivables	20,475	21,489	21,919	22,357	22,804
Others	29,050	27,274	28,403	30,156	32,028
Total current assets	73,005	73,182	93,922	123,910	155,301
Total assets	663,382	703,131	745,027	748,993	755,493
Short term debt	49,537	42,527	34,022	30,619	27,557
Accounts payable	107,887	102,616	107,747	110,979	114,309
Accrued expenses and other payable	43,497	48,516	50,942	53,489	56,163
Others	57,999	71,002	62,970	56,211	49,855
Total current liabilities	258,920	264,661	255,680	251,299	247,885
Long term debt and payable	44,852	32,051	25,641	23,077	20,769
Deferred revenue	13,138	19,078	20,365	21,712	23,121
Others	2,373	32,301	76,610	72,574	69,163
Total non-current liabilities	60,363	83,430	122,615	117,362	113,053
Total liabilities	319,283	348,091	378,296	368,661	360,938
Equity attributable to shareholders	343,069	352,510	364,334	377,838	391,960
Non-controlling interests	1,030	2,530	2,397	2,494	2,595
Total equity	344,099	355,040	366,731	380,332	394,555

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	108,080	121,681	121,948	124,276	126,485
Change in working capital	(3,269)	(2,703)	6,009	4,123	4,231
Others	(2,754)	(3,593)	(3,392)	(1,915)	(229)
Tax	(2,759)	(2,785)	(2,785)	(2,785)	(2,785)
Operating cash flow	99,298	112,600	121,780	123,699	127,702
CAPEX	(83,835)	(82,853)	(85,339)	(87,899)	(90,536)
Others	(2,119)	5,639	857	729	592
Investing cash flow	(85,954)	(77,214)	(84,482)	(87,170)	(89,944)
Dividend paid	(7,568)	(8,891)	(9,126)	(8,431)	(8,827)
Others	(8,715)	(22,397)	(8,903)	(211)	231
Financing cash flow	(16,283)	(31,288)	(18,029)	(8,642)	(8,596)
Net increase in cash & cash equivalents	(2,939)	4,098	19,270	27,887	29,162
Cash & cash equivalents at beginning of year	19,410	16,666	20,791	40,081	67,983
Effect of changes in foreign exchange rate	195	27	20	15	12
Cash & cash equivalents at end of year	16,666	20,791	40,081	67,983	97,157

Source(s): Company, ABCI Securities estimates



Financial Ratios (2018A-2022E)

As of Dec 31	2018A	2019A	2020E	2021E	2022E
EBITDA margin (%)	29.7	32.8	32.9	33.3	33.6
Operating margin (%)	8.2	8.1	7.9	8.0	8.1
Net profit margin (%)	5.6	5.5	5.5	5.7	5.9
ROAA (%)	3.2	3.0	2.9	2.9	3.1
ROAE (%)	6.3	5.9	5.8	5.9	6.0
% of revenue					
D&A	21.5	24.6	25.0	25.3	25.5
Network operation & support	33.1	30.7	30.5	30.2	30.0
Selling G&A	17.0	16.0	16.1	16.0	15.8
Personnel expenses	17.0	17.8	17.8	17.6	17.6
YoY Growth:					
Service revenue (%)	5.9	2.0	2.1	1.6	2.0
EBITDA (%)	2.0	12.5	2.6	2.7	2.5
Net profit (%)	13.9	(3.3)	2.1	4.7	4.6

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 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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