

China Tower Corporation Ltd. (788 HK) Increased 5G CAPEX to benefit business; upgrade to BUY

- China Tower is expected to benefit from the rollout of 5G services in China. Telecom operators will speed up their 5G network development in 2020.
- We estimate revenue to grow by 7.9% YoY in 2020, driven by improved tenancy ratio and average revenue per tower
- We project the Group's tenancy ratio to grow from 1.70 to 1.78 in 2020E-22E
- Our TP of HK\$2.20 represents 5.5x/5.1x FY20E/21E EV/EBITDA, implying a 39.2% upside potential

We expect tower tenancy ratio to rise from 1.62 in 2019 to 1.78 in 2022E. China Mobile (941 HK) has announced its 2020 CAPEX estimate at RMB179.8 bn (including RMB 100bn for 5G CAPEX). The government has emphasized 5G network to be one of the core infrastructures to stimulate domestic consumption for economic recovery.

We estimate revenue to grow by 7.9%/ 7.7% YoY in 2020-21E. China Tower's average tower co-sharing. We expect average revenue per tower to grow 2.0%/ 2.9% in 2020E-21E.

We project net profit to grow at a CAGR of 27.5% in 2019-22E. Driven by tenancy ratio improvement and scale effect, China Tower is expected to improve its net profit margin by 1.9ppt/ 1.5ppt YoY to 8.7%/ 10.2% in 2020E-21E.

Valuation. We revise up FY20/FY21 net profit by 2.5%/ 3.1% to reflect the larger-than-expected 5G CAPEX by China Mobile. Our TP of HK\$ 2.20 implies 5.5x/5.1x FY20E/21E EV/EBITDA. Recommend **BUY** with a 39.2% upside potential.

Risk factors: (1) Markup margin may change; (2) Delay in 5G network launch; (3) Business relies heavily on three major telecom operators; (4) Tenancy ratio may deviate from expectation.

Results and Valuation

| FY ended Dec 31 | FY18A | FY19A | FY20E | FY21E | FY22E |
|----------------------------------|--------|--------|--------|--------|--------|
| Revenue (RMB mn) | 71,819 | 76,428 | 82,441 | 88,819 | 95,091 |
| Chg (% YoY) | 4.6 | 6.4 | 7.9 | 7.7 | 7.1 |
| Net profit ¹ (RMB mn) | 2,650 | 5,222 | 7,168 | 9,065 | 10,831 |
| Chg (% YoY) | 36.4 | 97.1 | 37.3 | 26.5 | 19.5 |
| EPS (RMB) | 0.018 | 0.030 | 0.041 | 0.051 | 0.062 |
| Chg (% YoY) | 18.8 | 66.6 | 37.0 | 26.5 | 19.5 |
| BPS (RMB) | 1.22 | 1.04 | 1.06 | 1.09 | 1.13 |
| Chg (% YoY) | 23.3 | (14.5) | 2.3 | 2.9 | 3.3 |
| P/E (x) | 82.7 | 50.3 | 37.1 | 29.4 | 24.6 |
| P/B (x) | 1.21 | 1.44 | 1.42 | 1.38 | 1.34 |
| ROAE (%) | 1.7 | 2.9 | 3.9 | 4.8 | 5.5 |
| ROAA (%) | 0.8 | 1.6 | 2.0 | 2.2 | 2.4 |
| DPS (RMB cents) | 0.267 | 1.458 | 2.036 | 2.575 | 3.077 |
| Dividend Yield (%) | N/A | 0.98 | 1.35 | 1.70 | 2.03 |

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

¹Net profit = Net profit attributable to shareholders of the Company

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Mar 26, 2020

Rating: **BUY**
TP: HK\$ 2.20

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| | |
|-------------------------|--------------|
| Share price (HK\$) | 1.68 |
| Est. share price return | 31.0% |
| Est. dividend yield | 1.4% |
| Est. total return | 32.4% |
| Previous Rating & TP | HOLD/HK\$2.0 |
| Previous Report Date | Aug 9, 2019 |

Source(s): Bloomberg, ABCI Securities estimates

Key Data

| | |
|------------------------------|-----------|
| 52Wk H/L(HK\$) | 2.33/1.45 |
| Issued shares (mn) | 176,008 |
| Issued H-shares (mn) | 46,664 |
| H-share market cap (HK\$ mn) | 78,396 |
| Avg daily turnover (HK\$ mn) | 1,789 |
| Major shareholder(s) | |
| China Mobile | 28.5% |
| China Unicom | 21.1% |
| China Telecom | 20.9% |

Source(s): Company, ABCI Securities

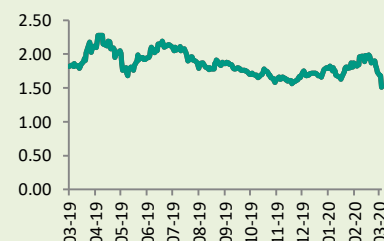
Share Performance (%)

| | Absolute | Relative* |
|-------|----------|-----------|
| 1-mth | (17.9) | 3.0 |
| 3-mth | (10.7) | 13.6 |
| 6-mth | (19.3) | (2.5) |

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Share performance (HK\$)

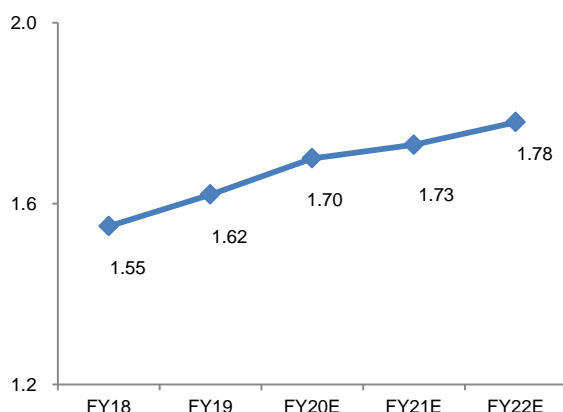


Source(s): Bloomberg, ABCI Securities

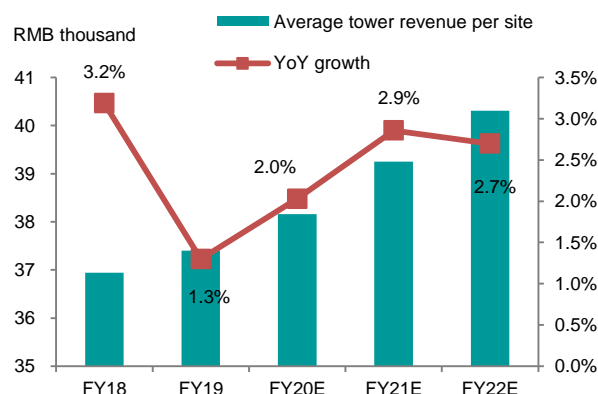
FY19 net profit missed our forecasts due to lower-than-expected average revenue per tower in FY19. Revenue and net profit grew 6.4% and 97.1% YoY in FY19 on improved margin and the change in accounting method. The accounting change was mainly related to the operating lease and lease liabilities.

Tower tenancy ratio improved 4.5% YoY to 1.62, driven by 5G network. The average revenue per tower site grew 1.3% YoY to RMB 37,400 in FY19. We estimate average revenue per tower site to grow 2.0%/ 2.9% YoY in FY20E-21E.

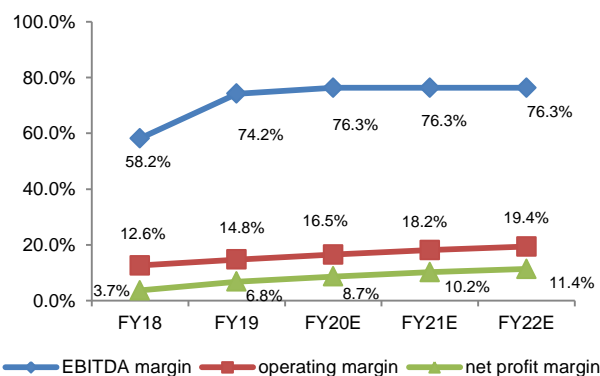
Telecom operators are speeding up the development of 5G network in China, aiming to reach the year-end target by 3Q20; this will benefit the Group on stronger demand for macro towers. Multiple authorities in China have emphasized the need to expedite 5G development to stimulate domestic consumption, alleviating the negative impacts of the virus outbreak on the domestic economy. China Tower is expected to spend RMB 17.8bn in 5G CAPEX (Total 2020 CAPEX: RMB 28bn) this year for construction of new towers for 5G. We estimate tenancy ratio to improve from 1.62 in 2019 to 1.78 in 2022E. China Mobile has announced its 2020 CAPEX budget of RMB 179.8bn in 2020 (including RMB100bn for 5G). As the 5G network requires a much denser base station distribution, the aggressive 5G development plan of China Mobile will benefit the Group with higher tower leasing revenue.

Exhibit 1: China Tower's tenancy ratio


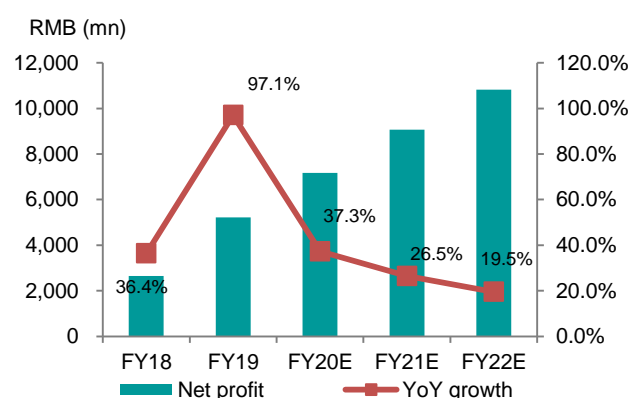
Source(s): Company, ABCI Securities estimates

Exhibit 2: China Tower's average tower revenue per tower


Source(s): Company, ABCI Securities estimates

Exhibit 3: China Tower's profit margins


Source(s): Company, ABCI Securities estimates

Exhibit 4: China Tower's net profit and YoY growth


Source(s): Company, ABCI Securities estimates

We revised up China Tower's FY20E/FY21E revenue by 2.1%/ 2.9%, based on our adjustment in average revenue per tower forecasts and tenancy ratio. Hence, net profit and EPS are changed accordingly. We revise up FY20E/FY21E net profit by 2.5% and 3.1% to reflect the higher 5G CAPEX estimate by China Mobile.

Exhibit 5: Changes in our financial estimates

| (RMB Bn) | OLD | | | NEW | | | CHANGE | | |
|------------|--------|--------|-------|--------|--------|--------|--------|-------|-------|
| | FY20E | FY21E | FY22E | FY20E | FY21E | FY22E | FY20E | FY21E | FY22E |
| Revenue | 80,745 | 86,316 | N/A | 82,441 | 88,819 | 95,091 | 2.10% | 2.90% | N/A |
| Net Profit | 6,993 | 8,792 | N/A | 7,168 | 9,065 | 10,831 | 2.50% | 3.10% | N/A |
| EPS (RMB) | 0.040 | 0.050 | N/A | 0.041 | 0.051 | 0.062 | 2.50% | 3.10% | N/A |
| EBITDA | 61,365 | 65,727 | N/A | 62,899 | 67,765 | 72,549 | 2.50% | 3.10% | N/A |

Source(s): Company, ABCI Securities estimates

Recommend BUY with TP at HK\$2.20

We raised our TP from HK\$2.00 to HK\$2.20. The new TP implying 5.5x/5.1x FY20E/21E EV/EBITDA based on DCF valuation (WACC: 13.0%; perpetuity growth rate: 2%). With a 39.2% upside potential, we recommend **BUY** for China Tower. Our EBITDA has a 27% difference with the market consensus, which may result in difference of EV/EBITDA with market consensus.

Exhibit 6: Peer comparison table

| | | P/E | | | | | P/B | | | | ROE | ROA | EV/EBITDA |
|-------------------------|---------|--------|------|------|------|------|------|------|------|------|-------|-----|-----------|
| | Ticker | Price | 18A | 19A | 20E | 21E | 18A | 19A | 20E | 21E | 20E | 20E | 20E |
| China Market | | | | | | | | | | | | | |
| China Unicom | 762 HK | 4.57 | 11.5 | 10.7 | 9.3 | 8.1 | 0.4 | 0.4 | 0.4 | 0.4 | 4.4 | 2.4 | 1.2 |
| China Mobile | 941 HK | 56.10 | 8.3 | 9.6 | 9.9 | 9.7 | 1.0 | 0.9 | 0.9 | 0.9 | 9.6 | 6.5 | 2.6 |
| China Telecom | 728 HK | 2.34 | 7.4 | 8.1 | 8.0 | 7.8 | 0.5 | 0.5 | 0.5 | 0.4 | 6.1 | 3.3 | 2.0 |
| China Tower | 788 HK | 1.68 | 78.2 | 49.3 | 34.6 | 26.3 | 1.4 | 0.4 | 1.4 | 1.4 | 4.0 | 2.3 | 5.8 |
| Simple Average | | | 26.4 | 19.4 | 15.5 | 13.0 | 0.8 | 0.5 | 0.8 | 0.8 | 6.0 | 3.6 | 2.9 |
| Weighted Average | | | 20.0 | 16.0 | 13.7 | 12.1 | 0.9 | 0.8 | 0.9 | 0.9 | 7.9 | 5.1 | 2.9 |
| US Market | | | | | | | | | | | | | |
| AT&T | T US | 31.15 | 10.1 | 19.9 | 17.4 | 14.0 | 2.9 | 2.7 | 2.3 | 2.0 | 15.3 | 6.7 | 13.5 |
| Verizon | VZ US | 53.62 | 13.4 | 10.8 | 10.2 | 9.8 | 3.9 | 3.4 | 2.9 | 2.6 | 30.9 | 7.0 | 6.4 |
| Sprint | S US | 8.01 | 4.1 | n.a. | n.a. | n.a. | 1.2 | 1.2 | 1.2 | 1.3 | (0.6) | 0.5 | 6.2 |
| T-Mobile | TMUS US | 79.45 | 22.3 | 18.6 | 16.7 | n.a. | 2.6 | 2.3 | 2.0 | 1.8 | 11.5 | 3.3 | 6.2 |
| American Tower | AMT US | 209.00 | 64.2 | 41.9 | 39.3 | 34.4 | 14.8 | 15.7 | 18.7 | 31.3 | 41.6 | 4.1 | 20.2 |
| Simple Average | | | 22.8 | 22.8 | 20.9 | 19.4 | 5.1 | 5.0 | 5.4 | 7.8 | 19.7 | 4.3 | 10.5 |
| Weighted Average | | | 23.5 | 19.3 | 17.9 | 16.4 | 5.5 | 5.3 | 5.6 | 7.8 | 26.4 | 5.3 | 9.5 |

Note: Data priced on Mar 25, 2020

Source(s): Bloomberg's market consensus



Consolidated income statement (2018A-2022E)

| FY Ended Dec 31 (RMB mn) | 2018A | 2019A | 2020E | 2021E | 2022E |
|--------------------------------|---------------|---------------|---------------|---------------|---------------|
| Tower business revenue | 68,597 | 71,406 | 74,364 | 76,828 | 79,032 |
| DAS revenue | 1,819 | 2,658 | 3,854 | 5,396 | 7,014 |
| TSSAI revenue | 1,222 | 1,887 | 3,680 | 5,998 | 8,397 |
| Others | 181 | 477 | 543 | 598 | 647 |
| Total revenue | 71,819 | 76,428 | 82,441 | 88,819 | 95,091 |
| D&A expenses | (32,692) | (45,415) | (49,275) | (51,640) | (54,119) |
| Site operating lease charges | (12,196) | (639) | (689) | (743) | (795) |
| Repairs and maintenance | (6,165) | (5,993) | (6,348) | (6,839) | (7,322) |
| Employee benefits and expenses | (4,917) | (5,863) | (4,699) | (5,063) | (5,420) |
| Other operating expenses | (6,768) | (7,237) | (7,806) | (8,410) | (9,004) |
| Other gains | 153 | 154 | 179 | 207 | 240 |
| Interest income | 248 | 63 | 37 | 248 | 493 |
| Finance costs | (6,007) | (4,661) | (4,496) | (4,761) | (5,043) |
| Profit before tax | 3,475 | 6,837 | 9,344 | 11,818 | 14,120 |
| Tax | (825) | (1,616) | (2,177) | (2,754) | (3,290) |
| Net profit* | 2,650 | 5,222 | 7,168 | 9,065 | 10,831 |
| MI | 0 | (1) | (1) | (1) | (1) |
| EBITDA | 41,773 | 56,696 | 62,899 | 67,765 | 72,549 |
| EPS (RMB) | 0.018 | 0.030 | 0.041 | 0.051 | 0.062 |
| Costs ratios: | | | | | |
| % to revenue | | | | | |
| D&A expenses | 45.5% | 59.4% | 44.1% | 43.9% | 43.9% |
| Site operating lease charges | 17.0% | 0.8% | 0.8% | 0.8% | 0.8% |
| Repairs and maintenance | 8.6% | 7.8% | 7.7% | 7.7% | 7.7% |
| Employee benefits and expenses | 6.8% | 7.7% | 5.7% | 5.7% | 5.7% |
| Other operating expenses | 9.4% | 9.5% | 9.5% | 9.5% | 9.5% |
| Business composition: | | | | | |
| Tower business | 95.5% | 93.4% | 90.2% | 86.5% | 83.1% |
| DAS business | 2.5% | 3.5% | 4.7% | 6.1% | 7.4% |
| TSSAI business | 1.7% | 2.5% | 4.5% | 6.8% | 8.8% |
| Others | 0.3% | 0.6% | 0.7% | 0.7% | 0.7% |

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

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2018A-2022E)

| As of Dec 31 (RMB mn) | 2018A | 2019A | 2020E | 2021E | 2022E |
|--------------------------------------|----------------|----------------|----------------|----------------|----------------|
| PPE | 249,055 | 239,925 | 251,901 | 256,449 | 259,398 |
| CIP | 12,193 | 12,263 | 10,424 | 8,860 | 7,531 |
| Deferred income tax assets | 706 | 1,199 | 839 | 588 | 411 |
| Other non-current assets | 21,611 | 43,685 | 47,911 | 52,434 | 57,272 |
| Total non-current assets | 283,565 | 297,072 | 311,075 | 318,330 | 324,613 |
| Cash & cash equivalents | 4,836 | 6,223 | 41,357 | 82,089 | 128,389 |
| Trade and other receivables | 19,158 | 26,258 | 24,945 | 23,698 | 22,513 |
| Prepayments & other current assets | 7,805 | 8,514 | 9,365 | 10,302 | 11,332 |
| Total current assets | 31,799 | 40,995 | 75,668 | 116,089 | 162,234 |
| Total assets | 315,364 | 338,067 | 386,743 | 434,419 | 486,847 |
| Interest bearing borrowings | 79,946 | 87,019 | 92,240 | 97,775 | 103,641 |
| Accounts payable | 30,591 | 29,313 | 27,847 | 26,455 | 25,132 |
| Others | 4,222 | 12,032 | 51,247 | 88,150 | 128,531 |
| Total current liabilities | 114,759 | 128,364 | 171,335 | 212,379 | 257,304 |
| Borrowings | 19,064 | 8,480 | 8,904 | 9,349 | 9,817 |
| Others | 1,039 | 18,662 | 19,336 | 20,042 | 20,778 |
| Total non-current liabilities | 20,103 | 27,142 | 28,240 | 29,391 | 30,595 |
| Total liabilities | 134,862 | 155,506 | 199,575 | 241,770 | 287,899 |
| Total equity | 180,502 | 182,561 | 187,168 | 192,649 | 198,948 |

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 tax | 3,475 | 6,837 | 9,344 | 11,818 | 14,120 |
| Others | 42,065 | 24,148 | 49,974 | 52,432 | 55,012 |
| Operating cash flow | 45,540 | 30,985 | 59,317 | 64,250 | 69,132 |
| CAPEX | (32,713) | (22,812) | (26,000) | (24,700) | (23,465) |
| Others | (210) | (227) | (245) | (265) | (286) |
| Investing cash flow | (32,923) | (23,039) | (26,245) | (24,965) | (23,751) |
| Change in borrowings | 19,064 | 8,480 | 8,904 | 9,349 | 9,817 |
| Others | (34,698) | (15,039) | (6,843) | (7,902) | (8,898) |
| Financing cash flow | (15,634) | (6,559) | 2,061 | 1,447 | 918 |
| Net increase in cash and cash equivalents | (3,017) | 1,387 | 35,134 | 40,732 | 46,299 |
| Cash and cash equivalents at beginning of year | 7,852 | 4,836 | 6,223 | 41,357 | 82,089 |
| Cash and cash equivalents at end of year | 4,836 | 6,223 | 41,357 | 82,089 | 128,389 |
| Financial ratio: | | | | | |
| <u>Growth rate:</u> | | | | | |
| Revenue | 4.6% | 6.4% | 7.9% | 7.7% | 7.1% |
| Net profit | 36.4% | 97.1% | 37.3% | 26.5% | 19.5% |
| EBITDA | 3.5% | 35.7% | 10.9% | 7.7% | 7.1% |
| ROAE | 1.7% | 2.9% | 3.9% | 4.8% | 5.5% |
| ROAA | 0.8% | 1.6% | 2.0% | 2.2% | 2.4% |
| EBITDA margin | 58.2% | 74.2% | 76.3% | 76.3% | 76.3% |
| Operating profit margin | 12.6% | 14.8% | 16.5% | 18.2% | 19.4% |
| Net profit margin | 3.7% | 6.8% | 8.7% | 10.2% | 11.4% |

Source(s): Company, ABCI Securities estimates

Disclosures

Analyst Certification

I, Lai Pak Kin, Ricky, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

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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 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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