



China Telecom (728 HK/601728 CH) Industrial digitalization business supported by policies

- China Telecom ("Group") is expected to benefit from the development of digital economy strategy in China
- 5G user penetration rate to reach 82.0% in 2023E
- Industrial digitalization business revenue to grow 22.0% YoY in 2023E
- Dividend payout ratio to increase to 70.0% in 2023E
- Recommend BUY with TP of HK\$4.80 for China Telecom-H (728 HK), which implies 2.2x 2023E EV/EBITDA, and BUY for China Telecom-A (601728 CH) with TP of RMB7.70, equivalent to 4.3x 2023E EV/EBITDA

Company Report

Apr 13, 2023

Rating (HK): BUY
Rating (A): BUY
TP(HK): HK\$ 4.80
TP(A): RMB 7.70

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Mobile communications service revenue to grow 14.1% YoY in 2023E. Thanks to the 5G network sharing with China Unicom (762 HK), the Group's overall mobile and 5G users are expected to reach 406.2mn and 333.0mn in 2023E. 5G user penetration rate would hit 82.0% in 2023E.

Industrial digitalization business supported by policies. The 2023 Government Report emphasized the development of digital economy, which can benefit the Group with higher demand for data center and telecom service. We forecast industrial digitalization business revenue to grow 22.0% YoY in 2023E.

Benefit from lower D&A expense-to-revenue ratio. As the revenue growth is much faster than D&A expense growth, the D&A expense-to-revenue ratio is trending down. We expect D&A expense-to-revenue ratio to dip 0.8ppt to 19.3% in 2023E. Net profit would grow 26.1% YoY in 2023E.

Valuation. We recommend **BUY** for both H/A-shr with TP at HK\$ 4.80/ RMB 7.70. H-shr TP implies 2.2x 2023E EV/EBITDA, while A-shr TP represents 4.3x 2023E EV/EBITDA.

Risk factors: 1) Slower-than-expected 5G and industrial digitalization business development; 2) User saturation; 3) Further reduction in mobile data tariff by regulators; 4) Fierce market competitions.

Price (H/A shr)	HK\$4.35/ RMB7.02
Est. s price return (H/A shr)	10.34%/ 9.69%
Est. dividend yield (H/A shr)	5.52%/ 3.80%
Est. total return (H/A shr)	15.86%/ 13.49%
Last Rating & TP (H/A shr)	BUY HK\$4.20/ BUY RMB5.10
Previous Report Date	Nov 4, 2022

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (HK\$) (H-shr)	4.53/2.39
52Wk H/L (RMB) (A-shr)	7.51/3.65
Total issued shares (mn)	91,507.1
Issued H shr (mn)	13,877.4
Issued A shr (mn)	77,629.7
H-shr market cap (HK\$ mn)	60,366.7
A-shr market cap (RMB mn)	544,960.7

Source(s): Bloomberg

Major shareholder(s):

China Telecom Cop.	63.14%
Guangdong Rising	6.14%
Zhejiang Provincial	2.28%

Source(s): Group

Results and Valuation

FY ended Dec 31	2021A	2022A	2023E	2024E	2025E
Revenue (RMB mn)	439,553	481,448	552,104	618,090	678,468
Chg (% YoY)	14.8	9.5	14.7	12.0	9.8
Shareholders' profit (RMB mn)	25,949	27,593	34,796	42,067	48,697
Chg (% YoY)	70.9	6.3	26.1	20.9	15.8
EPS (RMB)	0.307	0.302	0.380	0.460	0.532
Chg (% YoY)	63.8	(1.9)	26.1	20.9	15.8
BPS (RMB)	5.077	4.722	4.906	5.099	5.308
Chg (% YoY)	13.0	(7.0)	3.9	3.9	4.1
P/E (x) –HK shr	12.74	12.98	10.30	8.52	7.36
P/E (x) –A shr	22.84	23.28	18.46	15.27	13.19
P/B (x) –HK shr	0.77	0.83	0.80	0.77	0.74
P/B (x) –A shr	1.38	1.49	1.43	1.38	1.32
ROE (%)	6.6	6.4	7.9	9.2	10.2
ROA (%)	3.5	3.5	4.2	5.0	5.5
DPS (RMB)	0.184	0.196	0.267	0.323	0.374
Dividend Yield (%) –H-shr	3.81	4.06	5.52	6.68	7.73
Dividend Yield (%) –A-shr	2.62	2.79	3.80	4.60	5.32

*Exchange rate assumption for FY23E-25E: 1 HKD = 0.9 RMB

Source(s): Bloomberg, ABCI Securities estimates



5G user penetration rate is expected to reach 82.0% in 2023E

China Unicom is re-farming its 900MHz spectrum for 5G network usage. The Group will benefit from their strategic partnership in 5G network sharing. We expect the Group to add 65.0mn 5G users in 2023E, with 5G user penetration rate to hit 82.0%. The higher 5G penetration rate will drive up 2023E mobile ARPU to RMB 45.6, up 0.8% YoY. We revise up mobile communications service revenue by 6.8%/5.1% for 2023-24E.

Industrial digitalization business supported by policies

The 2023 Government Report has emphasized the development of digital economy, which will drive up data center and telecom service demand. More and more enterprises will transform their business to the cloud platforms to improve efficiency and reduce operating expenses. We revise up 2023-24E industrial digitalization business revenue by 3.4%/12.4%.

Benefit from lower D&A expense-to-revenue ratio

As the revenue growth (14.7% in 2023E; 12.0% in 2024E) is much faster than D&A expense growth (9.9% in 2023E; 9.1% in 2024E), the D&A expense-to-revenue ratio is trending down. The D&A expense-to-revenue ratio is expected to dip 0.8ppt/0.5ppt to 19.3%/18.8% in 2023-24E, which is 0.4ppt/0.2ppt lower than our previous forecast. Net profit margin is expected to improve 0.6ppt YoY to 6.3% in 2023E.

Exhibit 1: Major assumptions for our forecasts

	2021	2022	2023E	2024E	2025E
Overall mobile users (mn)	372.4	391.2	406.2	416.2	424.2
YoY	6.1%	5.0%	3.8%	2.5%	1.9%
5G users (mn)	187.8	268.0	333.0	383.0	423.0
YoY	117.1%	42.7%	24.3%	15.0%	10.4%
Mobile ARPU (RMB)	45.0	45.2	45.6	46.0	46.3
YoY	2.0%	0.4%	0.8%	1.0%	0.7%
Fixed line broadband users (mn)	169.7	180.9	190.9	198.2	199.2
YoY	7.1%	6.6%	5.5%	3.8%	0.5%
Fixed line ARPU (RMB)	45.9	46.4	47.2	47.8	48.1
YoY	3.4%	1.1%	1.7%	1.2%	0.8%

Source(s): Group, ABCI Securities estimates

Exhibit 2: Changes in our financial estimates

	OLD			NEW			CHANGE		
(RMB mn)	2023E	2024E	2025E	2023E	2024E	2025E	2023E	2024E	2025E
Revenue	538,879	586,481	N/A	552,104	618,090	678,468	2.5%	5.4%	N/A
Net Profit	32,356	37,883	N/A	34,796	42,067	48,697	7.5%	11.0%	N/A
EPS (RMB)	0.354	0.414	N/A	0.380	0.460	0.532	7.3%	11.1%	N/A

Source(s): Group, ABCI Securities estimates



Recommend BUY with HK/A share (728 HK/601728 CH)

We revise up 2023-24E net profit by 7.5%/11.0% due to the upward adjustment of mobile communications service and industrial digitalization service revenues, and lower D&A expense-to-revenue ratio. Our valuations for China Telecom-H/A (728 HK/601728CH) are based on DCF model (WACC: 12.3%/12.0%; perpetuity growth rate: 2.1%/2.1%). We recommend **BUY** for H-shr with TP at HK\$4.80, which implies 2.2x 2023E EV/EBITDA; **BUY** for A-shr with TP at RMB7.70, representing 4.3x 2023E EV/EBITDA.

Exhibit 3: EV/EBITDA calculations

	H-Share	A-Share
If share price at	HKD 4.80	RMB 7.70
Issued shares (mn)	91,507.1	91,507.1
Market cap (mn)	HKD 439,234.3	RMB 704,605.0
RMB/HKD	0.9	N/A
Market cap (mn)	RMB 395,310.8	RMB 704,605.0
- cash and cash equivalents in 2023E (RMB mn)	82,510.6	82,510.6
+ Short term and long term bank loans (RMB mn)	9,804.8	9,804.8
+ non-controlling interests (RMB mn)	4,289.3	4,289.3
Enterprise Value (RMB mn)	326,894.3	636,188.5
EBITDA in 2023E (RMB mn)	149,178.5	149,178.5
EV/EBITDA	2.2	4.3

Source(s): ABCI Securities estimates



Consolidated income statement (2021A-25E)

FY Ended Dec 31 (RMB mn)	2021A (Restated)	2022A	2023E	2024E	2025E
Mobile communications service revenues	184,158	191,026	217,974	227,056	233,650
Wireline and smart family service revenues	113,522	118,534	124,342	129,689	134,228
Industrial digitalization service revenues	98,945	117,756	143,662	179,578	213,698
Other service revenues	6,203	7,612	8,906	10,242	11,778
Sales of goods and others	36,725	46,520	57,220	71,525	85,114
Total revenue	439,553	481,448	552,104	618,090	678,468
Depreciation and amortisation	(92,966)	(96,932)	(106,556)	(116,201)	(124,160)
Network operations & support	(133,340)	(147,589)	(170,048)	(190,990)	(210,325)
Selling, general & administrative	(61,154)	(64,277)	(72,215)	(79,115)	(85,487)
Personnel expenses	(76,057)	(84,772)	(97,722)	(109,402)	(120,767)
Other operating expenses	(45,088)	(54,451)	(62,940)	(70,462)	(77,345)
Operating Profit	30,948	33,427	42,622	51,920	60,384
Investment income and others	2,244	243	265	289	315
Share of profits of associates and Joint ventures	1,966	2,051	2,143	2,229	2,318
Net finance costs	(1,293)	(7)	(7)	(6)	(6)
Profit before taxation	33,865	35,714	45,024	54,431	63,011
Income tax	(7,716)	(8,038)	(10,133)	(12,251)	(14,182)
Profit for the year	26,149	27,676	34,891	42,181	48,829
Shareholders' profit	25,949	27,593	34,796	42,067	48,697
Non-controlling interests	200	83	94	114	132
EBITDA	123,914	130,359	149,179	168,120	184,543
EPS (RMB)	0.307	0.302	0.380	0.460	0.532
DPS (RMB)	0.184	0.196	0.267	0.323	0.374

Source(s): Group, ABCI Securities estimates



Consolidated balance sheet (2021A-25E)

As of Dec 31 (RMB mn)	2021A (Restated)	2022A	2023E	2024E	2025E
Property, plant and equipment, net	415,981	413,963	411,893	407,362	402,881
Construction in progress	51,457	58,443	63,703	65,614	66,926
Interests in associates and joint ventures	41,166	42,220	44,331	45,218	46,122
Right-of-use assets	61,187	87,055	91,408	93,693	95,567
Others	65,085	64,945	65,384	66,122	66,945
Total non-current assets	634,876	666,626	676,718	678,009	678,441
Cash & cash equivalents	73,284	72,465	82,511	103,514	126,896
Prepayments and other current assets	24,585	33,751	37,464	41,585	46,159
Accounts receivable, net	22,389	24,312	26,135	28,096	30,203
Others	7,105	10,544	11,301	12,141	13,076
Total current assets	127,363	141,072	157,410	185,335	216,334
Total assets	762,239	807,698	834,129	863,344	894,775
Contract liabilities	70,914	67,841	61,057	54,951	49,456
Accounts payable	114,893	127,260	134,896	142,989	151,569
Short-term debts	2,821	2,840	2,925	3,013	3,103
Current portion of long-term debts	6,280	3,160	2,844	2,560	2,304
Others	70,163	80,636	84,967	89,535	93,262
Total current liabilities	265,071	281,737	286,689	293,048	299,694
Lease liabilities	28,594	52,408	56,077	60,002	64,202
Deferred tax liabilities	26,677	27,945	29,063	30,225	31,434
Long-term debts	7,395	4,484	4,036	3,632	3,269
Others	3,329	4,697	5,026	5,378	5,754
Total non-current liabilities	65,995	89,534	94,201	99,237	104,659
Total liabilities	331,066	371,271	380,890	392,285	404,353
Total equity attributable to equity holders of the Company	428,678	432,089	448,949	466,593	485,764
Non-controlling interests	2,495	4,338	4,289	4,466	4,659
Total equity	431,173	436,427	453,239	471,059	490,423

Source(s): Group, ABCI Securities estimates



Consolidated Cash Flow Statement (2021A-25E)

As of Dec 31 (RMB mn)	2021A (Restated)	2022E	2023E	2024E	2025E
Operating profit before					
change in working capital	131,895	138,282	143,142	164,426	177,190
Change in working capital	9,973	3,079	(3,214)	(2,427)	(2,813)
Others	(617)	(691)	(768)	(850)	(935)
Income tax paid	(3,718)	(4,239)	(5,044)	(5,851)	(6,787)
Operating cash flow	137,533	136,432	134,116	155,298	166,655
CAPEX	(84,847)	(92,500)	(95,275)	(98,133)	(101,077)
Others	4,559	(4,296)	1,566	1,333	1,064
Investing cash flow	(80,288)	(96,796)	(93,709)	(96,800)	(100,013)
Dividend paid	(8,439)	(26,537)	(17,936)	(24,423)	(29,526)
Change in bank and other loan	(35,564)	(2,892)	(363)	(316)	(273)
Proceeds from A Shares Offering, net of					
issuing expenses	47,516	0	0	0	0
Others	(11,031)	(11,477)	(12,404)	(13,016)	(13,658)
Financing cash flow	(7,518)	(40,906)	(30,704)	(37,755)	(43,457)
Net increase in cash and cash equivalents	49,727	(1,270)	9,702	20,743	23,185
Cash and cash equivalents at beginning of					
year	23,684	73,284	72,465	82,511	103,514
Effect of changes in foreign exchange rate	(127)	451	343	260	198
Cash and cash equivalents at end of year	73,284	72,465	82,511	103,514	126,896

Source(s): Group, ABCI Securities estimates

Financial Ratios

As of Dec 31 (RMB mn)	2021A	2022A	2023E	2024E	2025E
Profit margins:					
EBITDA margin (%)	9.5	5.2	14.4	12.7	9.8
Operating margin (%)	7.0	6.9	7.7	8.4	8.9
Net profit margin (%)	5.9	5.7	6.3	6.8	7.2
ROA (%)	3.5	3.5	4.2	5.0	5.5
ROE (%)	6.6	6.4	7.9	9.2	10.2
YoY Growth:					
Revenue (%)	14.8	9.5	14.7	12.0	9.8
EBITDA (%)	9.5	5.2	14.4	12.7	9.8
Net profit (%)	70.9	6.3	26.1	20.9	15.8

Source(s): Group, ABCI Securities estimates



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Rating	Definition
Buy	Stock return rate \geq Market return rate ($\sim 9\%$)
Hold	- Market return rate ($\sim 9\%$) \leq Stock return rate $<$ Market return rate ($\sim 9\%$)
Sell	Stock return $<$ - Market return ($\sim 9\%$)

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 2006 (HSI total return index 2006-22 averaged at 8.4%)

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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