

## China Unicom (762 HK)

### Digital economy demand to boost growth

- China Unicom (or "the Group") is expected to benefit from China's recent launch of the digital economy development strategy
- 5G user penetration rate to reach 79.7% in 2023E
- Industrial Internet business revenue to go up 24.0% YoY in 2023E
- Net profit margin to reach 5.6% YoY in 2023E
- Recommend BUY with TP of HK\$ 6.20, which implies 1.0x 2023E EV/EBITDA

**5G penetration rate to reach 79.7% in 2023E.** China Unicom added 57.8mn 5G users in 2022 and 5G penetration rate reached 65.9%. Driven by improved 5G network coverage with the co-operation with China Telecom and 900MHz frequency refarming, we forecast the Group to add another 47.0 mn 5G users in 2023E, driving 5G user penetration rate up to 79.7% in 2023E.

**Industrial Internet business revenue to grow 24.0% YoY in 2023E.** To develop the country's digital economy, there will be stronger demand for cloud computing and data centers. China Unicom is forming partnerships with four internet corporations to use its cloud platform. Driven by supporting policies and partnership agreement, we forecast Industrial Internet business revenue to go up 24.0% YoY in 2023E.

**Improving net profit margin.** Depreciation and amortization expenses-to-revenue ratio is estimated to lower by 0.1ppt YoY to 24.4% in 2023E due to reduced 5G depreciation expenses enabled by 5G network refarming. Net profit margin is projected to improve 0.9ppt YoY to 5.6% in 2023E.

**Valuation.** Recommend **BUY** with TP of HK\$6.20, implying 1.0x 2023E EV/EBITDA.

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

#### Results and Valuation

FY ended Dec 31	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	327,854	354,944	381,732	407,275	430,474
Chg (% YoY)	7.9	8.3	7.5	6.7	5.7
Net profit (RMB mn)	14,368	16,745	21,320	22,798	24,195
Chg (% YoY)	15.0	16.5	27.3	6.9	6.1
EPS (RMB)	0.470	0.547	0.697	0.745	0.791
Chg (% YoY)	15.0	16.5	27.3	6.9	6.1
BPS (RMB)	10.9	11.2	11.7	12.0	12.5
Chg (% YoY)	1.8	3.0	3.8	3.4	3.5
P/E (x)	11.0	9.4	7.4	6.9	6.5
P/B (x)	0.47	0.46	0.44	0.43	0.41
ROE (%)	4.4	5.0	6.2	6.4	6.5
ROA (%)	2.5	2.7	3.3	3.4	3.5
DPS (RMB)	0.22	0.27	0.35	0.37	0.40
Dividend Yield (%)	4.2	5.3	6.8	7.3	7.7

\*Exchange rate assumption for FY23-25E: 1 HKD=0.9 RMB

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

Mar 23, 2023

Rating: BUY

TP: HK\$ 6.20

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Share price (HK\$)	5.72
Est. share price return	8.4%
Est. dividend yield	6.8%
Est. total return	15.2%
Previous Rating & TP	BUY / HK\$6.7
Previous Report Date	Jan 6, 2023

Source(s): Bloomberg, ABCI Securities estimates

#### Key Data

52Wk H/L(HK\$)	6.54/3.27
Issued shares (mn)	30,598.1
Market cap (HK\$ mn)	175,021.3
Avg daily turnover (HK\$ mn)	832.1

#### Major shareholder(s)

China Unicom Group	53.3%
Capital Group Cos Inc	1.3%
Blackrock	1.0%

Source(s): Bloomberg

#### Share Performance (%)

	Absolute	Relative*
1-mth	(1.6%)	7.2%
3-mth	56.4%	51.1%
6-mth	53.5%	51.0%

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities



## 16.5% YoY growth in 2022 net profit

China Unicom recorded 16.5% YoY growth in 2022 net profit, driven by improvement in net profit margin (NPM) and revenue growth. Still, the net profit was 8.5% below our estimates, due to higher than expected general, administrative and other operating expenses. In 2022, the Group's 28.6% YoY growth in Industrial Internet business revenue was far higher than the 3.1% YoY growth in basic business revenue, thanks to strong demand from cloud computing and data centers. 2022 NPM improved 0.3ppt YoY to 4.7% due to lower depreciation and amortization expenses-to-revenue ratio.

## Industrial internet business revenue is projected to grow 24.0% in 2023E

In 2023, China is developing digital economy with stronger demand for cloud computing and data centers. China Unicom has formed strategic partnership with a number of internet corporations, including Tencent (700 HK), JD.com (9618 HK), Alibaba (9988 HK) and Baidu (9888 HK), for digital platform development, cloud computing, big data, among others. We revise up 2023-24E industrial Internet business revenue estimates by 2.9%/ 1.6%.

### Exhibit 1: China Unicom's Industrial Internet Revenue

RMB bn	2021	2022	2023E	2024E	2025E
Industrial Internet revenue	54.8	70.5	87.4	103.1	117.5
YoY	28.3%	28.6%	24.0%	18.0%	14.0%
% of total revenue	16.7%	19.9%	22.9%	25.3%	27.3%

Source(s): The Group, ABCI Securities estimates

## Net margin to benefit from better revenue growth and lower depreciation and amortization expenses-to-revenue ratio

We expect China Unicom to lower its 5G CAPEX through the partnership with China Telecom for 5G network sharing and 900MHz frequency refarming. Depreciation and amortization expenses-to-revenue ratio is estimated to dip 0.1ppt YoY to 24.4% in 2023E, thanks to the reduced 5G CAPEX enabled by 5G network refarming. We revise up 2023-24E depreciation and amortization expenses forecast by 1.0%/3.4%, due to the increment of depreciation and amortization expenses related to data centers. As such, we expect NPM to improve 0.9ppt YoY to 5.6% in 2023E.

### Exhibit 2: Major assumptions for our forecasts

	2021	2022	2023E	2024E	2025E
Overall mobile users (mn)	317.1	322.7	325.9	328.9	331.5
YoY	3.7%	1.8%	1.0%	0.9%	0.8%
5G users (mn)	154.9	212.7	259.7	289.7	320.7
YoY	118.7%	37.3%	22.1%	11.6%	10.7%
Mobile ARPU (RMB)	43.9	44.3	44.9	45.7	46.3
YoY	4.3%	0.9%	1.3%	1.8%	1.4%
Fixed line users (mn)	95.0	103.6	111.6	119.5	127.0
YoY	10.4%	9.0%	7.7%	7.1%	6.3%
Fixed line ARPU (RMB)	41.3	38.8	39.8	40.6	41.3
YoY	(0.5%)	(6.1%)	2.5%	2.0%	1.7%

Source(s): The Group, ABCI Securities estimates



### Exhibit 3: Changes in financial estimates

	OLD			NEW			CHANGE		
(RMB Bn)	2023E	2024E	2025E	2023E	2024E	2025E	2023E	2024E	2025E
Revenue	380,572	405,333	N/A	381,732	407,275	430,474	0.3%	0.5%	N/A
Net Profit	22,676	27,206	N/A	21,320	22,798	24,195	(6.0%)	(16.2%)	N/A
EPS (RMB)	0.741	0.889	N/A	0.697	0.745	0.791	(5.9%)	(16.2%)	N/A

Source(s): The Group, ABCI Securities estimates

### Recommend BUY with TP of HK\$6.20

We lower 2023-24E net profit by 6.0%/16.2% due to the upward adjustment of depreciation and amortization expenses forecast. The Group's TP is derived based on our DCF model (WACC: 12.8%; perpetuity growth rate: 2.2%), which represents 1.0x 2023E EV/EBITDA.

### Exhibit 4: EV/EBITDA calculations

If share price at	HKD 6.20
Issued shares (mn)	30,598.1
Market cap (HKD mn)	189,708.4
RMB/HKD	0.9
Market cap (RMB mn)	170,737.5
- cash and cash equivalents in 2023E (RMB mn)	68,217.3
+ Short term and long term bank loans (RMB mn)	1,696.3
+ non-controlling interests (RMB mn)	1,994.0
Enterprise Value (RMB mn)	106,209.8
EBITDA in 2023E (RMB mn)	110,084.9
EV/EBITDA	1.0

Source(s): ABCI Securities estimates



### Consolidated income statement (2021A-2025E)

FY Ended Dec 31 (RMB mn)	2021A	2022A	2023E	2024E	2025E
Total service revenue	296,153	319,348	344,000	367,619	389,153
Basic business revenue	241,373	248,890	256,633	264,525	271,625
Industrial internet revenue	54,780	70,458	87,368	103,094	117,527
Sales of telecommunications products	31,701	35,596	37,732	39,656	41,322
<b>Total revenue</b>	<b>327,854</b>	<b>354,944</b>	<b>381,732</b>	<b>407,275</b>	<b>430,474</b>
Interconnection charges	(11,557)	(10,947)	(10,307)	(9,367)	(9,040)
Depreciation and amortization	(85,652)	(86,829)	(93,143)	(98,153)	(103,314)
Network, operation & support expenses	(53,087)	(56,425)	(55,538)	(56,895)	(57,264)
Employee benefit expenses	(58,944)	(60,726)	(61,841)	(64,757)	(68,015)
Cost of telecom products sold	(30,683)	(34,720)	(35,543)	(37,396)	(39,008)
Finance cost	(1,385)	(1,095)	(1,387)	(1,426)	(1,467)
Interest income	1,215	1,747	2,100	2,510	3,172
Share of net profit of associates	1,862	2,153	2,691	3,364	4,205
Share of net profit of joint ventures	1,448	1,593	1,864	2,181	2,551
Selling and marketing expenses	(32,210)	(34,460)	(35,883)	(37,877)	(39,302)
General, administrative and other operating expenses	(45,053)	(58,497)	(72,536)	(85,593)	(97,576)
Other income — net	4,119	3,850	4,004	4,164	4,331
<b>Profit before income tax</b>	<b>17,927</b>	<b>20,588</b>	<b>26,214</b>	<b>28,031</b>	<b>29,749</b>
Income tax expenses	(3,420)	(3,751)	(4,776)	(5,108)	(5,421)
<b>Profit for the year</b>	<b>14,507</b>	<b>16,837</b>	<b>21,437</b>	<b>22,923</b>	<b>24,328</b>
<b>Net profit</b>	<b>14,368</b>	<b>16,745</b>	<b>21,320</b>	<b>22,798</b>	<b>24,195</b>
Non-controlling interests	139	92	117	125	133
<b>EBITDA</b>	<b>96,320</b>	<b>99,169</b>	<b>110,085</b>	<b>115,391</b>	<b>120,270</b>
<b>EPS (RMB)</b>	<b>0.470</b>	<b>0.547</b>	<b>0.697</b>	<b>0.745</b>	<b>0.791</b>
<b>DPS (RMB)</b>	<b>0.216</b>	<b>0.274</b>	<b>0.350</b>	<b>0.375</b>	<b>0.398</b>

Source(s): The Group, ABCI Securities estimates

### EBITDA calculations (2021A-2025E)

FY Ended Dec 31 (RMB mn)	2021A	2022A	2023E	2024E	2025E
Profit before income tax	17,927	20,588	26,214	28,031	29,749
Adjustment for:					
Other income - net	4,119	3,850	4,004	4,164	4,331
Share of net profit of joint ventures	1,448	1,593	1,864	2,181	2,551
Share of net profit of associates	1,862	2,153	2,691	3,364	4,205
Interest income	1,215	1,747	2,100	2,510	3,172
Finance cost	(1,385)	(1,095)	(1,387)	(1,426)	(1,467)
D&A	(85,652)	(86,829)	(93,143)	(98,153)	(103,314)
<b>EBITDA</b>	<b>96,320</b>	<b>99,169</b>	<b>110,085</b>	<b>115,391</b>	<b>120,270</b>

Source(s): The Group, ABCI Securities estimates



**Consolidated balance sheet (2021A-2025E)**

As of Dec 31 (RMB mn)	2021A	2022A	2023E	2024E	2025E
PPE	355,031	352,433	345,384	338,477	331,707
Interest in associates	41,278	42,469	43,318	44,185	45,068
Right-of-use assets	32,866	59,227	69,227	70,612	72,024
Other non-current assets	35,673	42,291	42,662	43,350	44,312
<b>Total non-current assets</b>	<b>464,848</b>	<b>496,420</b>	<b>500,592</b>	<b>496,623</b>	<b>493,112</b>
Cash & cash equivalents	34,280	55,297	68,217	89,539	111,470
Accounts receivables	17,957	26,331	27,121	27,935	28,773
Prepayments and other current assets	17,925	21,155	21,790	22,443	23,117
Financial assets measured at fair value	29,011	19,593	18,613	17,683	16,799
Others	27,055	23,867	24,575	25,340	26,163
<b>Total current assets</b>	<b>126,228</b>	<b>146,243</b>	<b>160,316</b>	<b>182,940</b>	<b>206,321</b>
<b>Total assets</b>	<b>591,076</b>	<b>642,663</b>	<b>660,908</b>	<b>679,563</b>	<b>699,432</b>
Accounts payable and accrued liabilities	140,124	154,838	160,257	165,866	171,672
Short-term bank loans	385	331	321	311	302
Contract liabilities	45,704	44,714	42,478	40,354	38,337
Others	49,972	50,987	52,629	54,250	56,053
<b>Total current liabilities</b>	<b>236,185</b>	<b>250,870</b>	<b>255,685</b>	<b>260,782</b>	<b>266,364</b>
Lease liabilities	10,415	36,429	37,522	38,648	39,807
Long-term bank loans	1,835	1,528	1,375	1,238	1,114
Deferred revenue	6,951	7,832	8,224	8,635	9,067
Others	2,257	2,468	1,553	1,564	1,580
<b>Total non-current liabilities</b>	<b>21,458</b>	<b>48,257</b>	<b>48,673</b>	<b>50,084</b>	<b>51,567</b>
<b>Total liabilities</b>	<b>257,643</b>	<b>299,127</b>	<b>304,359</b>	<b>310,866</b>	<b>317,931</b>
Equity attributable to ordinary shareholders	332,337	341,619	354,555	366,635	379,368
Non-controlling interests	1,096	1,917	1,994	2,062	2,133
<b>Total equity</b>	<b>333,433</b>	<b>343,536</b>	<b>356,549</b>	<b>368,696</b>	<b>381,501</b>

Source(s): The Group, ABCI Securities estimates



### Consolidated Cash Flow Statement (2021A-2025E)

As of Dec 31 (RMB mn)	2021A	2022E	2023E	2024E	2025E
Operating profit before change in working capital	17,927	20,588	26,214	28,031	29,749
Change in working capital	7,871	(39,657)	(30,349)	(24,374)	(19,464)
Others	89,831	124,455	111,096	117,929	123,038
Tax	(4,993)	(4,846)	(6,164)	(6,533)	(6,888)
<b>Operating cash flow</b>	<b>110,636</b>	<b>100,540</b>	<b>100,798</b>	<b>115,053</b>	<b>126,435</b>
CAPEX	(72,047)	(74,200)	(76,900)	(80,745)	(84,782)
Others	(2,737)	2,001	1,262	1,394	1,536
<b>Investing cash flow</b>	<b>(74,784)</b>	<b>(72,199)</b>	<b>(75,638)</b>	<b>(79,351)</b>	<b>(83,246)</b>
Dividend paid	(8,690)	(6,609)	(8,384)	(10,719)	(11,462)
Others	(15,889)	(644)	(3,792)	(3,604)	(9,745)
<b>Financing cash flow</b>	<b>(24,579)</b>	<b>(7,253)</b>	<b>(12,176)</b>	<b>(14,323)</b>	<b>(21,206)</b>
<b>Net increase in cash and cash equivalents</b>	<b>11,273</b>	<b>21,087</b>	<b>12,984</b>	<b>21,378</b>	<b>21,983</b>
Cash and cash equivalents at beginning of year	23,085	34,280	55,297	68,217	89,539
Effect of changes in foreign exchange rate	(78)	(70)	(63)	(57)	(51)
<b>Cash and cash equivalents at end of year</b>	<b>34,280</b>	<b>55,297</b>	<b>68,217</b>	<b>89,539</b>	<b>111,470</b>

Source(s): The Group, ABCI Securities estimates

### Financial Ratios

As of Dec 31 (RMB mn)	2021A	2022A	2023E	2024E	2025E
<b>Profit margins:</b>					
EBITDA margin (%)	32.8%	31.8%	33.6%	33.5%	33.4%
Operating margin (%)	3.3%	3.5%	4.4%	4.2%	3.9%
Net profit margin (%)	4.4%	4.7%	5.6%	5.6%	5.6%
ROA (%)	2.5%	2.7%	3.3%	3.4%	3.5%
ROE (%)	4.4%	5.0%	6.2%	6.4%	6.5%
<b>YoY Growth:</b>					
Revenue (%)	7.9%	8.3%	7.5%	6.7%	5.7%
Net profit (%)	15.0%	16.5%	27.3%	6.9%	6.1%

Source(s): The Group, ABCI Securities estimates



## Disclosures

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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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