



China Telecom (728 HK/601728 CH)

Strong mobile user growth in 9M22; industrial digitalization to support prospects

- China Telecom ("Group") is expected to benefit from higher 5G user penetration and growth in industrial digitalization business
- The Group added 17.46mn mobile users in 9M22, surpassing its year-end target of 15mn
- Industrial digitalization business revenue to grow 17.0%/20.0% YoY in 2022-23E.
- Dividend payout ratio to increase to 70.0% in 2022E
- Recommend **BUY** with TP of HK\$ 4.20 for China Telecom-H (728 HK), which implies 2.7x/ 2.4x 2022-23E EV/EBITDA, and **BUY** for China Telecom-A (601728 CH) with TP of RMB 5.10, equivalent to 3.5x/3.2x 2022-23E EV/EBITDA

Company Report

Nov 4, 2022

Rating (HK): BUY

Rating (A): BUY

TP(HK): HK\$ 4.20

TP(A): RMB 5.10

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Mobile communications service revenue is expected to grow 5.0%/5.5% YoY in 2022-23E, thanks to improving mobile ARPU and user growth. Through the partnership with China Unicom (762 HK) in 5G network sharing, the Group's overall mobile and 5G users are expected to reach 395.4mn and 272.8mn in 2022E. China Telecom's 5G user penetration rate is expected to reach 69.0%/ 82.5% in 2022-23E.

Industrial digitalization business supported by growing demand. Driven by growing demand from data center, cloud computing, and industrial internet, we forecast the Group's industrial digitalization business revenue to grow 17.0%/20.0% YoY in 2022-23E.

Benefit from lower D&A expense-to-revenue ratio. Thanks to the 5G network sharing with China Unicom, China Telecom manages to save 5G CAPEX and lower its D&A expense-to-revenue ratio, which we expect to dip 0.2ppt/0.1ppt to 22.9%/22.8% in 2022-23E. Net profit is estimated to grow 6.3%/17.3% YoY in 2022-23E.

Valuation. We recommend **BUY** for both H/A-shr with TP at HK\$ 4.20/ RMB 5.10. H-shr TP implies 2.7x/2.4x 2022-23E EV/EBITDA, while A-shr TP represents 3.5x/3.2x 2022-23E EV/EBITDA.

Risk factors: 1) Fierce market competition may lower mobile ARPU; 2) User saturation; 3) Cut fixed line broadband service tariff for SMEs

Price (H/A shr)	HK\$2.81/ RMB3.95
Est. s price return (H/A shr)	49.47%/29.11%
Est. dividend yield (H/A shr)	7.04%/5.39%
Est. total return (H/A shr)	56.51%/34.50%
Last Rating & TP (H/A shr)	BUY HK\$3.90/ BUY RMB4.70
Previous Report Date	Jun 16, 2022
Source(s): Bloomberg, ABCI Securities estimates	

Key Data

52Wk H/L (HK\$) (H-shr)	2.96/2.15
52Wk H/L (RMB) (A-shr)	4.47/3.65
Total issued shares (mn)	91,507.1
Issued HK shr (mn)	13,877.4
Issued A shr (mn)	77,629.7
HK-shr market cap (HK\$ mn)	38,995.5
A-shr market cap (RMB mn)	306,637.3

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	2020A	2021A	2022E	2023E	2024E
Revenue (RMB mn)	393,561	439,552	483,178	538,879	586,481
Chg (% YoY)	4.7	11.7	9.9	11.5	8.8
Shareholders' profit (RMB mn)	20,850	25,948	27,595	32,356	37,883
Chg (% YoY)	1.6	24.5	6.3	17.3	17.1
EPS (RMB)	0.258	0.307	0.302	0.354	0.414
Chg (% YoY)	1.6	19.3	(1.9)	17.3	17.1
BPS (RMB)	4.491	5.077	4.720	4.861	5.025
Chg (% YoY)	3.1	13.0	(7.0)	3.0	3.4
P/E (x) –HK shr	10.14	8.50	8.67	7.39	6.31
P/E (x) –A shr	15.33	12.85	13.10	11.17	9.54
P/B (x) –HK shr	0.58	0.51	0.55	0.54	0.52
P/B (x) –A shr	0.88	0.78	0.84	0.81	0.79
ROE (%)	5.8	6.6	6.4	7.4	8.4
ROA (%)	2.9	3.5	3.6	4.2	4.8
DPS (RMB)	0.104	0.170	0.213	0.249	0.292
Dividend Yield (%) –H-shr	3.45	5.63	7.04	8.25	9.67
Dividend Yield (%) –A-shr	2.64	4.30	5.39	6.31	7.39

*Exchange rate assumption for FY22E-24E: 1 HKD = 0.93 RMB

Source(s): Bloomberg, ABCI Securities estimates



3Q22 results beat expectations

In 3Q22, China Telecom's revenue grew 7.9% YoY to RMB 118.7bn; EBITDA grew 2.1% YoY to RMB 30.7bn; net profit grew 15.1% YoY to RMB 6.3bn. The net profit was 5% exceeded our expectations with the strong mobile user growth and revenue contribution from the industrial digitalization service.

Mobile user growth surpassed estimates in 9M22

China Telecom added 17.46mn mobile users in 9M22, surpassing its year-end target of 15.0mn. Therefore, we revise up 2022-23E mobile user additions by 53.3%/30.0% to 23.0mn/20.0mn. China Telecom's 5G user penetration rate is expected to reach 69.0%/82.5% in 2022-23E. Thanks to improved 5G use penetration rate, overall mobile ARPU would grow 0.3%/1.2% YoY to RMB45.1/ RMB45.7 in 2022-23E. China Telecom added 8.97mn fixed-line broadband users in 9M22. With more bundled service packages and smart home applications rolling out, the Group's overall fixed-line broadband users would grow 6.8%/5.0% YoY to 181.2mn/190.2mn for 2022-23E. Fixed-line ARPU is expected to edge up 1.1%/1.8% YoY to RMB46.4/ RMB47.2 for 2022-23E.

Industrial digitalization business supported by policy

Driven by growing demand from data center, cloud computing and industrial internet, we forecast the Group's industrial digitalization business revenue to grow 17.0%/20.0% YoY in 2022-23E. The "East-to-West Computing Resources Transfer" strategy introduced by the NDRC in Feb 2022 would support growth in the Group's industrial digitalization business. We revise up 2022-23E industrial digitalization business revenue by 5.0%/6.2%.

We revise up 2022-24E revenue by 2.7%/3.0%/4.7%, due to the adjustment to mobile users and industrial digitalization business revenue growth.

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

Thanks to the 5G network sharing with China Unicom, China Telecom manages to save 5G CAPEX and lower its D&A expense-to-revenue ratio, which we expect to dip 0.2ppt/0.1ppt YoY to 22.9%/22.8% in 2022-23E. Net profit is estimated to grow 6.3%/17.3% YoY in 2022-23E.

Exhibit 1: Major assumptions for our forecasts

	2020	2021	2022E	2023E	2024E
Overall mobile users (mn)	351.0	372.4	395.4	415.4	432.4
YoY	4.6%	6.1%	6.2%	5.1%	4.1%
5G users (mn)	86.5	187.8	272.8	342.8	402.8
YoY	N/A	117.1%	45.3%	25.7%	17.5%
Mobile ARPU (RMB)	44.1	45.0	45.1	45.7	46.6
YoY	(3.7%)	2.0%	0.3%	1.2%	2.0%
Fixed line broadband users (mn)	158.5	169.7	181.2	190.2	198.2
YoY	3.5%	7.1%	6.8%	5.0%	4.2%
Fixed line ARPU (RMB)	44.4	45.9	46.4	47.2	48.4
YoY	16.5%	3.4%	1.1%	1.8%	2.4%

Source(s): Group, ABCI Securities estimates



Exhibit 2: Changes in our financial estimates

	OLD			NEW			CHANGE		
(RMB mn)	2022E	2023E	2024E	2022E	2023E	2024E	2022E	2023E	2024E
Revenue	470,47	523,183	560,154	483,178	538,879	586,481	2.7%	3.0%	4.7%
Net Profit	26,508	30,963	36,079	27,595	32,356	37,883	4.1%	4.5%	5.0%
EPS (RMB)	0.290	0.339	0.394	0.302	0.354	0.414	4.1%	4.5%	5.0%

Source(s): Group, ABCI Securities estimates

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

We revise up 2022-23E net profit by 4.1%/4.5% to reflect the better-than-expected mobile user growth and revenue contribution from the industrial digitalization service. Our valuations for China Telecom-H/A (728 HK/601728CH) are based on DCF model (WACC: 12.8%/12.4%; perpetuity growth rate: 2.0%/2.0%). We recommend **BUY** for H-shr with TP at HK\$ 4.20, which implies 2.7x/2.4x 2022-23E EV/EBITDA; **BUY** for A-shr with TP at RMB 5.10, representing 3.5x/3.2x 2022-23E EV/EBITDA.



Consolidated income statement (2020A-24E)

FY Ended Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Mobile communications service revenues	175,564	184,157	193,365	204,000	216,036
Wireline and smart family service revenues	109,018	113,522	113,823	115,097	116,211
Industrial digitalization service revenues	83,968	98,945	115,766	138,919	159,757
Other service revenues	5,248	6,203	6,482	6,741	6,944
Sales of goods and others	19,763	36,725	53,743	74,123	87,534
Total revenue	393,561	439,552	483,178	538,879	586,481
Depreciation and amortisation	(90,240)	(92,965)	(98,341)	(105,965)	(112,762)
Network operations & support	(119,517)	(133,342)	(144,720)	(159,412)	(172,636)
Selling, general & administrative	(55,059)	(61,155)	(75,376)	(87,837)	(96,769)
Personnel expenses	(65,989)	(76,055)	(81,593)	(91,092)	(98,791)
Other operating expenses	(34,116)	(45,088)	(48,066)	(53,447)	(57,379)
Operating Profit	28,640	30,947	35,083	41,126	48,144
Investment income and others	60	2,244	65	71	77
Share of profits of associates and Joint ventures	1,701	1,966	2,064	2,168	2,276
Net finance costs	(3,014)	(1,293)	(1,198)	(1,138)	(1,057)
Profit before taxation	27,387	33,864	36,014	42,227	49,440
Income tax	(6,307)	(7,716)	(8,206)	(9,621)	(11,265)
Profit for the year	21,080	26,148	27,808	32,605	38,175
Non-controlling interests	230	200	213	249	292
Shareholders' profit	20,850	25,948	27,595	32,356	37,883
EBITDA	118,880	123,912	132,832	146,826	160,906
EPS (RMB)	0.258	0.307	0.302	0.354	0.414
DPS (RMB)	0.104	0.170	0.213	0.249	0.292

Source(s): Group, ABCI Securities estimates



Consolidated balance sheet (2020-24E)

As of Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Property, plant and equipment, net	418,605	415,981	402,254	400,242	395,840
Construction in progress	48,425	51,456	69,466	75,718	77,232
Interests in associates and joint ventures	40,303	41,166	42,401	44,521	45,679
Right-of-use assets	59,457	61,186	63,633	66,815	67,817
Others	64,290	65,085	63,786	36,452	63,035
Total non-current assets	631,080	634,874	641,539	623,748	649,602
Cash & cash equivalents	23,684	73,281	79,026	101,114	89,757
Prepayments and other current assets	25,167	24,585	25,568	26,591	27,123
Accounts receivable, net	21,502	22,389	23,285	24,449	25,671
Others	13,663	7,105	6,250	6,273	6,299
Total current assets	84,016	127,360	134,129	158,427	148,850
Total assets	715,096	762,234	775,668	782,175	798,452
Contract liabilities	63,849	70,914	63,823	59,355	53,420
Accounts payable	107,578	114,895	118,342	121,892	124,330
Accrued expenses and other payables	57,053	55,765	58,553	60,310	62,119
Others	42,662	23,498	26,042	16,790	17,033
Total current liabilities	271,142	265,072	266,760	258,347	256,901
Lease obligations	27,455	28,593	37,171	38,658	40,204
Deferred tax liabilities	24,208	26,677	27,211	27,755	29,142
Others	26,116	10,724	10,317	10,241	9,883
Total non-current liabilities	77,779	65,994	74,699	76,653	79,229
Total liabilities	348,921	331,066	341,459	335,001	336,131
Total equity attributable to equity holders of the Company	363,456	428,674	431,914	444,804	459,864
Non-controlling interests	2,719	2,494	2,295	2,370	2,457
Total equity	366,175	431,168	434,209	447,174	462,322

Source(s): Group, ABCI Securities estimates



Consolidated Cash Flow Statement (2020A-24E)

As of Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Operating profit before change in working capital	129,296	131,895	137,733	151,029	126,000
Change in working capital	5,523	9,973	(4,897)	(3,474)	(5,570)
Others	(2,327)	(617)	2,845	3,129	4,063
Income tax paid	(232)	(3,718)	(4,239)	(5,044)	(5,851)
Operating cash flow	132,260	137,533	131,442	145,641	118,642
CAPEX	(88,748)	(84,847)	(93,000)	(95,790)	(98,664)
Others	1,671	4,560	6,526	4,542	5,220
Investing cash flow	(87,077)	(80,287)	(86,474)	(91,248)	(93,443)
Dividend paid	(9,262)	(8,439)	(26,537)	(19,466)	(22,824)
Change in bank and other loan	(25,933)	(35,564)	(768)	(361)	(660)
Proceeds from A Shares Offering, net of issuing expenses	0	47,516	0	0	0
Others	(6,912)	(11,035)	(11,822)	(12,404)	(13,016)
Financing cash flow	(42,107)	(7,522)	(39,127)	(32,231)	(36,499)
Net increase in cash and cash equivalents	3,076	49,724	5,841	22,162	(11,301)
Cash and cash equivalents at beginning of year	20,791	23,684	73,281	79,026	101,114
Effect of changes in foreign exchange rate	(183)	(127)	(97)	(73)	(56)
Cash and cash equivalents at end of year	23,684	73,281	79,026	101,114	89,757

Source(s): Group, ABCI Securities estimates

Financial Ratios

As of Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Profit margins:					
EBITDA margin (%)	31.8	30.8	31.1	31.6	32.2
Operating margin (%)	7.7	7.7	8.2	8.8	9.6
Net profit margin (%)	5.3	5.9	5.7	6.0	6.5
ROA (%)	2.9	3.5	3.6	4.2	4.8
ROE (%)	5.8	6.6	6.4	7.4	8.4
YoY Growth:					
Revenue (%)	4.7	11.7	9.9	11.5	8.8
EBITDA (%)	1.4	4.2	7.2	10.5	9.6
Net profit (%)	1.6	24.5	6.3	17.3	17.1

Source(s): Group, ABCI Securities estimates



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Rating	Definition
Buy	Stock return rate \geq Market return rate ($\sim 10\%$)
Hold	- Market return rate ($\sim 10\%$) \leq Stock return rate $<$ Market return rate ($\sim +10\%$)
Sell	Stock return $<$ - Market return ($\sim -10\%$)

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 2009 (HSI total return index 2009-21 averaged at 9.2%)

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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