

## China Unicom (762 HK)

### Strategic partnership with corporations

- China Unicom (or "the Group") has formed strategic partnerships with 4 internet corporations to develop Industrial Internet business
- Approved by MIIT to reform 900MHz band for 5G network usage
- 5G user penetration rate to reach 74.9% in 2023E
- Supported by industrial internet, cloud computing, and smart home applications, Industrial Internet business revenue is expected to go up 23.0% YoY in 2023E
- Net profit margin to reach 6.0% YoY in 2023E
- Recommend BUY with TP of HK\$ 6.70, which implies 1.6x 2023E EV/EBITDA

**5G users estimated to reach 261.9mn in 2023E.** In Dec 2022, MIIT approved plans of China Unicom to reform 900MHz band for 5G network usage. We expect the Group to expand its 5G network coverage while lowering its 5G CAPEX. Driven by improved 5G network coverage, we forecast the Group to add 47mn 5G users in 2023E. 5G user penetration rate is expected to reach 74.9% in 2023E, which can help improve mobile ARPU by 1.0% YoY to RMB45.2 in 2023E.

**Industrial Internet revenue is estimated to grow 23.0% YoY in 2023E.** China Unicom is forming partnerships with 4 internet corporations to use its cloud platform. Driven by industrial internet, cloud computing, AI technology, and smart home applications, we forecast Industrial Internet revenue to go up 23.0% YoY in 2023E.

**Improving net profit margin.** Depreciation and amortization expenses-to-revenue ratio is estimated to lower by 0.8ppt YoY to 24.2% in 2023E due to reduced 5G depreciation expenses enabled by 5G network reform. Net profit margin is projected to improve 0.8ppt YoY to 6.0% in 2023E.

**Valuation.** Recommend **BUY** with TP of HK\$6.70, implying 1.6x 2023E EV/EBITDA.

**Risk factors:** 1) Slower-than-expected 5G business development; 2) Further reduction in mobile data tariff by regulators; 3) Fierce market competitions; 4) Slowing down of 5G and mobile users growth in 2023-24E, 5) Declining fixed line ARPU in 2023-24E.

#### Results and Valuation

FY ended Dec 31	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	303,838	327,854	355,119	380,572	405,333
Chg (% YoY)	4.6	7.9	8.3	7.2	6.5
Net profit (RMB mn)	12,493	14,368	18,310	22,676	27,206
Chg (% YoY)	10.3	15.0	27.4	23.8	20.0
EPS (RMB)	0.408	0.470	0.598	0.741	0.889
Chg (% YoY)	10.3	15.0	27.4	23.8	20.0
BPS (RMB)	10.7	10.9	11.3	11.7	12.2
Chg (% YoY)	2.1	1.8	3.3	3.7	4.2
P/E (x)	10.3	9.8	7.7	6.2	5.2
P/B (x)	0.39	0.42	0.41	0.39	0.38
ROE (%)	3.9	4.4	5.5	6.5	7.5
ROA (%)	2.2	2.5	3.0	3.2	3.1
DPS (RMB)	0.16	0.22	0.32	0.40	0.54
Dividend Yield (%)	3.6	4.7	7.0	8.7	11.8

\*Exchange rate assumption for FY23-24E: 1 HKD=0.9 RMB

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

Jan 6, 2023

Rating: BUY

TP: HK\$ 6.70

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Share price (HK\$)	5.09
Est. share price return	31.6%
Est. dividend yield	8.7%
Est. total return	40.3%
Previous Rating & TP	BUY / HK\$5.6
Previous Report Date	Apr 29, 2021

Source(s): Bloomberg, ABCI Securities estimates

#### Key Data

52Wk H/L (HK\$)	5.30/3.27
Issued shares (mn)	30,598.1
Market cap (HK\$ mn)	155,744.5
Avg daily turnover (HK\$ mn)	950.1

#### 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	11.0%	4.7%
3-mth	34.5%	19.9%
6-mth	39.6%	48.6%

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities



## Growing momentum from industrial internet business

In Dec 2022, 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. The Industrial Internet business is expected to be a driving momentum for the Group and we forecast the segment's revenue to grow 23.0% in 2023E.

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

RMB bn	2020	2021	2022E	2023E	2024E
Industrial Internet revenue	42.7	54.8	69.0	84.9	101.5
YoY	29.8%	28.3%	26.0%	23.0%	19.5%
% of total revenue	14.1%	16.7%	19.4%	22.3%	25.0%

Source(s): The Group, ABCI Securities estimates

## MIIT approved China Unicom's plans to reform 900MHz band for 5G network usage

In Nov 3, 2022, China Unicom was approved by MIIT to reform the 900MHz band for 5G network usage. We think the relatively low frequency of the 5G spectrum can help further expand 5G network with a lower 5G CAPEX. We forecast China Unicom to add 47.0mn of 5G users in 2023E, pushing the Group's total no. of 5G users to 261.9mn. 5G user penetration rate under the Group is expected to reach 74.9% in 2023E, which will help raise the mobile ARPU by 1.0% YoY to RMB45.2 in 2023E. We predict mobile ARPU growth rate to be 1.0%/1.9% in 2023-24E against 2.0% in 2022E.

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

Aside from a higher revenue growth, we forecast depreciation and amortization expenses-to-revenue ratio to dip 0.8ppt YoY to 24.2% in 2023E, thanks to the reduced 5G CAPEX enabled by 5G network reform. As such, we expect net margin to improve 0.8ppt YoY to 6.0% in 2023E.

### Exhibit 2: Major assumptions for our forecasts

	2020	2021	2022E	2023E	2024E
Overall mobile users (mn)	305.8	317.1	336.1	349.6	360.1
YoY	(4.0%)	3.7%	6.0%	4.0%	3.0%
5G users (mn)	70.8	154.9	214.9	261.9	291.9
YoY	N/A	118.7%	38.7%	21.9%	11.5%
Mobile ARPU (RMB)	42.1	43.9	44.8	45.2	46.1
YoY	4.2%	4.3%	2.0%	1.0%	1.9%
Fixed line users (mn)	86.1	95.0	103.5	111.6	119.4
YoY	3.1%	10.4%	8.9%	7.8%	7.0%
Fixed line ARPU (RMB)	41.5	41.3	41.2	41.1	41.0
YoY	(0.2%)	(0.5%)	(0.3%)	(0.3%)	(0.2%)

Source(s): The Group, ABCI Securities estimates

**Exhibit 3: Changes in financial estimates**

	OLD			NEW			CHANGE		
(RMB Bn)	2022E	2023E	2024E	2022E	2023E	2024E	2022E	2023E	2024E
Revenue	350,908	369,487	391,626	355,119	380,572	405,333	1.2%	3.0%	3.5%
Net Profit	17,777	21,846	26,134	18,310	22,676	27,206	3.0%	3.8%	4.1%
EPS (RMB)	0.581	0.714	0.854	0.598	0.741	0.889	3.0%	3.8%	4.1%

Source(s): The Group, ABCI Securities estimates

**Recommend BUY with TP of HK\$6.70**

We revise up 2023-24E net profit by 3.8%/4.1% due to the benefits resulted from strategic partnership with internet companies and 5G frequency reform. The Group's TP is derived based on our DCF model (WACC: 12.3%; perpetuity growth rate: 2.2%), which represents 1.6x 2023E EV/EBITDA.



Consolidated income statement (2020A-2024E)

FY Ended Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Total service revenue	275,814	296,153	320,247	342,388	363,636
Sales of telecommunications products	28,024	31,701	34,871	38,184	41,697
<b>Total revenue</b>	<b>303,838</b>	<b>327,854</b>	<b>355,119</b>	<b>380,572</b>	<b>405,333</b>
Interconnection charges	(10,574)	(11,557)	(12,655)	(13,414)	(14,058)
Depreciation and amortisation	(83,017)	(85,652)	(88,821)	(92,196)	(94,962)
Network, operation & support expenses	(46,286)	(53,087)	(57,216)	(61,033)	(63,971)
Employee benefit expenses	(55,740)	(58,944)	(63,566)	(67,742)	(71,744)
Cost of telecom products sold	(26,862)	(30,683)	(33,381)	(35,013)	(37,291)
Finance cost	(1,747)	(1,385)	(1,247)	(1,218)	(1,213)
Interest income	1,366	1,215	1,382	1,954	2,453
Share of net profit of associates	1,588	1,862	1,992	2,092	2,197
Share of net profit of joint ventures	787	1,448	1,549	1,627	1,708
Selling and marketing expenses	(30,460)	(32,210)	(35,157)	(37,677)	(40,939)
General, administrative and other operating expenses	(39,777)	(45,053)	(49,601)	(54,285)	(58,380)
Other income — net	2,911	4,119	4,449	4,626	4,812
<b>Profit before tax</b>	<b>16,027</b>	<b>17,927</b>	<b>22,846</b>	<b>28,293</b>	<b>33,945</b>
Tax	(3,450)	(3,420)	(4,359)	(5,398)	(6,476)
<b>Profit after tax</b>	<b>12,577</b>	<b>14,507</b>	<b>18,487</b>	<b>22,895</b>	<b>27,469</b>
Minority interests	84	139	177	219	263
<b>Net profit</b>	<b>12,493</b>	<b>14,368</b>	<b>18,310</b>	<b>22,676</b>	<b>27,206</b>
<b>EPS (RMB)</b>	<b>0.408</b>	<b>0.470</b>	<b>0.598</b>	<b>0.741</b>	<b>0.889</b>
<b>DPS (RMB)</b>	<b>0.164</b>	<b>0.216</b>	<b>0.320</b>	<b>0.397</b>	<b>0.539</b>

Source(s): The Group, ABCI Securities estimates



Consolidated balance sheet (2020A-2024E)

As of Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
PPE	364,187	355,031	365,682	376,652	387,952
Interest in associates	38,802	41,278	42,104	42,946	43,805
Right-of-use assets	37,960	32,866	32,866	32,866*	32,866*
Other non-current assets	31,031	35,673	35,910	146,190	286,381
<b>Total non-current assets</b>	<b>471,980</b>	<b>464,848</b>	<b>476,562</b>	<b>598,654</b>	<b>751,004</b>
Cash & cash equivalents	23,085	34,280	65,309	97,873	133,445
Accounts receivables	16,287	17,957	18,486	20,853	23,321
Prepayments and other current assets	15,882	17,925	17,029	16,177	15,368
Financial assets measured at fair value	24,189	29,011	29,011	29,011	29,011
Others	29,193	27,055	29,703	31,578	33,576
<b>Total current assets</b>	<b>108,636</b>	<b>126,228</b>	<b>159,537</b>	<b>195,493</b>	<b>234,721</b>
<b>Total assets</b>	<b>580,616</b>	<b>591,076</b>	<b>636,099</b>	<b>794,148</b>	<b>985,724</b>
Accounts payable and accrued liabilities	134,437	140,124	122,006	132,243	142,158
Contract liabilities	42,641	45,704	45,704	189,170	332,637
Others	44,950	50,357	103,259	94,664	117,499
<b>Total current liabilities</b>	<b>222,028</b>	<b>236,185</b>	<b>270,970</b>	<b>416,077</b>	<b>592,294</b>
Lease liabilities	16,458	10,415	10,415	10,415*	10,415*
Deferred revenue	5,927	6,951	7,529	8,069	8,594
Others	8,683	4,092	2,743	2,253	1,999
<b>Total non-current liabilities</b>	<b>31,068</b>	<b>21,458</b>	<b>20,687</b>	<b>20,736</b>	<b>21,008</b>
<b>Total liabilities</b>	<b>253,096</b>	<b>257,643</b>	<b>291,657</b>	<b>436,814</b>	<b>613,302</b>
Equity attributable to ordinary shareholders	326,587	332,337	344,038	356,916	371,987
Non-controlling interests	933	1,096	403	418	436
<b>Total equity</b>	<b>327,520</b>	<b>333,433</b>	<b>344,442</b>	<b>357,334</b>	<b>372,423</b>

Source(s): The Group, ABCI Securities estimates

Note \*: In our model, we have not factored in the lease arrangement between China Unicom and China Tower in 2023-24E. Subsequent to the commencement of new lease arrangements, right-of-use assets and lease liabilities will increase by RMB35.5 bn and RMB35.5 bn, respectively.



### Consolidated Cash Flow Statement (2020A-2024E)

As of Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Operating profit before change in working capital	16,027	17,927	22,846	28,293	33,945
Change in working capital	3,016	7,871	2,074	(321)	(693)
Others	89,694	89,831	104,829	109,981	114,525
Tax	(3,186)	(4,993)	(5,606)	(6,616)	(7,689)
<b>Operating cash flow</b>	<b>105,551</b>	<b>110,636</b>	<b>124,143</b>	<b>131,337</b>	<b>140,088</b>
CAPEX	(58,656)	(72,047)	(69,000)	(72,450)	(76,073)
Others	(33,362)	(2,737)	1,680	1,857	1,987
<b>Investing cash flow</b>	<b>(92,018)</b>	<b>(74,784)</b>	<b>(67,320)</b>	<b>(70,593)</b>	<b>(74,086)</b>
Dividend paid	(5,447)	(8,690)	(6,609)	(9,798)	(12,134)
Capital element of lease rentals paid	(11,696)	(12,727)	(13,491)	(14,300)	(15,158)
Others	(8,067)	(3,162)	(5,625)	(4,018)	(3,081)
<b>Financing cash flow</b>	<b>(25,210)</b>	<b>(24,579)</b>	<b>(25,724)</b>	<b>(28,116)</b>	<b>(30,374)</b>
<b>Net increase in cash and cash equivalents</b>	<b>(11,677)</b>	<b>11,273</b>	<b>31,099</b>	<b>32,628</b>	<b>35,628</b>
Cash and cash equivalents at beginning of year	34,945	23,085	34,280	65,309	97,873
Effect of changes in foreign exchange rate	(183)	(78)	(70)	(63)	(57)
<b>Cash and cash equivalents at end of year</b>	<b>23,085</b>	<b>34,280</b>	<b>65,309</b>	<b>97,873</b>	<b>133,445</b>

Source(s): The Group, ABCI Securities estimates

### Financial Ratios

As of Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
<b>Profit margins:</b>					
EBITDA margin (%)	31.0%	29.4%	29.2%	29.3%	29.3%
Operating margin (%)	3.7%	3.3%	4.1%	5.0%	5.9%
Net profit margin (%)	4.1%	4.4%	5.2%	6.0%	6.7%
ROA (%)	2.2%	2.5%	3.0%	3.2%	3.1%
ROE (%)	3.9%	4.4%	5.5%	6.5%	7.5%
<b>YoY Growth:</b>					
Revenue (%)	4.6%	7.9%	8.3%	7.2%	6.5%
Net profit (%)	10.3%	15.0%	27.4%	23.8%	20.0%

Source(s): The Group, ABCI Securities estimates



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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

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