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HONG KONG RESEARCH

Analyst: Kelvin Li **4th March, 2015**

CHINA UNICOM LIMITED (中國聯通)

Sector	:	Telecommunications
HKSE Code	:	00762
Market Price	:	HK$12.20 (04/03/2015)
HSI	:	24,450.47 (04/03/2015)
Shares Issued	:	23,947.0 million
Mkt. Cap.	:	HK$292,153 million
52 weeks Hi/ Lo	:	HK$14.22 / HK$9.03

Chairman & CEO : CHANG Xiaobing

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2014

Final Results Highlights

	FY2014 RMB million	**FY2013** RMB million	*Change*
• Revenue	284,681	295,038	*-3.5%*
• Operating Profit	18,903	15,767	*+19.9%*
• **Profit attributable to shareholders**	**12,055**	**10,408**	***+15.8%***
• *EBITDA*	92,771	83,963	*+10.5%*
• *EBITDA/Service Revenue (EBITDA margin)*	37.9%	35.2%	*+2.7 ppts*
• EPS – basic	RMB0.505	RMB0.440	*+24.9%*
• DPS – final	RMB0.200	RMB0.160	*+25.0%*
• DPS – total	RMB0.200	RMB0.160	*+25.0%*

- China Unicom (the 'Group') reported net profit of RMB12.06 billion for the year ended 31st December 2014, up 15.8% y-o-y, slightly weaker than market expectation of RMB12.87 billion. The Group's bottom-line growth was supported by lower operating costs on reduced interconnection charges upon government's reform of related settlement policy and dropping handset subsidies after value-added tax (VAT) reform in late 1H2014.
- Revenue fell 3.5% y-o-y to RMB284.7 billion in FY14, as handset sales fell 28.4% y-o-y to RMB41.1 billion after the VAT reform. The Group's service revenue inched up by 2.6% y-o-y, which was supported by the mobile non-voice services and the fixed-line broadband operation. Thanks to lower interconnection charges (-27.8% y-o-y) and reduced handset subsidies (-40.4% y-o-y), operating expenses dropped 4.8% y-o-y to RMB265.8 billion in FY14. As a result, the Group's EBITDA margin strengthened by 2.7 percentage points to 37.9% in FY14 from 35.2% a year earlier, while operating profit rose strongly by 19.9% y-o-y to RMB18.9 billion last year.
- EPS for FY14 was RMB0.505 (FY13: RMB0.44). A final dividend of RMB0.20 per share was proposed, representing a higher payout ratio at 40% (FY13: 36%).
- As of 31st Dec 2014, the Group had total debts of RMB94.9 billion (31st Dec 2013: RMB97.9 billion). With cash on hand of RMB25.3 billion, the Group's net debt-to-shareholders' equities ratio fell to 30.6% by end of FY14 from 34.9% a year earlier.

Business highlights

- Breakdown of revenue by activities:

(RMB million)	**FY2014**	%	**FY2013**	%	*Change*
Mobile – voice	74,601	26.2%	82,216	27.9%	*-9.3%*
Mobile – non-voice	80,494	28.3%	68,917	23.4%	*+16.8%*
Subtotal – mobile	**155,095**	**54.5%**	**151,133**	**51.2%**	***+2.6%***
Fixed line – voice	18,669	6.6%	22,314	7.6%	*-16.3%*
Fixed line – non-voice	69,812	24.5%	64,173	21.8%	*+8.8%*
Subtotal – fixed line	**88,481**	**31.1%**	**86,487**	**29.3%**	***+2.3%***
Sales of telecom products & unallocated items	41,105	14.4%	57,418	19.5%	*-28.4%*
Total	**284,681**	**100.0%**	**295,038**	**100.0%**	***-3.5%***

- Service revenue from the **mobile** segment was up by an unexciting 2.6% y-o-y to RMB155.1 billion in FY14, accounting for 54.5% of the total (FY13: 51.2%). The Group's 'mobile broadband' (3G/4G) customer base grew 21.6% y-o-y to 149.1 million by end of 2014. The total mobile subscriber base was up by 6.4% y-o-y to 299.1 million, as its 2G users fell 5.3% y-o-y. 3G/4G users now accounted for 49.9% of the Group's total mobile customer base, up from 43.6% a year earlier. The 3G/4G ARPU dropped to RMB63.6 in FY14, down by more than 15% y-o-y, owing to addition of more low-end 3G customers as well as the VAT reform. Overall, the Group mobile ARPU fell 8.5% y-o-y to RMB44.1 in FY14. Non-voice service substitution accelerated in FY14, amid more common use of mobile Internet and data services. In addition, the VAT reform also speeded up the service migration, as basic telecom services like voice services charged a higher VAT rate when compared with that of value-added services (VAS).

- Revenue from the Group's **fixed-line** segment inched up by 2.3% y-o-y to RMB88.5 billion in FY14. Non-voice (broadband, data, value-added services and others) business was the growth engine with an 8.8% top-line increase, which helped offset a 16.3% revenue drop in fixed-line voice operation. The fixed-line broadband operation reported higher ARPU at RMB62.2 from RMB61.4 a year earlier, supported by mobile-fixed line service bundling. Non-voice service substitution was also seen in the Group's fixed-line operation after the VAT reform.

Outlook & Prospects

- ***Nationwide FDD-LTE licenses granted*** China granted in late Feb 2015 China Unicom and China Telecom (00728) each the FDD-LTE license to conduct 4G business nationwide, after the two operators carried out trial FDD-LTE 4G services in 56 Mainland cities in 2014. It is expected China Unicom would speed up its 4G business development and marketing efforts in 2015, riding on the competitive edge of FDD-LTE against the home-grown TD-LTE standard as well as smooth/low-cost upgrade of its WCDMA 3G network to FDD-LTE 4G standard.

- ***Capex of no more than RMB100 billion in FY15 following the grant of FDD-LTE licenses*** China Unicom's capex amounted to RMB84.9 billion in FY14, higher than its initial estimate of RMB80 billion and up by 15.5% from RMB73.5 billion in FY13. Upon the recent grant of the FDD-LTE 4G license, the Group set a capex budget of no more than RMB100 billion in FY15, up 17.8% y-o-y.

- ***ARPU pressure to remain in 2015*** The Group's mobile ARPU fell 8.5%, bucking the upward trend in the recent years, which was mainly dragged by the VAT reform. However, excluding the impact of VAT reform, we may see ARPU pressure to linger in 2015, as the PRC mobile operators would compete each other with tariff cut or air time/data volume discounts, which would turn into downward pressure on the Group's overall mobile ARPU.

- ***Update of the Tower Company establishment*** Management revealed that the Group is undergoing the valuation process of its base station assets, as asset injections into the Tower Company (China Communications Facilities Services Corp) is expected to complete in 2H15. The asset injection would help strengthen the Group's financial position and lead to one-off disposal gain from the sale of the base station assets.

- ***Management sees better top-line growth in FY15*** The new VAT regime should continue to exert pressure on the Group's top-line in 1H15, as the tax reform had been only implemented in June 2014. Nevertheless, management said the Group should see improvement in revenue growth in 2015 with reviving 3G/4G subscriber addition. It may suggest that China Unicom aims to win over high-end customers from its rivals like China Mobile (00941) with its new and more popular FDD-LTE 4G services and also better FDD handset supply.

- ***Industry outlook stays challenging*** Investors would take extra time to assess China Unicom's FY14 results, as 2014 marked the first year of VAT reform in the PRC mobile/telecom industry and the operating environment and competitive landscape of the industry had changed significantly since the new VAT was introduced in June 2014. Following the VAT reform, the PRC mobile operators should no longer rely on handset subsidy (handset sales was charged at new VAT of 17% versus old business tax rate of 3%-5%) but compete with tariff cut, air time/data volume discounts and better service quality and network coverage. Despite a more challenging and competitive outlook in 2015, we should see limited downside to China Unicom's share price, which would be supported by continuous market share gain with its well-established 3G/4G services as well as potential benefits from disposal of its base station assets. Trading at 16.2x FY15E P/E, we maintain a 'HOLD' rating on the counter.

Recommendation: HOLD

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