

## COMMENT

**China Telecom (0728.HK) HK\$4.84**

Equity Research

**First Take: High network cost offsets relatively stable ARPU****News**

China Telecom (CT) reported 4Q14 revenue and net profit of Rmb72.8bn and Rmb1.5bn, +4% and -31% vs. our forecasts, respectively, as stronger ARPU was offset by higher network operating expenses.

**Highlights:** (1) Mobile ARPU of Rmb52.7 (-3.5% yoy) came in 5% above our estimate as a result of a clean-up of non-active users, in our view. Mobile net adds were zero in 2014. CT expects ARPU to increase slightly in 2015, in line with our forecast of +1% yoy. (2) CT aims to add 15mn wireless sub in 2015, below GHe of 18mn. (3) Handset internet access revenue grew by 49% yoy, above our forecast of +44% yoy. (4) Wireline broadband ARPU was 8% higher than our estimate, thanks to increasing mix of FTTH subs, in our view. CT aims to add 6mn wireline broadband sub in 2015, in line with GHe of 7mn. (5) Service EBITDA margin fell 190bps yoy despite a cut in selling expenses and was 420bps below our forecast due to higher network expenses, including Rmb1.3bn PHS write-off provision (1.8% of revenue). (6) CT spent Rmb15.3bn in handset subsidies, or 13% of mobile service revenue, in line with our forecasts. (7) 2015 capex guidance of Rmb108bn (mobile: Rmb63bn, fixed line: Rmb45bn) was higher than our estimate of Rmb94bn (mobile: Rmb60bn, fixed line: Rmb34bn), mostly driven by investment in 4G and VAS/ICT. (8) CT proposed a dividend per share of HK\$0.095, or 34% payout ratio, in line with our forecast.

**Analysis**

We view CT's solid execution in maintaining its wireless and wireline ARPU trend as encouraging. However, we are concerned about the sustainability of CT's ARPU trend after CT starts to grow its subs again and wireline competition intensifies.

**Implications**

We place our target prices and estimates for CT and the ADR under review pending further details from management; we maintain our Neutral ratings.

**INVESTMENT LIST MEMBERSHIP**

Neutral

**Coverage View: Neutral**

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**Exhibit 1: CT 4Q14 net profit was below our forecast due to higher-than-expected network operating expenses**  
CT 4Q14 results vs. estimates

in Rmb mn except for per share data	1Q14A	2Q14A	3Q14A	4Q14A	QoQ%	YoY%	GH 4Q14E	% Diff
<b>Total Revenue</b>	<b>83,184</b>	<b>82,789</b>	<b>77,635</b>	<b>80,786</b>	4.1%	-3.1%	<b>78,080</b>	3.5%
<b>Service revenue (ex-handset sales)</b>	<b>74,146</b>	<b>75,216</b>	<b>70,930</b>	<b>72,759</b>	2.6%	-1.8%	<b>69,816</b>	4.2%
CDMA service revenues (Rmb mn)	30,701	31,278	29,252	29,037	-0.7%	-3.4%	27,736	4.7%
Fixed line revenue (Rmb mn)	43,445	43,938	41,678	43,722	4.9%	-0.1%	42,080	3.9%
<b>Total Cost</b>								
Network operating expenses	(14,092)	(15,240)	(16,581)	(22,738)	37.1%	40.5%	(20,030)	13.5%
SG&A	(18,507)	(18,436)	(11,652)	(14,124)	21.2%	-26.7%	(13,920)	1.5%
Personnel	(12,994)	(11,648)	(14,578)	(11,433)	-21.6%	-4.4%	(11,427)	0.0%
Other operating	(12,506)	(12,012)	(10,569)	(12,431)	17.6%	-12.0%	(10,526)	18.1%
Total operating expenses	(58,099)	(57,336)	(53,380)	(60,726)	13.8%	-1.3%	(55,904)	8.6%
<b>Reported EBITDA</b>	<b>25,085</b>	<b>25,453</b>	<b>24,255</b>	<b>20,060</b>	<b>-17.3%</b>	<b>-8.2%</b>	<b>22,176</b>	<b>-9.5%</b>
<b>EBITDA Margin %</b>	<b>30.2%</b>	<b>30.7%</b>	<b>31.2%</b>	<b>24.8%</b>	<b>-6.4%</b>	<b>-1.4%</b>	<b>28.4%</b>	<b>-3.6%</b>
<b>Service EBITDA margin%</b>	<b>33.8%</b>	<b>33.8%</b>	<b>34.2%</b>	<b>27.6%</b>	<b>-6.6%</b>	<b>-1.9%</b>	<b>31.8%</b>	<b>-4.2%</b>
D&A	(16,363)	(16,413)	(16,627)	(16,942)	1.9%	-1.1%	(18,087)	-6.3%
<b>EBIT</b>	<b>8,722</b>	<b>9,040</b>	<b>7,628</b>	<b>3,118</b>	<b>-59.1%</b>	<b>-33.8%</b>	<b>4,090</b>	<b>-23.8%</b>
<b>EBIT Margin%</b>	<b>10.5%</b>	<b>10.9%</b>	<b>9.8%</b>	<b>3.9%</b>	<b>-6.0%</b>	<b>-1.8%</b>	<b>5.2%</b>	<b>-1.4%</b>
<b>Service EBIT margin%</b>	<b>11.8%</b>	<b>12.0%</b>	<b>10.8%</b>	<b>4.3%</b>	<b>-6.5%</b>	<b>-2.1%</b>	<b>5.9%</b>	<b>-1.6%</b>
Finance costs and investment gain	(1,391)	(1,336)	(1,245)	(1,279)	2.7%	7.3%	(1,333)	-4.1%
PBT (ex conn fee)	7,331	7,704	6,383	1,839	-71.2%	-47.8%	2,756	-33.3%
Tax & Minority interests	(1,784)	(1,815)	(1,650)	(328)	-80.1%	-52.5%	(555)	-40.9%
<b>Recurring net income</b>	<b>5,547</b>	<b>5,889</b>	<b>4,733</b>	<b>1,511</b>	<b>-68.1%</b>	<b>-46.6%</b>	<b>2,202</b>	<b>-31.4%</b>
<b>Net profit margin %</b>	<b>6.7%</b>	<b>7.1%</b>	<b>6.1%</b>	<b>1.9%</b>	<b>-4.2%</b>	<b>-1.5%</b>	<b>2.8%</b>	<b>-0.9%</b>
<b>EPS (Rmb)</b>	<b>0.07</b>	<b>0.07</b>	<b>0.06</b>	<b>0.02</b>	<b>-68.1%</b>	<b>-46.6%</b>	<b>0.03</b>	<b>-31.4%</b>
<b>Operating data</b>								
<b>CDMA</b>								
CDMA subs ('000)	183,200	180,240	181,570	185,620	2.2%	0.0%	186,184	-0.3%
Net add for period ('000)	(2,380)	(2,960)	1,330	4,050	204.5%	-8.8%	4,614	-12.2%
2G subs	79,060	73,000	69,060	66,990	-3.0%	-18.8%	65,774	1.8%
net adds	(3,410)	(6,060)	(3,940)	(2,070)	-47.5%	-5.5%	(3,286)	-37.0%
3G subs	104,140	107,240	112,510	118,630	5.4%	15.1%	120,410	-1.5%
net adds	1,030	3,100	5,270	6,120	16.1%	-7.7%	7,900	-22.5%
CDMA ARPU (Rmb)	55.5	57.4	53.9	52.7	-2.2%	-3.5%	50.3	4.9%
<b>INTERNET/DATA</b>								
Total broadband subs (000s)	102,330	104,130	105,710	106,950	1.2%	6.8%	107,192	-0.2%
Adds	2,230	1,800	1,580	1,240	-21.5%	-39.8%	1,482	-16.3%
Broadband ARPU (Rmb)	60	59	58	59	1.9%	-0.5%	55	7.6%

Source: Company data, Gao Hua Securities Research

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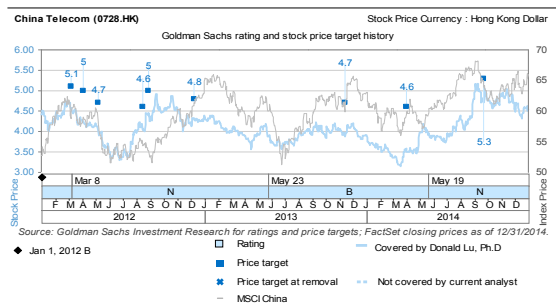
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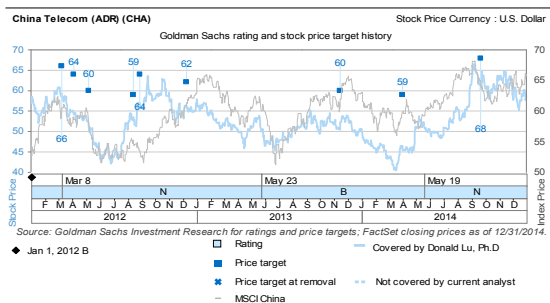
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