

Analyst: Kelvin Li

CHINA TELECOM CORPORATION LIMITED (中國電信)

| | | | |
|-------------------|--------------------------|----------------|----------------|
| Sector | : Telecommunications | Chairman & CEO | : WANG Xiaochu |
| HKSE code | : 00728 | | |
| Market price | : HK\$5.03 (19/03/2015) | | |
| HSI | : 24,468.89 (19/03/2015) | | |
| H shares issued | : 13,877 million | | |
| H-share mkt. cap. | : HK\$69,803 million | | |
| 52 weeks Hi/ Lo | : HK\$5.22 / HK\$3.12 | | |

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

| | FY2014 | FY2013 | <i>Change</i> |
|--|---------------|---------------|---------------|
| | RMB million | RMB million | |
| • Operating revenue | 324,394 | 321,584 | +0.9% |
| • Operating expenses | (295,886) | (294,116) | +0.6% |
| • Operating profit | 28,508 | 27,468 | +3.8% |
| • Profit attributable to shareholders | 17,680 | 17,545 | +0.8% |
| • <i>Adjusted* operating revenue (excluding handset sales)</i> | 287,379 | 278,851 | +3.1% |
| • <i>EBITDA</i> | 94,853 | 96,551 | -1.8% |
| • <i>Adjusted* EBITDA margin</i> | 33.0% | 34.6% | -1.6 ppts |
| • EPS – basic | RMB0.218 | RMB0.217 | +0.8% |
| • DPS – final | HK\$0.095 | HK\$0.095 | +0.0% |
| • DPS – total | HK\$0.095 | HK\$0.095 | +0.0% |

Remark: (*) handset sales was excluded from operating revenue.

- Net profit of China Telecom (the 'Group') was up by a tepid 0.8% y-o-y to RMB17.7 billion for the year ended 31st December 2014, in line with market expectation. The Group reported weaker earnings (-45.4% h-o-h) in the second half, following the VAT (value-added tax) reform started from June 2014.
- Operating revenue inched up by 0.9% y-o-y to RMB324.4 billion in FY14, driven by solid top-line growth in its data and Internet operations, which helped offset declining revenue in the voice businesses as well as reduced handset sales.
- Operating expenses rose marginally by 0.6% y-o-y to RMB295.9 billion in FY14. Network operations and support expenses was up by 29.3% y-o-y to RMB68.7 billion, amid network upgrade and enhancement to facilitate the 4G business development. Nevertheless, it was offset by lower cost of handsets sold and reduced handset subsidy expenses. Overall, the Group's adjusted EBITDA margin slipped to 33.0% in FY14 from 34.6% a year earlier, while EBITDA slipped 1.8% y-o-y to RMB94.6 billion.
- EPS for FY14 was RMB0.218 (FY13: RMB0.217). A final dividend of HK\$0.095 per share was proposed, representing unchanged dividend payout ratio of 35%.

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- As of 31st Dec 2014, the Group had total debts of RMB107.0 billion (31st Dec 2013: RMB110.4 billion). With cash on hand of RMB20.4 billion, the Group's net debt-to-shareholders' equity ratio eased to 29.9% by end of FY14 from 34.0% as of the end of 2013.

Business highlights

- Breakdown of turnover by activities:

| | FY2014 | | FY2013 | | Change |
|--|----------------|---------------|----------------|---------------|--------------|
| | RMB million | % | RMB million | % | |
| Wireline voice | 33,587 | 10.4% | 38,633 | 12.0% | -13.1% |
| Mobile voice | 54,673 | 16.9% | 58,217 | 18.1% | -6.1% |
| Subtotal – Voice | 88,260 | 27.2% | 96,850 | 30.1% | -8.9% |
| Internet | 112,431 | 34.7% | 99,394 | 30.9% | +13.1% |
| Value-added services (VAS) | 38,419 | 11.8% | 36,230 | 11.3% | +6.0% |
| Integrated info application services | 26,939 | 8.3% | 25,233 | 7.8% | +6.8% |
| Telecom network resource services & lease of network equipment | 17,332 | 5.3% | 17,586 | 5.5% | -1.4% |
| Others | 41,013 | 12.6% | 46,291 | 14.4% | -11.4% |
| Subtotal – Non-Voice | 236,134 | 72.8% | 224,734 | 69.9% | +5.1% |
| Total | 324,394 | 100.0% | 321,584 | 100.0% | +0.9% |

- Revenue from **wireline** (or fixed-line) **voice** services fell 13.1% y-o-y in FY14 on continued mobile substitution. As of the end of 2014, the number of access lines in service totalled 143.6 million, down 12.2% y-o-y from 155.8 million a year earlier.
- Revenue from **mobile voice** services fell 6.1% y-o-y to RMB54.7 billion in FY14, as non-voice business substitution speeded up following the VAT reform (Non-voice value-added services are subject to lower VAT rate). By the end of 2014, the Group had 118.63 million 3G/4G subscribers, up 15.5% y-o-y. The overall mobile subscriber base stood at 185.6 million, little changed from a year earlier. The Group's mobile ARPU for FY14 was RMB54.0, down by less than 2% from RMB54.8 in FY13.
- The Group's **non-voice** services continued to gain traction after the VAT reform in mid-2014. Revenue of the non-voice businesses (excluding handset sales) accounted for 61.4% of the Group's total revenue in FY14, up from 56.6% a year earlier. Internet posted the strongest top-line growth of 13.1% y-o-y, fuelled by the Group's fast-growing mobile data services. Meanwhile, broadband revenue grew by a tepid 3.8% y-o-y in FY14, amid increased broadband customer base (+6.8% y-o-y) but depressed broadband ARPU (-4.8% y-o-y).

Outlook & Prospects

- Jump in capex to speed up 3G/4G development*** China granted in late Feb 2015 China Telecom and China Unicom (00762) each the FDD-LTE license to operate the 4G business nationwide, after the two operators carried out trial FDD-LTE 4G services in 56 Mainland cities in 2014. Like its rival China Unicom, the Group plans to raise its capex sharply by 40% to RMB108 billion in 2015 from a year ago in order to speed the FDD-LTE 4G business development and network upgrade.
- FDD-LTE launch to lend support to share prices*** China Telecom's FY14 results failed to impress, as the earnings driver on 3G/4G development seemed to lose steam after the VAT reform. Nonetheless, we would see limited downside to China Telecom's share price, as investors expect the FDD-LTE business launch would help the Group revive growth momentum and earnings. Trading at unimpressive 15.5x FY15E P/E, we give the counter a 'HOLD' rating accordingly.

Recommendation: HOLD

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