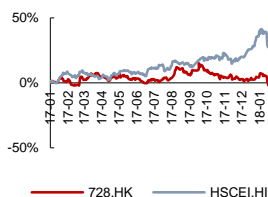


23 February 2018

**Outperform**  
Unchanged

**Market Data: 22 Feb.**

Closing Price (HK\$)	3.46
Price Target (HK\$)	4.05
HSCEI	12,528
HSCCI	4537
52-week High/Low (HK\$)	4.20/3.41
Market Cap (USD Mn)	35,900
Market Cap (HK\$ Mn)	280,025
Shares Outstanding (Mn)	80,932
Exchange Rate (HK\$-US\$)	7.80



Source: Bloomberg

**Analyst**

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**Related Reports**

- "China Telecom (728:HK)—Improving coverage" 28 April 2017
- "China Telecom (728:HK)—Good call" 24 August 2017
- "China Telecom (728:HK)—Strong signal" 30 October 2017

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# Ringling the changes

## CHINA TELECOM (728:HK)

### Financial summary and valuation

	2015	2016	2017E	2018E	2019E
Revenue (Rmbm)	331,202	352,285	372,449	389,059	399,895
YoY (%)	2%	6%	6%	4%	3%
Net income (Rmbm)	20,054	18,134	17,412	18,205	22,197
YoY (%)	13.43%	-9.57%	-3.98%	4.56%	21.93%
EPS (Rmb)	0.25	0.22	0.22	0.22	0.27
Diluted EPS (Rmb)	0.25	0.22	0.22	0.22	0.27
ROE (%)	6.6	5.7	5.3	5.3	6.2
Debt/asset (%)	18.5	17.2	17.9	17.4	17.0
Dividend Yield (%)	3.4	3.8	3.8	3.8	3.8
PE (x)	11.2	12.4	12.9	12.4	10.2
PB (x)	0.7	0.7	0.7	0.7	0.6
EV/Ebitda (x)	3.3	2.7	3.1	2.7	2.4

Note: Diluted EPS is calculated as if all outstanding convertible securities, such as convertible preferred shares, convertible debentures, stock options and warrants, were exercised.

Telecommunications service volume grew 76.4% YoY in 2017, according to latest data released by the Ministry of Industry and Information Technology, but revenue among the major telcos grew at substantially slower mid- single-digits pace as competition increased with China Unicom's (762:HK – BUY) entry into wireless services and China Mobile's (941:HK – N-R) aggressive expansion into wireline services. Taking into account changes in accounting methods, we lower our EPS forecasts from Rmb0.24 to Rmb0.22 in 17E (flat YoY), from Rmb0.26 to Rmb0.22 in 18E (+4.6% YoY) and from Rmb0.30 to Rmb0.27 in 19E (+21.9% YoY). We lower our target price from HK\$4.50 to HK\$4.05. Maintain Outperform rating.

**Service pressure.** Telcos have sought to raise average revenue per user (Arpu) by offering differentiated data packages. However, after Unicom began offering a promotional package featuring unlimited data, we see the race to compete as likely to cap Arpu in the near-term. China Telecom has begun to offer promotional bundled packages with more favourable prices. Net 4G subscriber additions in 17E came to 60m, while we expect net 4G additions in 18E to just 40m. Meanwhile, China Mobile continues to offer free bundled packages for wireline subscribers, slowing growth in wireline subscribers for both China Telecom and Unicom. We expect China Telecom's wireline Arpu to remain stable at current levels, but for China Mobile's overall wireline subscriber base to exceed China Telecom's in 18E.

**Upcoming operating expenses.** As we stated in our industry report Telecom: Sector outlook - *Technological burden* (published 24 January), we consider the 5G network infrastructure roll-out more as a burden than a business opportunity for telecom operators. Taking into consideration a likely heavy 5G capital outlay, telcos' ROEs are likely to decline as a result of the release of the next-generation services. Although lower tower leasing prices (-9% comparing to previous price) will help boost China Telecom's earnings, we do not believe it will be sufficient to fully offset the negative impact from the changes in depreciation accounting method and slow growth in its top line. Meanwhile, although doing so may help the company generate Opex savings, to date we have see no clear signals that the firm is shutting down its 2G networks.

**Maintain Outperform.** we lower our EPS forecasts from Rmb0.24 to Rmb0.22 in 17E (flat YoY), from Rmb0.26 to Rmb0.22 in 18E (+4.6% YoY) and from Rmb0.30 to Rmb0.27 in 19E (+21.9% YoY). The company's stock is currently trading at 12.4x 18E PE and 0.7x 18E PB. We lower our target price from HK\$4.50 to HK\$4.05, representing a 0.8x 18E PB multiple. With 16.7% upside, we maintain our Outperform rating.

根据工信部数据披露, 中国电信行业业务总量在 2017 年同比增长 76.4%。然而受中国联通(762.HK-买入)无线网业务扩张及中国移动(941.HK-未评级)固网业务扩张影响, 整体电信业务收入仅中单位数增长。考虑到公司会计科目变化, 我们将电信 17 年 EPS 从 0.24Rmb 下调至 0.22Rmb(同比持平), 18 年 EPS 从 0.26Rmb 下调至 0.22Rmb(同比增长 4.56%), 19 年 EPS 从 0.3Rmb 下调至 0.27Rmb(同比增长 21.93%)。我们将目标价从 4.5 港币下调至 4.05 港币, 维持增持评级。

**服务型收入压力。**国内电信运营商期望通过不同流量套餐来提升其平均用户收入。然而, 在中国联通提供无线流量套餐后。我们看到在短期平均用户收入增长出现瓶颈。中国电信也开始提供多元化且极具性价比的捆绑套餐。其 4G 用户数增长在 2017 年为 6000 万, 我们预计 2018 年 4G 用户增长约为 4000 万。与此同时, 中国移动也在持续性通过免费捆绑固网套餐提升其市场占比, 使得中国联通及中国电信固网用户数增长趋缓。我们预计中国电信固网平均用户收入将维持现在水平。而中国移动的固网用户基数可能会在 18 年超越中国电信。

**未来运营成本。**根据我们之前的行业报告, 我们认为 5G 建设对于国内运营商而言可能并不是机会而是负担。考虑到未来沉重的 5G 资本支出, 未来运营商的 ROE 可能还将进一步下滑。尽管中国铁塔租赁费用(较过去情况下调约 9%价格)下调将提升电信公司利润, 但我们认为这并不能抵消掉未来折旧准则及缓慢收入增长带来的负影响。尽管我们认为关闭 2G 网络会对三大运营商成本有所节省。但现在我们并未看到有任何关闭 2G 网络迹象。

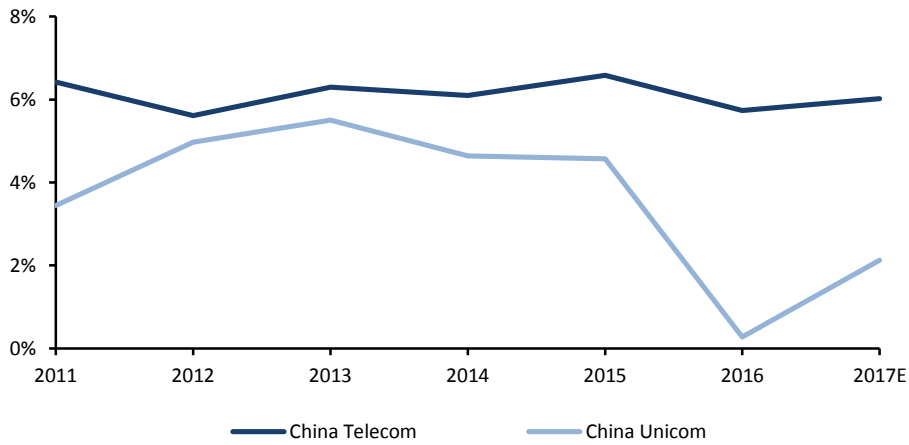
**维持增持。**我们将公司 17 年 EPS 从 0.24Rmb 下调至 0.22Rmb(同比持平), 18 年 EPS 从 0.26Rmb 下调至 0.22Rmb(同比增长 4.56%), 19 年 EPS 从 0.3Rmb 下调至 0.27Rmb(同比增长 21.93%)。公司如今股价对应约 12.4x 18E PE 及 0.7X PB,我们将目标价从 4.5 港币下调至 4.05 港币, 对应 0.8X 18 年 PB。如今股价对应 16.7%空间, 维持增持评级。

Fig 1: Key operating data

(m)	2017	2017 3Q	2016
Mobile subscribers	249.96	240.56	215
4G subscribers	182.04	167.52	121.87
Broadband subscribers	133.53	131.31	123.12
FTTH subscribers	126.17	121.80	105.99
Access line in service	121.80	123.31	126.86
Households		75.75	78.64
Government enterprises		40.34	40.41
Public telephones		7.22	7.81

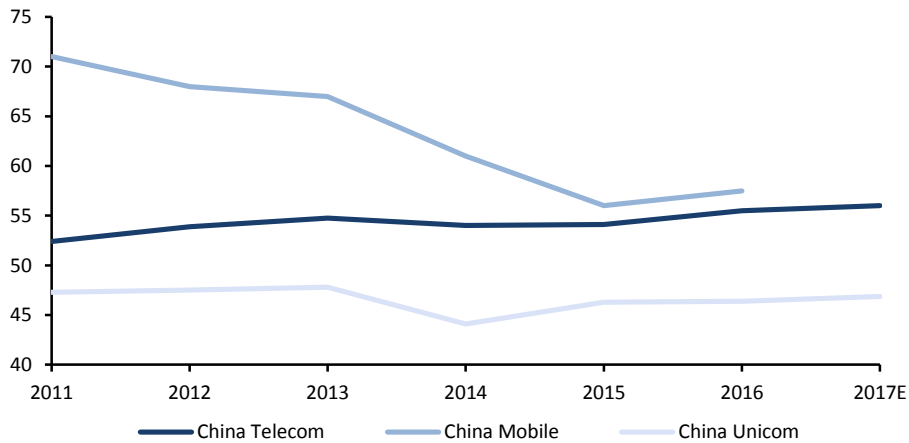
Source: Company, SWS Research

Fig 2: China Telecom and Unicom ROE



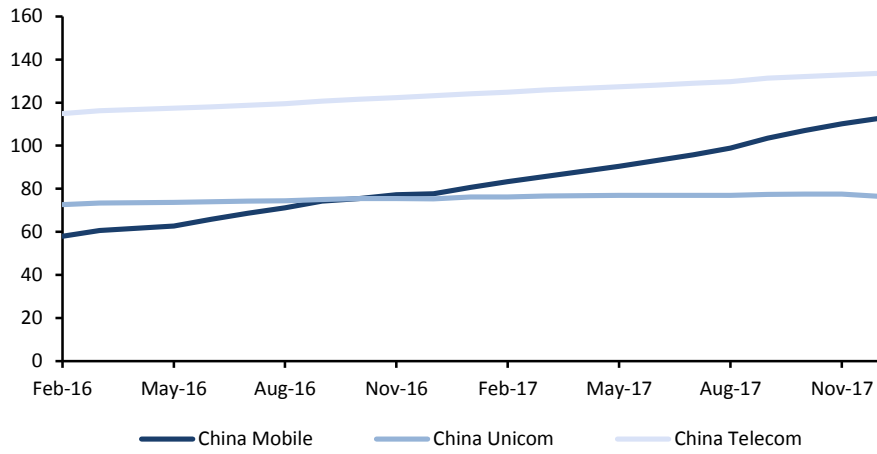
Source: Company, SWS Research

Fig 3: Arpu trend



Source: Company, SWS Research

Fig 4: Wireline subscriber trends



Source: Company, SWS Research

Income Statement	2015	2016	2017E	2018E	2019E
Revenue	331,202	352,285	372,449	389,060	399,895
D&A	-67,664	-67,938	-74,504	-81,621	-82,350
Networks, operation and support expenses	-81,240	-94,092	-90,382	-92,505	-93,171
SG&A	-54,472	-56,417	-63,316	-66,140	-67,982
Employee benefit expenses	-52,541	-54,460	-64,061	-66,918	-68,782
other income-net	-48,843	-52,177	-53,380	-54,011	-54,423
Total operating expense	-304,760	-325,084	-345,643	-361,196	-366,708
Operating profits	26,442	27,201	26,806	27,864	33,187
Financing cost	-4,273	-3,235	-3,490	-3,490	-3,490
Profit before income tax	26,693	24,097	23,315	24,373	29,696
Income tax expense	-6,551	-5,988	-5,829	-6,093	-7,424
Profit for the year	20,142	18,109	17,487	18,280	22,272
Minority interest	88	25	75	75	75
Net income	20,054	18,134	17,412	18,205	22,197

Source: Company, SWS Research

Balance sheet	2015	2016	2017E	2018E	2019E
Current Assets	78,108	73,972	86,029	109,021	127,959
Bank balances and cash	34,388	27,948	37,301	59,273	77,545
Trade and other receivables	37,334	40,893	43,597	44,617	45,282
Inventories	6,281	5,081	5,081	5,081	5,081
Other current assets	105	50	51	51	51
Long-term investment	1,624	1,535	1,535	1,535	1,535
PP&E	373,981	389,648	417,359	422,564	414,939
Intangible and other assets	10,739	11,244	14,842	17,568	19,502
Total Assets	629,561	652,368	675,808	694,001	697,451
Current Liabilities	255,929	318,998	322,492	327,889	330,749
Borrowings	116,550	112,426	121,062	121,062	121,062
Trade and other payables	120,209	123,550	126,739	129,147	130,056
Other current liabilities	82,934	91,088	90,461	93,451	95,401
Long-term liabilities	64,830	9,370	17,075	17,075	17,075
Total Liabilities	324,810	336,073	347,272	352,669	355,529
Minority Interests	967	971	971	971	971
Shareholder Equity	303,784	315,324	327,565	340,361	355,951
Total Liabilities and equity	629,561	652,368	675,808	694,001	712,451

Source: Company, SWS Research

Cash Flow statement	2015	2016	2017E	2018E	2019E
Profit before taxation	26,693	24,097	23,315	24,373	29,696
Plus : Depr. and amortisation	(67,664)	(67,938)	(74,504)	(81,621)	(82,350)
Finance cost	(4,273)	(3,235)	(3,490)	(3,490)	(3,490)
Losses from investments	2,092	5,643	(627)	2,990	1,950
Change in working capital	18,940	9,545	485	1,387	244
Others					
CF from operating activities	108,750	101,130	91,848	104,279	106,817
CAPEX	(102,022)	(96,772)	(89,000)	(80,000)	(85,000)
Proceeds from disposal of property	755	1,560	3,114	3,178	3,137
Other CF from investing activities	2,733	2,550	0	0	0
CF from investing activities	(102,250)	(99,038)	(85,886)	(76,822)	(81,863)
Equity financing	0	0	0	0	0
Net change in liabilities	10,999	(2,979)	8,636	0	0
Dividend and interest paid	6,160	(6,489)	5,246	5,484	6,682
Other CF from financing activities	(30)	(87)	0	0	0
CF from financing activities	4,809	(9,555)	3,390	(5,484)	(6,682)
Net cash flow	11,433	(7,252)	9,353	21,972	18,272

Source: Company, SWS Research

Key Financial Ratios					
	2015	2016	2017E	2018E	2019E
<b>Ratios per share (Rmb)</b>					
Earnings per share	0.25	0.22	0.22	0.22	0.27
Operating CF per share	1.34	1.25	1.13	1.29	1.32
Dividend per share	0.10	0.11	0.11	0.11	0.11
Net assets per share	3.77	3.91	4.06	4.22	4.41
<b>Key Operating Ratios (%)</b>					
ROE	6.58%	5.73%	5.30%	5.33%	6.22%
EBITDA Margin	28.41%	27.01%	27.20%	28.14%	28.89%
EBIT Margin	7.98%	7.72%	7.20%	7.16%	8.30%
Growth rate of Revenue(YoY)	2.10%	6.37%	5.72%	4.46%	2.79%
Growth rate of Profit(YoY)	13.43%	-9.57%	-3.98%	4.56%	21.93%
Debt-to-asset ratio	18.50%	17.23%	17.90%	17.43%	16.98%
Turnover rate of net assets	108.68%	111.38%	113.37%	113.98%	112.04%
Turnover rate of total assets	52.61%	54.00%	55.11%	56.06%	56.13%
Effective tax rate (%)	24.54%	25.00%	25.00%	25.00%	25.00%
Dividend yield (%)	3.41%	3.77%	3.77%	3.77%	3.77%
<b>Valuation Ratios (X)</b>					
P/E	11.24	12.42	12.94	12.38	10.15
P/B	0.74	0.71	0.69	0.66	0.63
EV/Sales	0.94	0.72	0.85	0.76	0.69
EV/EBITDA	3.31	2.68	3.13	2.69	2.39

Source: Company, SWS Research

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BUY: Share price performance is expected to generate more than 20% upside over a 12-month period.

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