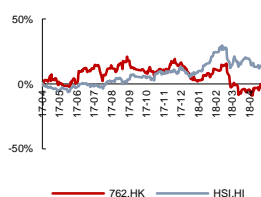


17 August 2018

Hold
Downgraded

Market Data: 16 Aug.

Closing Price (HK\$)	9.14
Price Target (HK\$)	9.50
HSCEI	10,535
HSCCI	4,043
52-week High/Low (HK\$)	12.36/9.26
Market Cap (USD Mn)	36,325
Market Cap (HK\$ Mn)	283,337
Shares Outstanding (Mn)	30,598
Exchange Rate (HK\$-US\$)	7.80



Source: Bloomberg

Analyst

Marcus Li
A0230518010004
BHK128
lixw@swsresearch.com

Related Reports

- "China Unicom (00762:HK) — Temporary outrage" 5 March 2018
- "China Unicom (00762:HK) — Clear line" 16 March 2018
- "China Unicom (00762:HK) — Solid signals" 23 April 2018

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Diminishing bandwidth

CHINA UNICOM (00762:HK)

Financial summary and valuation

	2016	2017	2018E	2019E	2020E
Revenue (Rmbm)	274,197	274,829	288,371	302,488	318,846
YoY (%)	-1.03%	0.23%	4.93%	1.38%	1.38%
Net income (Rmbm)	630	1,850	6,515	14,988	22,582
YoY (%)	-94.04%	193.65%	252.15%	130.06%	50.67%
EPS (Rmb)	0.03	0.07	0.21	0.49	0.74
Diluted EPS (Rmb)	0.03	0.07	0.21	0.49	0.74
ROE (%)	0.10%	0.32%	1.11%	2.67%	4.02%
Liability/asset (%)	62.93%	46.79%	47.39%	43.40%	40.95%
Dividend yield (%)	0.00%	0.32%	0.89%	2.04%	3.07%
PE (x)	414.10	155.63	51.17	22.24	14.76
PB (x)	0.83	0.62	0.78	0.76	0.73
EV/Ebitda (x)	3.93	2.51	3.06	2.46	2.08

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

China Unicom reported 1H18 service revenue of Rmb134.4bn, representing growth of 8.3% YoY (industry average: 4.1% YoY) and net profit of Rmb5.9bn, up 1.4x YoY, with the rapid pace of growth due mainly to a low comparative base. As we anticipate intensifying competition in future, we lower our EPS forecasts from Rmb0.36 to Rmb0.21 in 18E (+2.5x YoY), from Rmb0.65 to Rmb0.49 in 19E (+1.3x YoY) and from Rmb0.92 to Rmb0.74 in 20E (+50.7% YoY). We adjust our target price from HK\$12.10 to HK\$9.50, and downgrade our rating to Hold.

Uncertain future top line growth. Mobile service revenue increased 9.7% YoY. Mobile data usage per user ("DOU") reached 5.1GB, up 2.2x YoY. However, the company's average revenue per mobile subscriber ("Arpu") fell slightly to Rmb47.9. We highlight our rising concern over the firm's 2H18E prospects given China Mobile's (00941:HK - N-R) more aggressive price competition, starting 2Q18, while the government-mandated cancellation of data roaming charges for all operators will become effective on 1 July. Meanwhile, growth in Unicom's wireless data usage mainly comes from the carrier offering unlimited data packages and will thus not make positive revenue contribution. More notably, 4G subscriber net additions per month dropped from c.6.4m in 1Q18 to c.3m in 2Q18. We project total service revenue growth of 6.1% YoY in full-year 2018E. Nevertheless, the company has made some progress in sales-related cost savings. Its handset subsidy dropped 52.3% and selling & marketing expense increased just 2.4% YoY, below the pace of its service revenue growth. We see fixed-line broadband access revenue as likely to remain flat in future, considering the already-high fixed-line broadband penetration rate in China. We do note positive industrial internet revenue growth, rising 39% YoY in 1H18, vs company guidance of 30% YoY, which we attribute to the firm's cooperation with strategic investors.

Capex cycle. Unicom guided total capex of Rmb50bn for 2018. The company will focus investment on key cities, 4G networks and regions with high data traffic and returns. The company will launch 5G network trials in 17 cities, focusing on 10 industry applications. The initial investment for the first 1,000 5G base stations will be c.Rmb400m.

Other updates. Thanks to strong free cash flow and share placement completed in 2017, the company's liability-to-assets ratio dropped to 43.8%. Thus, its finance cost dropped 64% YoY to Rmb1.1bn. Employee cost increased 21.6% YoY, mainly due to strengthened performance-based incentives and recruitment of new talent in the firm's new businesses.

Downgrade to Hold. We lower our EPS forecasts from Rmb0.36 to Rmb0.21 in 18E (+2.5x YoY), from Rmb0.65 to Rmb0.49 in 19E (+1.3x YoY) and from Rmb0.92 to Rmb0.74 in 20E (+50.7% YoY). The company is currently trading at 0.8x 18E PB. We lower our target price from HK\$12.10 to HK\$9.50, representing 0.8x 18E PB. With 3.9% upside, we downgrade our rating from Outperform to Hold.

中国联通 2018 上半年收入为人民币 1344 亿元，同比增长 8.3%（行业平均增速为 4.1%），净利润为人民币 59 亿元，因去年同期基数较低，录得同比增长 1.4 倍。我们将每股盈利预测从人民币 0.36 元下调至 0.21 元人民币（同比增长 2.5 倍），19 年从人民币 0.65 元人民币下调至 0.49 元人民币（同比增长 1.3 倍），20 年，从人民币 0.92 元下调至 0.74 元人民币（同比增长 50.7%）。我们将目标价从 12.1 港币下调至 9.5 港币，评级从增持下调为中性。

收入增速的不确定。移动服务收入同比增长 9.7%。手机用户流量使用量达到 5.1Gb，同比增长 2.2 倍。但公司移动用户的 Arpu 值小幅下降至 47.90 元人民币，同时，因中国移动（941.HK，未评级）于 2 季度开始的价格战，以及 7 月 1 日即将取消的漫游费，我们对下半年公司 Arpu 的表现更为担忧。因公司流量数据的增量主要来自于无限流量包，因此不会对中国联通产生积极的收入贡献。更值得注意的是，联通每月 4G 用户净增数从第一季度的平均每月 640 万降至第二季度的 300 万。我们预计 18 年总服务收入增长预测为 6.1%。不过公司在销售成本方面取得了一些进展，其手机补贴费用下降了 52.3%，销售和营销费用仅增加 2.4%，低于其收入增速。固网业务，考虑到中国较高的固网宽带渗透率，我们认为公司固网宽带收入将维持。归功于与战略投资者的合作，公司工业互联网收入 1 季度同比增长 39%（公司指引 30%）。

资本支出周期。公司给出 2018 年总资本支出指引为 500 亿元人民币，将重点集中在主要城市，4G 网络以及高数据流量回报的地区。公司将在 17 个城市启动 5G 网络建设，集中于 10 个行业应用。首批 1000 个 5G 基站的初始投入将为 4 亿人民币。

其他更新。因公司强劲的自由现金流和 2017 年配售完成，公司的资产负债率降至 43.8%，因此其财务成本下降 64%，从 31 亿下降至 11 亿。公司员工成本同比增长 21.6%，主要是由于深化激励机制改革，强化绩效激励和创新业务人才的引进。

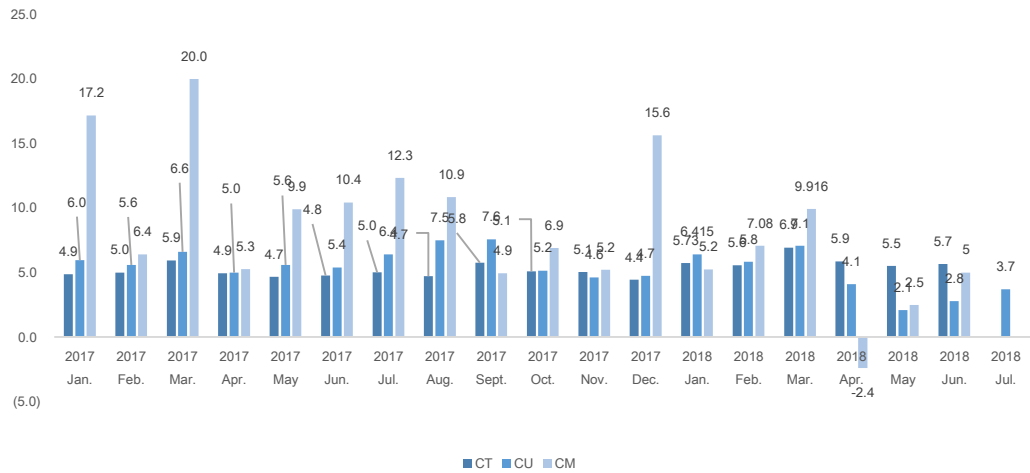
下调至中性。我们将每股盈利预测从人民币 0.36 元下调至 0.21 元人民币（同比增长 2.5 倍），19 年从人民币 0.65 元人民币下调至 0.49 元人民币（同比增长 1.3 倍），20 年，从人民币 0.92 元下跌至 0.74 元人民币（同比增长 50.7%）。该公司当前交易在 0.8 倍 18E PB。我们将目标价由 12.10 港元下调至 9.50 港元，相当于 0.8 倍 18E PB，有 3.9% 的上涨空间，我们将评级下调至中性。

Fig 1: 1H18 results highlights

Item	1Q Result	1H results
Ebitda growth	14.0% YoY	4.9% YoY
Wireless revenue growth	11.6% YoY	9.7%
4G subscriber monthly data usage	6.5GB	7.6GB
Industrial internet revenue	Rmb5.9bn	Rmb11.7bn
Wireless Arpu growth	2.6% YoY	Flat

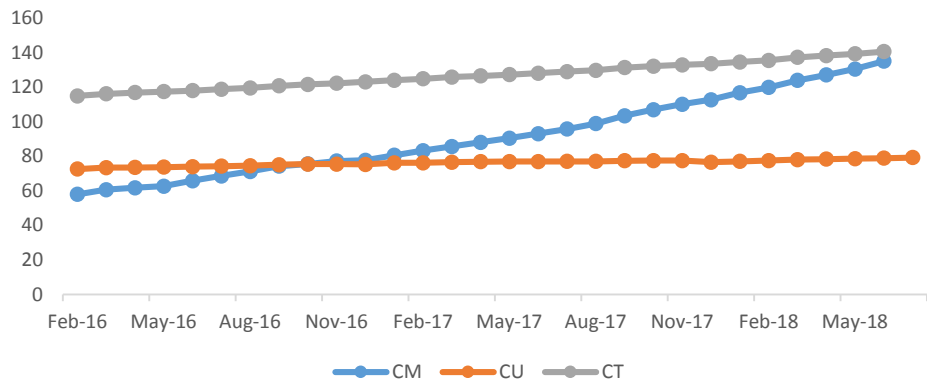
Source: Company data, SWS Research

Fig 2: 4G subscriber net additions for the three main operators



Source: Company data, SWS Research

Fig 3: fix-line broadband subscriber base



Source: Company data, SWS Research

Fig 4: Capex

(Rmbbn)	2017A	2018E	YoY
Total Capex	42.1	Less than 50	+18.7%
Of which: spending on mobile networks	16.0	Less than 18.5	+15.6%
spending on fixed-line broadband & data	8.8	Less than 10	+13.6%
spending on Infrastructure, transmission & others	17.3	Less than 21.5	+24.3%

Source: China Unicom, SWS Research

Company financials

Fig 7: Income Statement

	2016	2017	2018E	2019E	2020E
Revenue	274,197	274,829	288,371	302,488	318,846
Interconnection charges	(12,739)	(12,617)	(14,284)	(15,252)	(16,314)
Depreciation and amortization	(76,805)	(77,492)	(76,531)	(72,380)	(70,091)
Networks, operations and support expenses	(51,167)	(54,507)	(58,471)	(62,215)	(66,223)
Employee benefit expenses	(36,907)	(42,471)	(44,888)	(47,932)	(51,269)
Costs of telecommunications products sold	(36,529)	(26,643)	(26,242)	(22,044)	(18,406)
Other operating expenses	(57,357)	(57,166)	(58,538)	(62,444)	(66,738)
Finance costs	(5,017)	(5,734)	(3,189)	(2,630)	(2,085)
Interest income	1,160	1,647	1,200	1,059	990
Other income - net	1,364	1,365	1,366	1,367	1,368
Other income- net	1,591	1,854	0	0	0
Profit before income tax	784	2,593	8,629	19,851	29,910
Income tax expenses	(154)	(743)	(2,114)	(4,864)	(7,328)
Profit for the year	630	1,850	6,515	14,988	22,582

Source: Company, SWS Research

Fig 8: Balance Sheet

	2016	2017	2018E	2019E	2020E
cash and cash equivalent	23,633	32,836	74,564	64,942	60,326
inventory and consumables	2,431	2,239	2,257	1,896	1,583
account receivable	13,622	13,964	14,732	15,608	16,634
Prepayments and other current assets	14,023	13,801	13,617	14,538	15,600
Amounts due from related parties	22,724	3,274	3,274	3,274	3,274
Amounts due from domestic carriers	3,908	4,683	2,884	3,025	3,188
Short-term bank deposits	1,754	5,526	5,425	5,664	5,664
Financial Asset	123	160	160	160	160
CurrentAsset	82,218	76,722	117,152	109,106	106,429
FixedAsset	451,115	416,596	389,907	372,380	374,644
Lease prepayments	9,436	9,313	9,499	9,689	9,883
GoodWill	2,771	2,771	2,771	2,771	2,771
Interests in the Associate Companies	32,248	33,233	33,233	33,233	33,233
co-company sharing	1,175	2,368	2,368	2,368	2,368
receivable from related company	0	0	0	0	0
Financial assets at fair value through other comprehensive income	4,326	4,286	4,286	4,286	4,286
Other assets	24,879	20,721	20,908	21,240	21,694
Deferred income tax assets	5,986	5,973	5,973	5,973	5,973
Non-currentAsset	531,936	495,261	468,946	451,940	454,853
TotalAsset	614,154	571,983	586,097	561,046	561,281
Non-currentLiability	43,817	25,014	33,308	13,308	3,808
CurrentLiability	342,655	242,622	244,436	230,167	226,015
TotalLiability	386,472	267,636	277,744	243,475	229,823
Equity	227,682	304,347	308,354	317,571	331,459
TotalLiability&Equity	614,154	571,983	586,097	561,046	561,281

Source: Company, SWS Research

Fig 9: Cash Flow statement

	2016	2017	2018E	2019E	2020E
Profit before income tax	625	1,828	6,515	14,988	22,582
Add: depreciation and amortisation	76,805	77,492	73,185	68,982	66,620
Amortisation					
Net working capital	(3,898)	1,966	356	2,509	2,382
Other non-cash adjustments	1,061	3,766	1,983	(1,062)	(1,225)
Proceeds from China Tower					
Net cash inflow from operating activities	74,593	85,054	85,384	88,814	93,830
Cash flow from Investment activities					
Proceeds from disposal of property	6,392	22,121	3,504	3,545	3,616

Purchase of property, plant and equipment	(98,293)	(61,489)	(50,000)	(55,000)	(72,500)
Other fixed assets	0	0	(3,532)		
Decrease (increase) in short-term bank deposits	68	0	0	0	0
Less: investment increase	(181)	0	0	0	0
Other investment activities	(3,735)	(7,968)	30,347	7,518	7,559
Net cash outflow from investing activities	(95,749)	(47,336)	(19,682)	(47,667)	(65,251)
Increase in debt	226,116	0	0	0	0
Less: decrease in debt	197,759	0	0	0	0
Net debt increase	28,357	(103,368)	(21,567)	(45,000)	(24,500)
Capital increase	0	74,954	0	0	0
Total dividend paid	(4,071)	0	2,508	5,770	8,694
Net cash inflow from financing activities	22,877	(28,414)	(24,075)	(50,770)	(33,194)
Exchange rate fluctuation	0	0	0	0	0
Net increase (decrease) in cash and cash equivalents	1,878	9,304	41,627	(9,623)	(4,616)
Cash and cash equivalents, beginning of the year	21,755	23,633	32,937	74,564	64,942
Cash and cash equivalents, end of the year	23,633	32,937	74,564	64,942	60,326

Source: Company, SWS Research

Fig 10: Key Financial Ratios

	2016	2017	2018E	2019E	2020E
Ratios per share (Rmb)					
Earnings per share	0.03	0.07	0.21	0.49	0.74
OperatingCFPerShare	3.11	3.55	2.79	2.90	3.07
DividendPerShare	0.00	0.03	0.08	0.19	0.28
Key Operating Ratios(%)					
NetAssetsPerShare	9.51	12.71	10.08	10.38	10.83
ROIC	0.85%	0.95%	1.54%	3.24%	4.63%
ROE	0.28%	0.61%	2.11%	4.72%	6.81%
GrossProfitMargin					
EBITDAMargin	29.57%	30.30%	29.80%	30.61%	31.33%
EBITMargin	1.56%	2.11%	3.27%	6.69%	9.35%
GrowthRateOfRevenue	-1.03%	0.23%	4.93%	1.38%	1.38%
GrowthRateOfProfit	-94.04%	193.65%	252.15%	130.06%	50.67%
DebtToAssetRatio	0.29	0.13	0.13	0.05	0.01
TurnoverRateOfNetAssets	1.20	0.90	0.94	0.95	0.96
TurnoverRateOfTotalAssets	0.45	0.48	0.49	0.54	0.57
EffectiveTax rate	24.50%	24.50%	24.50%	24.50%	24.50%
DividendYield	0.00%	0.32%	0.89%	2.04%	3.07%
Valuation Ratios (X)					
PE	414.10	155.63	51.17	22.24	14.76
PB	0.83	0.62	0.78	0.76	0.73
EVEBITDA	3.93	2.51	3.06	2.46	2.08

Source: Company, SWS Research

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Trading BUY: Share price performance is expected to generate more than 20% upside over a 6-month period.

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

Outperform: Share price performance is expected to generate between 10-20% upside over a 12-month period.

Hold: Share price performance is expected to generate between 10% downside to 10% upside over a 12-month period.

Underperform: Share price performance is expected to generate between 10-20% downside over a 12-month period.

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

Industry Investment Rating:

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Equal weight: Industry performs about the same as that of the whole market;

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