

China Telecom

Bloomberg: 728 HK EQUITY | Reuters: 0728.HK

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DBS Group Research . Equity

18 Mar 2022

BUY

Last Traded Price (17 Mar 2022): HK\$2.95 (HSI : 21,501)
Price Target 12-mth: HK\$4.28 (45% upside) (Prev HK\$4.20)

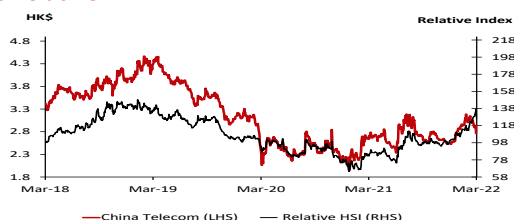
Analyst

Tsz Wang Tam +852 36684195 tszwangtam@db.com
Harry Zhuang harryzhuangy@db.com

What's New

- FY21 results in line; net profit increased by 24.5% y-o-y
- Industrial Digitalisation business expanded by 17.8% y-o-y, accounting for 24.6% of total service revenue
- Dividend payout ratio reached 60% in FY21, in line with market expectations
- Maintain BUY for its strong earnings growth, with a TP of HK\$4.28

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2020A	2021A	2022F	2023F
Turnover	393,561	439,552	486,009	520,671
EBITDA	118,880	124,350	132,795	140,514
Pre-tax Profit	27,387	33,864	35,807	38,773
Net Profit	20,848	25,948	27,183	29,434
Net Profit Gth (Pre-ex) (%)	1.6	24.5	4.8	8.3
EPS (RMB)	0.26	0.31	0.30	0.32
EPS (HK\$)	0.32	0.38	0.37	0.40
EPS Gth (%)	1.6	19.3	(3.3)	8.3
Diluted EPS (HK\$)	0.32	0.38	0.37	0.40
DPS (HK\$)	0.13	0.21	0.24	0.28
BV Per Share (HK\$)	5.53	5.77	5.93	6.09
PE (X)	9.3	7.8	8.1	7.5
P/Cash Flow (X)	1.5	1.5	1.7	1.6
P/Free CF (X)	4.5	4.0	6.0	5.0
EV/EBITDA (X)	2.2	1.5	1.3	1.0
Net Div Yield (%)	4.3	7.1	8.1	9.4
P/Book Value (X)	0.5	0.5	0.5	0.5
Net Debt/Equity (X)	0.2	CASH	CASH	CASH
ROAE (%)	5.8	6.6	6.3	6.6
Adi Net Profit (%)	1.6	17.7	10.8	8.3
Earnings Rev (%)			1	1
Consensus EPS (RMB)			0.31	0.34
Other Broker Recs:		B:29	S:0	H:0

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Set for market share gains in 5G

Investment Thesis

Co-building and co-sharing one 5G network with China Unicom (CU, 762 HK) to narrow competitive disadvantage against China Mobile (CM, 941 HK) on network quality and coverage.

Expect 5G penetration to increase from 50% in FY21 to 69% in FY22 for China Telecom, supported by more choices of 5G handset models and proliferation of mobile multimedia content. We expect mobile ARPU to improve by 2% in FY22.

Accelerated earnings growth to support valuation re-rating.

Adjusted net profit growth accelerated from c.2% in FY20 to 18% in FY21 and will continue to grow by c.11% and c.8% for FY22 and FY23, respectively. This should support a valuation re-rating.

Valuation:

The stock is trading at a c.8x FY22F PE, 1.5SD below its historical average, with a decent yield of c.8%. Our TP of HK\$4.28 is based on a 12x FY22F PE, in line with its historical average.

Where we differ:

Expect market share gains. While the market expects CM to maintain its dominant market share of c.60% in the 5G era, the implementation of a mobile number portability policy will reduce customer stickiness. Meanwhile, CT is co-building and co-sharing the 5G network with CU, which will improve its network quality and enable it to gain market share.

Key Risks to Our View:

Policy risks. China's telecom sector is exposed to policy risks, management reshuffles, and tariff cuts. This could be unfavourable to business performance.

Irrational competition in the mobile market. Irrational competition for mobile subscriber market share could lead to higher ARPU pressure.

At A Glance

Issued Capital (m shrs)	91,507
Mkt Cap (HK\$/US\$m)	269,946 / 34,527
Major Shareholders (%)	
GIC Private Limited	14.0
Free Float (%)	86.0
3m Avg. Daily Val. (US\$m)	28.73
GICS Industry: Communication Services / Telecommunication Services	



Watchlist the stock on Insights Direct to receive prompt updates



WHAT'S NEW**FY21 results in line; higher capex underpins Industrial Digitalisation business growth****FY21 results highlights**

Operating revenue grew by 11.7% y-o-y to Rmb439.6 billion in FY21, with service revenue up by 7.8% y-o-y to Rmb402.8 billion. Mobile service revenue increased by 7.5% y-o-y to Rmb195.2 billion. Wireline service revenue increased by 8.1% y-o-y to Rmb207.6 billion. Revenue from Industrial Digitalisation increased by 17.8% to Rmb98.9 billion, contributing 24.6% of total service revenue, up by 2.1ppts.

Mobile ARPU increased by 2% y-o-y to Rmb45 in FY21, thanks to a 25.8ppts increase in the 5G penetration rate to 50.4%.

EBITDA increased by 4.2% y-o-y to Rmb123.9 billion in FY21, with EBITDA as a percentage of service revenue contracting 1ppt to 30.8%. Net profit increased by 24.5% y-o-y to Rmb25.9 billion in FY21 and adjusted net profit increased by 17.7% to Rmb24.5 billion, excluding a one-off after-tax gain from the disposals of subsidiaries, in line with the preliminary results.

The company proposed a final dividend of Rmb0.17 per share (pre-tax), representing a payout ratio of 60% in FY21 (vs. c.40% in FY20), in line with market expectations.

Outlook

Management has set a mobile and 5G package subscribers net-adds target of 15m and 80m in FY22 respectively. We expect 5G penetration to increase from 50% in FY21 to 69% in FY22, which will support mobile ARPU and mobile service revenue to improve by 2.0% and 7.3% in FY22, respectively.

Capex was Rmb86.7 billion in FY21, slightly lower than the original guidance of Rmb87 billion, representing a 2.2% y-o-y growth from FY20. The company has guided for a 7% higher capex of Rmb93 billion in FY22, with 5G capex declining 10% to Rmb34 billion and capex for Industrial Digitalisation business increasing 62% to Rmb27.9 billion. With the increasing capex, management targeted to achieve a similar growth rate for the Industrial Digitalisation business in FY22 as FY21.

Besides, we expect CT to further increase its dividend payout ratio to 65% and 70% in FY22 and FY23, respectively. The company will also start to declare interim dividend in FY22.

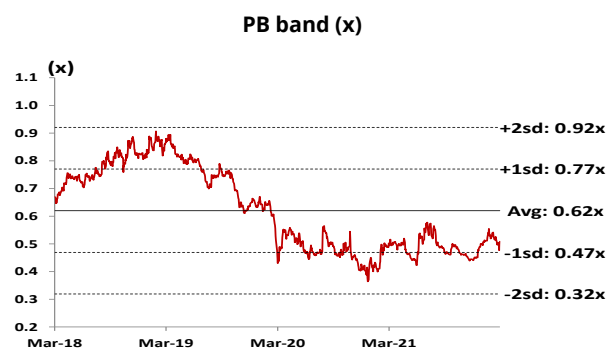
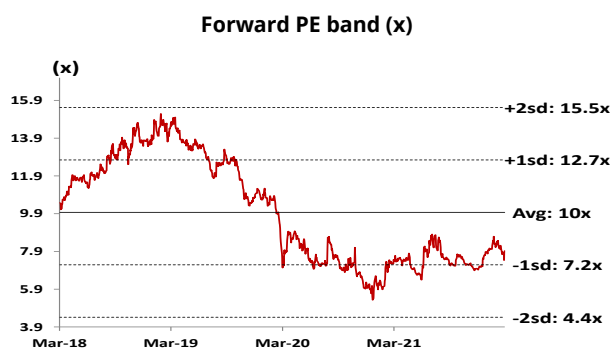
We have raised our earnings estimates by c.1% each for FY22 and FY23, with a higher growth assumption for Industrial Digitalisation business due to higher capex. We forecast adjusted net profit to grow by 10.8% and 8.3% in FY22 and FY23, respectively. We maintain BUY on CT for its strong earnings growth with a TP of HK\$4.28. Our TP is pegged to a 12x FY22 PE, in line with its historical average. The stock also offers an attractive yield of c.8%.

Company Background

China Telecom (CT) is an integrated telecom operator in mainland China. It provides 2G/3G services based on code-division multiple access (CDMA) technology and 4G services mainly based on Frequency Division-Long Term Evolution (FD-LTE) technologies, as well as 5G services based on 5G SA network. Its fixed-line business mainly covers southern China.

China Telecom

Historical PE and PB band



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Mobile sub net add (m)	32.6	15.5	21.4	15.0	8.0
Mobile ARPU (Rmb)	45.8	44.1	45.0	45.9	46.6
EBITDA margin (%)	31.2	30.2	28.2	27.3	27.0
Broadband sub net add (m)	7.3	5.4	11.2	8.0	5.0
Fixed-line sub net add (m)	(5.6)	(3.0)	(1.2)	(4.2)	(4.0)

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (RMB m)					
Mobile	175,546	181,687	195,244	209,423	218,661
Broadband	68,413	71,872	76,548	81,831	85,742
Industrial Digitalisation	76,538	83,968	98,945	116,755	134,268
Sales of Goods and Others	18,124	19,763	36,725	48,000	54,000
All other segments	37,113	36,271	32,090	30,000	28,000
Total	375,734	393,561	439,552	486,009	520,671

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	375,734	393,561	439,552	486,009	520,671
Cost of Goods Sold	(346,664)	(364,921)	(408,605)	(451,589)	(483,983)
Gross Profit	29,070	28,640	30,947	34,420	36,689
Other Opng (Exp)/Inc	0	0	0	0	0
Operating Profit	29,070	28,640	30,947	34,420	36,689
Other Non Opng (Exp)/Inc	30	60	2,244	1,000	800
Associates & JV Inc	1,573	1,701	1,966	1,800	1,800
Net Interest (Exp)/Inc	(3,639)	(3,014)	(1,293)	(1,413)	(516)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	27,034	27,387	33,864	35,807	38,773
Tax	(6,322)	(6,307)	(7,716)	(8,415)	(9,112)
Minority Interest	(195)	(232)	(200)	(210)	(227)
Preference Dividend	0	0	0	0	0
Net Profit	20,517	20,848	25,948	27,183	29,434
Net Profit before Except.	20,517	20,848	25,948	27,183	29,434
EBITDA	117,215	118,880	124,350	132,795	140,514
Growth					
Revenue Gth (%)	(0.4)	4.7	11.7	10.6	7.1
EBITDA Gth (%)	12.5	1.4	4.6	6.8	5.8
Opg Profit Gth (%)	1.2	(1.5)	8.1	11.2	6.6
Net Profit Gth (%)	(3.3)	1.6	24.5	4.8	8.3
Margins & Ratio					
Gross Margins (%)	7.7	7.3	7.0	7.1	7.0
Opg Profit Margin (%)	7.7	7.3	7.0	7.1	7.0
Net Profit Margin (%)	5.5	5.3	5.9	5.6	5.7
ROAE (%)	5.9	5.8	6.6	6.3	6.6
ROA (%)	3.0	2.9	3.5	3.5	3.6
ROCE (%)	4.7	4.5	4.7	4.9	5.1
Div Payout Ratio (%)	44.5	40.3	60.0	65.0	70.0
Net Interest Cover (x)	8.0	9.5	23.9	24.4	71.1

Source: Company, DBS HK

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Interim Income Statement (RMB m)

FY Dec	2H2019	1H2020	2H2020	1H2021	2H2021
Revenue	185,246	193,803	199,758	219,237	220,315
Cost of Goods Sold	(176,120)	(174,825)	(190,096)	(197,986)	(210,619)
Gross Profit	9,126	18,978	9,662	21,251	9,696
Other Oper. (Exp)/Inc	0	0	0	0	0
Operating Profit	9,126	18,978	9,662	21,251	9,696
Other Non Opg (Exp)/Inc	4	53	7	2,224	20
Associates & JV Inc	968	787	914	1,019	947
Net Interest (Exp)/Inc	(1,582)	(1,572)	(1,442)	(1,079)	(214)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	8,516	18,246	9,141	23,415	10,449
Tax	(1,829)	(4,175)	(2,132)	(5,549)	(2,167)
Minority Interest	(79)	(122)	(110)	(123)	(77)
Net Profit	6,608	13,949	6,899	17,743	8,205
Net profit bef Except.	6,608	13,949	6,899	17,743	8,205
Growth					
Revenue Gth (%)	0.6	1.7	7.8	13.1	10.3
Opg Profit Gth (%)	(4.5)	(4.8)	5.9	12.0	0.4
Net Profit Gth (%)	(13.5)	0.3	4.4	27.2	18.9
Margins					
Gross Margins (%)	4.9	9.8	4.8	9.7	4.4
Opg Profit Margins (%)	4.9	9.8	4.8	9.7	4.4
Net Profit Margins (%)	3.6	7.2	3.5	8.1	3.7

Source: Company, DBS HK

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Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	469,214	467,030	467,437	465,520	459,230
Invt in Associates & JVs	39,192	40,303	41,166	42,966	44,766
Other LT Assets	121,543	123,747	126,271	117,378	111,508
Cash & ST Invt	24,419	33,092	75,210	122,769	155,139
Inventory	2,880	3,317	3,827	3,827	3,827
Debtors	21,489	21,502	22,389	23,061	23,752
Other Current Assets	24,394	26,105	25,934	25,442	24,960
Total Assets	703,131	715,096	762,234	800,963	823,184
ST Debt	58,540	42,312	22,910	22,910	22,910
Creditors	102,616	107,578	114,895	122,710	131,056
Other Current Liab	103,505	121,252	127,267	129,201	131,135
LT Debt	62,628	51,677	35,988	52,815	52,815
Other LT Liabilities	20,802	26,102	30,006	30,006	30,006
Shareholder's Equity	352,510	363,456	428,674	440,288	452,053
Minority Interests	2,530	2,719	2,494	3,033	3,209
Total Cap. & Liab.	703,131	715,096	762,234	800,963	823,184
Non-Cash Wkg. Capital	(157,358)	(177,906)	(190,012)	(199,581)	(209,651)
Net Cash/(Debt)	(96,749)	(60,897)	16,312	47,044	79,414
Debtors Turn (avg days)	20.4	19.9	18.2	17.1	16.4
Creditors Turn (avg days)	148.6	139.7	128.8	122.8	121.8
Inventory Turn (avg days)	5.4	4.1	4.1	4.0	3.7
Asset Turnover (x)	0.5	0.6	0.6	0.6	0.6
Current Ratio (x)	0.3	0.3	0.5	0.6	0.7
Quick Ratio (x)	0.2	0.2	0.4	0.5	0.6
Net Debt/Equity (X)	0.3	0.2	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	0.3	0.2	CASH	CASH	CASH
Capex to Debt (%)	68.6	94.7	147.2	122.8	122.8
Z-Score (X)	1.2	1.2	1.3	1.3	1.3

Source: Company, DBS HK

Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	27,034	27,387	33,864	35,807	38,773
Dep. & Amort.	88,145	90,240	84,111	87,883	92,333
Tax Paid	(2,785)	(232)	(6,307)	(7,716)	(8,415)
Assoc. & JV Inc/(loss)	(1,573)	(1,701)	(1,966)	(1,800)	(1,800)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg. Cap.	(2,703)	5,523	15,919	9,569	10,070
Other Operating CF	4,482	11,043	11,912	5,715	5,638
Net Operating CF	112,600	132,260	137,533	129,457	136,599
Capital Exp. (net)	(83,163)	(88,968)	(86,723)	(93,000)	(93,000)
Other Invt. (net)	3,024	957	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	2,925	934	6,436	9,727	0
Net Investing CF	(77,214)	(87,077)	(80,287)	(83,273)	(93,000)
Div Paid	(8,891)	(9,262)	(8,403)	(15,569)	(17,669)
Chg in Gross Debt	(27,491)	(38,671)	(18,264)	0	0
Capital Issues	0	0	54,159	0	0
Other Financing CF	5,094	5,826	(35,014)	9,464	6,440
Net Financing CF	(31,288)	(42,107)	(7,522)	(6,105)	(11,228)
Currency Adjustments	27	(183)	(127)	0	0
Chg in Cash	4,125	2,893	49,597	40,080	32,370
Opg CFPS (RMB)	1.42	1.57	1.44	1.31	1.38
Free CFPS (RMB)	0.36	0.53	0.60	0.40	0.48

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	25-Jun-21	HK\$2.72	HK\$3.60	Buy
2:	11-Aug-21	HK\$2.89	HK\$4.10	Buy
3:	17-Aug-21	HK\$3.04	HK\$4.10	Buy
4:	26-Oct-21	HK\$2.76	HK\$4.20	Buy
5:	6-Jan-22	HK\$2.75	HK\$4.20	Buy

Source: DBS HK

Analyst: Tsz Wang Tam
Harry Zhuang

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

Completed Date: 18 Mar 2022 08:00:38 (HKT)

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Sources for all charts and tables are DBS HK unless otherwise specified.

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DBS Bank (Hong Kong) Limited

13th Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong

Tel: (852) 3668-4181, Fax: (852) 2521-1812

China Telecom

DBS Regional Research Offices

HONG KONG

DBS Bank (Hong Kong) Ltd

Contact: Carol Wu

13th Floor One Island East,

18 Westlands Road, Quarry Bay, Hong Kong

Tel: 852 3668 4181

Fax: 852 2521 1812

e-mail: dbsvhk@dbs.com

MALAYSIA

AllianceDBS Research Sdn Bhd

Contact: Wong Ming Tek (128540 U)

19th Floor, Menara Multi-Purpose, Capital Square,

8 Jalan Munshi Abdullah 50100, Kuala Lumpur, Malaysia.

Tel.: 603 2604 3333

Fax: 603 2604 3921

e-mail: general@alliancedbs.com

Co. Regn No. 198401015984 (128540-U)

SINGAPORE

DBS Bank Ltd

Contact: Janice Chua

12 Marina Boulevard,

Marina Bay Financial Centre Tower 3

Singapore 018982

Tel: 65 6878 8888

e-mail: groupresearch@dbs.com

Company Regn. No. 196800306E

INDONESIA

PT DBS Vickers Sekuritas (Indonesia)

Contact: Maynard Priajaya Arif

DBS Bank Tower

Ciputra World 1, 32/F

Jl. Prof. Dr. Satrio Kav. 3-5

Jakarta 12940, Indonesia

Tel: 62 21 3003 4900

Fax: 6221 3003 4943

e-mail: indonesiaresearch@dbs.com

THAILAND

DBS Vickers Securities (Thailand) Co Ltd

Contact: Chanpen Sirithanarattanakul

989 Siam Piwat Tower Building,

9th, 14th-15th Floor

Rama 1 Road, Pathumwan,

Bangkok Thailand 10330

Tel. 66 2 857 7831

Fax: 66 2 658 1269

e-mail: research@th.dbs.com

Company Regn. No 0105539127012

Securities and Exchange Commission, Thailand