

China / Hong Kong Industry Focus

China Telecom Sector

Refer to important disclosures at the end of this report

DBS Group Research . Equity

7 Feb 2024

Prefer telecom operators on attractive yields and stable outlook

- Operators' earnings will grow 7-10% in FY24, on solid growth in industrial internet business
- Stable capex outlook in FY24; computing power investments will grow further, by c.30%
- Prefer operators over equipment providers, on former's yields of 7-8% and stable growth
- Top pick: [China Mobile \(941 HK\)](#) on its 8% yield and share price defensiveness

Expect industrial internet business to grow 18% in FY24.

Operators' industrial internet business, including IDC, cloud, and ICT services, contributed c.50% of their service revenue growth. We expect this non-traditional business segment to grow c.18%, driving solid earnings growth of 7-10% for operators in FY24, along with stable growth in their mobile and fixed-line businesses.

Stable capex with rising investment in computing power. We expect telecom operators' capex to remain stable, at around Rmb359bn per year, in FY24. However, operators' computing power-related investments (e.g., cloud and IDC) are expected to increase by 20-40% in FY23. We expect computing power-related investments will further increase by c.30% in FY24, supporting the rapid growth of operators' industrial internet business.

Prefer telecom operators; top pick: China Mobile. We like operators' stable yields and business outlook amid an uncertain macroeconomy. China Mobile remains our top pick, on the back of its (1) share price defensiveness and (2) strong net cash position and declining capex trend that could potentially lead to a further uplift in its payout ratio. We are selective when it comes to equipment providers, given the static capex outlook, and lean towards those with higher business exposure to the fast-growing industrial internet sector, such as CCS (552 HK) and ZTE (763 HK).

HSI: 16,137

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Recommendation & valuation

Company Name	Price HK\$	Target Price HK\$	Recom	Mkt Cap US\$m	PE 24F x
China Mobile (941 HK)	66.75	93.00	BUY	182,587	8.7
China Telecom (728 HK)	4.06	6.10	BUY	47,505	10.1
China Unicom (762 HK)	5.39	8.70	BUY	21,088	7.5
CCS (552 HK)	3.28	4.90	BUY	2,905	5.4
ZTE (763 HK)	14.34	19.80	BUY	18,924	5.8
China Tower (788 HK)	0.88	1.40	BUY	20,017	11.7
YOFC (6869 HK)	7.70	8.30	HOLD	2,264	4.7

Source: Thomson Reuters, DBS Bank (Hong Kong) Limited ("DBS HK")

Closing price as of 6 Feb 2024

Introduction

The share prices of China's telecom operators rose 2-26% and outperformed the HSI in 2023. This is primarily attributed to (1) operators' commitment to increasing dividend payouts and (2) their rapidly growing industrial internet business, including cloud.

Looking ahead, we expect telecom operators will continue to outperform the market, given their defensiveness and stable outlook, amid an uncertain macroeconomy and volatile market. We anticipate solid earnings growth of 7%-10% for telecom operators in FY24, supported by (1) rapid growth of c.18% in the industrial internet business and (2) stable growth in traditional telecom.

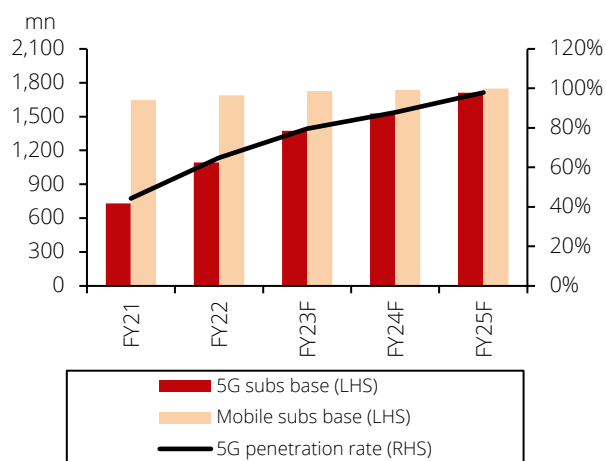
We expect operators' capex to remain stable in FY24, with a decrease in mobile network-related investments. However, we expect a c.30% increase in computing power-related capex (e.g., cloud and IDC). We favour China's telecom operators due to their attractive yield of 7-8% and defensive nature. We are selective when it comes to telecom equipment providers and are leaning towards those with higher business exposure to the fast-growing industrial internet sector.

Steady growth in traditional telecom business

Mobile: Increasing ARPU along with 5G penetration

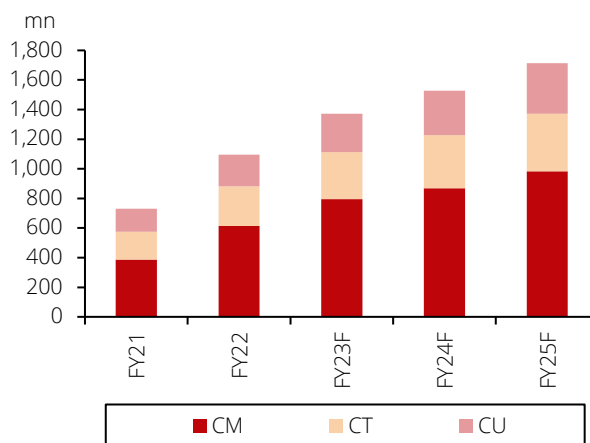
We forecast 5G penetration would reach 88% with 1.5bn 5G subs by the end of 2024. Since the launch of 5G services in 2019, the number of 5G subs has been increasing rapidly. As of Dec 2023, the 5G penetration rate was 80%, with total 5G subs at 1.4bn, representing a 25% y-o-y increase.

Mobile subscriber base in China



Source: Companies, DBS HK

5G subscriber base in China



Source: Companies, DBS HK

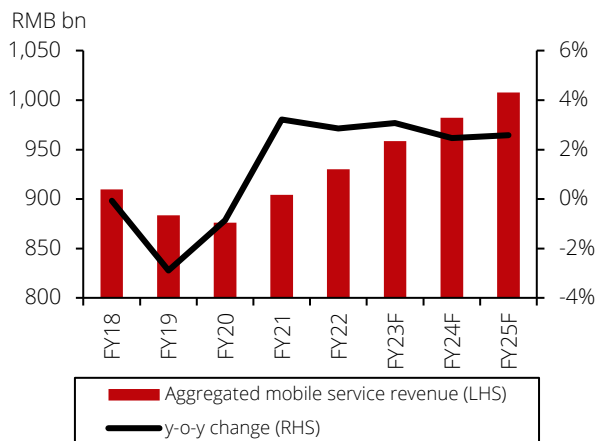
The three operators ceased offering low-data volume 5G plans (10G or below) in 2023. Meanwhile, prices for other 5G mobile services (15G or above) remained largely unchanged over the past year. We expect mobile ARPU will continue its uptrend, as there is a 10% uplift for operators when customers upgrade to 5G from 4G. We expect overall ARPU to expand steadily, by 1% in FY24 and FY25, leading to a 3% increase in total mobile service revenue in FY24 and FY25, respectively.

5G mobile service plans (Rmb per month)

Data volume (download speed)	CM	CT	CU
15G (300Mbps)	78	n.a.	59
20G (300Mbps)	98	99	68
30G (500Mbps)	128	129	129
40G (500Mbps)	158	169	159
60G (1Gbps)	198	199	199
80G (1Gbps)	238	239	239
100G (1Gbps)	298	299	299
150G (1Gbps)	398	399	399
300G (1Gbps)	598	599	599
400G (2Gbps)	n.a.	n.a.	799
500G (2Gbps)	n.a.	n.a.	999

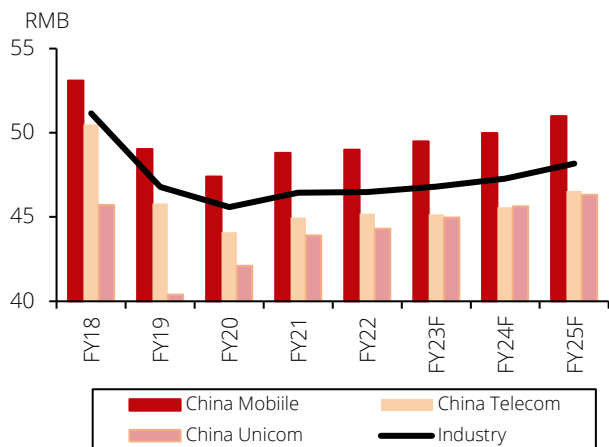
Source: Companies, DBS HK

Total mobile service revenue in China



Source: Companies, DBS HK

Mobile ARPU of individual operators



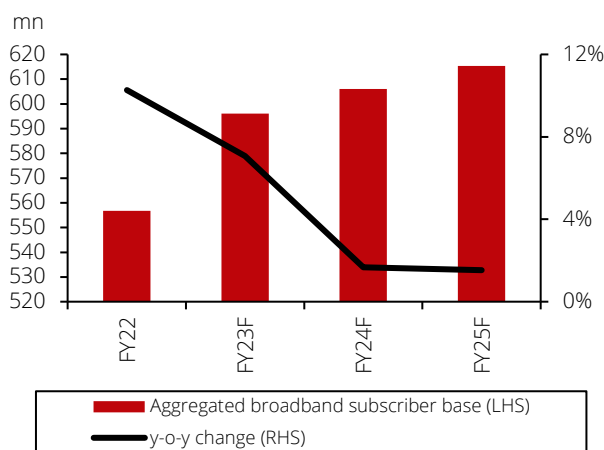
Source: Companies, DBS HK

Broadband: Stable revenue growth with bandwidth upgrade

We expect broadband access ARPU to increase steadily, by 1% each year in 2024 and 2025, mainly driven by bandwidth upgrades. According to the Ministry of Industry and Information Technology (MIIT), the percentage of broadband subscribers with bandwidth access rates of >100Mbps and >1,000Mbps stood at 94.5% and 25.7% in Dec 2023, up 0.6ppt and 10.1ppt, respectively, from one year ago. We believe the number of broadband subscribers with higher bandwidth access will continue to increase, leading to higher broadband ARPU.

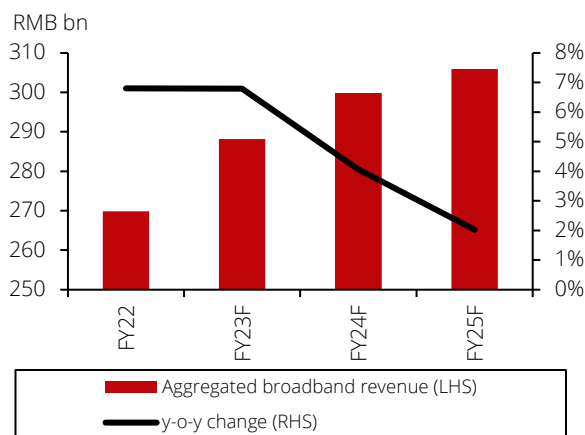
According to the Cyberspace Administration of China (CAC), the internet broadband penetration rate in China was 76% in Jun 2023. We expect the broadband customer base to increase further, by 7% and 2% in FY23 and FY24, respectively. All in all, we forecast the total broadband revenue of the three operators would grow by 7% and 4% in FY23 and FY24, respectively.

Broadband subscriber base in China



Source: Companies, DBS HK

Total broadband revenue in China



Source: Companies, DBS HK

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Solid growth of industrial internet business to continue

We expect industrial internet business to grow 18% y-o-y in FY24, riding on the enterprise digitalisation trend in China. Telecom operators' industrial internet business, including IDC, cloud, ICT services, and IoT, contributed 55% of the growth in service revenue of the industry, and grew by 19.4%, widely exceeding total service revenue growth of 6.2% in 1H23. Considering individual operators, industrial internet business revenue increased by 25%, 16.7%, and 16.3% for CM, CT, and CU, accounting for 13.3%, 29.2%, and 25.1% of each of their total service revenue, respectively. We believe this business segment will continue to serve as a major growth contributor in the coming years.

Industrial internet business (1H23)

(Rmb bn)	1H23 revenue from new business	y-o-y growth	% of service revenue	1H23 total service revenue	y-o-y growth
CM	60.2	25.0%	13.3%	452	6.1%
CT	68.8	16.7%	29.2%	236	6.6%
CU	43.0	16.3%	25.1%	171	6.3%
Total	172.0	19.4%	20.0%	859	6.2%

Source: Companies, DBS HK

Operators will continue to improve shareholder return

The State-owned Assets Supervision and Administration Commission (SASAC) reiterated, on 24 January 2024, that it would consider including "Market Value Management" to the key performance indicators of state-owned enterprises (SOEs). The goal is to guide these companies to focus on shareholder return through methods like dividend payouts and share buybacks.

In terms of dividend payout, both CM and CT have committed to raise payouts to 70% by FY23, up from c.65% in FY22. While CU has not provided a specific guidance on dividend payouts, we anticipate a slight increase to 53% in FY23 from 50% in FY22. Looking ahead, we believe CM will likely deliver a payout ratio of >70% in FY23 and FY24, thanks to its abundant net cash position and declining capex trend. We also note that CM is the only operator that has started buying back its shares in the Hong Kong market in 2024.

Net cash position of individual operators (FY22)

Rmb m	Gross cash	Gross debt	Net cash
CM	277,488	-	277,488
CT	76,300	77,380	(1,080)
CU	69,996	43,681	26,315

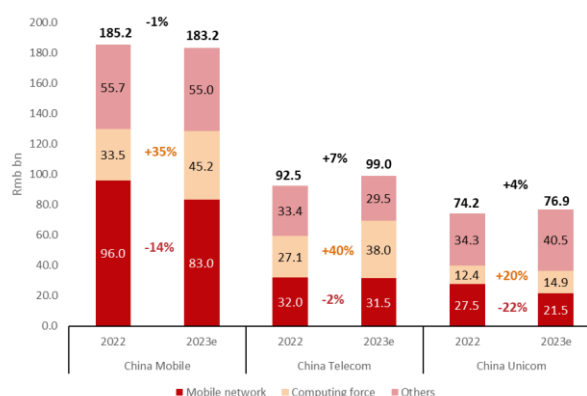
Source: Companies, DBS HK

Operators' capex shift to computing power continues

We expect telecom operators' capex to be stable, at c.Rmb359bn per year for FY23 and FY24. As operators have undergone four years of large-scale 5G network deployment, we expect investment in mobile network will be on a decreasing trend going forward. Operators will instead focus on network coverage optimisation, especially in rural areas. In 2023, China deployed an additional 1.1m 5G base stations, reaching 3.4m by the end of 2023. We expect the annual net adds of 5G stations to be at 900k in 2024.

In terms of capex mix, operators' mobile network investments are expected to drop by 2-22% in FY23, benefitting from the new five-year pricing agreement in Dec 2022 (2.4% discount for both new and renewal contracts). On the other hand, operators' computing power-related investments (e.g., cloud and IDC) are expected to increase by 20-40% in FY23. Looking into FY24, we expect computing power-related investment will further increase by c.30% to support operators' fast-growing industrial internet business.

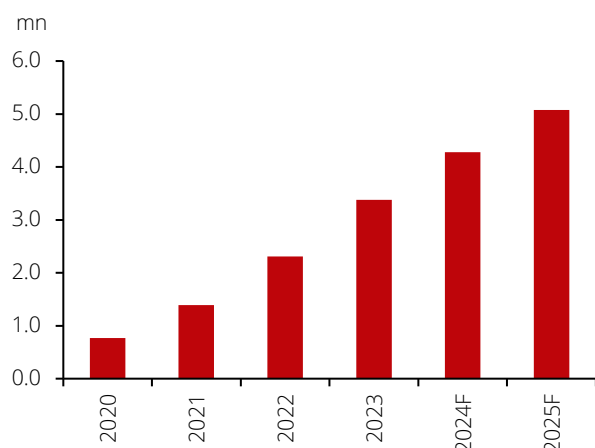
Operators' capex in FY23



Source: Companies, DBS HK

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5G base stations in China



Source: MIIT, DBS HK

Stock recommendations and valuations

We like telecom operators' defensiveness, their attractive yield of 7-8%, and stable business outlook amid an uncertain macroeconomy and volatile market. CM remains our top pick, given its (1) share price defensiveness and (2) strong net cash position and declining capex trend, which could potentially lead to a further uplift in the payout ratio.

As we expect overall operators' capex to remain stable in FY24, we are selective when it comes to equipment providers and are leaning towards those with higher business exposure to the fast-growing industrial internet sector. We like CCS (552 HK), as the company is seeing an increase in orders related to operators' industrial internet business and the enterprise digitalisation trend (related contracts increased by 30% y-o-y in 1H23, compared to a 6% increase in total contracts). We also like ZTE (763 HK), as we expect revenue growth from its carrier and corporate segments to accelerate in FY24, supported by improving competencies in its computing power-related product offerings, such as AI servers and optical equipment. We estimate that the company currently enjoys a c.10% revenue contribution from its operators' industrial internet segment and enterprise digital infrastructure.

Telecom operators

China Mobile (CM, 941 HK, BUY). We have lowered our earnings forecast by 1%, 4%, and 6% for FY23, FY24, and FY25, respectively, mainly to factor in slightly softer enterprise spending amidst a weak macro. We forecast earnings would grow by 7% p.a. for FY23, FY24, and FY25, respectively. We maintain BUY on CM for its attractive dividend yield of 8%, with TP of HK\$93 (lowered from HK\$97). Our TP is based on 12x FY24 PE (unchanged), c.2SD above its historical average, supported by its increasing dividend payout ratio.

China Telecom (CT, 728 HK, BUY). We trimmed our earnings forecast by 1%, 3%, and 9% for FY23, FY24, and FY25, respectively, on softer enterprise spending amidst a weak macro. Despite the adjustment, we forecast earnings growth to stay robust at 10-11% p.a. for FY23-25. Maintain BUY on CT for its attractive yield of 7% with TP of HK\$6.1 (lowered from HK\$6.3), premised on an unchanged 15x FY24 PE, or 2SD higher than its historical average. We view the slight premium over its peers as warranted, given it has the highest revenue exposure to industrial internet business.

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China Unicom (CU, 762 HK, BUY). We revised down our earnings forecast by 1%, 0.5%, and 4% for FY23, FY24, and FY25, respectively, as we edged down industry internet revenue on softer enterprise spending amidst a weak macro. We forecast earnings would grow by 11%, 9%, and 10% for FY23, FY24, and FY25, respectively. We maintain BUY on CU for its attractive dividend yield of 7% with TP of HK\$8.7 (unchanged), based on 12x FY24F PE (unchanged), slightly above its historical average, as we expect ROE will continue its uptrend and reach >5% in FY23.

Telecom equipment providers

CCS (552 HK, BUY). We have lowered our earnings forecasts by 1%, 3%, and 3% for FY23, FY24, and FY25, respectively, mainly on assumption of higher operating expenses. We forecast earnings would grow by 7%, 7%, and 8% for FY23, FY24, and FY25, respectively. We maintain BUY on CCS for its attractive dividend yield of 7%, with TP of HK\$4.9 (lowered from HK\$5.0). Our TP is based on an 8x FY24 PE (unchanged), in line with its historical average.

ZTE (763 HK, BUY). We trim FY23 earnings by 1% on lower revenue assumptions for corporate and consumer businesses. We forecast earnings would grow by 16%, 14%, and 11% for FY23, FY24, and FY25, respectively. We maintain BUY on ZTE-H/ZTE-A, as ZTE continues to gain market share in the telecom equipment space, with TPs of HK\$19.8/Rmb36.1 (lowered from HK\$37.3/Rmb56.5). Our

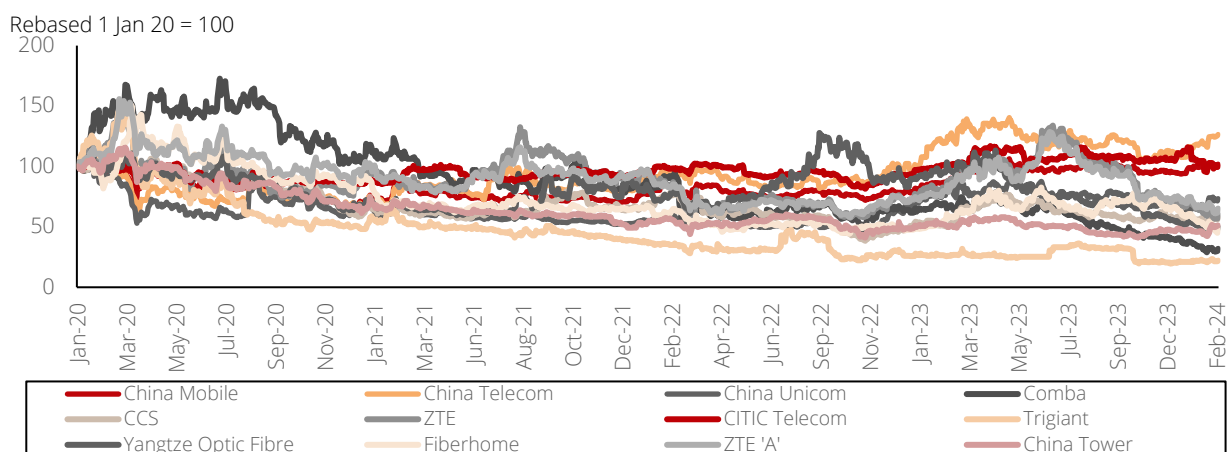
TPs for ZTE-H and ZTE-A are based on 8x and 16x FY24 PE (lowered from 15x and 25x), respectively, slightly below its historical average given its muted near-term revenue growth. The A-H valuation premium is in line with the recent trading averages.

China Tower (788 HK, BUY). We have kept our EBITDA forecasts unchanged. We forecast EBITDA would grow by 3%, 4%, and 4% for FY23, FY24, and FY25, respectively. We maintain BUY on China Tower due to the stable outlook in its core tower business, coupled with the rapidly growing 'Two Wings' business, with a TP of HK\$1.4 (unchanged). The company also offers a stable dividend yield of 6%. Our TP is based on 4x FY24 EV/EBITDA (unchanged), in line with its historical average.

YOFC (6869 HK, HOLD). We have kept our earnings forecasts unchanged. We forecast earnings would drop by 4% in FY23 and increase by 2% and 5% in FY24 and FY25, respectively. We maintain HOLD on YOFC, with TP of HK\$8.3 (lowered from HK\$9.9). Our TP is based on 5x FY24 PE (lowered from the previous 6x), 1SD below its historical average, due to a muted near-term demand outlook for its core optical business.

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Share price performance



Source: Thomson Reuters

Share price performance table – Telecom operators

Share price performance (%)	1-mth	3-mth	6-mth	12-mth	YTD
China Mobile	1.4	7.1	3.0	17.9	3.0
China Telecom	8.0	18.4	3.3	2.8	8.6
China Unicom	11.4	10.7	(2.7)	(1.6)	10.0
HSI Index	(2.4)	(10.2)	(17.4)	(24.0)	(5.3)

Source: Thomson Reuters

Share price performance table – Telecom services

Share price performance (%)	1-mth	3-mth	6-mth	12-mth	YTD
Comba	(12.7)	(28.1)	(46.1)	(53.4)	(15.9)
CCS	1.5	(1.2)	(8.1)	12.7	1.2
ZTE	(11.8)	(23.9)	(49.9)	(23.5)	(17.8)
Trigiant	4.7	6.3	(38.0)	(16.3)	4.7
Yangtze Optic Fibre	(5.9)	(18.3)	(35.3)	(46.5)	(7.9)
Fiberhome	(15.1)	(31.1)	(28.1)	(7.6)	(20.2)
ZTE 'A'	(6.0)	(14.7)	(43.5)	(14.0)	(12.8)
China Tower	10.0	14.3	2.3	(2.2)	7.3
HSI Index	(2.4)	(10.2)	(17.4)	(24.0)	(5.3)

Source: Thomson Reuters

Valuation

Company Name	Code	Currency	Target		Mkt	PE	PE Yield		P/Bk		EV/EBITDA		ROE					
			Price	Price Recom			Cap	Fiscal	23F	24F	23F	24F	23F	24F	23F	24F		
			Local\$	Local\$	US\$m	Yr	x	x	%	%	x	x	x	x	%	%		
China Telecom operators																		
China Mobile*	941	HK	HKD	66.75	93.00	BUY	182,587	Dec	9.3	8.7	7.7	8.3	0.9	0.9	2.4	2.1	10.2	10.6
China Telecom*	728	HK	HKD	4.06	6.10	BUY	47,505	Dec	11.1	10.1	6.3	6.9	0.8	0.7	1.9	1.6	7.0	7.5
China Unicom*	762	HK	HKD	5.39	8.70	BUY	21,088	Dec	8.1	7.5	6.6	7.5	0.4	0.4	0.2	0.3	5.4	5.7
China telecom services																		
China Tower 'H'*	788	HK	HKD	0.88	1.40	BUY	20,017	Dec	13.6	11.7	5.1	6.0	0.7	0.7	3.1	2.7	5.3	6.1
CCS*	552	HK	HKD	3.28	4.90	BUY	2,905	Dec	5.8	5.4	7.0	7.5	0.5	0.5	(2.6)	(5.8)	8.6	8.8
YOFC 'H'*	6869	HK	HKD	7.7	8.30	HOLD	2,264	Dec	4.8	4.7	6.2	6.4	0.5	0.5	5.1	5.2	10.6	10.1
YOFC 'A'	601869	CH	CNY	23.55	n.a.	NR	1,926	Dec	13.1	14.7	2.0	1.9	1.6	1.4	10.9	10.3	11.9	11.1
Fiberhome Telecom	600498	CH	CNY	13.28	31.90	BUY	2,196	Dec	37.6	27.0	0.8	1.2	1.2	1.2	24.4	18.4	4.0	5.4
ZTE 'H'*	763	HK	HKD	14.34	19.80	BUY	18,924	Dec	6.6	5.8	2.6	3.0	0.9	0.8	3.4	2.7	15.0	15.0
ZTE'A'*	000063	CH	CNY	23.08	36.10	BUY	15,158	Dec	11.6	10.2	1.5	1.7	1.6	1.4	6.9	5.9	15.0	15.0

Source: Thomson Reuters

DBS Group Research 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

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

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listed as Chinese Military-Industrial Complex Companies ("CMICs"). The list of CMICs can be found on the US Department of the Treasury's website at <https://home.treasury.gov/policy-issues/financial-sanctions/consolidated-sanctions-list/ns-cmic-list>.

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2. DBS Bank Ltd, DBS HK, DBSVS, their subsidiaries and/or other affiliates have a net long position exceeding 0.5% of the total issued share capital in China Telecom Corp Ltd (728 HK) recommended in this report as of 31 Jan 2024.
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