

China / Hong Kong Company Update

China Telecom

Bloomberg: 728 HK EQUITY | Reuters: 0728.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

7 Feb 2024

BUY

Last Traded Price (6 Feb 2024): HK\$4.06 (HSI : 16,137)
Price Target 12-mth: HK\$6.10 (50% upside) (Prev HK\$6.30)

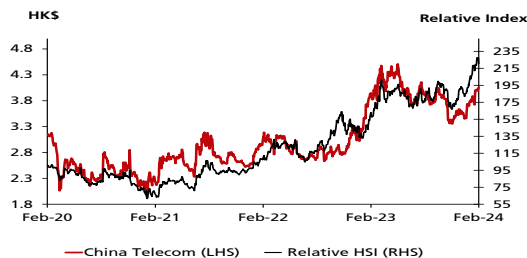
Analysts

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What's New

- Industrial digitalisation remains the key growth driver, with highest revenue exposure of 30% among peers
- Earnings trimmed by 1%/3%/9% for FY23-25, on softer enterprise spending amidst a weak macro
- Forecast earnings to grow by 11%/10%/11% in FY23/24/25, respectively
- Maintain BUY for attractive dividend yield of 7%; TP of HK\$6.1

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2022A	2023F	2024F	2025F
Turnover	481,448	519,144	553,846	589,795
EBITDA	130,359	139,340	145,540	151,365
Pre-tax Profit	35,714	39,696	43,690	48,487
Net Profit	27,593	30,670	33,789	37,499
Net Profit Gth (Pre-ex) (%)	6.3	11.1	10.2	11.0
EPS (RMB)	0.30	0.34	0.37	0.41
EPS (HK\$)	0.33	0.36	0.40	0.45
EPS Gth (%)	(1.9)	11.1	10.2	11.0
Diluted EPS (HK\$)	0.33	0.36	0.40	0.45
DPS (HK\$)	0.21	0.26	0.28	0.31
BV Per Share (HK\$)	5.14	5.29	5.44	5.60
PE (X)	12.4	11.1	10.1	9.1
P/Cash Flow (X)	2.5	2.7	2.8	2.9
P/Free CF (X)	7.6	10.6	9.7	8.1
EV/EBITDA (X)	2.2	1.9	1.6	1.4
Net Div Yield (%)	5.2	6.3	6.9	7.7
P/Book Value (X)	0.8	0.8	0.7	0.7
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE(%)	6.4	7.0	7.5	8.1
Earnings Rev (%)		(1)	(3)	(9)
Consensus EPS (RMB)		0.33	0.37	0.41
Other Broker Recs:		B:27	S:0	H:0

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

Surfing the wave of industrial digitalisation

Investment Thesis

An integrated player with strong presence in Southern China. China Telecom's 5G penetration reached 78% in Dec 2023. The company has also co-built and co-shared one 5G network with China Unicom to narrow its competitive disadvantage against China Mobile in terms of network quality and coverage.

Industrial digitalisation business the key growth driver. Its industrial digitalisation business (including IDC, cloud computing, etc.) is the key revenue growth driver, accounting for more than c.70% of incremental service revenue. We expect the revenue of this segment to grow by c.18% y-o-y in FY24. The company has the highest exposure in this business segment, which contributes c.30% of its service revenue.

Dividend hike to improve shareholder return. China Telecom was the first operator to commit to raising its payout ratio from 65% in FY22 to 70% by FY23. An ARPU uplift from increasing 5G penetration and the rapid growth of its industrial digitalisation business should support its earnings growth of c.11% in FY23.

BUY with a TP of HK\$6.1. We maintain BUY on China Telecom for its attractive dividend yield of 7% with a TP of HK\$6.1 (HK\$6.3 previously). Our TP is pegged to 15x FY24 PE (unchanged), which is 2.5SD higher than its historical average, given it has the highest revenue exposure to the industrial internet business among its peers.

Key Risks

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

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

At A Glance

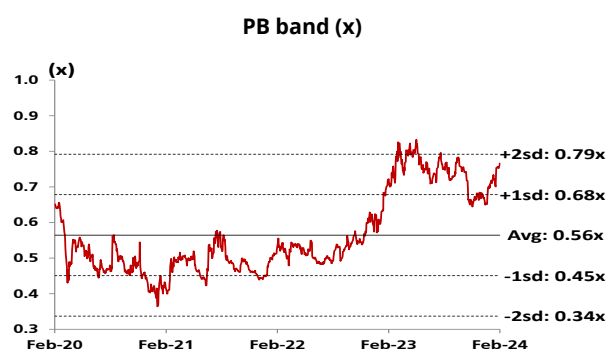
Issued Capital (m shrs)	91,507
Mkt Cap (HKm/US\$m)	371,518 / 47,493
Major Shareholders (%)	
GIC Private Limited	9.0
Free Float (%)	91.0
3m Avg. Daily Val. (US\$m)	23.7
GICS Industry: Communication Services / Telecommunication Services	

China Telecom

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.

Historical PE and PB band



Source: Thomson Reuters, DBS HK

China Telecom

Key Assumptions

FY Dec	2021A	2022A	2023F	2024F	2025F
Mobile sub net add (m)	21.4	18.8	16.6	5.0	5.0
Mobile ARPU (Rmb)	42.4	41.7	41.6	42.0	42.9
EBITDA margin (%)	28.2	27.1	26.8	26.3	25.7
Broadband sub net add (m)	11.2	11.2	9.3	4.0	3.5
Fixed-line sub net add (m)	(1.2)	(4.2)	(4.0)	(3.9)	(3.7)

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenues (RMB m)					
Mobile	184,158	191,026	199,646	206,957	213,916
Broadband	113,522	118,534	122,546	126,926	129,402
Industrial Digitalisation	98,945	117,756	138,952	163,963	193,477
Sales of Goods and Others	36,725	46,000	47,000	48,000	48,000
All other segments	6,203	8,132	11,000	8,000	5,000
Total	439,553	481,448	519,144	553,846	589,795

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenue	439,553	481,448	519,144	553,846	589,795
Cost of Goods Sold	(178,428)	(202,040)	(217,859)	(234,295)	(250,969)
Gross Profit	261,125	279,408	301,285	319,551	338,826
Other Opng (Exp)/Inc	(230,177)	(245,981)	(263,077)	(277,038)	(291,869)
Operating Profit	30,948	33,427	38,208	42,513	46,958
Other Non Opng (Exp)/Inc	2,244	243	50	50	50
Associates & JV Inc	1,966	2,051	2,051	2,051	2,051
Net Interest (Exp)/Inc	(1,293)	(7)	(613)	(924)	(572)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	33,865	35,714	39,696	43,690	48,487
Tax	(7,716)	(8,038)	(8,934)	(9,833)	(10,913)
Minority Interest	(200)	(83)	(92)	(68)	(75)
Preference Dividend	0	0	0	0	0
Net Profit	25,949	27,593	30,670	33,789	37,499
Net Profit before Except.	25,949	27,593	30,670	33,789	37,499
EBITDA	123,914	130,359	139,340	145,540	151,365
Growth					
Revenue Gth (%)	11.7	9.5	7.8	6.7	6.5
EBITDA Gth (%)	4.2	5.2	6.9	4.4	4.0
Opg Profit Gth (%)	8.1	8.0	14.3	11.3	10.5
Net Profit Gth (%)	24.5	6.3	11.1	10.2	11.0
Margins & Ratio					
Gross Margins (%)	59.4	58.0	58.0	57.7	57.4
Opg Profit Margin (%)	7.0	6.9	7.4	7.7	8.0
Net Profit Margin (%)	5.9	5.7	5.9	6.1	6.4
ROAE (%)	6.6	6.4	7.0	7.5	8.1
ROA (%)	3.5	3.5	3.7	3.9	4.2
ROCE (%)	4.9	5.0	5.5	6.0	6.5
Div Payout Ratio (%)	60.0	65.0	70.0	70.0	70.0
Net Interest Cover (x)	23.9	4,775.3	62.3	46.0	82.2

Source: Company, DBS HK

Interim Income Statement (RMB m)

FY Dec	1H2021	2H2021	1H2022	2H2022	1H2023
Revenue	219,237	220,316	242,319	239,129	260,664
Cost of Goods Sold	(84,464)	(93,964)	(95,827)	(106,213)	(105,481)
Gross Profit	134,773	126,352	146,492	132,916	155,183
Other Oper. (Exp)/Inc	(113,522)	(116,655)	(123,379)	(122,602)	(129,675)
Operating Profit	21,251	9,697	23,113	10,314	25,508
Other Non Opg (Exp)/Inc	2,224	20	9	234	159
Associates & JV Inc	1,019	947	833	1,218	996
Net Interest (Exp)/Inc	(1,079)	(214)	(30)	23	(483)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	23,415	10,450	23,925	11,789	26,180
Tax	(5,549)	(2,167)	(5,572)	(2,466)	(6,006)
Minority Interest	(123)	(77)	(62)	(21)	(21)
Net Profit	17,743	8,206	18,291	9,302	20,153
Net profit bef Except.	17,743	8,206	18,291	9,302	20,153

Growth

Revenue Gth (%)	13.1	10.3	10.5	8.5	7.6
Opg Profit Gth (%)	12.0	0.4	8.8	6.4	10.4
Net Profit Gth (%)	27.2	18.9	3.1	13.4	10.2

Margins

Gross Margins (%)	61.5	57.4	60.5	55.6	59.5
Opg Profit Margins (%)	9.7	4.4	9.5	4.3	9.8
Net Profit Margins (%)	8.1	3.7	7.5	3.9	7.7

Source: Company, DBS HK

Balance Sheet (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Net Fixed Assets	528,625	559,461	564,853	550,901	531,258
Invts in Associates & JVs	41,166	42,220	44,271	46,322	48,373
Other LT Assets	65,085	64,945	62,871	60,794	58,536
Cash & ST Invts	75,213	76,300	91,578	117,793	146,412
Inventory	3,827	3,513	3,513	3,513	3,513
Debtors	22,389	24,312	26,400	28,668	31,130
Other Current Assets	25,934	36,947	49,530	66,805	90,520
Total Assets	762,239	807,698	843,016	874,796	909,743
ST Debt	9,101	6,000	6,000	6,000	6,000
Creditors	114,893	127,260	140,958	156,131	172,937
Other Current Liab	141,077	148,477	157,344	161,637	165,930
LT Debt	7,395	4,484	4,484	4,484	4,484
Other LT Liabilities	58,600	85,050	85,050	85,050	85,050
Shareholder's Equity	428,678	432,089	444,823	457,143	470,990
Minority Interests	2,495	4,338	4,357	4,350	4,351
Total Cap. & Liab.	762,239	807,698	843,016	874,796	909,743
Non-Cash Wkg. Capital	(203,820)	(210,965)	(218,859)	(218,782)	(213,704)
Net Cash/(Debt)	58,717	65,816	81,094	107,309	135,928
Debtors Turn (avg days)	18.2	17.7	17.8	18.1	18.5
Creditors Turn (avg days)	475.1	420.5	419.4	413.0	409.8
Inventory Turn (avg days)	15.3	12.7	11.0	9.8	8.7
Asset Turnover (x)	0.6	0.6	0.6	0.6	0.7
Current Ratio (x)	0.5	0.5	0.6	0.7	0.8
Quick Ratio (x)	0.4	0.4	0.4	0.5	0.5
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	516.3	872.9	887.1	810.8	715.4
Z-Score (X)	1.3	1.3	1.3	NA	NA

Source: Company, DBS HK

China Telecom

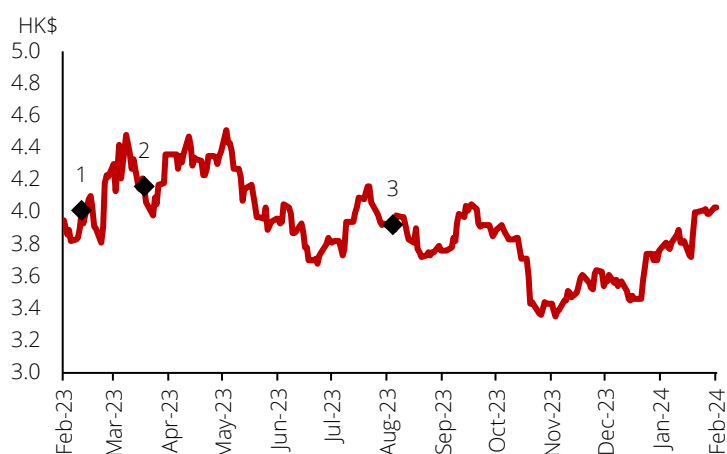
Cash Flow Statement (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Profit	33,865	35,714	39,696	43,690	48,487
Dep. & Amort.	92,966	96,932	79,728	79,404	77,425
Tax Paid	(3,718)	(3,240)	(8,038)	(8,934)	(9,833)
Assoc. & JV Inc/(loss)	(1,966)	(2,051)	(2,051)	(2,051)	(2,051)
(Pft)/ Loss on disposal of FAs	6,095	6,158	8,154	8,204	8,213
Chg in Wkg.Cap.	9,971	(93)	3,320	(77)	(5,079)
Other Operating CF	320	3,012	4,574	0	0
Net Operating CF	137,533	136,432	125,384	120,235	117,162
Capital Exp.(net)	(85,175)	(91,512)	(93,000)	(85,000)	(75,000)
Other Invt.(net)	1,352	(977)	0	0	0
Invt in Assoc. & JV	3,764	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(229)	(4,307)	0	0	0
Net Investing CF	(80,288)	(96,796)	(93,000)	(85,000)	(75,000)
Div Paid	(8,439)	(26,537)	(17,935)	(21,469)	(23,652)
Chg in Gross Debt	(35,564)	(5,923)	0	0	0
Capital Issues	47,516	0	0	0	0
Other Financing CF	(11,031)	(8,446)	829	12,449	10,109
Net Financing CF	(7,518)	(40,906)	(17,106)	(9,020)	(13,543)
Currency Adjustments	(127)	451	0	0	0
Chg in Cash	49,600	(819)	15,278	26,216	28,619
Opg CFPS (RMB)	1.51	1.49	1.33	1.31	1.34
Free CFPS (RMB)	0.62	0.49	0.35	0.39	0.46

Source: Company, DBS HK

China Telecom

Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	Target Price	Rating
1	16-Feb-23	HK\$3.90	HK\$4.50	BUY
2	23-Mar-23	HK\$4.21	HK\$5.90	BUY
3	9-Aug-23	HK\$3.93	HK\$6.30	BUY

Source: DBS HK

Analyst: Tsz Wang Tam
 Andy Yu

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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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China Telecom

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