

China telecoms sector

Recovery slow but on track

	Ticker	Rec	Mkt cap		Price	PT	Up/ dn (%)	EV/EBITDA (x)		PER (x)		Yield (%)	
			(US\$m)	Ccy				2016E	2017E	2016E	2017E	2016E	2017E
China Mobile	941 HK	Buy	228,728	HKD	86.95	120.00	38.0	4.5	4.2	12.9	12.0	3.3	3.6
China Telecom	728 HK	Buy	36,518	HKD	3.51	5.20	48.1	3.6	3.3	10.8	9.8	2.9	3.2
China Unicom	762 HK	Buy	25,284	HKD	8.21	12.20	48.6	3.5	3.3	18.8	13.4	2.9	3.6

Source: Company data, CSCI estimates

- In spite of market concerns over potential new entrants and continued regulatory pressure on telcos to cut tariffs, China telcos are likely to return to earnings growth over the coming 3-5 years, underpinned by rapid mobile subs migration to 4G and declining capex.
- On the back of the telcos' stronger-than-expected 1Q16 revenue growth and YTD 4G subs figures, we nudged up our revenue forecasts for the telcos but trimmed earnings estimates for China Unicom (CU) and China Telecom (CT) to reflect the negative earnings impacts from the TowerCo.
- In stock picks, China Mobile (CM) should remain a good proxy for China telecoms sector, while CU should provide good medium-term buying opportunities with on-track earnings turnaround, in our view.

Improving earnings outlook. After five years of tough times, China's telcos are likely to return to sustainable earnings growth over the coming 3-5 years, which would be underpinned by 1) improving service revenue growth on subscribers (subs) migration to 4G, 2) declining capex as 5G commercial deployment is likely still 3-5 years away, and 3) continued operation model shift from handset subsidies to traffic subsidies. As evident, all three telcos reported stronger-than-expected services revenue growth and improving underlying earnings in 1Q16.

Regulatory uncertainties remain, but limited impact on industry trajectory. With the telecoms authorities in China having issued policies on major regulatory matters in the past five years, we expect to see a more benign regulatory environment in the coming three years. Though the government is expected to grant a full set of telecoms licenses to the newly established China Broadcasting & Telecoms Network, we don't expect it to have any major impacts on the aforementioned positive industry trajectory.

Revisions of forecasts and valuation. On the back of the telcos' 1Q16 results and Jan-May16 subs data, we nudged up our 2016E/17E revenue forecasts by 1.3%/1.9% and earnings by 0.6%/3.5% for CM and raised our DCF based price target for CM to HKD120.0 (from HKD115.0). Factoring in more earnings erosion from the TowerCo, we trimmed our 2016E/17E earnings for CT and CU by 1.3%/1.2% and 0.8%/17.8% respectively and lowered our DCF based price target to HKD5.20 (from HKD5.50) for CT and HKD12.20 (from HKD13.6) for CU. Amidst concerns over regulatory uncertainties, the past two months saw substantial pullbacks in CT and CU's share prices. We see this selloff unwarranted and good entry points, as the telcos are likely at the starting points on a historical basis with a few years of sustainable earnings growth. In view of its continued dominance in 4G, we see CM a proxy for China telcos sector, but also see great medium-term re-rating potential for CU given its on-track earnings turnaround.

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China Mobile
Income statement (RMB m)

Year end: Dec	2014	2015	2016E	2017E	2018E
Revenue	65,150.9	668,335	682,857	700,543	716,816
SG&A	(30,165.4)	(31,144.0)	(336,610)	(341,195)	(343,833)
Personnel	(70,385)	(74,805)	(77,049)	(79,361)	(81,741)
Other operating expenses	(39,345)	(42,336)	(40,885)	(39,710)	(39,165)
Other operating income					
EBITDA	240,125	239,754	228,312	240,277	252,076
Depreciation & Amortization	(22,805)	(26,832)	(10,101)	(13,184)	(13,750)
Other income	1.71	17,325	1,829	1,859	1,889
EBIT	118,491	120,247	120,041	128,952	140,216
Net interest	5,783	5,397	14,955	14,719	15,436
Associates	8,248	8,090	9,614	11,597	12,980
Exceptional items					
Pretax profit	142,522	143,734	144,610	155,268	168,632
Taxation	(33,179)	(35,079)	(33,747)	(36,467)	(39,874)
Minority interests	(125)	(116)	(122)	(128)	(134)
Net profit	109,218	108,539	110,741	118,673	128,624
Net profit (adjusted)	109,218	108,539	110,741	118,673	128,624
Basic EPS (RMB)	5.38	5.30	5.41	5.79	6.28
EPS (adjusted) (RMB)	5.35	5.30	5.40	5.79	6.28
DPS (RMB)	2.30	2.28	2.32	2.49	2.70

Cash flow statement (RMB m)

Year end: Dec	2014	2015	2016E	2017E	2018E
EBIT	118,491	120,247	120,041	128,952	140,216
Depreciation & amortisation	22,805	26,832	10,101	13,184	13,750
Net interest	5,783	5,397	14,955	14,719	15,436
Taxes paid	(39,056)	(37,794)	(33,747)	(36,467)	(39,874)
Changes in working capital	3,794	17,751	5,848	8,935	14,244
Others	(5,379)	(17,344)	(16,812)	(16,545)	(17,206)
Cash flow from operations	216,438	235,089	210,386	212,778	226,565
Capex	(174,673)	(172,243)	(186,200)	(165,000)	(160,000)
Acquisitions	(10,083)	(5,727)	(223)	(234)	(245)
Disposals	2	7	1	1	1
Others	33,524	45,220	12,558	11,830	12,285
Cash flow from investing	(151,230)	(142,743)	(174,264)	(153,403)	(147,960)
Dividends	(50,934)	(47,933)	(46,665)	(49,492)	(53,379)
Issue of shares	8,248	10,24	-	-	-
Change in debt	669	(8,149)	-	-	-
Others	(480)	(31,452)	(436)	(376)	(147)
Cash flow from financing	(42,530)	(86,510)	(47,101)	(49,868)	(53,526)
Change in cash	22,678	5,836	(10,979)	9,507	25,080
Free cash flow	57,462	73,402	34,929	67,159	82,691

Balance sheet (RMB m)

Year end: Dec	2014	2015	2016E	2017E	2018E
Cash	427,319	403,172	395,426	408,198	436,576
Short term investments	2,000	9,167	18,209	17,288	16,433
Accounts receivables	16,715	17,743	19,162	20,695	22,351
Inventory	9,292	9,994	10,494	11,018	11,569
Other current assets	31,599	38,621	40,026	41,754	43,561
Total current assets	486,925	488,697	483,317	498,964	530,491
PP&E	700,133	673,643	749,739	801,552	847,799
Intangible Assets	36,190	36,111	36,046	35,978	35,906
Associates and JVs	70,451	15,933	22,782	13,450	14,139
Other long term assets	54,396	113,511	18,423	13,483	128,694
Total long term assets	861,110	939,198	1,026,990	1,091,462	1,153,707
TOTAL ASSETS	1,348,035	1,427,895	1,510,307	1,591,426	1,684,198
Short term debt	1,000	-	-	-	-
Accounts payables	227,577	243,579	252,104	259,667	267,457
Other current liabilities	223,915	257,459	267,083	276,257	285,788
Total current liabilities	452,492	501,038	519,187	535,924	553,246
Long term debt	-	-	-	-	-
Deferred tax	98	203	203	203	203
Convertible bonds	-	-	-	-	-
Other long term liabilities	6,462	6,286	6,351	1,423	1,494
Total long term liabilities	6,560	6,489	6,554	1,626	1,697
TOTAL LIABILITIES	459,052	507,527	525,741	537,551	554,943
Shareholders' funds	886,916	917,336	981,412	1,050,594	1,125,838
Minority interests	2,067	3,032	3,154	3,282	3,416
TOTAL LIAB AND EQUITY	1,348,035	1,427,895	1,510,307	1,591,426	1,684,198
Net cash / (debt)	426,319	403,172	395,426	408,198	436,576

Key ratios

Year end: Dec	2014	2015	2016E	2017E	2018E
Operating ratios					
EBIT margin (%)	18.2	18.0	17.6	18.4	19.6
EBITDA margin (%)	36.9	35.9	33.4	34.3	35.2
Effective tax rate (%)	23.3	24.4	23.3	23.5	23.6
Revenue growth (%)	3.4	2.6	2.2	2.6	2.3
Net income growth (%)	(10.4)	(0.6)	2.0	7.2	8.4
EPS growth adj (%)	(10.7)	(1.0)	2.0	7.2	8.4
DPS growth (%)	(12.3)	(0.8)	2.0	7.2	8.4
Efficiency ratios					
ROE (%)	16.8	16.2	16.2	16.9	17.9
ROCE (%)	13.2	13.0	12.1	12.2	12.4
Asset turnover (x)	0.5	0.5	0.5	0.4	0.4
Op cash / EBIT (x)	1.8	2.0	1.8	1.7	1.6
Depreciation / CAPEX (x)	0.7	0.8	0.6	0.7	0.7
Accounts receivable days	16.9	20.5	24.2	25.1	26.0
Accounts payable days	177.8	200.6	199.0	202.9	207.0
Leverage ratios					
Net gearing (%)	(48.1)	(44.0)	(40.3)	(38.9)	(38.8)
Net debt / EBITDA (x)	(1.8)	(1.7)	(1.7)	(1.7)	(1.7)
Interest cover (x)	-	-	-	-	-
Current ratio (x)	1.1	1.0	0.9	0.9	1.0
Valuation					
PER (x)	13.0	13.1	12.9	12.0	11.1
EV/EBITDA (x)	4.1	4.2	4.5	4.2	3.9
PBR (x)	1.6	1.6	1.5	1.4	1.3
Dividend yield (x)	3.3	3.3	3.3	3.6	3.9

Source: Company, Bloomberg, CSCI Research estimates

China Telecom
Income statement (RMBm)

Year end: Dec	2014	2015	2016E	2017E	2018E
Revenue	324,394	331,202	345,633	360,52	374,162
SG&A	(62,79)	(54,472)	(53,709)	(54,001)	(55,866)
Personnel	(50,653)	(52,541)	(55,220)	(57,826)	(60,489)
Other operating expenses	(16,169)	(30,083)	(14,779)	(52,716)	(58,756)
Other operating income					
EBITDA	94,853	94,106	91,925	95,607	99,051
Depreciation & Amortization	(66,345)	(67,664)	(58,966)	(60,500)	(61,514)
Other income	6	8	6	7	7
EBIT	28,514	26,450	32,966	35,115	37,544
Net interest	(5,291)	(4,273)	(4,405)	(4,311)	(3,572)
Associates	34	(698)	798	1,708	2,080
Exceptional items	-	-	-	-	-
Pretax profit	23,257	21,479	29,359	32,512	36,051
Taxation	(5,498)	(6,551)	(7,271)	(8,115)	(9,050)
Minority interests	(79)	(88)	(70)	(56)	(45)
Net profit	17,680	14,840	22,017	24,341	26,956
Net profit (adjusted)	17,680	20,054	22,017	24,341	26,956
Basic EPS (RMB)	0.22	0.25	0.27	0.30	0.33
EPS (adjusted) (RMB)	0.22	0.25	0.27	0.30	0.33
DPS (RMB)	0.08	0.08	0.08	0.09	0.90

Cash flow statement (RMBm)

Year end: Dec	2014	2015	2016E	2017E	2018E
EBIT	28,514	26,450	32,966	35,115	37,544
Depreciation & amortisation	66,345	67,664	58,966	60,500	61,514
Net interest	5,291	4,273	4,405	4,311	3,572
Taxes paid	(6,407)	(4,099)	(7,115)	(7,946)	(8,866)
Changes in working capital	8,796	18,940	3,147	6,040	6,146
Others	(6,134)	(4,478)	(5,394)	(4,698)	(2,687)
Cash flow from operations	96,405	108,750	86,974	93,321	97,223
Capex	(80,273)	(101,898)	(97,485)	(85,461)	(80,438)
Acquisitions	-	-	-	-	-
Disposals	-	-	-	-	-
Others	(1,435)	(352)	9,234	9,840	10,266
Cash flow from investing	(81,708)	(102,250)	(88,251)	(75,622)	(70,173)
Dividends	(6,198)	(6,160)	(6,850)	(7,503)	(72,745)
Issue of shares	-	-	-	-	-
Change in debt	(4,075)	11,013	(1,119)	(1,098)	(62,784)
Others	(54)	(44)	(84)	(88)	(93)
Cash flow from financing	(10,327)	4,809	(8,053)	(8,689)	(135,621)
Change in cash	4,370	11,309	(9,330)	9,010	(108,570)
Free cash flow	9,082	(14,343)	(12,832)	2,031	9,563

Balance sheet (RMBm)

Year end: Dec	2014	2015	2016E	2017E	2018E
Cash	20,436	31,869	22,539	31,549	(77,021)
Short term investments	1,379	2,519	2,519	2,519	2,519
Accounts receivables	21,562	21,105	21,801	22,530	23,294
Inventory	4,225	6,281	6,607	6,951	7,312
Other current assets	11,941	16,334	17,145	17,997	18,892
Total current assets	59,543	78,108	70,612	81,547	(25,004)
PP&E	372,876	373,981	398,497	415,747	426,378
Intangible Assets	38,901	40,659	42,707	44,968	47,438
Associates and JVs	4,106	34,473	35,271	36,979	39,059
Other long term assets	85,848	102,340	104,962	100,481	95,952
Total long term assets	501,731	551,453	581,438	598,176	608,827
TOTAL ASSETS	561,274	629,561	652,050	679,722	583,823
Short term debt	44,058	51,720	50,689	111,383	110,390
Accounts payables	88,458	18,055	14,145	10,550	17,288
Other current liabilities	73,809	86,154	88,007	92,963	98,274
Total current liabilities	206,325	255,929	262,841	334,896	345,952
Long term debt	62,494	64,830	64,742	2,950	(58,841)
Deferred tax	1,125	2,061	2,080	2,099	2,118
Convertible bonds					
Other long term liabilities	1,222	1,990	2,483	3,067	3,720
Total long term liabilities	64,841	68,881	69,305	8,116	(53,003)
TOTAL LIABILITIES	271,166	324,810	332,146	343,012	292,949
Shareholders' funds	289,183	303,784	318,951	335,789	290,001
Minority Interests	925	967	953	922	874
TOTAL LIAB AND EQUITY	561,274	629,561	652,050	679,722	583,823
Net cash / (debt)	(86,116)	(84,681)	(92,892)	(82,784)	(128,570)

Key ratios

Year end: Dec	2014	2015	2016E	2017E	2018E
Operating ratios					
EBIT margin (%)	8.8	8.0	9.5	9.7	10.0
EBITDA margin (%)	29.2	28.4	26.6	26.5	26.5
Effective tax rate (%)	23.6	30.5	24.8	25.0	25.1
Revenue growth (%)	0.9	2.1	4.4	4.2	3.9
Net income growth (%)	0.8	13.4	9.8	10.6	10.7
EPS growth adj (%)	0.8	13.4	9.8	10.6	10.7
DPS growth (%)	16	-	10.5	9.5	869.6
Efficiency ratios					
ROE (%)	6.1	6.6	6.9	7.2	9.3
ROCE (%)	5.7	4.8	5.7	5.9	6.2
Asset turnover (x)	0.6	0.5	0.5	0.5	0.6
Op cash / EBIT (x)	3.4	4.1	2.6	2.7	2.6
Depreciation / CAPEX (x)	0.8	0.7	0.6	0.7	0.8
Accounts receivable days	23.4	23.5	22.7	22.5	22.4
Accounts payable days	134.8	159.0	174.2	175.7	177.7
Leverage ratios					
Net gearing (%)	29.8	27.9	29.1	24.7	44.3
Net debt / EBITDA (x)	0.9	0.9	1.0	0.9	1.3
Interest cover (x)	5.4	6.2	7.5	8.1	10.5
Current ratio (x)	0.3	0.3	0.3	0.2	(0.1)
Valuation					
PER (x)	13.4	11.8	10.8	9.8	8.8
EV/EBITDA (x)	3.4	3.4	3.6	3.3	3.7
PBR (x)	0.8	0.8	0.7	0.7	0.8
Dividend yield (x)	2.6	2.6	2.9	3.2	30.6

Source: Company, Bloomberg, CSCI Research estimates

China Unicom
Income statement (RMBm)

Year end: Dec	2014	2015	2016E	2017E	2018E
Revenue	284,681	277,049	282,664	293,663	304,629
SG&A	(104,808)	(99,006)	(97,861)	(100,327)	(102,905)
Personnel	(34,652)	(35,140)	(35,316)	(36,375)	(37,466)
Other operating expenses	(52,450)	(55,401)	(64,177)	(65,430)	(66,885)
Other operating income	-	-	-	-	-
EBITDA	92,771	87,502	85,309	91,530	97,372
Depreciation & Amortization	(73,868)	(76,738)	(71,336)	(73,401)	(74,541)
EBIT	18,903	10,764	13,973	18,129	22,832
Net interest	(4,334)	(6,496)	(4,233)	(4,522)	(4,692)
Share of associate and JV	-	(801)	560	1,341	1,690
Other income, net	1,362	10,568	1,342	1,363	1,384
Pretax profit	15,931	14,035	11,641	16,311	21,214
Taxation	(3,876)	(3,473)	(2,894)	(4,050)	(5,261)
Minority interests	-	-	-	-	-
Net profit	12,055	10,562	8,747	12,261	15,953
Net profit (adjusted)	11,034	2,636	7,741	11,239	14,915
Basic EPS (RMB)	0.51	0.44	0.37	0.51	0.67
EPS (adjusted) (RMB)	0.51	0.44	0.37	0.51	0.67
DPS (RMB)	0.20	0.17	0.20	0.25	0.30

Balance sheet (RMBm)

Year end: Dec	2014	2015E	2016E	2017E	2017E
Cash	25,308	21,755	9,529	3,631	4,033
Short term investments	56	202	222	244	269
Accounts receivables	14,671	14,957	15,107	15,258	15,410
Inventory	4,378	3,946	3,867	3,790	3,744
Other current assets	12,161	15,810	15,392	15,199	15,102
Total current assets	56,574	56,670	44,116	38,122	38,528
PP&E	438,321	454,631	465,816	473,087	476,372
Intangible Assets	2,771	2,771	2,771	2,771	2,771
Associates and JVs	3,037	32,975	33,535	34,876	36,566
Other long term assets	44,369	63,299	64,615	66,052	67,617
Total long term assets	488,498	553,676	566,737	576,786	583,325
TOTAL ASSETS	545,072	610,346	610,853	614,908	621,853
Short term debt	112,694	106,380	103,601	101,241	99,232
Accounts payables	120,371	167,396	165,722	164,065	162,424
Other current liabilities	58,855	62,298	62,495	63,674	65,227
Total current liabilities	291,920	336,074	331,818	328,980	326,883
Long term debt	23,880	40,676	41,327	41,778	41,867
Deferred tax	17	18	19	20	21
Convertible bonds	-	-	-	-	1
Other long term liabilities	1,714	2,362	2,516	2,683	2,864
Total long term liabilities	25,611	43,056	43,861	44,480	44,753
TOTAL LIABILITIES	317,531	379,130	375,680	373,460	371,636
Shareholders' funds	227,541	231,216	235,174	241,448	250,216
Minority interests	-	-	-	-	-
TOTAL LIAB AND EQUITY	545,072	610,346	610,853	614,908	621,853
Net cash / (debt)	(111,266)	(125,301)	(135,399)	(139,387)	(137,067)

Source: Company, Bloomberg, CSCI Research estimates

Cash flow statement (RMBm)

Year end: Dec	2014	2015	2016E	2017E	2018E
EBIT	18,903	10,764	13,973	18,129	22,832
Depreciation & amortisation	73,868	76,738	71,336	73,401	74,541
Net interest	(4,334)	(6,496)	(4,233)	(4,522)	(4,692)
Taxes paid	(4,620)	(2,244)	(2,894)	(4,050)	(5,261)
Changes in working capital	(1,329)	(3,340)	(2,311)	(1,621)	(1,414)
Others	5,606	8,879	(6,099)	(6,239)	(6,382)
Cash flow from operatio	88,094	84,301	69,771	75,098	79,623
Capex	(69,586)	(88,465)	(75,000)	(73,000)	(70,000)
Acquisitions	(3,807)	(4,542)	(69)	(77)	(95)
Disposals	796	2,333	(20)	(22)	(24)
Others	(2,722)	(680)	-	-	-
Cash flow from investin	(75,319)	(91,354)	(75,080)	(73,100)	(70,120)
Dividends	(3,677)	(4,643)	(4,789)	(5,987)	(7,184)
Issue of shares	871	1	-	-	-
Change in debt	(2,490)	12,72	2,661	4,078	5,266
Others	(3,677)	(4,643)	(4,789)	(5,987)	(7,184)
Cash flow from financin	(8,973)	3,427	(6,918)	(7,896)	(9,102)
Change in cash	3,802	(3,626)	(12,226)	(5,897)	401
Free cash flow	19,309	(4,436)	7,415	14,480	22,111

Key ratios

Year end: Dec	2014	2015E	2016E	2017E	2017E
Operating ratios					
EBIT margin (%)	6.6	3.9	4.9	6.2	7.5
EBITDA margin	32.6	31.6	30.2	31.2	32.0
Effective tax rate (%)	24.3	24.7	24.9	24.8	24.8
Revenue growth (%)	(3.5)	(2.7)	2.0	3.9	3.7
Net income growth (%)	15.8	(12.4)	(17.2)	40.2	30.1
EPS growth adj (%)	14.9	(12.7)	(17.2)	40.2	30.1
DPS growth (%)	24.8	(15.3)	17.6	25.0	20.0

Efficiency ratios

ROE (%)	2.2	1.7	1.4	2.0	2.6
ROCE (%)	7.5	3.9	5.0	6.3	7.7
Asset turnover (x)	0.5	0.5	0.5	0.5	0.5
Op cash / EBIT (x)	4.7	7.8	5.0	4.1	3.5
Depreciation / CAPEX (x)	11	0.9	1.0	10	11
Accounts receivable days	18.9	19.5	19.4	18.9	18.4
Accounts payable days	217	277.1	308.0	297.8	287.5

Leverage ratios

Net gearing (%)	48.9	54.2	57.6	57.7	54.8
Net debt / EBITDA (x)	12	14	16	15	14
Interest cover (x)	4.4	1.7	3.3	4.0	4.9
Current ratio (x)	0.2	0.2	0.1	0.1	0.1

Valuation

PER (x)	13.6	15.6	18.8	13.4	10.3
EV/EBITDA (x)	3.0	3.3	3.5	3.3	3.1
PBR (x)	0.7	0.7	0.7	0.7	0.7
Dividend yield (x)	2.9	2.5	2.9	3.6	4.4



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Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	12-month absolute total return: $\geq 10\%$
Hold	12-month absolute total return: $> -10\%$ but $< 10\%$
Sell	12-month absolute total return: $\leq -10\%$

Disclosure of Interests

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