



## China telecom services: Reversing the slowdown

### China Mobile upgraded to Buy, maintain Buy on China Unicom and Neutral on China Telecom

We believe the recent regulatory changes will gradually resolve the major bottlenecks in China's telecom sector. We expect the telecom industry's service revenue growth to reverse its declining trend in recent years, driven by the rapid growth of mobile data services.

We upgrade China Mobile to Buy for its 4G-driven revenue stabilization, and maintain our Buy on China Unicom, and Neutral on China Telecom. Our new pecking order in the telecoms sector is CM > CU > CT.

#### Key analysis in this anchor report includes

- The impact of tariff liberalisation and handset subsidy reductions on 4G subscriber and smartphone growth
- The impact of FD-LTE and tower companies on telecom capex and operators' relative strength
- China telecom industry's revenues, capex and subscriber forecasts

3 June 2014

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### Reversing the slowdown

Upgrade China Mobile to Buy, maintain Buy on CU and Neutral on CT

#### 4G to mark an inflection point for telecoms revenue in 2015F

Recent regulatory changes (eg, VAT reform, tariff liberalisation and handset subsidy reductions) should gradually resolve the major bottlenecks in China's telecom sector during the transition from voice-centric to data-centric business models. We expect telecom industry service revenue growth to reverse its declining trend in recent years and moderately rise from 6.4% in 2014F to 7.3% in 2016F, driven by rapid growth of mobile data services. We upgrade China Mobile (CM) to Buy with a new TP of HKD90 for its 4G-driven revenue growth. We maintain Buy on China Unicom (CU) with TP of HKD13.5, and stay Neutral on China Telecom with a new TP of HKD4.0. Our new pecking order in the telecoms sector is CM > CU > CT.

#### China Mobile: Buy for 4G-driven revenue stabilisation

We suggest investors Buy CM for its 4G subscriber growth and stabilising revenue growth. We think CM still faces structural issues such as large exposure to voice/SMS and high dependency on 2G subscribers, but its new 4G tariff plan and aggressive 4G network deployment should gradually stabilise its revenue growth. While some are concerned that CM may lose its technological edge if it is granted an FD-LTE license, we would see it as an opportunity for CM to deploy 4G services in a lower frequency band.

#### China Unicom: structural advantage intact, albeit ST uncertainty

Although we expect a temporary slowdown in CU's 3G net additions, we think the firm will maintain its technology advantage in 3G and 4G as well. Its 3G/4G net additions should soon recover once it has its FD-LTE license.

#### China Telecom: short-term structural challenge remains

We raise our TP to HKD4 but maintain our Neutral call as we expect it to record growth below industry averages even after the government issues its FD-LTE license this year. CT's mobile net adds and service revenue growth will likely remain weak even after the FD-LTE licenses are issued, due to disadvantages in the speed of its CDMA network (3.1Mbps) vs CM's TD-LTE network (100Mbps), and technological difficulties in both handset chipsets and the 3G/4G handover on the network side.

Fig. 1: Stocks for action

Code	Company	Trading Curncy	Nomura Rating	Price 5/28/2014	Target Price	Potential Upside
941 HK	China Mobile	HKD	Buy ↑	75.7	90 ↑	19%
762 HK	China Unicom	HKD	Buy	11.6	13.5	16%
728 HK	China Telecom	HKD	Neutral	3.9	4 ↑	3%

Source: Bloomberg, Nomura estimates. Note: ↑ Upgrading.

### Global Markets Research

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#### Anchor themes

Recent regulatory announcements have clarified the details for MVNO and VAT, and have also shed more light on the government's stance on towercos, subsidies, and FDD licenses.

#### Nomura vs consensus

We are more bullish than the Street on CM for its advantages in 4G deployment.

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# Telecom sector growth to stabilize

The Chinese government has announced a series of regulatory changes in the past couple of months, including VAT reform, tariff liberalisation, handset subsidy cuts, and a new tower company. We think it may also announce FD-LTE licenses in the near future.

We do not yet have enough details to quantify the impact of these changes, but in terms of direction, we think the latest regulatory changes will gradually resolve the bottlenecks in the sector and stabilize industry growth in the next few years.

**Fig. 2: Summary of regulatory changes announced since April 2014**

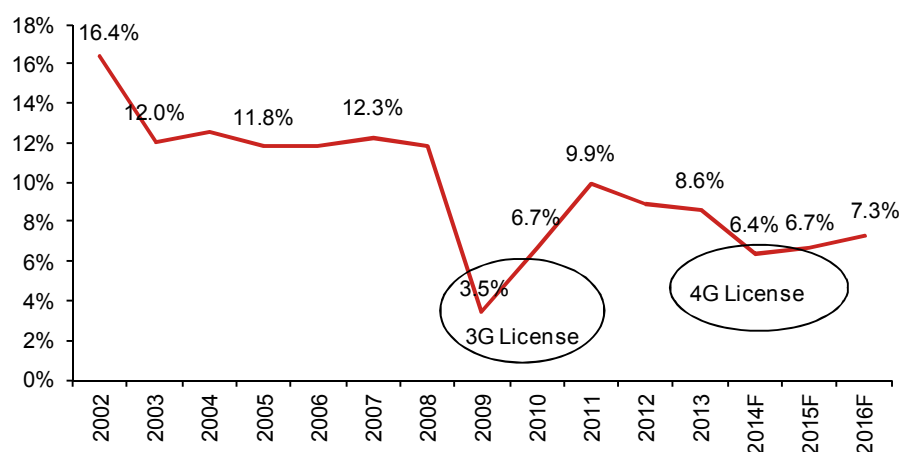
VAT reform	<ul style="list-style-type: none"> <li>• CNY15.7bn (10%) negative to industry profits</li> <li>• NP impacts: CM (~15%), CT (~30%), CU (~40%)</li> </ul>
Tariff liberalization	<ul style="list-style-type: none"> <li>• Resolved consumers' concerns on high 4G tariffs</li> <li>• Positive to the growth of 4G sub and mobile data traffic</li> </ul>
Handset subsidy cut	<ul style="list-style-type: none"> <li>• 5.7% (CNY10bn) positive to industry pre-tax income, more room to lower tariffs</li> <li>• Negative to smartphone shipment volumes</li> </ul>
Tower company	<ul style="list-style-type: none"> <li>• Positive in CNY20bn/year (4.6%) capex saving</li> <li>• Positive to CT/CU in accelerating 4G network rollout</li> <li>• Negative to CM in losing a major differentiation factor</li> </ul>
FD-LTE license	<ul style="list-style-type: none"> <li>• Positive to CU/CT to accelerate 4G services</li> <li>• Positive to CM if CM also gets FD-LTE</li> </ul>

Source: Nomura research

## 4G to mark inflection point for telecom revenue in 2015F

We expect the industry's service revenue growth to stabilize in 2015F, driven by the acceleration of mobile data service revenue. We think the 4G network has resolved the technical bottlenecks for China Mobile's subscribers using mobile data services, and the new 4G tariff plans will resolve subscribers' concerns on the excess costs in using 4G services in China.

**Fig. 3: Telecom industry service revenue growth to stabilize in 2015F**



Source: Company data, Nomura estimates

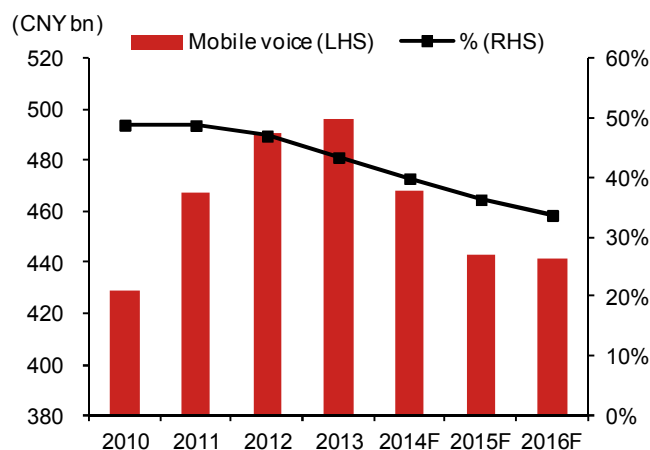
### Mobile data services revenue to show 30% CAGR over 2014-16F

We expect mobile data services to show a 30% revenue CAGR over 2014-16F, with the revenue contribution from mobile data services reaching 29% in 2016F, from 15% in 2013. This should offset the anticipated decline in mobile voice/SMS and the slowdown in fixed-line services.

### Mobile voice revenue to decline and eventually stabilise on rigid demand

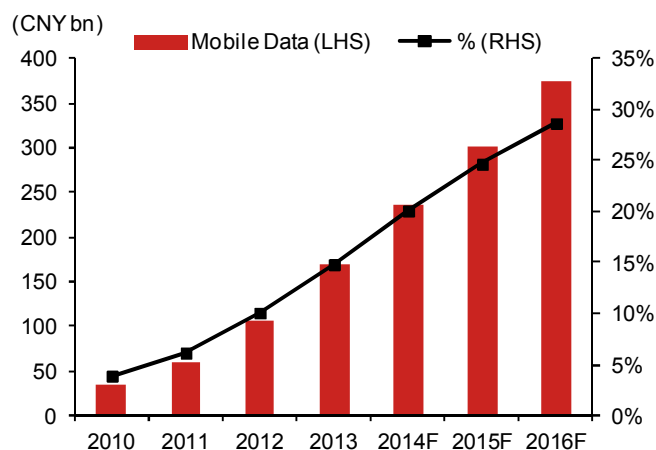
We expect industry mobile voice revenue to decline on substituting OTT services. However, the gross amount should stabilise in 2016F, when we expect voice service usage to reach a sustainable level, supported by rigid demand. At the same time, its revenue proportion will likely continue to fall, to ~34% in 2016F from 49% in 2013.

Fig. 4: Mobile voice revenue trending down



Source: Company data, Nomura estimates

Fig. 5: Mobile data services driving growth



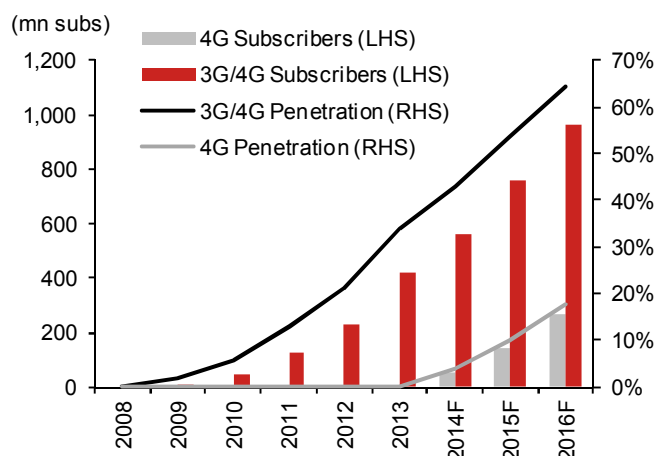
Source: Company data, Nomura estimates

### 4G migration to boost ARPUs and data usage

We expect China's 4G subscriber total to reach 52mn (4% penetration) by end-2014F and 139mn (10% penetration) by end-2015F. This transition will greatly boost per-subscriber data usage and ARPUs, in our view.

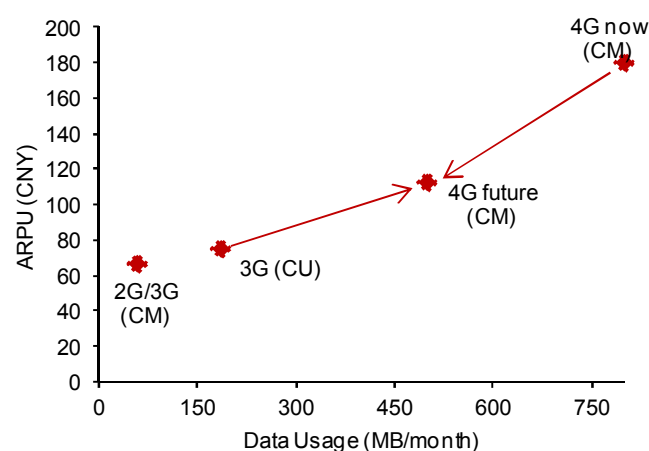
Figure 7 below compares CU's 3G service against CM's 4G service. We see a huge improvement in both data usage and ARPU (+330% for data usage and +140% for ARPU) with CM's 4G service. Nevertheless, as CM's 4G subscriber base builds, we expect a drop in average data usage and ARPU to a more reasonable level, since early service adapters tend to be heavy data users who are willing to pay more.

Fig. 6: China's 3G/4G subscriber and subscriber penetration forecasts



Source: Company data, Nomura estimates

Fig. 7: Comparison of CU's 3G vs CM's 4G

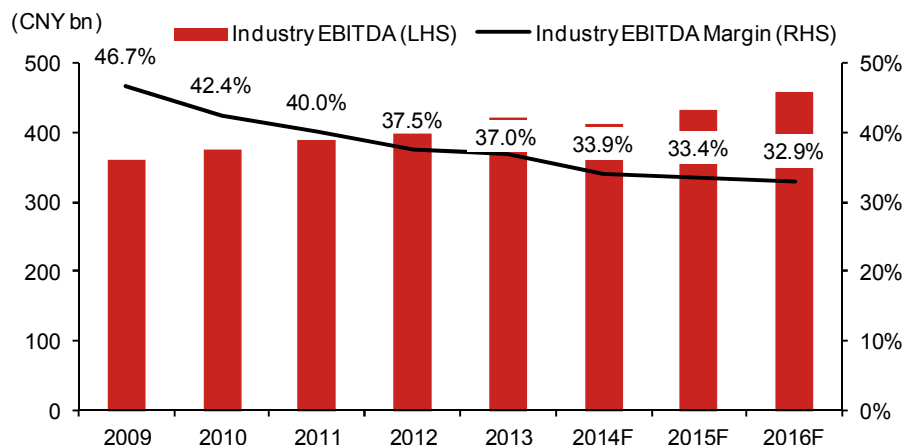


Source: Company data, Cisco

## EBITDA margin decline will continue, but EBITDA growth to turn positive in 2015F

We expect industry EBITDA margin will continue to decline in 2014F, due to rising network operating and sales marketing expenses. However, we expect EBITDA to stabilise starting in 2015F as 3G/4G (especially 4G) users start to drive up data usage sufficiently at lower network costs, which can offset falls in voice/SMS businesses. We expect EBITDA to fall by 2% in 2014F and then to see 5%/6% y-y growth in 2015F/16F.

Fig. 8: Industry EBITDA and EBITDA margins

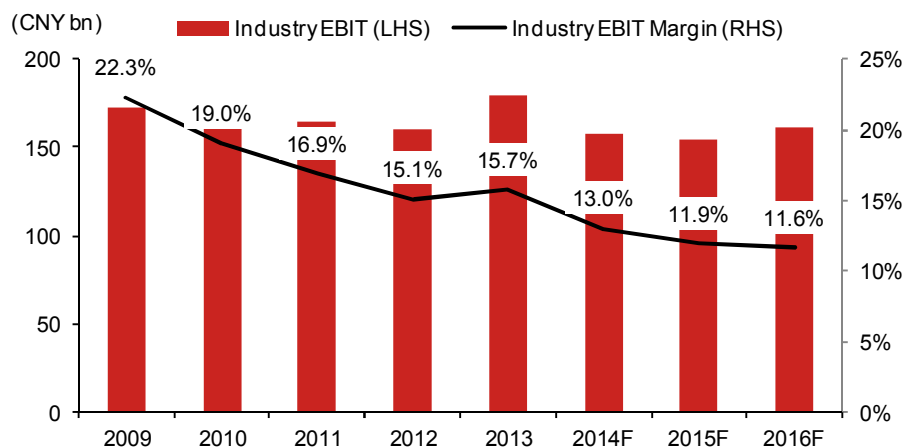


Source: Company data, Nomura estimates

## EBIT growth to turn positive in 2016F

We expect EBIT to decline a sharp 12% y-y in 2014F and 2% y-y in 2015F due to the VAT reform and the rise in depreciation for heavy capex. However, we believe EBIT will resume growth (+5% y-y in 2016F) and EBIT margin will stabilize, driven by higher network utilisation rates as the 3G/4G user bases increase. In particular, the surge in EBIT in 2013 was driven by strong EBIT growth from CT and CU, where depreciation was lower than expected.

Fig. 9: Industry EBIT and EBIT margins



Source: Company data, Nomura estimates



## Capex to peak and free cashflow to bottom in 2015F

We expect China's telecom capex to peak in 2015F, driven by CU and CT's large-scale 4G network rollouts from 2015F, following CM's heavy capex spending that begun in 2013. We expect 4G-related capex to reach CNY165bn in 2015F (~78% of mobile capex) and CNY173bn in 2016F (~85%), up significantly from the CNY35bn in 2013 (~23% of mobile capex). Domestic telecom equipment vendors such as Huawei and ZTE stand to be the largest beneficiaries of this trend in terms of both market-share gains and increases in overall telecom industry capex (making a larger pie), we believe.

We expect CM's capex will start to decline from 2015F, but we believe industry capex will remain positive, thanks to CT and CU's 4G network rollouts. We expect industry capex to start to decline from 2016F.

Fig. 10: China's telecom industry capex summary

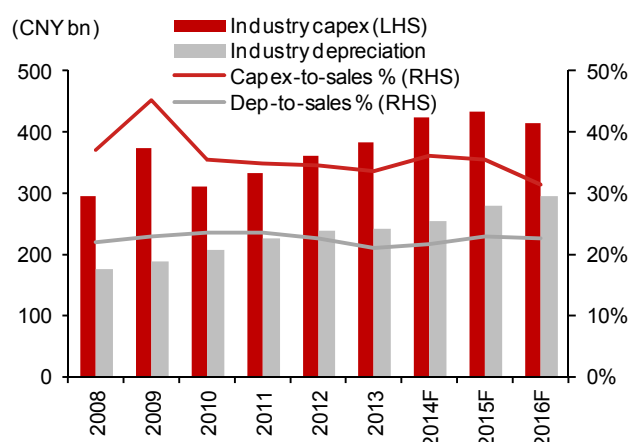
(CNY bn)		FY11	FY12	FY13	FY14F	FY15F	FY16F	y-y Change	
								FY14F	FY15F
		A	A	A	NOM	NOM	NOM		
China Telecom industry CAPEX		333	361	384	425	432	413		
	y-y	7%	8%	6%	11%	2%	-4%		
China Mobile (group)		160	173	215	249	237	217	16%	-5%
China Telecom (group)		72	73	80	80	100	100	0%	25%
China Unicom (group)		77	100	73	80	80	80	9%	0%
Others		25	16	16	16	16	16	0%	0%
Total									
Mobile		131	142	148	185	212	203	26%	14%
2G		76	59	46	24	20	10	-47%	-17%
3G		55	82	66	39	27	20	-41%	-31%
4G		0	0	35	122	165	173	246%	35%
Fixedline broadband		111	143	153	149	143	135	-3%	-4%
Infrastructure/Others		91	77	83	91	77	75	9%	-15%

Source: Company data, Nomura estimates

Despite the expected decline in industry capex from 2016F onward, we think depreciation will continue to climb, albeit at slower rates, until around 2020F, before we start to see a decline.

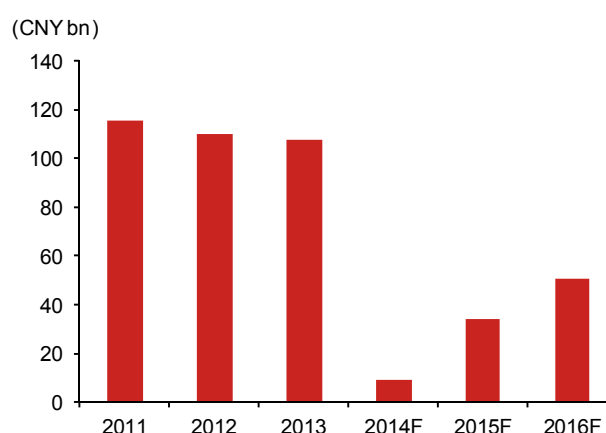
We expect industry FCF to reach a bottom in 2014F, for two reasons: 1) VAT reform will likely lead to earnings deterioration; and 2) CM/CT are pumping up their capex. Thereafter, we should start to see a recovery in industry FCF in 2015F, driven by a diminishing VAT impact and the peak out of CM's capex.

Fig. 11: Industry capex and depreciation trends



Source: Company data, Nomura estimates

Fig. 12: Industry free cashflow trends



Source: Company data, Nomura estimates

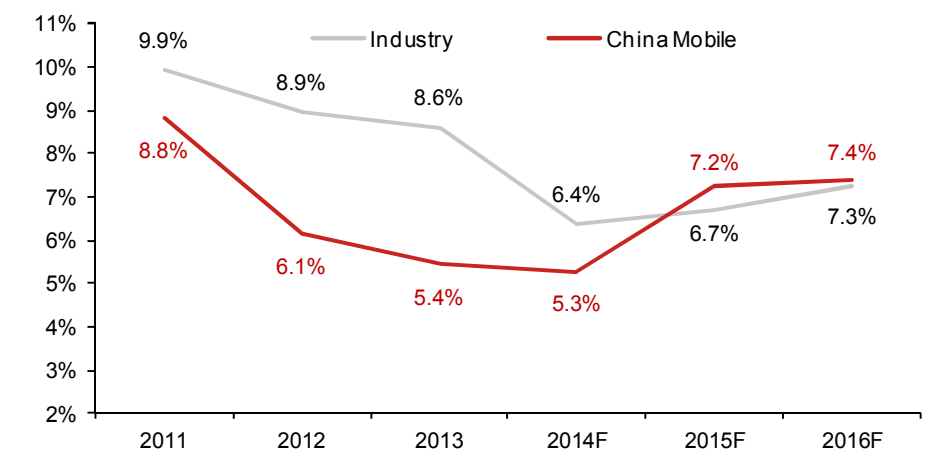


# China Mobile: upgrade to Buy

## Revenue growth to stabilize

We expect CM to register lower-than-industry-average revenue growth in 2014F but to improve in 2015F, driven by 4G subscriber growth. We believe that 2015F will be a year of robust growth for CM's 4G subscriber base and that any delays in issuing FD-LTE licenses will play to CM's advantage.

Fig. 13: CM vs industry-average revenue growth

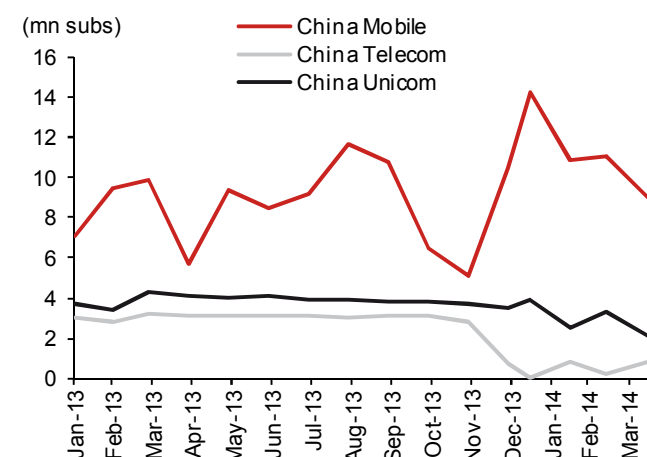


Source: Company data, Nomura estimates

## 4G subscriber base to pick up

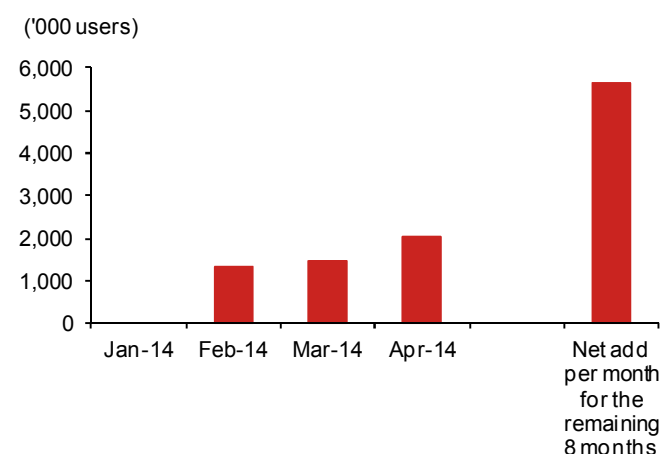
As of end-April 2014, CM had only 4.8mn 4G subscribers, with the growth much slower than we and the market had expected. We expect the monthly subscriber numbers to pick up from 2H14F, driven by: 1) the decline in 4G smartphone ASPs; and 2) the decline in 4G data tariffs thanks to CM's new tariff plan.

Fig. 14: CM/CT/CU monthly 3G/4G net addition trends



Source: Company data

Fig. 15: CM targets 50mn 4G subs in 2014F



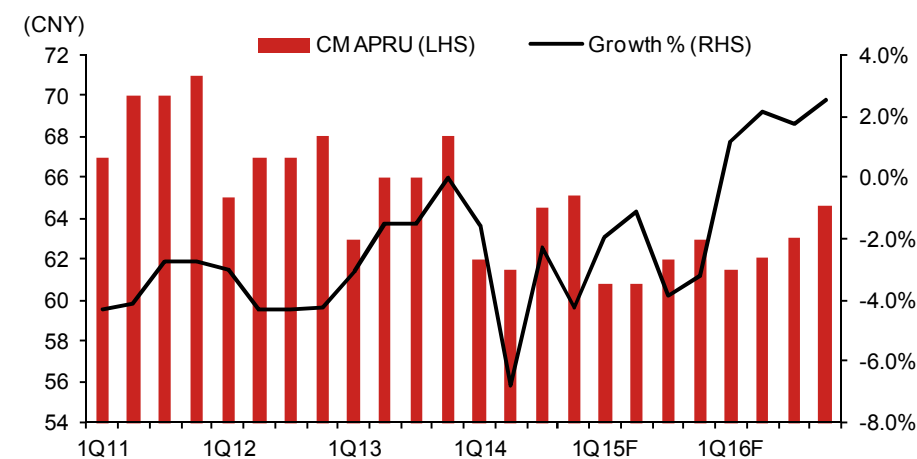
Source: Company data, Nomura estimates

## ARPU growth may turn positive in 2016F

We expect CM's blended ARPU to continue to decline as OTT cannibalisation is likely to persist until CM's 3G/4G subscriber adoption rate reaches a large enough base for growth in data revenue to offset the decline in voice and related VAS revenues.

We expect CM's 3G/4G subscriber adoption rate to reach 37%/48%/60% by the end of 2014F/2015F/2016F, respectively, from 25% in 2013. Accordingly, we expect CM's blended ARPU to stabilise and see positive growth in 2016F.

Fig. 16: CM ARPU trend and growth rate



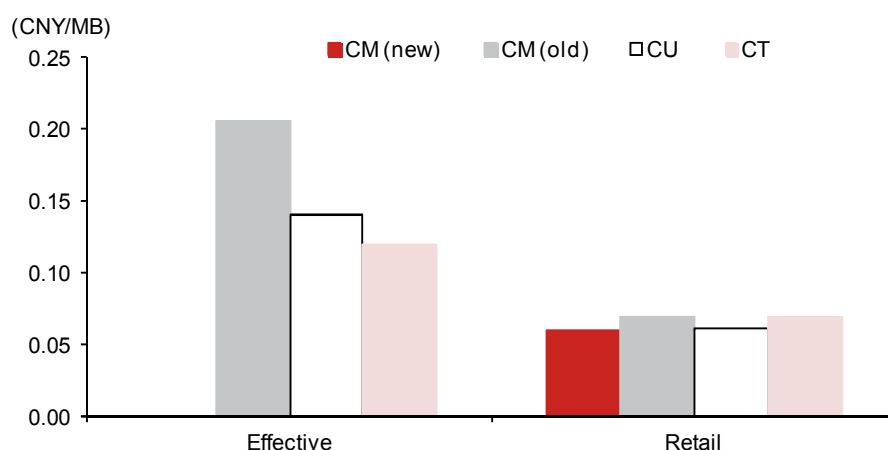
Source: Company data, Nomura estimates

## New tariff plan makes 4G service more attractive

We think one major bottleneck slowing CM's 4G adoption is its existing mobile data tariff plan. As shown below, CM's effective data tariff is 46% higher than CU's and 71% above CT's. Moreover, its official data tariff is 15% higher than CU's and the same as CT's.

CM's new official data tariff announced after the MIIT's tariff regulation is now 14% lower than its existing plan and 2% cheaper than CU's, which is an important factor in accelerating 4G service adoption.

Fig. 17: Comparison of three operators' actual data tariffs in 2013



Source: Company data, Nomura estimates

The new tariff plan also provides several other advantages:

- **Lower entry tariff:** (CNY58 for 500MB and 50 minutes, vs CNY88 for 400MB and 200 minutes).

- **Data sharing:** up to four devices can be linked to share a data package (CNY10 per device), which can lead to further savings for group users.
- **Peace of mind for data over-usage:** CM has introduced options for users to automatically purchase additional data packages (eg, CNY10 for 500MB, which is 66% cheaper than being charged on a per-MB basis).

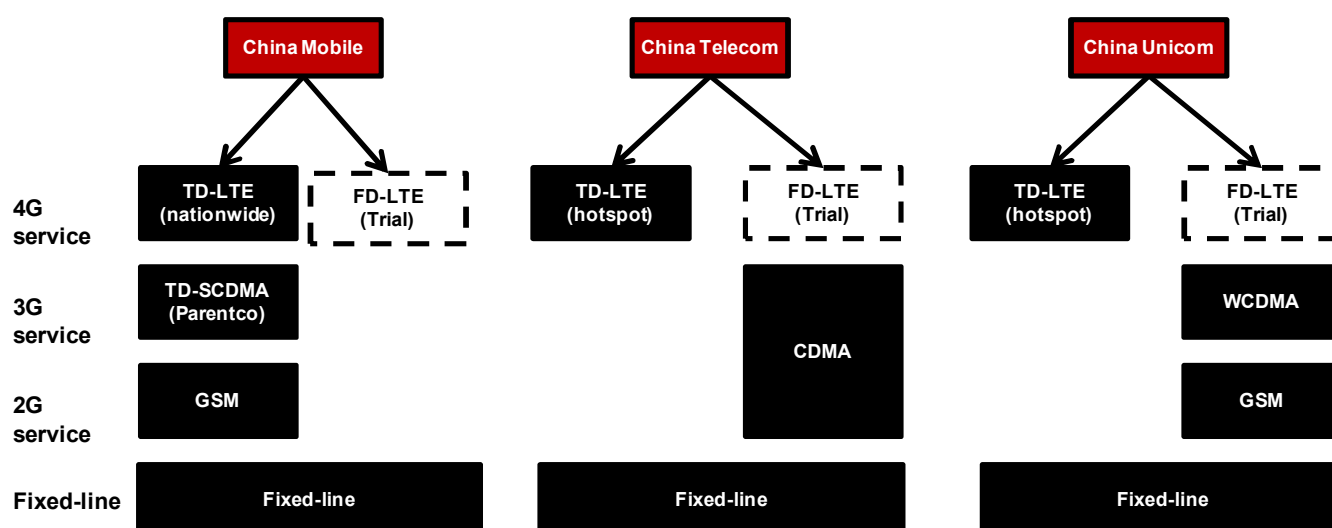
## FD-LTE license may not be a bad thing for CM

We note that some investors appear to be concerned about potential negative impacts from an FD-LTE license. Based on our industry studies, we think CM is also preparing FD-LTE services on the 900MHz frequency band by reusing the 2G spectrum it currently owns (ie, spectrum re-farming).

We have seen evidence to support our assumptions, including: 1) CM's change in 4G smartphone requirements from three modes (TD-LTE, TD-SCDMA, GSM) to five modes (TD-LTE, FD-LTE, TD-SCDMA, WCDMA, GSM) in April 2014, and 2) CM's new initiative to drive commercialisation of VoLTE by end-2014.

If the government grants an FD-LTE license to CM in 2014 or 2015, we believe this would greatly improve CM's 4G network coverage. If FD-LTE is granted to CM at the same time as CU/CT, we think it would be a big benefit for the company.

Fig. 18: Summary of telecom operators' network roadmap



Source: Nomura research

Fig. 19: China telecom industry spectrum map

Frequency Band	China Mobile Technology	Bandwidth (MHz)	China Unicom Technology	Bandwidth (MHz)	China Telecom Technology	Bandwidth (MHz)
800~900MHz	GSM	48	GSM	12	CDMA	30
1.8GHz	GSM	60	GSM	20	LTE/FDD	60
1.9GHz	TD-SCDMA/TD-LTE	20	LTE/FDD	50	PHS	20
2.0GHz	TD-SCDMA	15	PHS	20	PHS	20
2.1GHz	TD-SCDMA	15	WCDMA	30	CDMA2000	30
2.3GHz	TD-SCDMA	30	TD-LTE (indoor)	20	TD-LTE (indoor)	20
2.5~2.6GHz	TD-LTE	60	TD-LTE	20	TD-LTE	20
Total		253		172		180

Source: Nomura research

## Tower company is a necessary compromise

We believe that the upcoming new tower company is structurally negative for CM, given that CM will lose one of its most important competitive advantages against CT/CU and the new towerco may become a new competitor.

As shown in the following figure, CM owns 57% of the telecom towers in China, vs 26% by CU and 16% by CT. If all tower assets in China are transferred to this new company, it would help CT/CU to accelerate their 4G network rollouts and intensify the competition against CM. But we think this is a rational compromise for CM to get its FD-LTE license and get tariff liberalisation, and it should benefit CM in terms of short-term earnings and cashflow.

**Fig. 20: Summary of China operator base station assets**

k units	FY11	FY12	FY13	% of towers	FY14F	FY15F
GSM BTS	700	800	881		920	1,000
TD-SCDMA BTS	220	280	446		500	600
TD-LTE BTS		20	220		500	800
China Mobile's # of towers	700	800	881	57%	920	1,000
GSM BTS	350	360	360		360	360
WCDMA BTS	230	331	407		487	500
4G LTE BTS					50	100
China Unicom's # of towers	350	360	407	26%	487	500
CDMA	200	220	250		250	250
4G LTE BTS					60	120
China Telecom's # of towers	200	220	250	16%	250	250
Total number of telecom towers in China	1,250	1,380	1,538		1,657	1,750
new towers		130	158		119	93

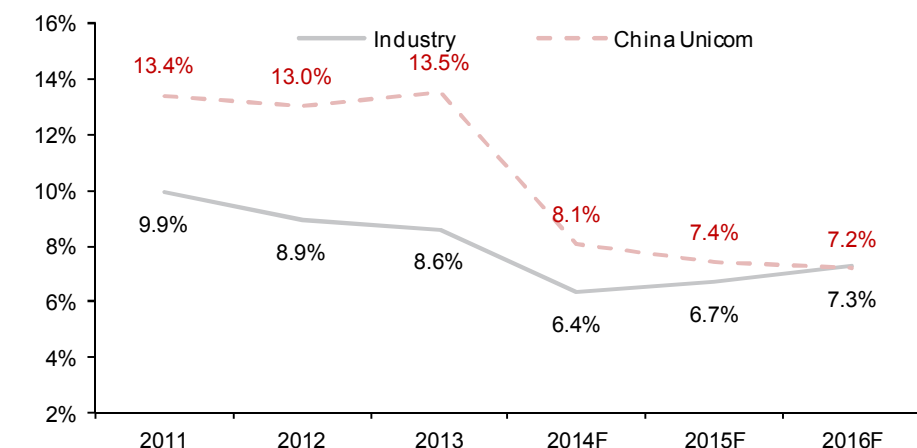
Source: Company data, Nomura estimates

# China Unicom: maintain Buy

## Buy for strong revenue growth

From a marketing perspective, 4G will be part of CU's integrated mobile broadband service, and it will not be marketed or priced differently than its existing 3G services. CU launched 4G TD-LTE trial services in 25 cities on 18 March and will launch 4G services in 300-plus cities by end-2014F. Despite seeing a slowdown in 3G subscriber net adds in recent months (feeling the heat from CM's aggressive push for LTE services), we believe CU's subscriber growth will rebound once its FD-LTE license is issued, likely in 3Q14. We believe CU will continue to outperform its local peers in top-line growth.

Fig. 21: CU vs industry revenue growth



Source: Company data, Nomura estimates

## Structural advantages intact

Although we see a temporary slowdown in CU's 3G net additions, we expect its 3G/4G net additions to recover quickly after it receives its FD-LTE license, thanks to its structural advantages in 3G technology.

On the network side, since CU's current 3G/WCDMA network already provides speeds up to 42Mbps (vs 100Mbps in 4G/TD-LTE), CU only needs to spend a small amount of capex on 4G network upgrades to provide 4G services in hotspot areas.

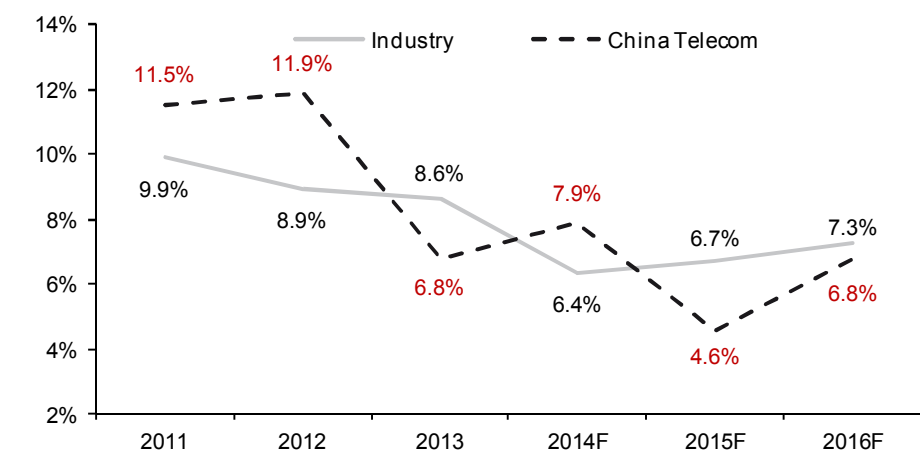
On the handset side, given that FD-LTE/WCDMA dual-mode handsets are already widely used in developed markets, the FD-LTE/WCDMA eco-system is extremely mature, and we expect CU to quickly launch 4G smartphones.

# China Telecom: maintain Neutral

## Revenue growth to slow even after FD-LTE license

We expect CT's revenue growth to remain slow in 2014F/2015F, even after the government grants an FD-LTE license.

Fig. 22: CT vs industry revenue growth



Source: Company data, Nomura estimates

As shown below, CT's current network only supports 3.1Mbps download speeds. To provide similar download speeds as CU and CM, CT needs to densely deploy its 4G network. Before finishing its 4G network deployment (two years), CT may not be able to provide a similar user experience as CU (42Mbps 3.5G services) or CM (100Mbps 4G services).

In addition to service quality, CT users may also face difficulties such as 1) limited handset availability and limited roaming capability as the 6-mode (TD-LTE, FD-LTE, TD-SCDMA, WCDMA, CDMA, GSM) chipset solution is not yet mature, and 2) fast power drain and TD-LTE/CDMA handover instability. We think the above issues won't be solved until major chipset vendors launch CDMA/LTE chipsets at the earliest in summer 2015, based on our industry studies.

Fig. 23: China telcos: network speed comparison

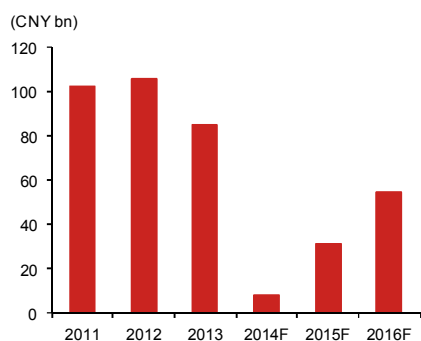
	Generation	Technology	Version	Downlink Mbps	Uplink Mbps
China Telecom	3G	CDMA	EVDO Rev.A	3.1	1.8
China Mobile	3G	TD-SCDMA		2.8	0.4
	4G	TD-LTE		100	50
China Unicom	3G	WCDMA	DC-HSPA	42	11

Source: Nomura research

## Free cashflow will remain challenging

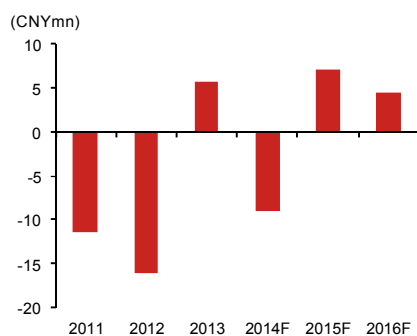
We expect CT's FCF to decline in 2014F, largely driven by VAT reform. We expect its FCF to continue to decline in 2015F/16F as the company finally ramps 4G capex starting in 2015F. We expect CT to have the worst FCF trend among the telcos.

**Fig. 24: CM: FCF trends**



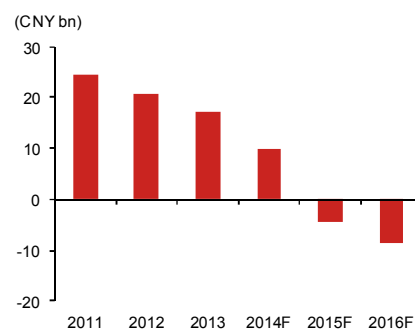
Source: Company data, Nomura estimates

**Fig. 25: CU: FCF trends**



Source: Company data, Nomura estimates

**Fig. 26: CT: FCF trends**



Source: Company data, Nomura estimates

## Largest beneficiary of tower company, but already priced in

Among the telcos, we expect CT and CU to benefit from the new tower company given they are at a disadvantage compared to CM in terms of their tower site portfolios. We think CT will be the bigger beneficiary of the two, since it has the lowest number of towers, which is already becoming an issue for the company in choosing sites for 4G deployment.



# Earnings forecast revisions / valuations

Fig. 27: Nomura and consensus summary forecasts for China telecom operators

(CNY bn)		2013	2014F	2015F	2016F	2014	2015	2016	2014	2015	2016
Industry Revenue		1,168.9	1,243.3	1,326.6	1,423.0	CON	CON	CON	Diff	Diff	Diff
y-y		8.6%	6.4%	6.7%	7.3%						
China Mobile	Revenue	630	645	671	721	657	698	738	-2%	-4%	-2%
	Service Revenue	591	603	629	677						
	y-y	5.42%	2.14%	4.18%	7.60%						
	EBITDA	240	228	241	258	234	241	254	-3%	0%	2%
	% of sales	40.7%	37.8%	38.4%	38.2%						
	Net Income	122	102	97	100	101	97	103	1%	-1%	-3%
	y-y	-5.9%	-16.4%	-4.8%	3.5%	-17.1%	-3.4%	5.7%			
	% of sales	51%	45%	40%	39%						
	EPS	6.05	5.06	4.82	4.98	5.24	5.03	5.17	-3%	-4%	-4%
	DPS	2.62	2.19	2.08	2.16	2.23	2.17	2.28	-2%	-4%	-6%
China Telecom	Revenue	322	323	340	365	343	366	388	-6%	-7%	-6%
	Service Revenue	284	290	297	317						
	y-y	10.1%	2.2%	2.2%	6.9%						
	EBITDA	97	96	100	102	100	106	112	-3%	-6%	-9%
	% of sales	34.0%	33.2%	33.6%	32.3%						
	Net Income	18	17	17	17	19	21	24	-11%	-19%	-28%
	y-y	17.6%	-5.4%	1.3%	1.0%	6.8%	10.2%	13.9%			
	% of sales	18.2%	17.2%	16.9%	16.6%						
	EPS	0.22	0.21	0.21	0.21	0.24	0.26	0.29	-13%	-20%	-28%
	DPS	0.02	0.01	0.02	0.02	0.08	0.09	0.10	-82%	-83%	-85%
China Unicom	Revenue	295	313	326	352	321	351	382	-3%	-7%	-8%
	Service Revenue	239	252	264	284						
	y-y	13.5%	5.7%	4.9%	7.5%						
	EBITDA	84	87	92	96	94	102	110	-8%	-10%	-12%
	% of sales	35.2%	34.6%	34.7%	33.8%						
	Net Income	10	13	14	15	14	16	19	-8%	-14%	-21%
	y-y	46.7%	21.1%	9.7%	9.7%	32.1%	17.1%	20.0%			
	% of sales	12.4%	14.4%	15.1%	15.8%						
	EPS	0.42	0.51	0.56	0.62	0.57	0.69	0.80	-10%	-18%	-23%
	DPS	0.16	0.19	0.21	0.23	0.19	0.23	0.29	1%	-7%	-20%

Source: Company data, Nomura estimates, Bloomberg consensus

## Investment recommendations

Fig. 28: China telco valuation summary based on current prices

Code	Company	Trading	Price	M/Caps	Nomura	P/E (x)		P/BV (x)		EPS Growth	
		Currency	5/28/2014	USD mn	Rating	FY14F	FY15F	FY14F	FY15F	FY14F	FY15F
941 HK	China Mobile	HKD	75.7	197,724	Buy ↑	11.8	12.4	1.4	1.3	-16%	-5%
762 HK	China Unicom	HKD	11.6	35,603	Buy	18.0	16.4	1.0	0.9	21%	10%
728 HK	China Telecom	HKD	3.9	40,609	Neutral	15.0	14.8	0.9	0.8	-5%	1%
Telecom Average						14.9	14.5	1.1	1.0	0%	2%

Source: Bloomberg, Nomura estimates

### • China Mobile (Buy, TP at HKD90):

We suggest investors Buy CM for its 4G subscriber growth and stabilizing revenue growth. We think CM still faces structural issues such as large exposure to voice/SMS and high dependency on 2G subscribers, but its new 4G tariff plan and aggressive 4G network deployment should gradually stabilize its revenue growth. While some are concerned that CM may lose its technological edge if it is granted an FD-LTE license, we would see it as an opportunity for CM to deploy 4G services in a lower frequency band. Our HKD90 TP is based on 14x FY14F EPS of CNY5.07 (previously 11x). The valuation also implies 5.8x EV/EBITDA, 1.7x FY14F BVPS, and a 3.1% dividend yield.

### • China Unicom (Buy, TP at HKD13.50):

Although we expect a temporary slowdown in CU's 3G net additions, we think the firm will maintain its technology advantage in 3G and 4G as well. Its 3G/4G net additions should soon recover once it has its FD-LTE license. We maintain CU's TP at HKD13.5, which is based on 21x FY14F EPS of CNY0.51 (previously 15x). The valuation also implies 4.7x EV/EBITDA, 1.2x FY14F BVPS, and 1.6% dividend yield.

### • China Telecom (Neutral, TP HKD4.0):

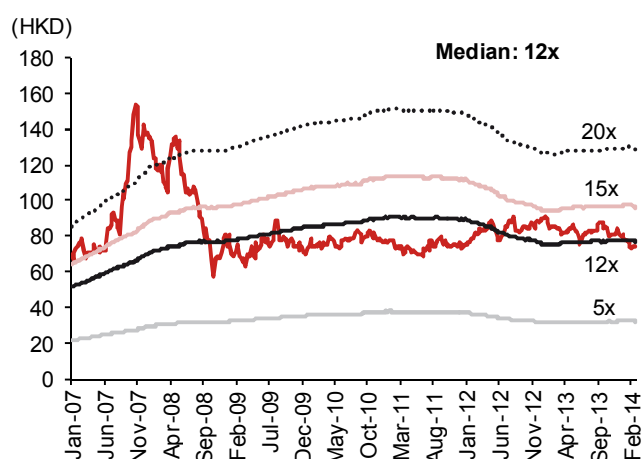
We raise our TP to HKD4 but maintain our Neutral call as we expect it to record growth below industry averages even after the government issues its FD-LTE license this year. CT's mobile net adds and service revenue growth will likely remain weak even after the FD-LTE licenses are issued, due to disadvantages in the speed of its CDMA network (3.1Mbps) vs CM's TD-LTE network (100Mbps), and technological difficulties in both handset chipsets and the 3G/4G handover on the network side. Our HKD4 TP is based on 15.4x FY14F EPS of CNY0.21 (previously 12.5x). The valuation also implies 3.8x EV/EBITDA, 0.9x FY14F BVPS, and 3% dividend yield.

**Fig. 29: China telco valuation summary based on target prices**

Code	Company	Trading Currency	Target Price	M/Caps USD mn	Nomura Rating	P/E (x)		P/BV (x)		EPS Growth	
						FY14F	FY15F	FY14F	FY15F	FY14F	FY15F
941 HK	China Mobile	HKD	90 ↑	197,719	Buy ↑	14.0	14.7	1.7	1.5	-16%	-5%
762 HK	China Unicom	HKD	13.5	35,602	Buy	20.9	19.1	1.2	1.0	21%	10%
728 HK	China Telecom	HKD	4 ↑	40,608	Neutral	15.4	15.2	0.9	0.8	-5%	1%
<b>Telecom Average</b>						<b>16.8</b>	<b>16.3</b>	<b>1.3</b>	<b>1.1</b>	<b>0%</b>	<b>2%</b>

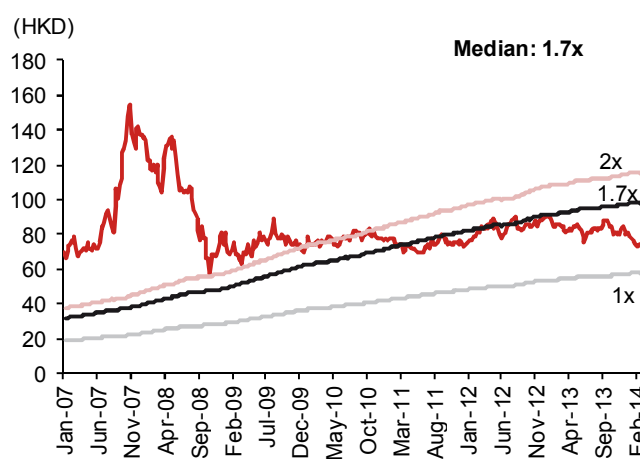
Source: Bloomberg, Nomura estimates

**Fig. 30: China Mobile: 12-month forward P/E band**

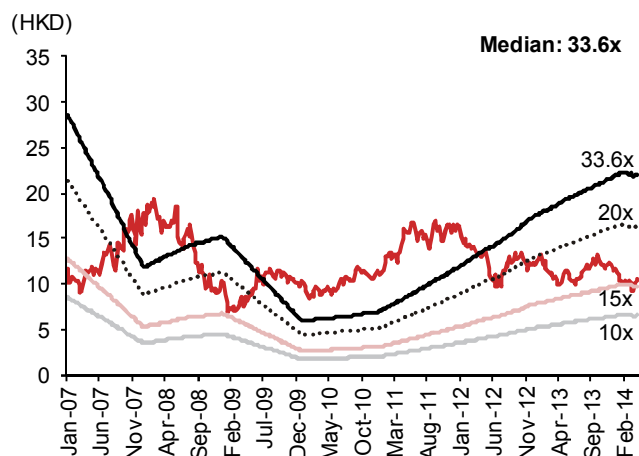


Source: Bloomberg, Nomura estimates

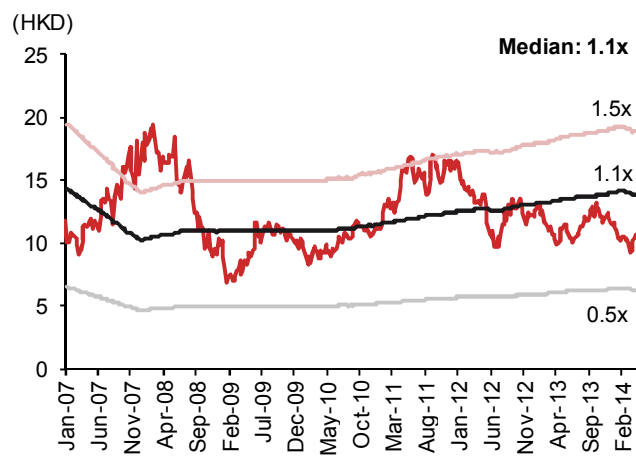
**Fig. 31: China Mobile: 12-month forward P/B**



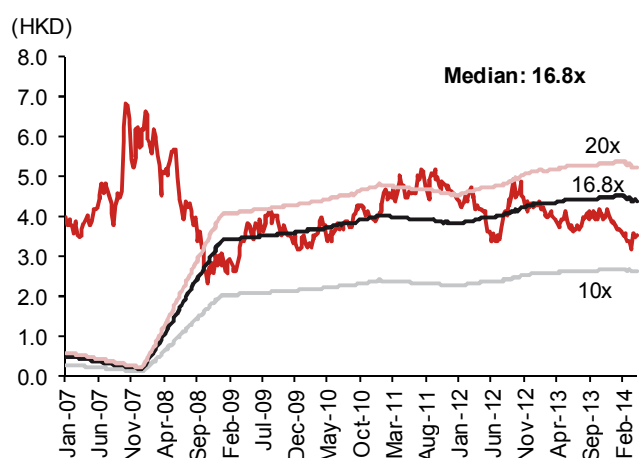
Source: Bloomberg, Nomura estimates

**Fig. 32: China Unicom: 12-month forward P/E band**

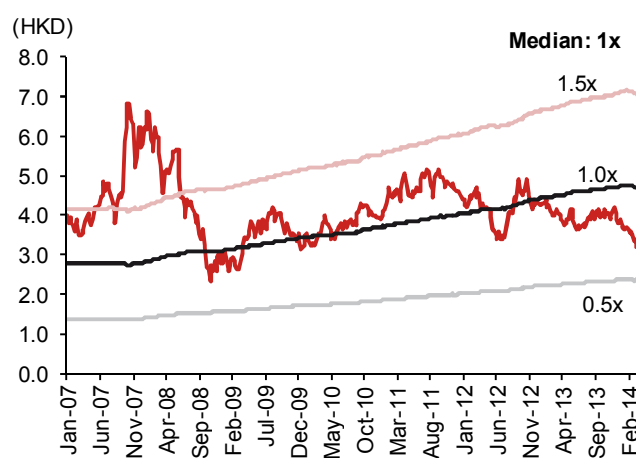
Source: Bloomberg, Nomura estimates

**Fig. 33: China Unicom: 12-month forward P/B**

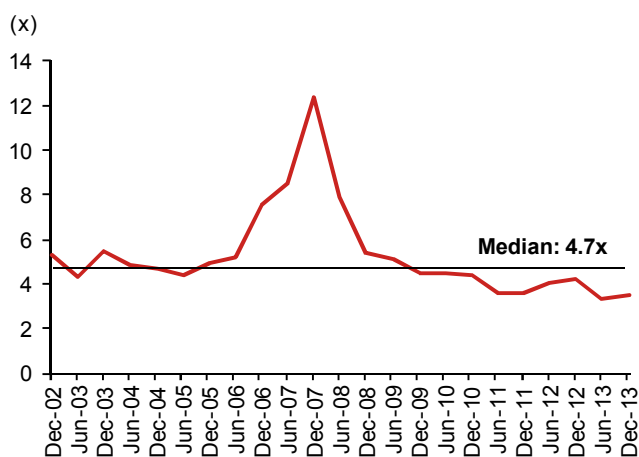
Source: Bloomberg, Nomura estimates

**Fig. 34: China Telecom: 12-month forward P/E band**

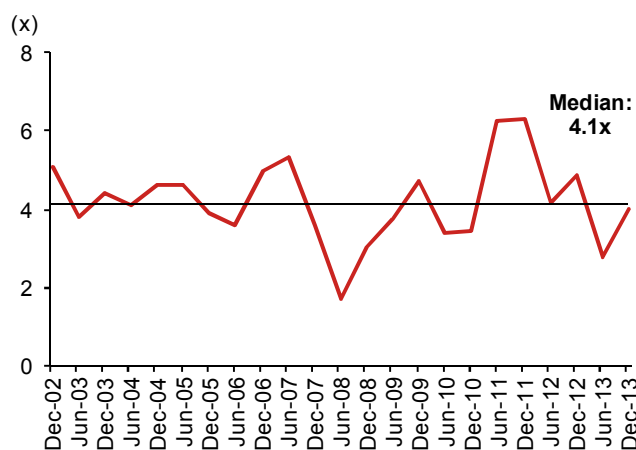
Source: Bloomberg, Nomura estimates

**Fig. 35: China Telecom: 12-month forward P/B**

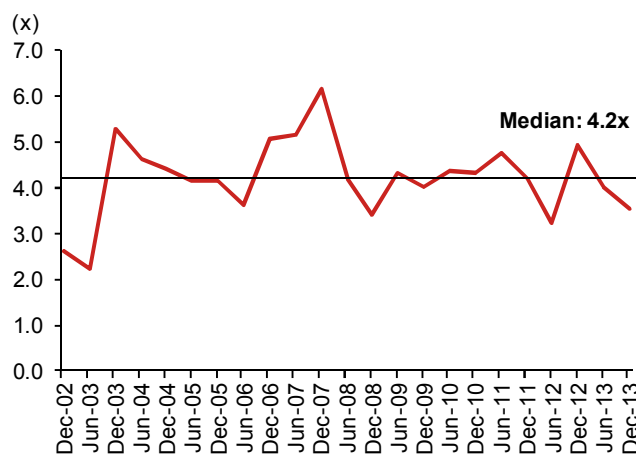
Source: Bloomberg, Nomura estimates

**Fig. 36: China Mobile: 12-month trailing EV/EBITDA**

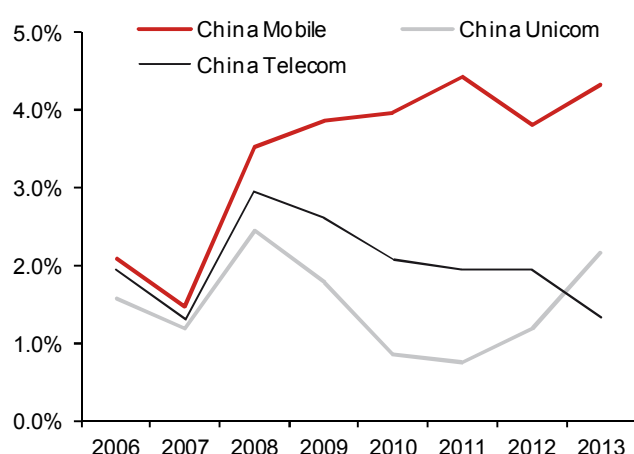
Source: Bloomberg, Nomura estimates

**Fig. 37: China Unicom: 12-month trailing EV/EBITDA**

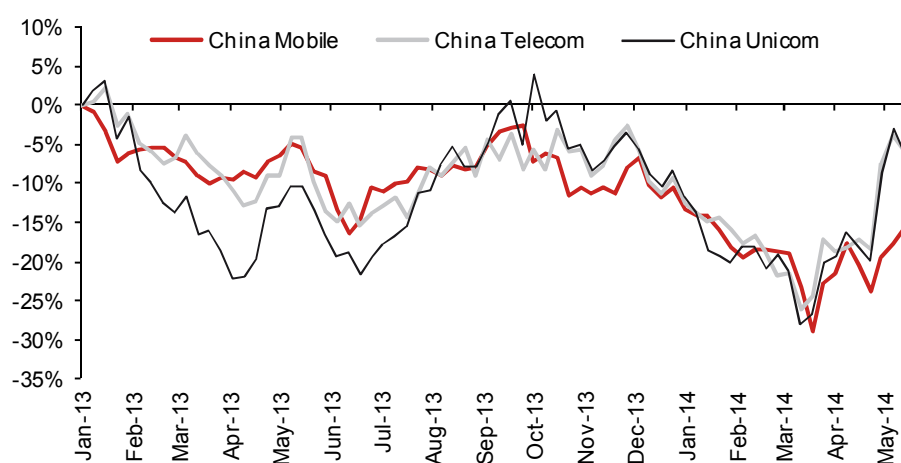
Source: Bloomberg, Nomura estimates

**Fig. 38: China Telecom: 12-month trailing EV/EBITDA**

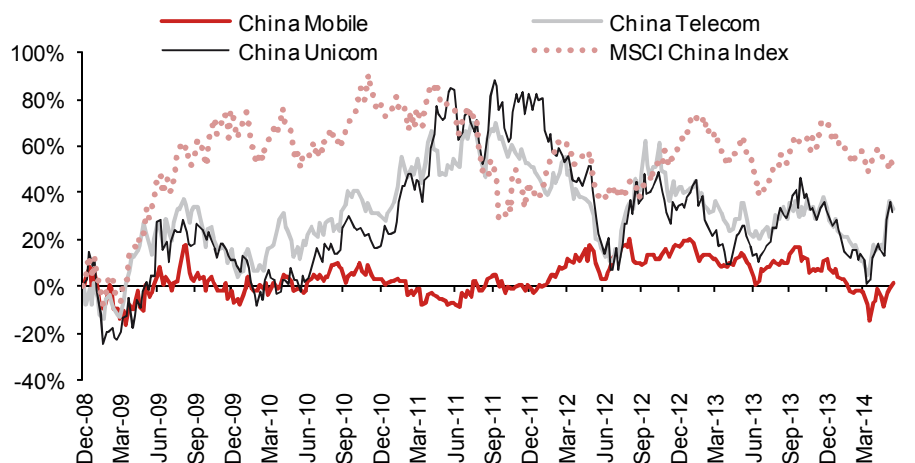
Source: Bloomberg, Nomura estimates

**Fig. 39: China telcos: 12-month trailing dividend yields**

Source: Bloomberg, Nomura estimates

**Fig. 40: China telcos: Relative share price trends from Jan 2013**

Source: Bloomberg, Nomura research

**Fig. 41: China telcos: Relative share price trends vs. MSCI China**

Source: Bloomberg, Nomura research

Fig. 42: Regional telco peer comparison table

	Bloomberg ticker	Rating	Cncy	Local price	Mkt Cap (USDmn)	PE (x)		EV/EBITDA (x)		Div Yield (%)		NI Growth	
						14E	15E	14E	15E	14E	15E	14E	15E
<b>Wireless</b>													
AIS	ADVANC TB	Buy	THB	228	20,735	18.8	17.6	10.4	9.5	5.3%	5.7%	-1%	7%
Axiata	AXIATA MK	Buy	MYR	6.82	17,861	21.1	19.5	8.8	8.2	3.8%	4.6%	0%	8%
Bharti Airtel	BHARTI IN	Buy	INR	342	22,006	24.8	19.3	6.5	5.9	1.0%	1.6%	31%	28%
CM	941 HK	Buy	HKD	76	197,719	11.8	12.4	4.9	4.6	3.7%	3.5%	-16%	-5%
DiGi	Digi MK	Neutral	MYR	5.50	13,261	24.3	23.5	13.6	13.1	4.1%	4.3%	4%	4%
FET	4904 TT	Neutral	TWD	68.60	7,420	19.9	19.8	9.5	9.2	5.0%	5.1%	-4%	1%
Globe	GLO PM	Neutral	PHP	1,703	5,137	17.6	16.6	7.5	7.0	4.6%	5.0%	10%	6%
IDEA	IDEA IN	Neutral	INR	136	7,602	19.8	17.8	6.8	6.1	0.5%	0.8%	13%	11%
Maxis	Maxis MK	Reduce	MYR	6.61	15,373	22.9	22.3	12.3	12.0	6.1%	6.1%	1%	3%
MobileOne	M1 SP	Buy	SGD	3.50	2,527	18.5	17.6	10.1	9.7	4.3%	4.3%	9%	5%
NTT DoCoMo	9437 JP	Neutral	JPY	1,691	63,703	14.2	12.3	4.4	4.2	3.5%	3.5%	4%	10%
XL	EXCL IJ	Buy	IDR	5,525	4,051	147.4	68.8	7.3	6.4	0.2%	0.4%	-84%	114%
RCOM	RCOM IN	Neutral	INR	145	5,083	31.1	24.1	9.3	8.7	0.5%	0.6%	37%	29%
SKT	017670 KS	Buy	KRW	223,500	15,241	7.3	6.8	4.3	4.2	4.2%	4.2%	16%	7%
TWM	3045 TT	Buy	TWD	99	11,254	18.1	17.8	12.3	11.9	5.0%	5.1%	-5%	2%
DTAC	DTAC TB	Buy	THB	121	8,728	21.6	19.6	8.8	8.0	4.2%	4.6%	18%	10%
<b>Average</b>						<b>27.5</b>	<b>21.0</b>	<b>8.5</b>	<b>8.0</b>	<b>3.5%</b>	<b>3.7%</b>	<b>2.0%</b>	<b>15.0%</b>
<b>Median</b>						<b>19.8</b>	<b>18.6</b>	<b>8.8</b>	<b>8.1</b>	<b>4.1%</b>	<b>4.3%</b>	<b>3.8%</b>	<b>7.0%</b>
<b>Integrated</b>													
CT	728 HK	Neutral	HKD	3.89	40,608	15.0	14.8	3.8	3.5	2.3%	2.3%	-5%	1%
CU	762 HK	Buy	HKD	11.60	35,602	18.0	16.4	3.9	3.6	2.1%	2.3%	21%	10%
CHT	2412 TT	Neutral	TWD	96.70	24,902	20.6	21.0	9.6	9.5	4.9%	4.8%	-8%	-2%
KDDI	9433 JP	Buy	JPY	5,881	48,246	11.4	10.2	4.5	4.1	2.7%	3.2%	17%	12%
KT Corp	030200 KS	Neutral	KRW	31,350	8,009	7.8	7.1	4.3	4.2	4.8%	5.4%	41%	10%
LG Uplus	032640 KS	Buy	KRW	9,950	5,012	8.9	6.8	4.2	3.8	2.8%	3.5%	37%	31%
NTT	9432 JP	Buy	JPY	6,020	63,027	11.7	10.6	3.9	3.8	3.0%	3.2%	3%	6%
PLDT	TEL PM	Neutral	PHP	2,896	14,257	15.9	15.6	8.9	8.8	6.3%	6.4%	2%	2%
Indosat	ISAT IJ	Neutral	IDR	4,035	1,889	25.1	21.2	5.7	6.7	2.0%	2.1%	-21%	18%
TLKM	TLKM IJ	Neutral	IDR	2,550	22,149	17.3	16.1	5.8	5.4	4.0%	4.3%	3%	7%
SingTel	ST SP	Buy	SGD	3.83	48,646	16.7	15.7	8.9	8.4	4.4%	4.7%	1%	6%
Softbank	9984 JP	Buy	JPY	7,192	83,978	15.5	12.4	6.3	5.8	0.6%	0.6%	61%	24%
StarHub	STH SP	Neutral	SGD	4.17	5,693	19.1	19.3	10.2	10.3	4.8%	4.8%	1%	-1%
TM	T MK	Buy	MYR	6.38	7,075	26.4	29.0	7.3	7.2	3.4%	3.1%	-10%	-9%
Telstra	TLS AU	Buy	AUD	5.34	61,316	17.2	17.1	7.3	7.3	5.4%	5.4%	1%	0%
<b>Average</b>						<b>16.4</b>	<b>15.6</b>	<b>6.3</b>	<b>6.2</b>	<b>3.6%</b>	<b>3.7%</b>	<b>9.6%</b>	<b>7.7%</b>
<b>Median</b>						<b>16.7</b>	<b>15.7</b>	<b>5.8</b>	<b>5.8</b>	<b>3.4%</b>	<b>3.5%</b>	<b>1.6%</b>	<b>6.4%</b>

Note: Bharti's forecast and TP are currently under review. Pricing as of 28 May 2014.

Source: Bloomberg, Nomura estimates

# Appendix

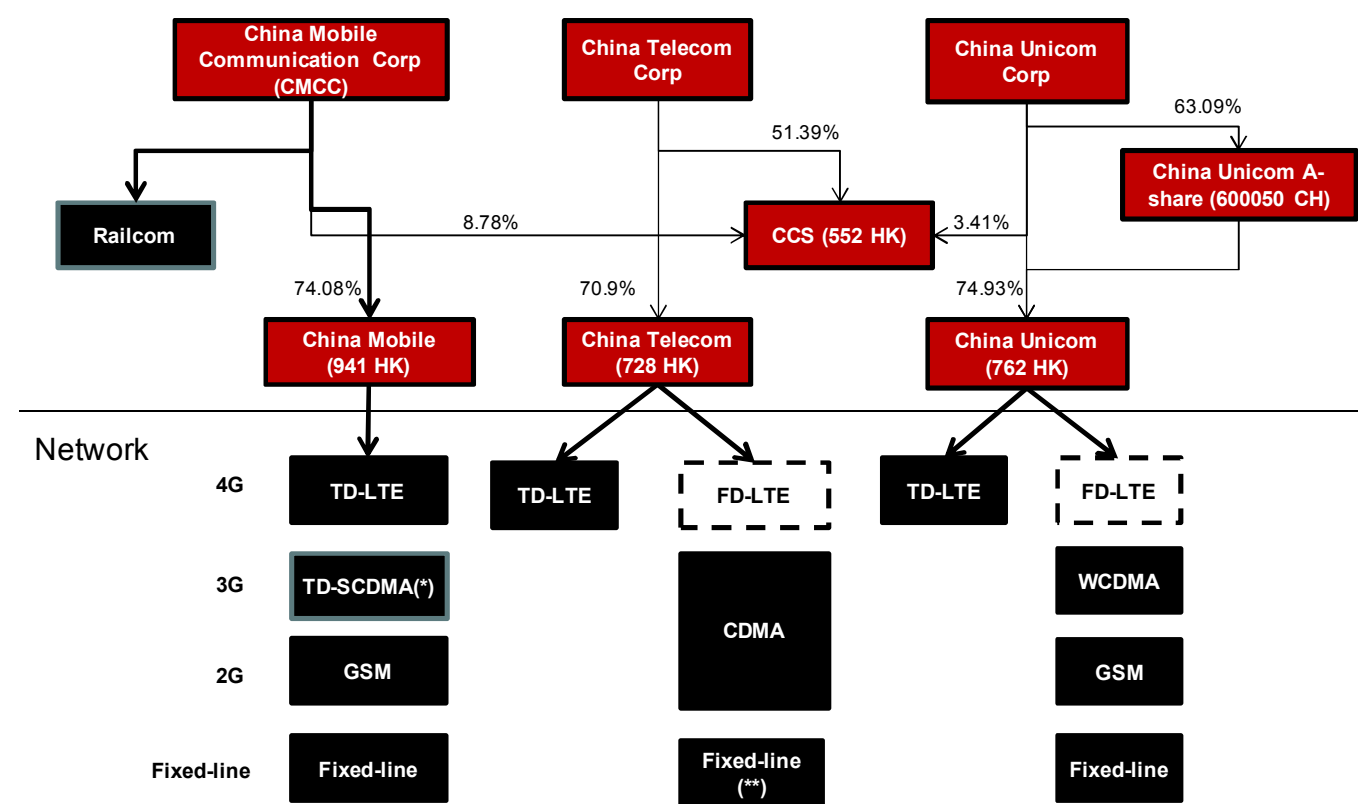
## China telcos' corporate structures and network ownership

China Mobile Ltd, China Unicom Ltd and China Telecom Ltd are owned by China Mobile Communication Corporation (CMCC), China Telecommunications Corporation, and China Unicom Group, respectively. CMCC, China Telecom Corp and China Unicom Corp are owned by the state-owned Assets Supervision and Administration Commission of the State Council (SASAC).

In addition, China Communications Services, China's largest construction service provider, is a spin-off from China Telecommunications Corporation, with CMCC and China Unicom Group as minority shareholders.

After a series of acquisitions from parentcos, the three listcos own most of the network assets now. The two major exceptions are the TD-CDMA network, owned by China Mobile's parentco, and China Telecom's fixed-line network in the northern ten provinces.

Fig. 43: Telcos' shareholding and network asset ownership structures



\* China Mobile: TD-SCDMA network is owned by CMCC (parent)

\*\* China Telecom: its northern China fixed-line network is owned by China Telecom Corp (parent)

Source: Nomura research

## Value-added tax reform

On 30 April, the Ministry of Finance and State Administration of Taxation jointly announced that they would implement a value-added tax (VAT) for China's telecom industry effective from 1 June, 2014, to replace the existing business tax as part of the grand plan to promote China's services sector and economic transformation. According to the new tax scheme, telecom operators will be taxed at:

- 11% for the basic telecom services, which is mainly voice services and selling/leasing of network bandwidth.
- 6% for value added services which includes data, SMS, MMS, Internet, IPTV, etc.
- 17% for hardware sales, including SIMs, smartphones, data cards, etc.

Meanwhile, telcos will have deductible items under the VAT system, unlike the sales tax system. From our discussion with operators, large opex items such as: 1) SG&A, 2) interconnection, and 3) maintenance, may qualify. On the other hand, depreciation and personnel expenses may not be deductible.

**Fig. 44: Analysis on the impact of VAT on operators' FY14F earnings**

CNY bn		2012	2013	2014F	2014 with VAT impact
China Mobile	Revenue	560	630	690	669
	y-y	24.0%	12.4%	9.4%	6.2%
	Net Income	129	122	114	105
	y-y	12.3%	-5.9%	-6.7%	-13.4%
	% of sales	23%	19%	16%	16%
China Telecom	EPS	6.43	6.05	5.64	5.24
	Revenue	283	320	350	325
	y-y	35.2%	13.2%	9.3%	1.5%
	Net Income	14.9	17.4	20.2	17.0
	y-y	3.5%	16.7%	16.1%	-2.2%
China Unicom	% of sales	5%	5%	6%	5%
	EPS	0.19	0.20	0.18	0.16
	Revenue	249	295	329	264
	y-y	61.7%	18.5%	11.7%	-10.7%
	Net Income	7	10	16	12.5
	y-y	-25.7%	46.7%	50.4%	20.3%
	% of sales	3%	4%	5%	5%
	EPS	0.16	0.18	0.29	0.23

Source: Company data, Nomura estimates

### Potential negative NP impacts in 2013: CM (11~18%), CT (31%), CU (40% Nomura estimates)

- China Mobile: 10.9-18.0% negative NP impact

Based on a sensitivity analysis on CM's 2013 financial data, CM expects 10.9-18.0% negative earnings impact if the policy is effective from the beginning of 2013.

- China Telecom: 30.7% negative NP impact

Based on a sensitivity analysis on CT's 2013 financial data, CT expects 30.7% negative earnings impact if the policy is effective from the beginning of 2013.

- China Unicom: 40% negative impact, based on our estimates

CU did not disclose a sensitivity analysis result on VAT reform, but we expect a larger negative impact than at CM and CU due to its smaller profitability base, which is more sensitive to large expense items such as personnel expenses and depreciation. Based on our sensitivity analysis, we expect a 40% negative earnings impact in 2013.

*We expect the first year of VAT implementation will cause the worst impact because many VAT invoices may not be issued and collected. Impact from VAT should smooth out over the long term when more vendors for telecom operators start to implement VAT.*



## Tariff liberalization

On 9 May, the MIIT, China's telecom regulator, announced that it will ease regulation of telecom tariffs. Effective from 10 May, telecom operators can determine their tariff plans independently instead of requiring pre-approval from the MIIT. To protect the interests of consumers, the MIIT requires operators to comply with the following rules with regards to designs and promotions of tariff plans.

- Telecom operators need to provide standalone tariff plans for basic telecom services (data/voice/SMS) in addition to existing voice/data/SMS bundling service plans.
- MIIT requests telecom operators to provide tariff plans that are more favourable to low-income earners in rural areas.
- Telecom operators need to properly disclose conditions (eg, contract period) in their tariff plans.

We think this regulation change is part of the State Council's policy to liberalise the pricing mechanism in a number of public service sectors.

Following MIIT's tariff liberalisation announcement on 9 May, China Mobile announced its newly revised 4G tariff plan on 14 May. CM's new tariff plan highlights the following:

- **Lower entry tariff:** (CNY58 for 500MB and 50 minutes vs. CNY88 for 400MB and 200 minutes).
- **Cheaper data tariff:** per MB data tariff is up to 50% cheaper than before. The largest saving is realized for the 2GB data package.
- **Data sharing:** up to four devices can be linked to share a data package (for CNY10 per device), which can lead to further savings for a group of users.
- **Peace of mind for data over-usage:** CM introduces options for users to automatically purchase additional data packages (eg, CNY10 for 500MB), which is 66% cheaper than being charged on a per-MB basis.

We see a drastic decline in CM's data tariff post the adjustments across the board. If we compare CM and CU's 4G data tariff (assuming the highlighted data packs are the most popular ones), CM's new tariff is now up to 25% cheaper than that of CU's vs. being up to 15% more expensive previously.

We believe lower tariff and more reasonable charges on over-usage will resolve investors' concern on the price of 4G tariffs, and accelerate 4G transition at China Mobile.

**Fig. 45: Tariff plan comparison (CM's new and old plans vs. CU's)**

China Unicom 4G tariff			China Telecom 4G tariff			China Mobile 4G tariff (New)			CM vs. CU	China Mobile 4G tariff			CM vs. CU
Tariff (CNY)	Data (GB)	per MB price*	Tariff (CNY)	Data(GB)	per MB price	Tariff (CNY)	Data (GB)	per MB price		Tariff (CNY)	Data (GB)	per MB price	
76	0.4	0.115				30	0.5	0.060	-48%	40	0.4	0.100	-13%
106	0.8	0.076				40	0.7	0.057	-25%	50	0.6	0.083	9%
136	1.0	0.061	70	1.0	0.070	50	1.0	0.050	-18%	70	1.0	0.070	15%
166	2.0	0.046	100	2.0	0.050	70	2.0	0.035	-23%	100	2.0	0.050	10%
196	3.0	0.040	130	3.0	0.043	100	3.0	0.033	-17%	130	3.0	0.043	7%
296	4.0	0.037	200	6.0	0.033	130	4.0	0.033	-11%	180	5.0	0.036	-1%
396	6.0	0.016				180	6.0	0.030					
596	11.0	0.013	280	10.0	0.028	280	11.0	0.025		280	10.0	0.028	

Source: Company data, Nomura research

## Handset subsidy reduction

According to *Sina News*, the State-owned Assets Supervision and Administration Commission (SASAC) requires the three telco operators to reduce CNY10bn handset subsidies in 2014, including a CNY7bn reduction for China Mobile, CNY1.8bn for CU and CNY1.2bn for CT as shown below. The news also indicated that the reduction will continue beyond 2015 in order to offset the negative impacts on telco profitability brought by the VAT reform.

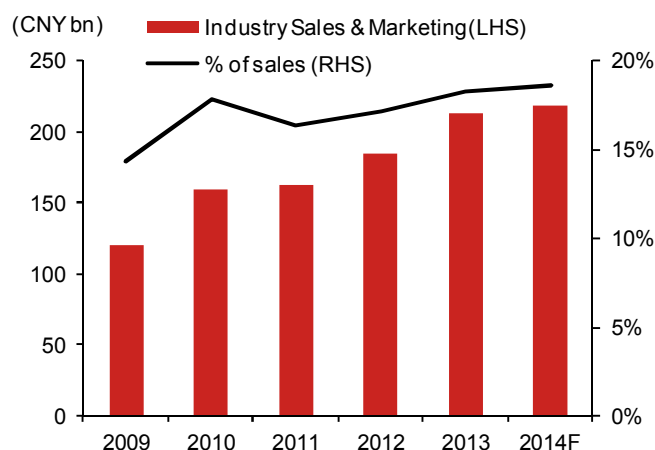
**Fig. 46: Handset subsidy reduction summary**

(CNY bn)	2013	Before	2014 After	Cut %	Subsidy cut	
					Amount	% of total
China Mobile	26.3	34.0	27.0	-21%	7.0	70%
China Unicom	23.4	23.4	21.6	-8%	1.8	18%
China Telecom	22.8	25.4	24.2	-5%	1.2	12%
Total	72.4	82.8	72.8	-12%	10.0	

Source: Company data, Nomura estimates

As shown in the charts below, the three operators spent CNY213bn in sales and marketing and CNY72.4bn in handset subsidies in 2013. The CNY10bn cut is equivalent to 14% of total handset subsidies or 3.5% of total handset subsidies + sales and marketing expenses.

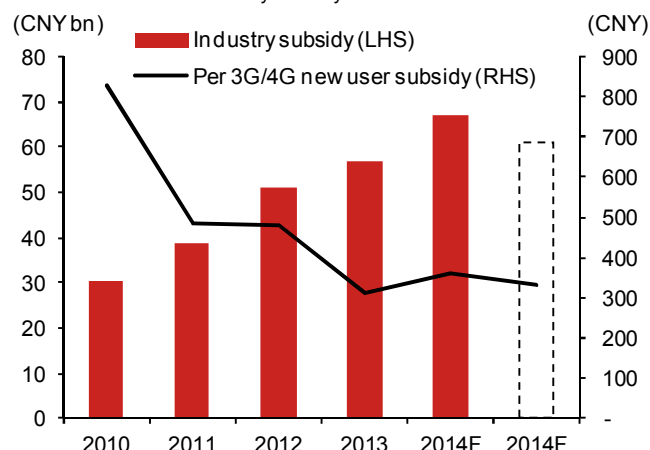
**Fig. 47: China telecom sector's sales and marketing expenses**



Source: Company data, Nomura estimates

**Fig. 48: China telecom sector's handset subsidy trends**

Note: the dotted bar is industry subsidy after the cut



Source: Company data, Nomura estimates

Overall, the subsidy reduction is negative to smartphone shipment volume and may result in a longer smartphone replacement cycle and supply chain inventory build-up.

Telecom operators mainly provide handset subsidies in three segments, including flagship models (>CNY3,000 mainly by Apple and Samsung), CNY1000 4G smartphones (mainly by ZTE, Huawei, Lenovo, Coolpad, Xiaomi) and low-end (below CNY700 tier-2 local brand and white-box models). We think operators will mainly reduce the subsidy on 3G smartphones in order to accelerate 4G migration.

## Tower Company

According to the MIIT's announcement in April 2014, China Mobile, China Unicom, and China Telecom will set up a new joint venture responsible for constructing and maintaining new telecom towers to be built in the future. This new JV will also acquire the three telecom operators' existing telecom tower assets in the future.

According to CM during its AGM in May, the tower company may be formed in as early as 3Q14, although no further details were provided.

### • CT to benefit the most from the tower company

Among the telcos, we expect CT and CU to benefit from the new tower company given they are at a disadvantage compared to CM in terms of their tower site portfolios. We think CT will be the bigger beneficiary of the two, since it has the lowest number of towers, which is already becoming an issue for the company in choosing sites for 4G deployment.

In addition, if CCS eventually becomes the tower company, CT which has a 50.7% stake in CCS, will be in a good position strategically, in our view.

### • CM needs to make necessary compromises

Not only will CM lose its competitive advantage in having a large tower site portfolio over CT and CU, according to Sina News, CM may also not be able to hold a majority stake in the tower company.

As shown in the chart below, CM owns 57% of the telecom towers in China vs 26% owned by CU and 16% owned by CT. If all tower assets in China are transferred to this new company, it will help CT/CU to accelerate their 4G network rollout and intensify the competition to CM. But we think this is a rational compromise to CM in order to receive a FD-LTE license and tariff liberalization, and will also benefit CM in short-term earnings and cash flow.

Fig. 49: Summary of China operators' base stations assets

k units	FY11	FY12	FY13	% of towers	FY14F	FY15F
GSM BTS	700	800	881		920	1,000
TD-SCDMA BTS	220	280	446		500	600
TD-LTE BTS		20	220		500	800
China Mobile's # of towers	700	800	881	57%	920	1,000
GSM BTS	350	360	360		360	360
WCDMA BTS	230	331	407		487	500
4G LTE BTS					50	100
China Unicom's # of towers	350	360	407	26%	487	500
CDMA	200	220	250		250	250
4G LTE BTS					60	120
China Telecom's # of towers	200	220	250	16%	250	250
Total number of telecom towers in China	1,250	1,380	1,538		1,657	1,750
new towers		130	158		119	93

Source: Company data, Nomura estimates

### • What does a tower company do?

An independent telecom tower company is a common business model in some countries like the US, India and Indonesia. A tower company typically will purchase or lease land, build telecom towers on the land, and lease the space in the tower to telecom operators. Telecom operators will use the space to install base station equipment they purchase from telecom equipment vendors.

China has not had an independent tower company until now due to complicated interest adjustments among the three operators (eg, different preferences on network rollout plans and tower sites).

**Fig. 50: Summary of major global tower companies**

Company	Ticker	Rating	Market Cap (\$mn)	EV (\$mn)	# of towers (k)	EV per tower (k)	ROE 2014F	OPM 2014F
Bharti Infratel	BHIN IN	Buy	6,773	6,556	83	79	8%	13%
Protelindo	TOWR IJ	Buy	3,376	4,014	10	347	13%	43%
Tower Bersama	TBIG IJ	Buy	2,645	3,566	9	298	13%	71%
American tower	AMT US	Neutral	32,840	47,080	67	1,184	7%	34%
Crown Castle	CCI US	Buy	23,967	35,356	41	579	6%	29%
SBA Comm	SBAC US	Buy	11,548	17,329	20	575	5%	21%
Reference								

Source: Bloomberg, Nomura estimates

### Upgrade to Buy with new TP of HKD90

#### Buy for 4G-driven revenue stabilisation

##### Action: Upgrade to Buy; TP raised by 13% to HKD90

We suggest investors buy China Mobile (CM) for its ramp-up of 4G subscriber adoption, stabilizing revenue growth, and ARPU improvement. In our opinion, CM still faces structural issues such as large exposure to voice/SMS and high dependency on 2G subscribers, but its new 4G tariff plan and aggressive 4G network deployment should gradually resolve these bottlenecks and help CM to stabilize its revenue growth.

##### Catalyst: FD-LTE license issue may not be an entirely bad thing

While some investors appear to be concerned that CM may lose its technological edge if it is granted an FD-LTE license, we would view this as an opportunity for CM to deploy 4G service in a lower frequency band.

##### Catalyst: New tariff plan to accelerate 4G subscriber growth

CM's new tariff plan announced after the MIIT's tariff regulation is now 14% lower than its existing plan and 2% cheaper than that of CU's, which is an important factor in accelerating 4G service adoption.

##### Tower Company is a necessary compromise

We think the upcoming new tower company is structurally negative to CM, given that it will lose one of its most important competitive advantages against CT/CU and the new towerco may become a new competitor.

##### Valuation and earnings revisions

Our TP of HKD90 is based on 14x FY14F EPS of CNY5.07 (previously 11x). The multiple expansion is a movement towards the regional wireless telco median of 19.8x, reflecting its long-term revenue reacceleration. Valuation also implies 5.8x EV/EBITDA, 1.7x FY14F BVPS of CNY42.11, and 3.1% dividend yield.

### Global Markets Research

3 June 2014

<b>Rating</b> Up from Neutral	<b>Buy</b>
<b>Target price</b> Increased from 80.00	HKD 90.00
<b>Closing price</b> 28 May 2014	HKD 75.70
<b>Potential upside</b>	+18.9%

### Anchor themes

Recent regulatory announcements have clarified the details for MVNO and VAT, and have also shed more light on the government's stance on towercos, subsidies, and FDD licenses.

### Nomura vs consensus

Our FY14F earnings is 1% above consensus.

### Research analysts

#### China Telecoms

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Year-end 31 Dec	FY13	FY14F		FY15F		FY16F	
Currency (CNY)	Actual	Old	New	Old	New	Old	New
<b>Revenue (mn)</b>	630,177	689,632	644,867	735,701	671,363	721,417	
<b>Reported net profit (mn)</b>	121,692	113,596	101,857	116,788	96,983	100,185	
<b>Normalised net profit (mn)</b>	121,692	113,596	101,857	116,788	96,983	100,185	
<b>FD normalised EPS</b>	6.05	5.64	5.07	5.80	4.82	4.98	
<b>FD norm. EPS growth (%)</b>	-5.9	-6.8	-16.3	2.8	-4.8	3.3	
<b>FD normalised P/E (x)</b>	10.1	N/A	11.8	N/A	12.4	N/A	12.0
<b>EV/EBITDA (x)</b>	4.6	N/A	4.8	N/A	4.6	N/A	4.3
<b>Price/book (x)</b>	1.6	N/A	1.4	N/A	1.3	N/A	1.3
<b>Dividend yield (%)</b>	4.3	N/A	3.7	N/A	3.5	N/A	3.6
<b>ROE (%)</b>	16.1	13.8	12.5	13.0	11.1	10.8	
<b>Net debt/equity (%)</b>	net cash	net cash	net cash	net cash	net cash	net cash	

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

# Key data on China Mobile

## Relative performance chart



Source: Thomson Reuters, Nomura research

## Notes:

## Performance

(%)	1M	3M	12M		
Absolute (HKD)	8.2	2.6	-9.4	M cap (USDmn)	197,723.6
Absolute (USD)	8.2	2.8	-9.3	Free float (%)	18.3
Rel to MSCI China	3.5	2.3	-8.6	52-week (HKD)	89.2/63.65

## Income statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	581,835	630,177	644,867	671,363	721,417
Cost of goods sold	0	0	0	0	0
Gross profit	581,835	630,177	644,867	671,363	721,417
SG&A	-431,313	-494,528	-533,904	-565,442	-610,793
Employee share expense					
Operating profit	150,522	135,649	110,963	105,921	110,623
EBITDA	251,784	240,811	228,142	241,197	258,192
Depreciation	-101,262	-105,162	-117,178	-135,276	-147,569
Amortisation	0	0	0	0	0
EBIT	150,522	135,649	110,963	105,921	110,623
Net interest expense	12,271	14,958	16,582	14,856	14,384
Associates & JCEs	5,684	7,062	7,421	7,593	7,593
Other income	2,823	910	910	1,001	1,101
Earnings before tax	171,300	158,579	135,876	129,371	133,701
Income tax	-41,919	-36,776	-33,926	-32,300	-33,425
Net profit after tax	129,381	121,803	101,950	97,072	100,276
Minorities	-107	-111	-93	-88	-91
Other items					
Preferred dividends					
Normalised NPAT	129,274	121,692	101,857	96,983	100,185
Extraordinary items					
Reported NPAT	129,274	121,692	101,857	96,983	100,185
Dividends	-55,821	-52,675	-44,015	-41,905	-43,365
Transfer to reserves	73,453	69,017	57,843	55,078	56,819

## Valuation and ratios

Reported P/E (x)	9.5	10.1	11.8	12.4	12.0
Normalised P/E (x)	9.5	10.1	11.8	12.4	12.0
FD normalised P/E (x)	9.5	10.1	11.8	12.4	12.0
Dividend yield (%)	4.5	4.3	3.7	3.5	3.6
Price/cashflow (x)	5.3	5.5	5.1	4.8	4.8
Price/book (x)	1.7	1.6	1.4	1.3	1.3
EV/EBITDA (x)	4.4	4.6	4.8	4.6	4.3
EV/EBIT (x)	7.4	8.2	10.0	10.4	10.0
Gross margin (%)	100.0	100.0	100.0	100.0	100.0
EBITDA margin (%)	43.3	38.2	35.4	35.9	35.8
EBIT margin (%)	25.9	21.5	17.2	15.8	15.3
Net margin (%)	22.2	19.3	15.8	14.4	13.9
Effective tax rate (%)	24.5	23.2	25.0	25.0	25.0
Dividend payout (%)	43.2	43.3	43.2	43.2	43.3
ROE (%)	18.8	16.1	12.5	11.1	10.8
ROA (pretax %)	16.9	13.6	10.2	9.2	9.1

## Growth (%)

Revenue	8.2	8.3	2.3	4.1	7.5
EBITDA	1.2	-4.4	-5.3	5.7	7.0
Normalised EPS	2.6	-5.9	-16.3	-4.8	3.3
Normalised FDEPS	2.6	-5.9	-16.3	-4.8	3.3

Source: Company data, Nomura estimates

## Cash flow statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	251,784	240,811	228,142	241,197	258,192
Change in working capital	5,365	45,320	7,129	18,143	178,911
Other operating cashflow	-26,440	-61,146	-577	-7,144	-184,205
CF from operations	230,709	224,985	234,694	252,195	252,898
Capital expenditure	-125,198	-140,396	-225,200	-220,000	-200,000
Free cash flow	105,511	84,589	9,494	32,195	52,898
Reduction in investments	-89,858	-48,571	40,040	20,000	-10,000
Net acquisitions					
Dec in other LT assets	-7,927	-5,255	44	0	0
Inc in other LT liabilities	107	381	0	-144	-200
Adjustments	31,700	22,366	39,916	20,144	10,200
CF after investing acts	39,533	53,510	89,494	72,195	52,898
Cash dividends	-55,425	-55,491	-52,675	-44,015	-41,905
Equity issue	531	43	0	0	0
Debt issue	0	0	0	0	0
Convertible debt issue					
Others	8	-24,037	0	0	0
CF from financial acts	-54,886	-79,485	-52,675	-44,015	-41,905
Net cashflow	-15,353	-25,975	36,819	28,180	10,993
Beginning cash	86,259	70,906	44,931	41,750	49,930
Ending cash	70,906	44,931	81,750	69,930	60,923
Ending net debt	-42,219	-39,874	-36,693	-44,873	-45,866

## Balance sheet (CNYmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	70,906	44,931	41,750	49,930	50,923
Marketable securities	331,997	374,977	334,977	314,977	324,977
Accounts receivable	11,722	13,907	15,853	18,808	18,437
Inventories	7,195	9,152	10,601	12,145	12,349
Other current assets	24,773	24,222	24,222	24,222	24,222
Total current assets	446,593	467,189	427,402	420,083	430,908
LT investments	48,349	53,940	53,900	53,900	53,900
Fixed assets	500,260	583,962	691,984	776,708	829,139
Goodwill	0	0	0	0	0
Other intangible assets	37,818	37,957	38,000	38,000	38,000
Other LT assets	19,089	24,344	24,300	24,300	24,300
Total assets	1,052,109	1,167,392	1,235,586	1,312,991	1,376,247
Short-term debt	68	68	68	68	68
Accounts payable	125,055	174,517	185,041	207,684	214,321
Other current liabilities	172,673	196,328	196,328	196,328	196,328
Total current liabilities	297,796	370,913	381,437	404,080	410,717
Long-term debt	28,619	4,989	4,989	4,989	4,989
Convertible debt					
Other LT liabilities	385	766	766	622	422
Total liabilities	326,800	376,668	387,192	409,691	416,128
Minority interest	1,862	1,951	1,951	1,951	1,951
Preferred stock	0	0	0	0	0
Common stock	2,142	2,142	2,142	2,142	2,142
Retained earnings	721,305	786,631	844,301	899,207	956,026
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	723,447	788,773	846,443	901,349	958,168
Total equity & liabilities	1,052,109	1,167,392	1,235,586	1,312,991	1,376,247

## Liquidity (x)

Current ratio	1.50	1.26	1.12	1.04	1.05
Interest cover	na	na	na	na	na

## Leverage

Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash

## Per share

Reported EPS (CNY)	6.43	6.05	5.07	4.82	4.98
Norm EPS (CNY)	6.43	6.05	5.07	4.82	4.98
FD norm EPS (CNY)	6.43	6.05	5.07	4.82	4.98
BVPS (CNY)	35.99	39.24	42.11	44.84	47.74
DPS (CNY)	2.78	2.62	2.19	2.08	2.16

## Activity (days)

Days receivable	6.6	7.4	8.4	9.4	9.4
Days inventory	na	na	na	na	na
Days payable	na	na	na	na	na
Cash cycle	na	na	na	na	na

Source: Company data, Nomura estimates

## Earnings forecast revisions

- We have revised downwards our FY14/15F service revenues by 4.2%/7.5% to reflect the continual decline in mobile ARPU vs our previous view of an ARPU recovery driven by 3G/4G services. This is due to slower-than-expected increase in data usage by 3G/4G subscribers.
- We have revised downwards our FY14/15F opex by 25.9%/28.9% to reflect the impact of value added tax (VAT), as some expense items will become deductible starting 1 June 2014.
- At the same time, we revise downward our FY14/15F pre-tax income by 9.8%/16.4% to also reflect the impact of VAT.
- We revise upward our FY14/15F 3G subscribers by 12%/34% to reflect faster-than-expected pick-up in 3G subscribers as CM is aggressively promoting 3G services as its 4G service is gradually taking shape.

Fig. 51: Earnings revision summary

(CNY mn)	2013	2014E	2015E	2016E	FY14F	FY15F	FY14F	FY15F
	A	NOM	NOM	NOM	OLD	OLD	Diff.	Diff.
Sales	630,177	644,867	671,363	721,417	689,632	735,701	-6.5%	-8.7%
pre-tax service revenue	609,084	641,227	687,676	738,594	710,961	758,455	-9.8%	-9.3%
% chg y-y	5.4%	5.3%	7.2%	7.4%	16.7%	6.7%		
Service revenue	590,811	603,472	628,697	676,504	629,996	679,941	-4.2%	-7.5%
% chg y-y	5.4%	2.1%	4.2%	7.6%	6.6%	7.9%		
OPEX	(389,829)	(416,612)	(430,047)	(463,099)	(562,479)	(605,030)	-25.9%	-28.9%
EBITDA	240,456	228,255	241,316	258,318	249,049	271,085	-8.3%	-11.0%
Depreciation	(104,699)	(117,178)	(135,276)	(147,569)	(121,896)	(140,413)	-3.9%	-3.7%
Pretax income	158,579	135,703	129,199	133,701	150,401	154,627	-9.8%	-16.4%
Reported NPAT	121,692	101,685	96,811	100,185	113,596	116,788	-10.5%	-17.1%
% chg y-y	-5.9%	-16.4%	-4.8%	3.5%	-6.7%	2.8%		
Per share info								
EPS	6.05	5.06	4.82	4.98				
DPS	2.62	2.19	2.08	2.16				
BPS	39.2	42.2	44.9	47.8				
Ratio analysis								
EBITDA	40.7%	37.8%	38.4%	38.2%	39.5%	39.9%	-1.7pp	-1.5pp
DEP	-17.7%	-19.4%	-21.5%	-21.8%	-19.3%	-20.7%	-0.1pp	-0.9pp
EBIT	23.0%	18.4%	16.8%	16.4%	20.2%	19.2%	-1.8pp	-2.4pp
Pre-tax income	26.8%	22.5%	20.6%	19.8%	23.9%	22.7%	-1.4pp	-2.2pp
Net Income	20.6%	16.8%	15.4%	14.8%	18.0%	17.2%	-1.2pp	-1.8pp
KPIs								
Total Customers	767	822	877	917	804	834	2%	5%
3G Customers	192	252	302	342	225	225	12%	34%
4G Customers	0	50	120	210	50	130	0%	-8%
Mobile ARPU	66.6	63	62	63	67	69	-6%	-11%

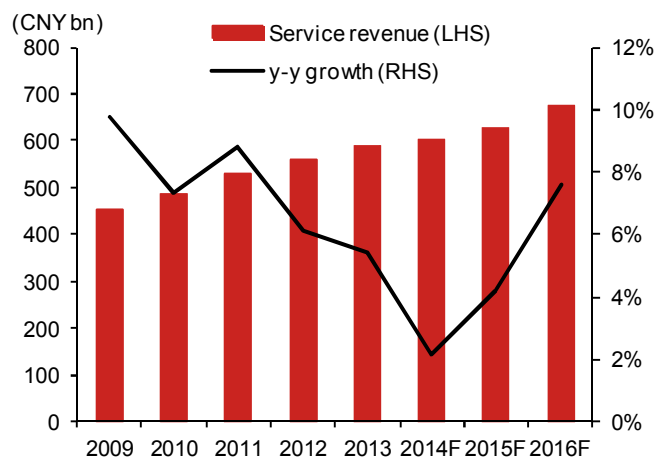
Source: Company data, Nomura estimates

Fig. 52: Nomura vs. consensus

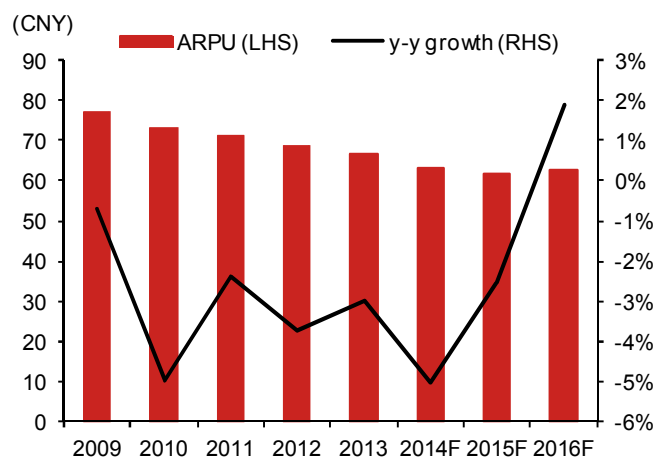
(CNY mn)	FY2013	FY2014			FY2015			FY2016		
		(NOM)	(CON)	diff	(NOM)	(CON)	diff	(NOM)	(CON)	diff
Revenue	630,177	644,867	657,292	-2%	671,363	698,192	-4%	721,417	737,844	-2%
Operating Profit	135,649	110,963	110,948	0%	105,921	108,349	-2%	110,623	110,053	1%
Net Profit (adjusted)	121,692	101,857	103,288	-1%	96,983	100,806	-4%	100,185	103,740	-3%
EPS(Adjusted)	6.05	5.07	5.24	-3%	4.82	5.03	-4%	4.98	5.17	-4%

Source: Bloomberg, Nomura estimates

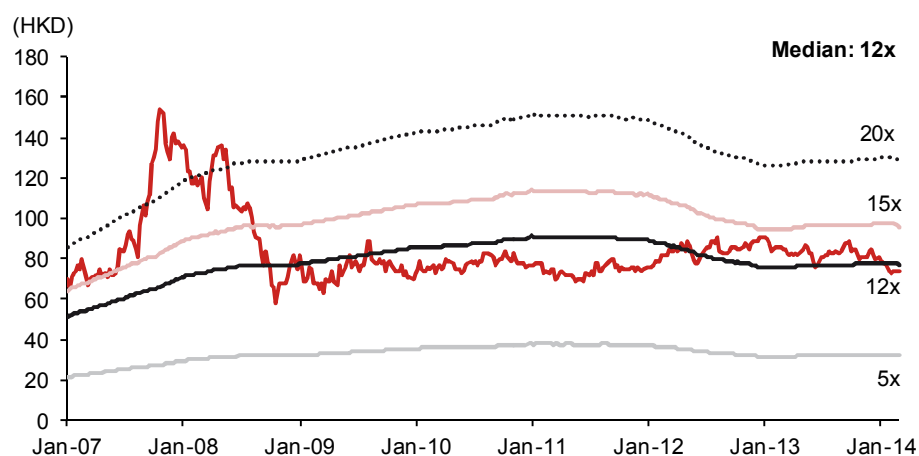


**Fig. 53: Service revenue trends and y-y growth**

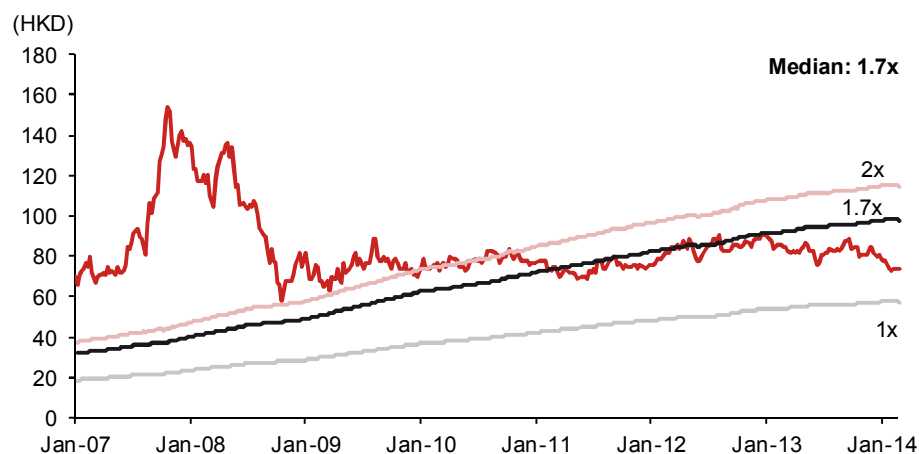
Source: Company data, Nomura estimates

**Fig. 54: Mobile ARPU trends and y-y growth**

Source: Company data, Nomura estimates

**Fig. 55: 12-month forward P/E band**

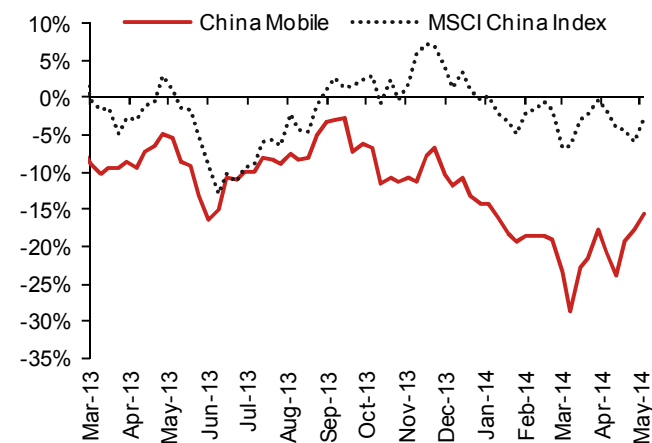
Source: Bloomberg, Nomura estimates

**Fig. 56: 12-month forward P/B band**

Source: Bloomberg, Nomura estimates

**Fig. 57: CM's share price movement vs. MSCI China index**

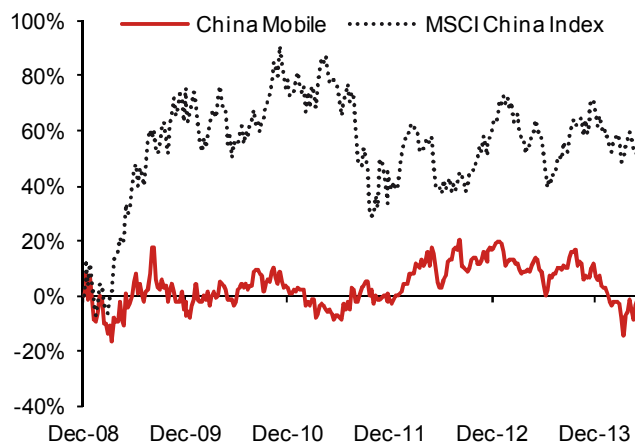
Past 12 months



Source: Bloomberg

**Fig. 58: CM's share price movement vs. MSCI China index**

Past 5 years since the 3G license issue



Source: Bloomberg

**Fig. 59: Asia wireless operators – peer comparison table**

	Bloomberg ticker	Rating	Cncy	Local price	Mkt Cap (USDmn)	PE (x)		EV/EBITDA (x)		Div Yield (%)		NI Growth	
						14E	15E	14E	15E	14E	15E	14E	15E
<b>Wireless</b>													
AIS	ADVANC TB	Buy	THB	228	20,735	18.8	17.6	10.4	9.5	5.3%	5.7%	-1%	7%
Axiata	AXIATA MK	Buy	MYR	6.82	17,861	21.1	19.5	8.8	8.2	3.8%	4.6%	0%	8%
Bharti Airtel	BHARTI IN	Buy	INR	342	22,006	24.8	19.3	6.5	5.9	1.0%	1.6%	31%	28%
CM	941 HK	Buy	HKD	76	197,719	11.8	12.4	4.9	4.6	3.7%	3.5%	-16%	-5%
DiGi	Digi MK	Neutral	MYR	5.50	13,261	24.3	23.5	13.6	13.1	4.1%	4.3%	4%	4%
FET	4904 TT	Neutral	TWD	68.60	7,420	19.9	19.8	9.5	9.2	5.0%	5.1%	-4%	1%
Globe	GLO PM	Neutral	PHP	1,703	5,137	17.6	16.6	7.5	7.0	4.6%	5.0%	10%	6%
IDEA	IDEA IN	Neutral	INR	136	7,602	19.8	17.8	6.8	6.1	0.5%	0.8%	13%	11%
Maxis	Maxis MK	Reduce	MYR	6.61	15,373	22.9	22.3	12.3	12.0	6.1%	6.1%	1%	3%
MobileOne	M1 SP	Buy	SGD	3.50	2,527	18.5	17.6	10.1	9.7	4.3%	4.3%	9%	5%
NTT DoCoMo	9437 JP	Neutral	JPY	1,691	63,703	14.2	12.3	4.4	4.2	3.5%	3.5%	4%	10%
XL	EXCL IJ	Buy	IDR	5,525	4,051	147.4	68.8	7.3	6.4	0.2%	0.4%	-84%	114%
RCOM	RCOM IN	Neutral	INR	145	5,083	31.1	24.1	9.3	8.7	0.5%	0.6%	37%	29%
SKT	017670 KS	Buy	KRW	223,500	15,241	7.3	6.8	4.3	4.2	4.2%	4.2%	16%	7%
TWM	3045 TT	Buy	TWD	99	11,254	18.1	17.8	12.3	11.9	5.0%	5.1%	-5%	2%
DTAC	DTAC TB	Buy	THB	121	8,728	21.6	19.6	8.8	8.0	4.2%	4.6%	18%	10%
<b>Average</b>						<b>27.5</b>	<b>21.0</b>	<b>8.5</b>	<b>8.0</b>	<b>3.5%</b>	<b>3.7%</b>	<b>2.0%</b>	<b>15.0%</b>
<b>Median</b>						<b>19.8</b>	<b>18.6</b>	<b>8.8</b>	<b>8.1</b>	<b>4.1%</b>	<b>4.3%</b>	<b>3.8%</b>	<b>7.0%</b>

Source: Bloomberg, Nomura estimates. Share prices are as of 28 May 2014.

### Maintain Buy at HKD13.5

Structural advantage intact, albeit with ST uncertainty

#### Action: Maintain Buy and TP of HKD13.5

We revise downwards our FY14F/15F net profits by 29%/35%, respectively, to reflect :1) negative earnings impacts due to VAT reform, and 2) slowdown in 3G subscriber growth due to intensified competition from China Mobile's 4G service. Although we expect a temporary slowdown in CU's 3G net addition, we think CU will maintain its technology advantage in 3G and 4G as well. Its 3G/4G net additions should soon recover once it has its FD-LTE license thanks to its structural advantage in 3G technology.

#### Catalysts: 3G/4G subscriber growth, EBITDA margin and ARPU trend

##### Capex ramp up unlikely, benefiting from WCDMA

On the network side, since CU's current 3G/WCDMA network already provides up to 42Mbps speed (vs 100Mbps in 4G/TD-LTE), CU only needs to spend a small amount of capex for 4G network upgrade to provide 4G service in hotspot areas.

##### Tower company to help accelerate 4G service rollout

Since CU only owns 26% of the telecom towers in China, the creation of a tower company will benefit CU to potentially share CM's tower sites, in the form of: 1) even lower 4G capex, 2) reduced tower maintenance cost, and 3) faster network deployment and wider coverage.

#### Valuation

Our TP of HKD13.5 is based on 21x FY14F EPS of CNY0.51 (previously 15x). The multiple is at the high end among regional integrated telcos (7.8-26.4x), reflecting CU's above-average growth in earnings (21% in FY14F, vs 9.6% regional average). The valuation also implies 4.7x EV/EBITDA, 1.2x FY14F BVPS, and 1.6% dividend yield.

Year-end 31 Dec	FY13		FY14F		FY15F		FY16F	
Currency (CNY)	Actual	Old	New	Old	New	Old	New	
<b>Revenue (mn)</b>	295,038	329,480	312,588	358,454	325,712	387,166	351,591	
<b>Reported net profit (mn)</b>	10,408	15,658	12,600	19,121	13,822	22,202	15,169	
<b>Normalised net profit (mn)</b>	10,408	15,658	12,600	19,121	13,822	22,202	15,169	
<b>FD normalised EPS</b>	42.21c	63.50c	51.10c	77.55c	56.06c	90.05c	61.52c	
<b>FD norm. EPS growth (%)</b>	46.7	50.4	21.1	22.1	9.7	16.1	9.7	
<b>FD normalised P/E (x)</b>	22.2	N/A	18.0	N/A	16.4	N/A	14.9	
<b>EV/EBITDA (x)</b>	4.1	N/A	3.9	N/A	3.6	N/A	3.3	
<b>Price/book (x)</b>	1.0	N/A	1.0	N/A	0.9	N/A	0.9	
<b>Dividend yield (%)</b>	1.7	N/A	2.1	N/A	2.3	N/A	2.6	
<b>ROE (%)</b>	4.9	7.0	5.7	8.1	6.0	9.0	6.3	
<b>Net debt/equity (%)</b>	56.7	47.7	52.3	41.0	46.6	33.6	42.0	

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

### Global Markets Research

3 June 2014

<b>Rating</b> Remains	<b>Buy</b>
<b>Target price</b> Remains	HKD 13.50
<b>Closing price</b> 28 May 2014	HKD 11.60
<b>Potential upside</b>	+16.4%

#### Anchor themes

Recent regulatory announcements have clarified details for MVNO and VAT, and have also shed more light on the government's stance on towercos, subsidies, and FDD licenses.

#### Nomura vs consensus

Our FY14F EPS is 7% below Bloomberg consensus. We believe consensus estimates have yet to fully reflect the recent regulatory developments.

#### Research analysts

##### China Telecoms

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# Key data on China Unicom

## Relative performance chart



## Notes:

## Performance

(%)	1M	3M	12M		
Absolute (HKD)	9.8	12.2	4.3	M cap (USDmn)	35,603.0
Absolute (USD)	9.9	12.3	4.5	Free float (%)	13.0
Rel to MSCI China	5.1	11.9	5.1	52-week (HKD)	13.34/9.03

## Income statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	248,926	295,038	312,588	325,712	351,591
Cost of goods sold					
Gross profit	248,926	295,038	312,588	325,712	351,591
SG&A	-237,324	-279,271	-293,922	-305,566	-329,881
Employee share expense					
Operating profit	11,602	15,767	18,666	20,146	21,709
EBITDA	72,659	83,963	87,204	91,692	96,041
Depreciation	-61,057	-68,196	-68,538	-71,546	-74,332
Amortisation	0	0	0	0	0
EBIT	11,602	15,767	18,666	20,146	21,709
Net interest expense	-2,889	-2,940	-2,954	-2,824	-2,613
Associates & JCEs	0	0	0	0	0
Other income	808	887	890	890	890
Earnings before tax	9,521	13,714	16,602	18,212	19,987
Income tax	-2,425	-3,306	-4,002	-4,390	-4,818
Net profit after tax	7,096	10,408	12,600	13,822	15,169
Minorities	0	0	0	0	0
Other items					
Preferred dividends					
Normalised NPAT	7,096	10,408	12,600	13,822	15,169
Extraordinary items					
Reported NPAT	7,096	10,408	12,600	13,822	15,169
Dividends	-2,828	-3,805	-4,606	-5,053	-5,545
Transfer to reserves	4,268	6,603	7,994	8,769	9,623

## Valuation and ratios

Reported P/E (x)	31.1	21.3	17.3	15.7	14.3
Normalised P/E (x)	31.1	21.3	17.3	15.7	14.3
FD normalised P/E (x)	32.5	22.2	18.0	16.4	14.9
Dividend yield (%)	1.3	1.7	2.1	2.3	2.6
Price/cashflow (x)	3.3	2.9	3.2	2.6	2.7
Price/book (x)	1.1	1.0	1.0	0.9	0.9
EV/EBITDA (x)	4.8	4.1	3.9	3.6	3.3
EV/EBIT (x)	29.8	22.0	18.1	16.3	14.8
Gross margin (%)	100.0	100.0	100.0	100.0	100.0
EBITDA margin (%)	29.2	28.5	27.9	28.2	27.3
EBIT margin (%)	4.7	5.3	6.0	6.2	6.2
Net margin (%)	2.9	3.5	4.0	4.2	4.3
Effective tax rate (%)	25.5	24.1	24.1	24.1	24.1
Dividend payout (%)	39.9	36.6	36.6	36.6	36.6
ROE (%)	3.4	4.9	5.7	6.0	6.3
ROA (pretax %)	2.5	3.1	3.7	4.0	4.3

## Growth (%)

Revenue	19.0	18.5	5.9	4.2	7.9
EBITDA	14.6	15.6	3.9	5.1	4.7
Normalised EPS	67.9	46.1	21.1	9.7	9.7
Normalised FDEPS	61.9	46.7	21.1	9.7	9.7

Source: Company data, Nomura estimates

## Cash flow statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	72,659	83,963	87,204	91,692	96,041
Change in working capital	7,323	-6,218	-10,198	1,750	-4,928
Other operating cashflow	-9,362	737	-6,066	-6,324	-6,541
CF from operations	70,620	78,482	70,940	87,118	84,572
Capital expenditure	-86,783	-72,758	-80,000	-80,000	-80,000
Free cash flow	-16,163	5,724	-9,060	7,118	4,572
Reduction in investments					
Net acquisitions					
Dec in other LT assets					
Inc in other LT liabilities					
Adjustments	-12,697	-4,352	18,351	6,353	7,346
CF after investing acts	-28,860	1,372	9,291	13,471	11,918
Cash dividends	-2,283	-2,686	-3,805	-4,606	-5,053
Equity issue	1	1,102	0	0	0
Debt issue	34,286	3,510	0	0	0
Convertible debt issue					
Others	0	-42	0	0	0
CF from financial acts	32,004	1,884	-3,805	-4,606	-5,053
Net cashflow	3,144	3,256	5,486	8,865	6,865
Beginning cash	15,106	18,250	21,506	26,992	35,857
Ending cash	18,250	21,506	26,992	35,857	42,721
Ending net debt	123,526	124,119	118,633	109,768	102,904

## Balance sheet (CNYmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	18,250	21,506	26,992	35,857	42,721
Marketable securities	0	0	0	0	0
Accounts receivable	24,089	25,114	27,016	27,303	31,332
Inventories	5,803	5,536	6,398	6,009	7,385
Other current assets	32	54	54	54	54
Total current assets	48,174	52,210	60,460	69,222	81,492
LT investments	0	0	0	0	0
Fixed assets	430,997	431,625	430,421	432,075	429,905
Goodwill					
Other intangible assets	9,135	2,771	2,800	2,800	2,800
Other LT assets	27,818	42,565	36,100	36,100	36,100
Total assets	516,124	529,171	529,781	540,197	550,297
Short-term debt	139,240	132,142	132,142	132,142	132,142
Accounts payable	110,306	104,846	97,412	99,060	99,537
Other current liabilities	52,774	58,251	58,251	58,251	58,251
Total current liabilities	302,320	295,239	287,805	289,453	289,930
Long-term debt	2,536	13,483	13,483	13,483	13,483
Convertible debt					
Other LT liabilities	1,763	1,550	1,600	1,600	1,600
Total liabilities	306,619	310,272	302,888	304,536	305,013
Minority interest	0	0	0	0	0
Preferred stock	0	0	0	0	0
Common stock	2,311	2,328	2,328	2,328	2,328
Retained earnings	207,194	216,571	224,565	233,333	242,957
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	209,505	218,899	226,893	235,661	245,285
Total equity & liabilities	516,124	529,171	529,781	540,197	550,297

## Liquidity (x)

Current ratio	0.16	0.18	0.21	0.24	0.28
Interest cover	4.0	5.4	6.3	7.1	8.3

## Leverage

Net debt/EBITDA (x)	1.70	1.48	1.36	1.20	1.07
Net debt/equity (%)	58.96	56.70	52.29	46.58	41.95

## Per share

Reported EPS (CNY)	30.11c	43.99c	53.26c	58.42c	64.12c
Norm EPS (CNY)	30.11c	43.99c	53.26c	58.42c	64.12c
FD norm EPS (CNY)	28.77c	42.21c	51.10c	56.06c	61.52c
BVPS (CNY)	8.89	9.25	9.59	9.96	10.37
DPS (CNY)	0.12	0.16	0.19	0.21	0.23

## Activity (days)

Days receivable	31.5	30.4	30.4	30.4	30.5
Days inventory	na	na	na	na	na
Days payable	na	na	na	na	na
Cash cycle	na	na	na	na	na

Source: Company data, Nomura estimates

# Earnings forecast revisions

- We revise downwards our FY14/15F service revenues by 6%/9%, respectively, to reflect the recent slowdown in 3G subscriber net adds, although growth may pick up if FD-LTE license is issued in 3Q14.
- We revise downwards our FY14/15F EBIT by 31%/36%, respectively, to reflect the impact from VAT reform. CU is expected to experience the largest impact among the three telcos, in our opinion.
- We revise downwards our FY14/15F blended mobile ARPUs by 7%/11%, respectively, to reflect the impact from the recent tariff liberation, which we believe will promote competition.

**Fig. 60: Earnings revision summary**

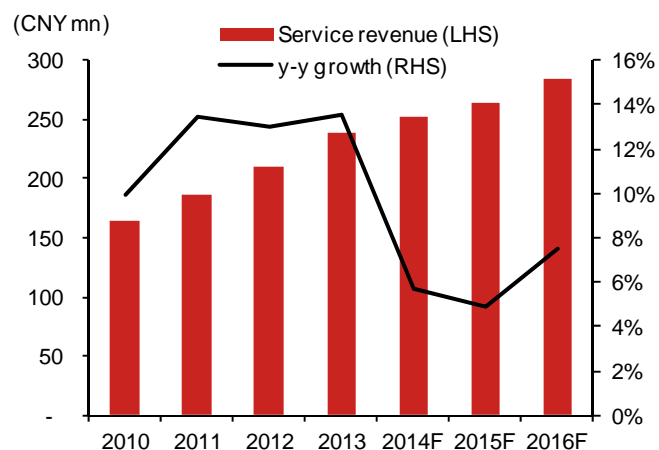
(CNY mn)	2013	2014E	2015E	2016E	FY14F	FY15F	FY14F	FY15F
	A	A	A	A	OLD	OLD	Diff.	Diff.
Sales	295,038	312,588	325,712	351,591	335,231	358,454	-7%	-9%
pre-tax service revenue	245,948	265,788	285,538	306,060	345,599	369,540	-23%	-23%
% chg y-y	13.5%	8.1%	7.4%	7.2%	40.5%	6.9%		
Telecom service	238,570	252,131	264,382	284,128	268,435	290,829	-6%	-9%
% chg y-y	13.5%	5.7%	4.9%	7.5%	12.5%	8.3%		
OPEX	(211,078)	(225,384)	(234,020)	(255,550)	(238,699)	(267,720)	-6%	-13%
EBITDA	83,960	87,204	91,692	96,041	96,532	104,750	-10%	-12%
Depreciation	(68,196)	(68,538)	(71,546)	(74,332)	(69,562)	(73,226)	-1%	-2%
EBIT	15,764	18,666	20,146	21,709	26,970	31,524	-31%	-36%
Net Finance Cost	(2,940)	(2,954)	(2,824)	(2,613)				
Pretax income	13,714	16,602	18,212	19,987	23,904	28,465	-31%	-36%
Reported NPAT	10,408	12,600	13,822	15,169	17,815	21,215	-29%	-35%
% chg y-y	47%	21%	10%	10%	71.2%	19.1%		
Ratio Analysis								
EBITDA	35.2%	34.6%	34.7%	33.8%	36.0%	36.0%	-1.4pp	-1.3pp
Depreciation	-28.6%	-27.2%	-27.1%	-26.2%	-25.9%	-25.2%	-1.3pp	-1.9pp
EBIT	6.6%	7.4%	7.6%	7.6%	10.0%	10.8%	-2.6pp	-3.2pp
Pretax income	5.7%	6.6%	6.9%	7.0%	8.9%	9.8%	-2.3pp	-2.9pp
Reported NPAT	4.4%	5.0%	5.2%	5.3%	6.6%	7.3%	-1.6pp	-2.1pp
KPIs								
Total Mobile Sub	281	306	331	351	305	320	0%	3%
3G/4G Mobile Sub	123	153	198	243	141	116	8%	70%
4G Subscriber	0	1	13	37	0	0		
Fixed-line Sub	88	86	84	82	88	87	-3%	-4%
Mobile ARPU	48.4	46.7	46.1	47.2	50	52	-7%	-11%
3G ARPU	75.2	67.0	61.9	59.1				

Source: Company data, Nomura estimates

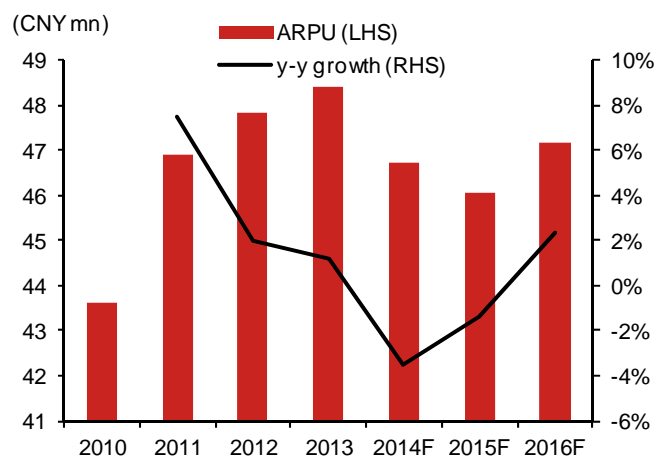
**Fig. 61: Nomura vs. Consensus**

(CNY mn)	FY2013	FY2014	FY2015	FY2016					
		(NOM)	(CON)	(NOM)	(CON)	diff	(NOM)	(CON)	diff
Revenue	295,038	312,588	320,299	325,712	350,153	-7%	351,591	380,889	-8%
EBITDA	83,963	87,204	94,292	91,692	101,732	-10%	96,041	109,296	-12%
Operating Profit	15,767	18,666	20,934	20,146	23,528	-14%	21,709	28,278	-23%
Net Profit (reported)	10,408	12,600	13,590	13,822	13,590	2%	15,169	18,942	-20%
EPS (reported)	0.44	0.53	0.57	0.58	0.66	-12%	0.64	0.77	-17%

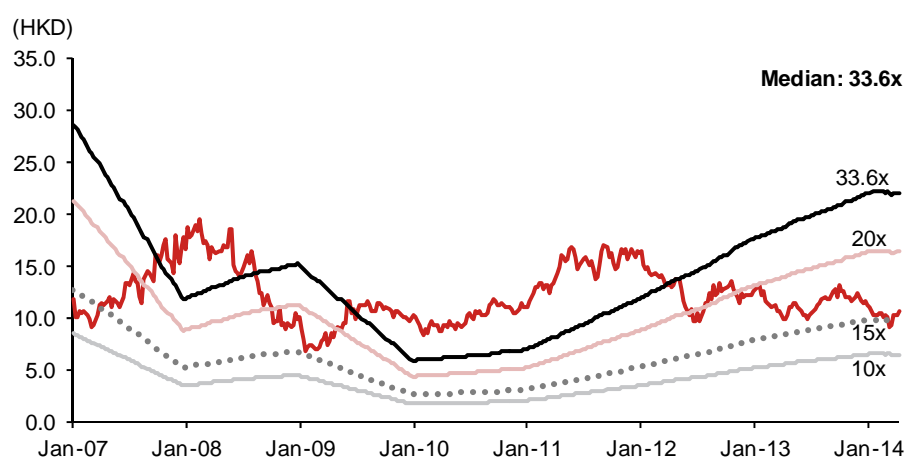
Source: Bloomberg, Nomura research

**Fig. 62: Revenues and y-y revenue growth**

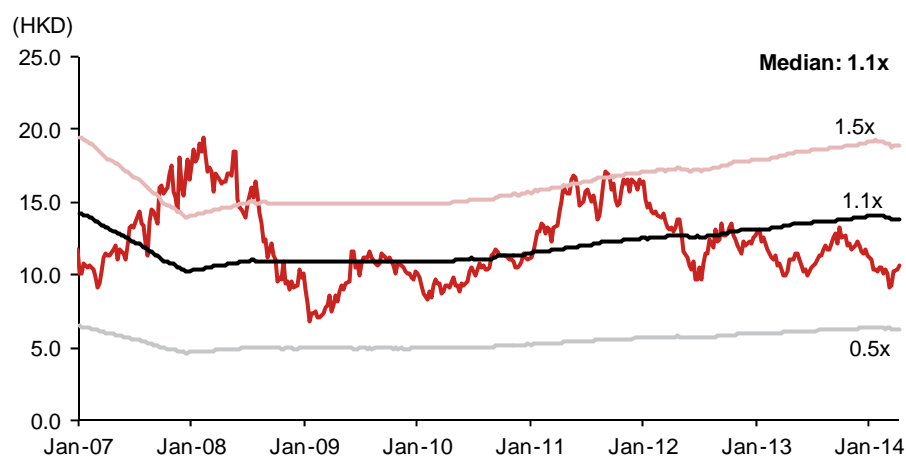
Source: Company data, Nomura estimates

**Fig. 63: y-y mobile ARPU and mobile ARPU growth**

Source: Company data, Nomura estimates

**Fig. 64: 12-month forward PE band**

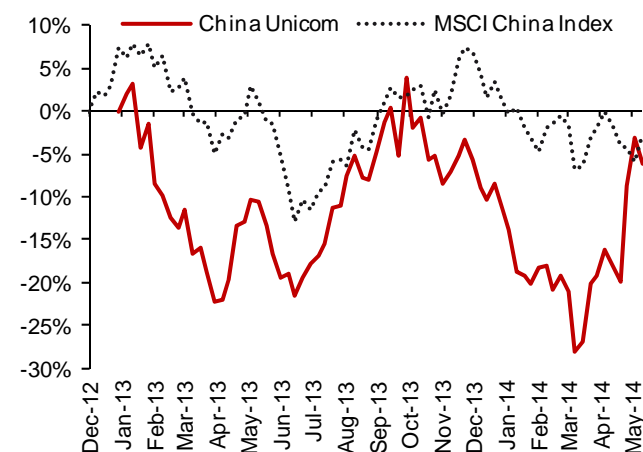
Source: Bloomberg, Nomura estimates

**Fig. 65: 12-month forward P/B**

Source: Bloomberg, Nomura estimates

**Fig. 66: CM's share price movement vs. MSCI China index**

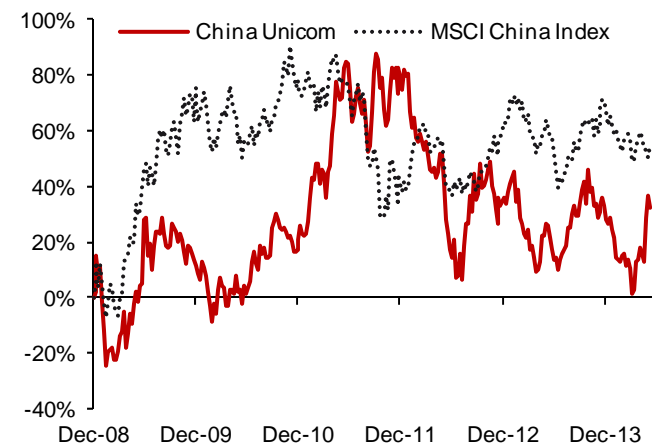
Past 12 months



Source: Bloomberg

**Fig. 67: CM's share price movement vs. MSCI China index**

Past 5 years since 3G license issue



Source: Bloomberg

**Fig. 68: Asia integrated operators – peer comparison table**

	Bloomberg ticker	Rating	Cncy	Local price	Mkt Cap (US\$ mn)	PE (x)		EV/EBITDA (x)		Div Yield (%)		NI Growth	
						14E	15E	14E	15E	14E	15E	14E	15E
Integrated													
CT	728 HK	Neutral	HKD	3.89	40,608	15.0	14.8	3.8	3.5	2.3%	2.3%	-5%	1%
CU	762 HK	Buy	HKD	11.60	35,602	18.0	16.4	3.9	3.6	2.1%	2.3%	21%	10%
CHT	2412 TT	Neutral	TWD	96.70	24,902	20.6	21.0	9.6	9.5	4.9%	4.8%	-8%	-2%
KDDI	9433 JP	Buy	JPY	5,881	48,246	11.4	10.2	4.5	4.1	2.7%	3.2%	17%	12%
KT Corp	030200 KS	Neutral	KRW	31,350	8,009	7.8	7.1	4.3	4.2	4.8%	5.4%	41%	10%
LG Uplus	032640 KS	Buy	KRW	9,950	5,012	8.9	6.8	4.2	3.8	2.8%	3.5%	37%	31%
NTT	9432 JP	Buy	JPY	6,020	63,027	11.7	10.6	3.9	3.8	3.0%	3.2%	3%	6%
PLDT	TEL PM	Neutral	PHP	2,896	14,257	15.9	15.6	8.9	8.8	6.3%	6.4%	2%	2%
Indosat	ISAT IJ	Neutral	IDR	4,035	1,889	25.1	21.2	5.7	6.7	2.0%	2.1%	-21%	18%
TLKM	TLKM IJ	Neutral	IDR	2,550	22,149	17.3	16.1	5.8	5.4	4.0%	4.3%	3%	7%
SingTel	ST SP	Buy	SGD	3.83	48,646	16.7	15.7	8.9	8.4	4.4%	4.7%	1%	6%
Softbank	9984 JP	Buy	JPY	7,192	83,978	15.5	12.4	6.3	5.8	0.6%	0.6%	61%	24%
StarHub	STH SP	Neutral	SGD	4.17	5,693	19.1	19.3	10.2	10.3	4.8%	4.8%	1%	-1%
TM	T MK	Buy	MYR	6.38	7,075	26.4	29.0	7.3	7.2	3.4%	3.1%	-10%	-9%
Telstra	TLS AU	Buy	AUD	5.34	61,316	17.2	17.1	7.3	7.3	5.4%	5.4%	1%	0%
Average						16.4	15.6	6.3	6.2	3.6%	3.7%	9.6%	7.7%
Median						16.7	15.7	5.8	5.8	3.4%	3.5%	1.6%	6.4%

Note: Pricing as of 28 May 2014

Source: Bloomberg, Nomura estimates



### Forecast updates; TP raised to HKD4.0

#### Short-term structural challenges remain

##### Action: Maintain Neutral, TP up HKD4.0

We raise our TP to HKD4.0 to reflect potential upside from the tower company but maintain our Neutral call as we expect China Telecom (CT) to record below-industry average growth even after the government issues its FD-LTE license in 2H14. CT's mobile net add and service revenue growth is likely to remain weak even after FD-LTE licenses are issued, due to disadvantages in the speed of its CDMA network (3.1Mbps) vs CM's TD-LTE network (100Mbps), and technology difficulty in both handset chipset and 3G/4G handover on the network side.

##### Catalyst: Largest beneficiary from the creation of tower company

Among the telcos, we expect CT to become the largest beneficiary for having the least amount of towers, which is already becoming an issue for the company in choosing sites for 4G deployment. The tower company will play a critical role in helping CT to save capex and accelerate its 4G network deployment.

##### Catalyst: Free cash flow to remain challenging

We estimate CT's FCF to decline in 2014F, largely driven by VAT reform. We expect its FCF to continue to fall in 2015F/16F as the company finally ramps up 4G capex starting in 2015F. We expect CT to have the worst FCF trend among the telcos.

##### Valuation: TP of HKD4.0 based on 15.4x of FY14F EPS of CNY0.21

Our TP of HKD4 is based on 15.4x FY14F EPS of CNY0.21 (previously 12.5x). Our previous multiple was priced in the mid-range of CM's and CU's (11x and 15x, respectively), we now adjust the multiple more towards CM's new multiple of 14x to reflect CT's challenging outlook in the medium term. Our valuation also implies 3.8x EV/EBITDA, 0.9x FY14F BVPS of CNY3.57, and 3% dividend yield.

Year-end 31 Dec	FY13		FY14F		FY15F		FY16F	
Currency (CNY)	Actual	Old	New	Old	New	Old	New	
Revenue (mn)	321,584	350,145	322,990	378,064	339,948		364,760	
Reported net profit (mn)	17,545	20,222	16,597	23,548	16,815		16,982	
Normalised net profit (mn)	17,545	20,222	16,597	23,548	16,815		16,982	
FD normalised EPS	21.68c	24.99c	20.51c	29.10c	20.78c		20.98c	
FD norm. EPS growth (%)	17.6	16.1	-5.4	16.4	1.3		1.0	
FD normalised P/E (x)	14.2	N/A	15.0	N/A	14.8		14.7	
EV/EBITDA (x)	3.8	N/A	3.8	N/A	3.5		3.5	
Price/book (x)	0.9	N/A	0.9	N/A	0.8		0.8	
Dividend yield (%)	2.4	N/A	2.3	N/A	2.3		2.4	
ROE (%)	6.5	7.1	5.9	7.9	5.7		5.6	
Net debt/equity (%)	34.0	40.5	30.0	34.3	31.4		34.2	

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

### Global Markets Research

3 June 2014

Rating Remains	<b>Neutral</b>
Target price Increased from 3.50	HKD 4.00
Closing price 28 May 2014	HKD 3.89
Potential upside	+2.8%

#### Anchor themes

Recent regulatory announcements have clarified the details for MVNO and VAT, and have also shed more light on the government's stance on towercos, subsidies, and FDD licenses.

#### Nomura vs consensus

Our FY14F NP is 10% below consensus. We believe consensus hasn't fully reflected the recent developments and will eventually downgrade estimates.

#### Research analysts

##### China Telecoms

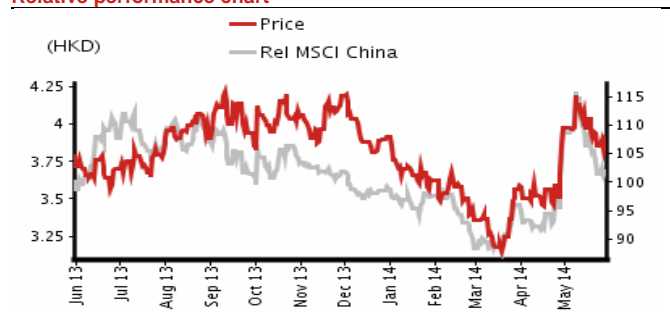
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# Key data on China Telecom

## Relative performance chart



Source: Thomson Reuters, Nomura research

## Notes:

## Performance

(%)	1M	3M	12M		
Absolute (HKD)	6.0	15.8	-0.8	M cap (USDmn)	40,608.7
Absolute (USD)	6.0	15.9	-0.6	Free float (%)	18.3
Rel to MSCI China	1.3	15.5	0.1	52-week (HKD)	4.26/3.12

## Income statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	283,073	321,584	322,990	339,948	364,760
Cost of goods sold	0	0	0	0	0
Gross profit	283,073	321,584	322,990	339,948	364,760
SG&A	-261,875	-294,116	-301,660	-312,215	-336,243
Employee share expense					
Operating profit	21,198	27,468	21,330	27,733	28,517
EBITDA	66,483	91,332	89,727	99,583	102,361
Depreciation	-45,285	-63,864	-68,397	-71,850	-73,844
Amortisation	0	0	0	0	0
EBIT	21,198	27,468	21,330	27,733	28,517
Net interest expense	-2,154	-5,511	-7,317	-6,739	-7,303
Associates & JCEs	0	0	0	0	0
Other income	749	1,131	7,827	1,134	1,134
Earnings before tax	19,793	23,088	21,841	22,128	22,348
Income tax	-4,753	-5,422	-5,129	-5,197	-5,248
Net profit after tax	15,040	17,666	16,712	16,932	17,100
Minorities	-115	-121	-115	-117	-118
Other items					
Preferred dividends					
Normalised NPAT	14,925	17,545	16,597	16,815	16,982
Extraordinary items					
Reported NPAT	14,925	17,545	16,597	16,815	16,982
Dividends	-5,522	-6,098	-5,768	-5,844	-5,902
Transfer to reserves	9,403	11,447	10,828	10,971	11,080

## Valuation and ratios

Reported P/E (x)	17.0	14.2	15.0	14.8	14.7
Normalised P/E (x)	17.0	14.2	15.0	14.8	14.7
FD normalised P/E (x)	17.0	14.2	15.0	14.8	14.7
Dividend yield (%)	2.2	2.4	2.3	2.3	2.4
Price/cashflow (x)	3.6	2.8	2.8	2.6	2.7
Price/book (x)	1.0	0.9	0.9	0.8	0.8
EV/EBITDA (x)	4.9	3.8	3.8	3.5	3.5
EV/EBIT (x)	15.4	12.6	15.8	12.4	12.5
Gross margin (%)	100.0	100.0	100.0	100.0	100.0
EBITDA margin (%)	23.5	28.4	27.8	29.3	28.1
EBIT margin (%)	7.5	8.5	6.6	8.2	7.8
Net margin (%)	5.3	5.5	5.1	4.9	4.7
Effective tax rate (%)	24.0	23.5	23.5	23.5	23.5
Dividend payout (%)	37.0	34.8	34.8	34.8	34.8
ROE (%)	5.7	6.5	5.9	5.7	5.6
ROA (pretax %)	4.7	5.3	4.0	5.0	4.9

## Growth (%)

Revenue	15.5	13.6	0.4	5.3	7.3
EBITDA	-6.4	37.4	-1.8	11.0	2.8
Normalised EPS	-9.5	17.6	-5.4	1.3	1.0
Normalised FDEPS	-9.5	17.6	-5.4	1.3	1.0

Source: Company data, Nomura estimates

## Cash flow statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	66,483	91,332	89,727	99,583	102,361
Change in working capital	22,402	10,239	4,826	6,862	68,818
Other operating cashflow	-18,218	-13,220	-4,734	-10,918	-80,083
CF from operations	70,667	88,351	89,819	95,527	91,095
Capital expenditure	-50,161	-71,032	-80,000	-100,000	-100,000
Free cash flow	20,506	17,319	9,819	-4,473	-8,905
Reduction in investments					0
Net acquisitions	0	-25,500	0	0	0
Dec in other LT assets	82	507	1,096	0	0
Inc in other LT liabilities	-1,321	-648	-138	-200	-200
Adjustments	3,148	-11,275	3,155	2,787	2,805
CF after investing acts	22,415	-19,597	13,932	-1,886	-6,300
Cash dividends	-5,625	-5,433	-6,098	-5,768	-5,844
Equity issue	0	0	0	0	0
Debt issue	-14,431	10,928	40,000	15,000	15,000
Convertible debt issue					
Others	251	190	0	0	0
CF from financial acts	-19,805	5,685	33,902	9,232	9,156
Net cashflow	2,610	-13,912	47,834	7,345	2,856
Beginning cash	27,372	29,982	16,070	63,904	71,250
Ending cash	29,982	16,070	63,904	71,250	74,106
Ending net debt	69,826	94,307	86,473	94,127	106,271

## Balance sheet (CNYmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	29,982	16,070	63,904	71,250	74,106
Marketable securities	0	0	0	0	0
Accounts receivable	26,570	27,903	28,578	30,868	32,917
Inventories	5,928	6,523	7,213	8,204	9,284
Other current assets	2,730	2,287	2,287	2,287	2,287
Total current assets	65,210	52,783	101,982	112,609	118,594
LT investments	0	0	0	0	0
Fixed assets	406,227	418,498	427,238	452,524	475,818
Goodwill					
Other intangible assets	39,132	37,962	38,000	38,000	38,000
Other LT assets	34,503	33,996	32,900	32,900	32,900
Total assets	545,072	543,239	600,120	636,034	665,311
Short-term debt	16,735	47,760	47,760	47,760	47,760
Accounts payable	69,336	81,503	87,694	97,837	101,235
Other current liabilities	107,390	70,835	70,835	70,835	70,835
Total current liabilities	193,461	200,098	206,289	216,432	219,830
Long-term debt	83,073	62,617	102,617	117,617	132,617
Convertible debt					
Other LT liabilities	2,508	1,860	1,722	1,522	1,322
Total liabilities	279,042	264,575	310,628	335,571	353,769
Minority interest	961	923	923	923	923
Preferred stock	0	0	0	0	0
Common stock	80,932	80,932	80,932	80,932	80,932
Retained earnings	184,137	196,809	207,637	218,608	229,687
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	265,069	277,741	288,569	299,540	310,619
Total equity & liabilities	545,072	543,239	600,120	636,034	665,312

## Liquidity (x)

Current ratio	0.34	0.26	0.49	0.52	0.54
Interest cover	9.8	5.0	2.9	4.1	3.9

## Leverage

Net debt/EBITDA (x)	1.05	1.03	0.96	0.95	1.04
Net debt/equity (%)	26.34	33.96	29.97	31.42	34.21

## Per share

Reported EPS (CNY)	18.44c	21.68c	20.51c	20.78c	20.98c
Norm EPS (CNY)	18.44c	21.68c	20.51c	20.78c	20.98c
FD norm EPS (CNY)	18.44c	21.68c	20.51c	20.78c	20.98c
BVPS (CNY)	3.28	3.43	3.57	3.70	3.84
DPS (CNY)	0.07	0.08	0.07	0.07	0.07

## Activity (days)

Days receivable	33.7	30.9	31.9	31.9	32.0
Days inventory	na	na	na	na	na
Days payable	na	na	na	na	na
Cash cycle	na	na	na	na	na

Source: Company data, Nomura estimates

## Earnings forecast revisions

- We revised downwards our FY14/15F service revenues by 6%/11% respectively, to reflect the delay in FD-LTE license issue, and our view that subscriber and revenues growth won't pick up even after the license is issued.
- We revised downwards our FY14/15F EBIT by 18%/30%, respectively, to reflect impacts from the VAT reform.
- We revise downwards our FY14/15F 3G subscriber by 23%/19%, respectively, to reflect weakness in CT's short-to-medium subscriber net add, facing intense competition from CM's aggressive 4G push and disadvantage in building a hybrid LTE network.

**Fig. 69: Summary of earnings forecast revisions**

(CNY mn)	2013	2014E	2015E	2016E	FY14F	FY15F	FY13F	FY14F
	A	NOM	NOM	NOM	OLD	OLD	Diff.	Diff.
Sales	321,584	322,990	339,948	364,760	350,145	378,064	-8%	-10%
Pre-tax telecom revenue	284,149	306,572	320,663	342,383	360,974	389,757	-15%	-18%
y-y	7%	8%	5%	7%				
Telecom Service Revenue	284,149	290,296	296,618	317,097	308,029	331,737	-6%	-11%
y-y	10%	2%	2%	7%				
Operating Expense	(225,033)	(226,567)	(240,365)	(262,399)	(239,203)	(258,498)	-5%	-7%
EBITDA	96,551	96,424	99,583	102,361	110,942	119,566	-13%	-17%
Depreciation	(69,083)	(68,397)	(71,850)	(73,844)	(76,565)	(79,925)	-11%	-10%
EBIT	27,468	28,027	27,733	28,517	34,377	39,641	-18%	-30%
Net Finance Cost	(5,150)	(6,956)	(6,378)	(6,942)				
Others incomes	770	770	773	773				
Pretax income	23,088	21,841	22,128	22,348	26,819	31,230	-19%	-29%
Reported NPAT	17,545	16,597	16,815	16,982	20,222	23,548	-18%	-29%
% chg y-y	17.6%	-5.4%	1.3%	1.0%				
Ratio analysis								
EBITDA	34.0%	33.2%	33.6%	32.3%	36.0%	36.0%	-2.8pp	-2.5pp
Depreciation	24.3%	23.6%	24.2%	23.3%	24.9%	24.1%	-1.3pp	0.1pp
EBIT	9.7%	9.7%	9.3%	9.0%	11.2%	11.9%	-1.5pp	-2.6pp
Pre-tax income	8.1%	7.5%	7.5%	7.0%	8.7%	9.4%	-1.2pp	-2.0pp
Net income	6.2%	5.7%	5.7%	5.4%	6.6%	7.1%	-0.8pp	-1.4pp
Subscriber (mn)								
Total Mobile Sub	186	186	206	226	212	232	-12%	-11%
3G/4G Sub	103	108	138	168	141	171	-23%	-19%
4G Sub	0	1	6	16				
Fixed-line Sub	156	149	141	134	153	152	-3%	-7%
Broadband sub	100	108	115	121	57	59	90%	95%

Source: Company data, Nomura estimates

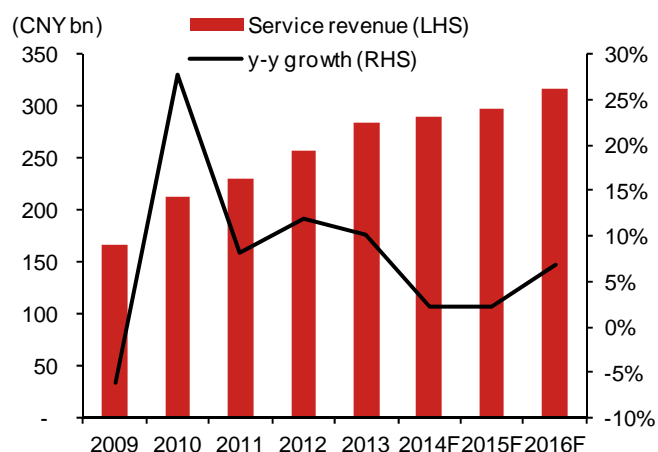
**Fig. 70: Nomura vs. consensus**

(CNY mn)	FY2013	FY2014			FY2015			FY2016		
		(NOM)	(CON)	diff	(NOM)	(CON)	diff	(NOM)	(CON)	diff
Revenue	321,584	322,990	342,920	-6%	339,948	365,857	-7%	364,760	388,371	-6%
Operating Profit	27,468	21,330	29,660	-28%	27,733	31,680	-12%	28,517	34,741	-18%
Pretax Profit	23,088	21,841	24,765	-12%	22,128	27,422	-19%	22,348	31,499	-29%
Net Profit (adjusted)	17,545	16,597	18,539	-10%	16,815	20,405	-18%	16,982	23,500	-28%
EPS(Adjusted)	0.22	0.21	0.24	-13%	0.21	0.26	-20%	0.21	0.29	-28%

Source: Bloomberg, Nomura estimates

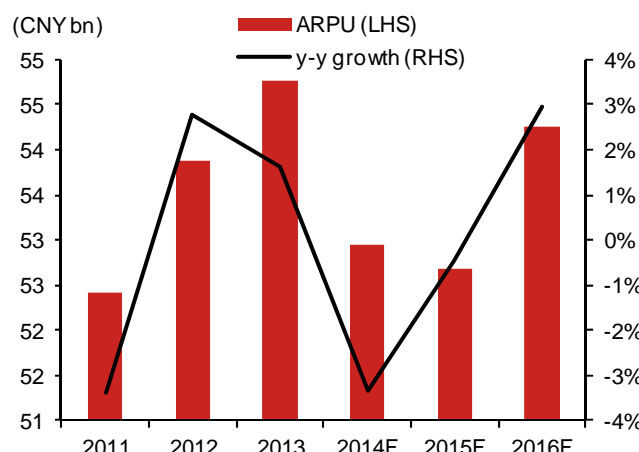
# Valuation

**Fig. 71: Service revenue trends and growth rates**



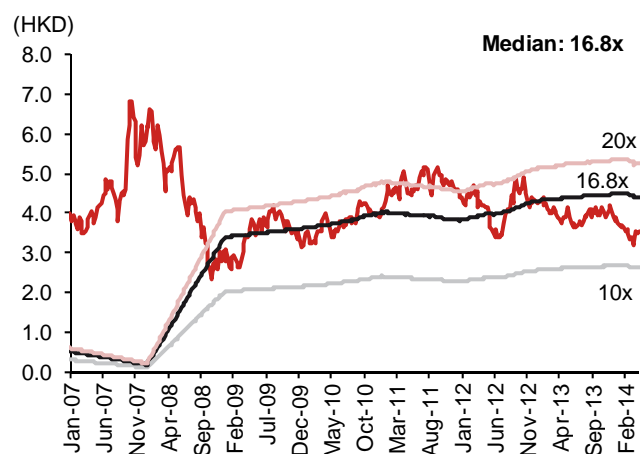
Source: Bloomberg, Nomura estimates

**Fig. 72: ARPU trends and growth rates**



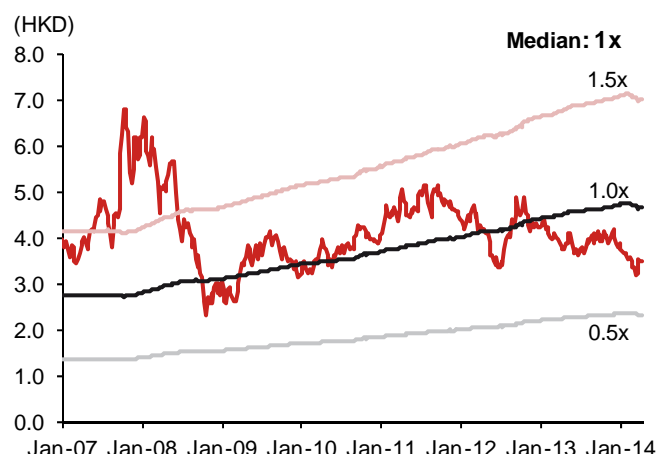
Source: Bloomberg, Nomura estimates

**Fig. 73: 12-month forward P/E band**



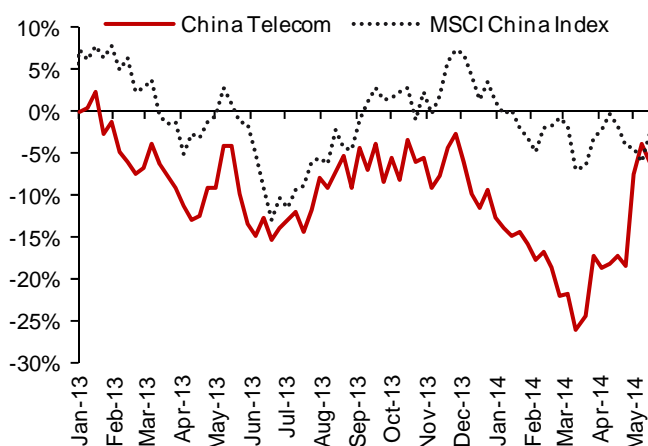
Source: Bloomberg, Nomura estimates

**Fig. 74: 12-month forward P/B band**



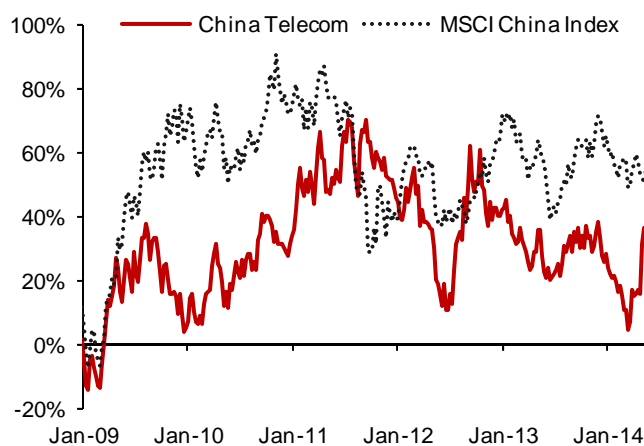
Source: Bloomberg, Nomura estimates

**Fig. 75: Price vs. MSCI (12 months)**



Source: Bloomberg, Nomura research

**Fig. 76: Price vs. MSCI (5 years)**



Source: Bloomberg, Nomura research

Fig. 77: Asia integrated operator peer valuation table

	Bloomberg ticker	Rating	Cncy	Local price	Mkt Cap (USDmn)	PE (x)		EV/EBITDA (x)		Div Yield (%)		NI Growth	
						14E	15E	14E	15E	14E	15E	14E	15E
Integrated													
CT	728 HK	Neutral	HKD	3.89	40,608	15.0	14.8	3.8	3.5	2.3%	2.3%	-5%	1%
CU	762 HK	Buy	HKD	11.60	35,602	18.0	16.4	3.9	3.6	2.1%	2.3%	21%	10%
CHT	2412 TT	Neutral	TWD	96.70	24,902	20.6	21.0	9.6	9.5	4.9%	4.8%	-8%	-2%
KDDI	9433 JP	Buy	JPY	5,881	48,246	11.4	10.2	4.5	4.1	2.7%	3.2%	17%	12%
KT Corp	030200 KS	Neutral	KRW	31,350	8,009	7.8	7.1	4.3	4.2	4.8%	5.4%	41%	10%
LG Uplus	032640 KS	Buy	KRW	9,950	5,012	8.9	6.8	4.2	3.8	2.8%	3.5%	37%	31%
NTT	9432 JP	Buy	JPY	6,020	63,027	11.7	10.6	3.9	3.8	3.0%	3.2%	3%	6%
PLDT	TEL PM	Neutral	PHP	2,896	14,257	15.9	15.6	8.9	8.8	6.3%	6.4%	2%	2%
Indosat	ISAT IJ	Neutral	IDR	4,035	1,889	25.1	21.2	5.7	6.7	2.0%	2.1%	-21%	18%
TLKM	TLKM IJ	Neutral	IDR	2,550	22,149	17.3	16.1	5.8	5.4	4.0%	4.3%	3%	7%
SingTel	ST SP	Buy	SGD	3.83	48,646	16.7	15.7	8.9	8.4	4.4%	4.7%	1%	6%
Softbank	9984 JP	Buy	JPY	7,192	83,978	15.5	12.4	6.3	5.8	0.6%	0.6%	61%	24%
StarHub	STH SP	Neutral	SGD	4.17	5,693	19.1	19.3	10.2	10.3	4.8%	4.8%	1%	-1%
TM	T MK	Buy	MYR	6.38	7,075	26.4	29.0	7.3	7.2	3.4%	3.1%	-10%	-9%
Telstra	TLS AU	Buy	AUD	5.34	61,316	17.2	17.1	7.3	7.3	5.4%	5.4%	1%	0%
Average						16.4	15.6	6.3	6.2	3.6%	3.7%	9.6%	7.7%
Median						16.7	15.7	5.8	5.8	3.4%	3.5%	1.6%	6.4%

Source: Bloomberg, Nomura estimates. Share prices are as of 28 May 2014.

NOMURA

NOMURA

NOMURA

# Appendix A-1

## Analyst Certification

I, Leping Huang, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

## Issuer Specific Regulatory Disclosures

The term "Nomura Group" used herein refers to Nomura Holdings, Inc. or any of its affiliates or subsidiaries, and may refer to one or more Nomura Group companies.

### Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
China Telecom	728 HK	HKD 3.90	30-May-2014	Neutral	N/A	A10
China Unicom	762 HK	HKD 11.60	30-May-2014	Buy	N/A	A4,A5,A6,A10
China Mobile	941 HK	HKD 75.84	30-May-2014	Buy	N/A	

A4 The Nomura Group had an investment banking services client relationship with the issuer during the past 12 months.

A5 The Nomura Group has received compensation for investment banking services from the issuer in the past 12 months.

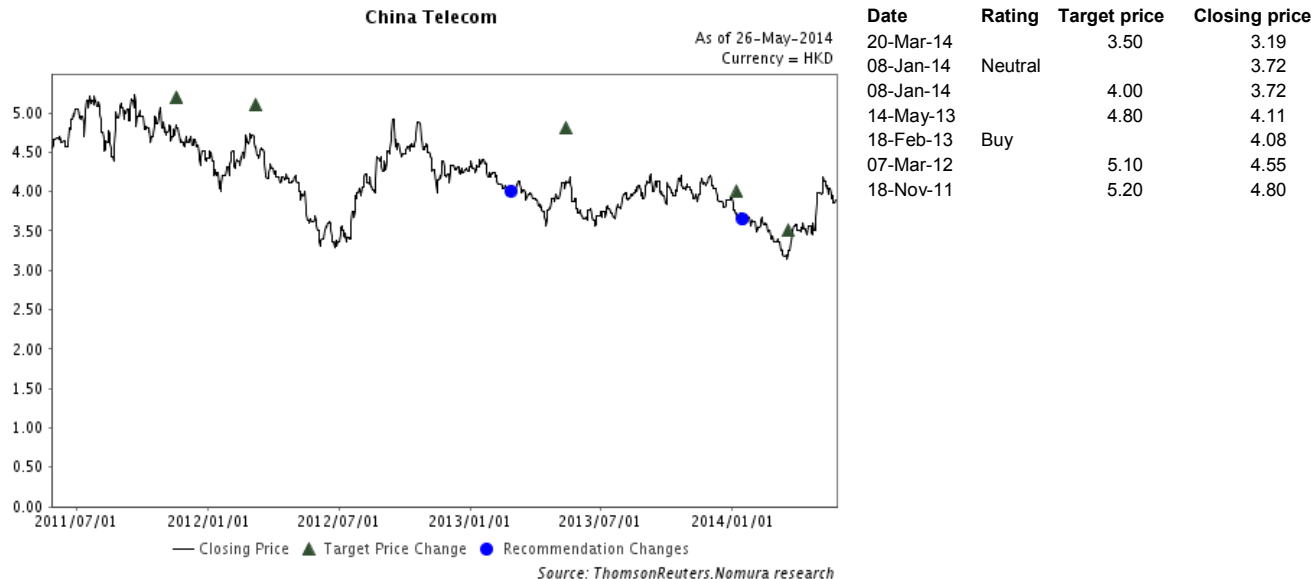
A6 The Nomura Group expects to receive or intends to seek compensation for investment banking services from the issuer in the next three months.

A10 The Nomura Group is a registered market maker in the securities / related derivatives of the issuer.

### China Telecom (728 HK)

HKD 3.90 (30-May-2014) Neutral (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

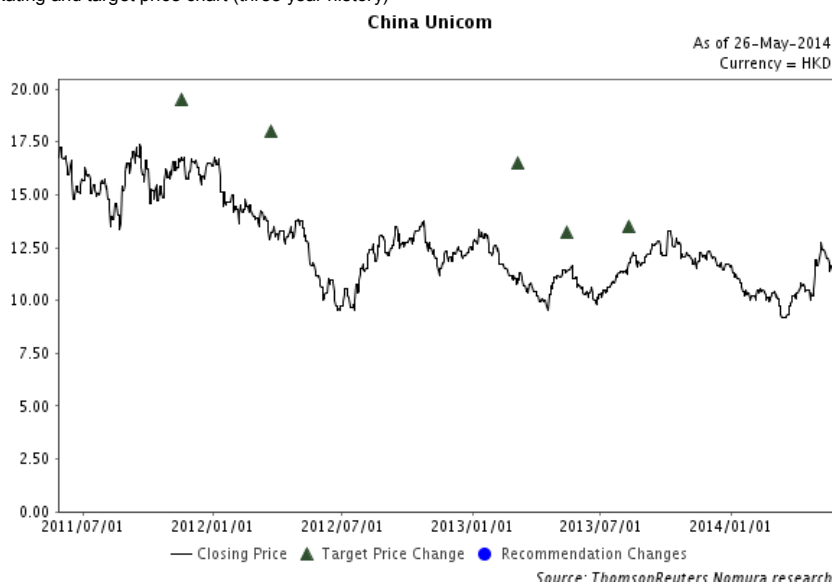
**Valuation Methodology** Our TP of HKD4 is based on 15.4x FY14F EPS of CNY0.21 (previously 12.5x). Our previous multiple was priced in the mid-range of CM's and CU's (11x and 15x), we now adjust the multiple more toward CM's new multiple of 14x to reflect CT's challenging outlook in the medium term. The valuation also implies 3.8x EV/EBTIDA, 0.9x FY14F BVPS, and 3% dividend yield. The benchmark index is MSCI China.

**Risks that may impede the achievement of the target price** Risk factors include: 1) irrational tariff and handset subsidy competition; and 2) rising capex for its 4G upgrade.



**China Unicom (762 HK)****HKD 11.60 (30-May-2014)** Buy (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
09-Aug-13		13.50	11.80
14-May-13		13.20	11.40
06-Mar-13		16.50	11.00
23-Mar-12		18.00	13.24
18-Nov-11		19.50	16.60

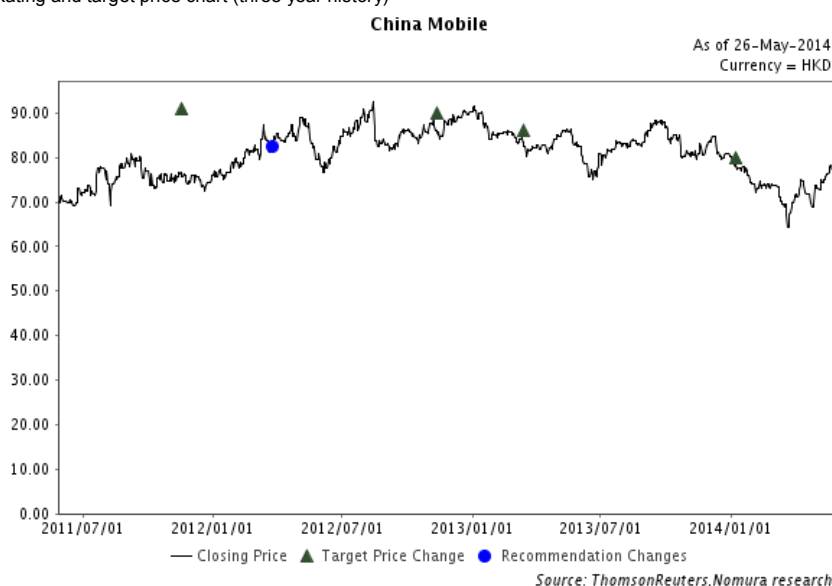
For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** Our HKD13.5 TP is based on 21x FY14F EPS of CNY0.51. The multiple is at the high end among regional integrated telcos (7.8-26.4x), reflecting CU's above average growth in earnings (21% in FY14F, vs 9.6% regional average). The valuation also implies 4.7x EV/EBITDA, 1.2x FY14F BVPS, and 1.6% dividend yield. The benchmark index for this stock is MSCI China.

**Risks that may impede the achievement of the target price** The major downside risks are irrational competition in handset subsidies and data tariffs.

**China Mobile (941 HK)****HKD 75.84 (30-May-2014)** Buy (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
08-Jan-14		80.00	78.45
14-Mar-13		86.00	83.35
12-Nov-12		90.00	85.65
16-Mar-12	Neutral		83.75
18-Nov-11		91.00	75.85

For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** Our TP of HKD90 is based on 14x FY14F EPS of CNY5.07 (previously 11x). The multiple expansion is a movement towards the regional wireless telco median of 19.8x, reflecting its long-term revenue reacceleration. Valuation also implies 5.8x EV/EBITDA, 1.7x FY14F BVPS of CNY42.11, and 3.1% dividend yield. The benchmark index is MSCI China.

**Risks that may impede the achievement of the target price** Risks to our investment view include the following: 1) irrational tariff and handset subsidy competition, which would hurt CM's EBITDA margin; and 2) faster-than-expected substitution between voice/SMS service and emerging OTT services such as WeChat.

## Rating and target price changes

Issuer	Ticker	Old stock rating	New stock rating	Old target price	New target price
China Telecom	728 HK	Neutral	Neutral	HKD 3.50	HKD 4.00
China Mobile	941 HK	Neutral	Buy	HKD 80.00	HKD 90.00

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#### STOCKS

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