

**Analyst: Kelvin Li**
**CHINA TELECOM CORPORATION LIMITED (中國電信)**

Sector	: Telecommunications	Chairman & CEO	: WANG Xiaochu
HKSE code	: 0728	President & COO	: LENG Rongquan
Market price	: HK\$4.88 (31/03/2008)		
HSI	: 22,849.20 (31/03/2008)		
H shares issued	: 13,877 million		
H-share mkt. cap.	: HK\$67,721.8 million		
52 weeks Hi/ Lo	: HK\$7.58 / HK\$3.48		

**SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31<sup>ST</sup> DECEMBER 2007**
**Final Results Highlights**

	FY2007	FY2006 (restated <sup>^</sup> )	Change
	RMB million	RMB million	
• Operating revenue	178,656	175,616	+1.7%
• Operating expenses	(141,645)	(137,080)	+3.3%
• Operating profit	37,011	38,536	-4.0%
• Deficit on revaluation of property, plant and equipment	(2,755)	-	N/A
• <b>Profit attributable to shareholders</b>	<b>23,702</b>	<b>27,241</b>	<b>-13.0%</b>
• <i>Upfront connection fees*</i>	3,294	4,971	-33.7%
• <i>Operating revenue (excluding upfront connection fee)</i>	175,362	170,645	+2.8%
• <i>Adjusted EBITDA (excluding upfront connection fee)</i>	85,974	84,866	+1.3%
• <b>Adjusted profit attributable to shareholders**</b>	<b>22,517</b>	<b>22,270</b>	<b>+1.1%</b>
• EPS – basic	RMB0.293	RMB0.337	-13.1%
• <i>Adjusted basic EPS**</i>	RMB0.278	RMB0.275	+1.1%
• DPS – final	HK\$0.085	HK\$0.085	+0.0%
• DPS – total	HK\$0.085	HK\$0.085	+0.0%

Remark: (\*) Effective July 2001, the Group ceased charging upfront connection fees from new subscribers. Upfront connection fees received before July 2001 was amortized over a period of 10 years. (^) The results of FY2006 were restated since the Group acquired on 15<sup>th</sup> June 2007 the entire equity interests in China Telecom System Integration Co., China Telecom (Hong Kong) International and China Telecom (USA) Corporation from its parent company.

(\*\*) China Telecom revaluates its property, plant and equipment once in every 3 years. For sake of like-for-like comparison, both revaluation deficit and upfront connection fees are excluded in the “adjusted” profit figures.

- China Telecom reported a 13.0% y-o-y drop in net profit to RMB23.7 billion for FY2007, dragged by its core voice business, a drop in upfront connection fee and a revaluation deficit from fixed assets. Excluding the one-off items (upfront connection fee and revaluation deficit), the adjusted net profit grew a mere 1.1% y-o-y to RMB22.5 billion in FY07, as robust growth in internet and VAS businesses was offset by the sluggish voice business.
- Operating revenue (excluding upfront connection fees) grew 2.8% y-o-y to RMB175.4 billion, driven by revenue growth in Internet and VAS businesses. Operating expenses was up 3.3% y-o-y to RMB141.6 billion last year, in line with the rise in rival China Netcom (HKEx: 0906), as the Mainland fixed-line operators strived to retain its clients via subsidy and greater marketing effort amid severe fixed line-to-mobile substitution. EBITDA (excluding upfront connection fees) increased 1.3% to RMB86.0 billion in FY07, while EBITDA margin was little changed at 49.0%, compared with 49.7% a year earlier.

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- EPS fell by 13.1% y-o-y to RMB0.293 (FY06: RMB0.337). A final dividend of HK\$0.085 was declared, unchanged from a year earlier.
- As of 31/12/2007, China Telecom had total debts of RMB105.2 billion (31/12/2006: RMB125.1 billion). With cash on hand of RMB20.6 billion (31/12/2006: RMB22.4 billion), the Group's net debt-to-shareholders' equity ratio eased to 38.3% as by the end of FY07 from 49.8% a year earlier.

### **Business highlights**

- Breakdown of turnover by activities

	FY2007		FY2006		Change
	RMB million	%	RMB million	%	
Upfront installation fees	2,735	1.5%	2,913	1.7%	-6.1%
Monthly fees	25,346	14.2%	28,973	16.5%	-12.5%
Local usage fees	42,343	23.7%	46,188	26.3%	-8.3%
Domestic long distance (DLD)	24,127	13.5%	25,517	14.5%	-5.4%
International long distance (ILD)	2,882	1.6%	3,225	1.8%	-10.6%
Interconnections	13,879	7.8%	14,095	8.0%	-1.5%
<b>Subtotal – Voice</b>	<b>111,312</b>	<b>62.3%</b>	<b>120,911</b>	<b>68.8%</b>	<b>-7.9%</b>
Internet	31,340	17.5%	23,724	13.5%	+32.1%
Managed data	3,013	1.7%	3,080	1.8%	-2.2%
Leased line	5,321	3.0%	4,548	2.6%	+17.0%
Value-added services (VAS)	19,231	10.8%	14,203	8.1%	+35.4%
Others	5,145	2.9%	4,179	2.4%	+23.1%
<b>Subtotal – Non-Voice</b>	<b>64,050</b>	<b>35.9%</b>	<b>49,734</b>	<b>28.3%</b>	<b>+28.8%</b>
Upfront connection fees	3,294	1.8%	4,971	2.8%	-33.7%
<b>Total</b>	<b>178,656</b>	<b>100.0%</b>	<b>175,616</b>	<b>100.0%</b>	<b>+1.7%</b>

- Revenue from **voice** services fell by 7.9% y-o-y to RMB111.3 billion in FY07, as the segment saw higher revenue drop of 9.0% in 2H07 y-o-y (1H07: -6.9%) amid severe mobile substitution. Local voice usage volume dropped 3.9% y-o-y to 406.27 billion pulses on a 1.2% y-o-y decrease in the number of access lines to 220.3 million.
- Dragged by a contracted customer base, China Telecom's long distance services also saw weak business performance last year. Revenue from domestic long distance (DLD) services slipped 5.4% y-o-y in FY07, despite a 2.8% y-o-y rise in usage. International long distance (ILD) services fell an even sharper 10.6% y-o-y in revenue in FY07 on a 0.8% y-o-y fall in usage. Results from both the Group's DLD and ILD operators showed that long distance service tariff was under serious pressure last year. Overall, the Group's voice ARPU fell 10.1% y-o-y to RMB41.8 in FY07 from RMB46.5 in FY06.
- Revenue from **non-voice** services increased a solid 28.8% y-o-y to RMB64.1 billion FY07, thanks to the robust Internet related business and VAS as well as the acquisition of several overseas units from the parent in June 2007. Internet access revenue grew a sharp 32.1% y-o-y to RMB31.3 billion, thanks to 25.9% y-o-y rise in broadband subscriber to 35.65 million as at the end of 2007. Broadband ARPU surged to RMB80 in FY07 from RMB77 a year earlier, adding further steam in the Group's Internet operation.
- Meanwhile, China Telecom's VAS kept outperforming and registered the strongest growth among different segments last year, with revenue up 35.4% y-o-y to RMB19.2 billion. Overall, revenue from non-voice businesses accounted for 35.9% of the Group's total in FY07, compared with 28.3% a year earlier (On exclusion of upfront connection fees – FY07: 36.5% & FY06: 29.1%).

**Outlook & Prospects**

- **Non-voice business to gain a higher weight in China Telecom** The non-voice business (Internet & VAS) segment has been China Telecom's key growth driver in recent years, which helped offset the sluggish momentum in the core voice operation. Thanks to the solid growth, the non-voice business is of greater importance in the Group's income structure, accounting for more than 35% in FY07 (FY06: 29%). Driven by stronger non-voice subscriber base and higher usage, management of China Telecom expects the non-voice segment to contribute at least half of the Group's total revenue by 2010. Meanwhile, management forecast China Telecom would add 8.5 million broadband subscribers in 2008 after a net addition of 7.3 million in 2007, lifting its broadband subscriber base to over 50 million by the end of this year.
- **Lower capex for 2008** China Telecom has been reducing capital expenditure over the last couple years amid cost saving on its battered fixed-line and PHS/PAS businesses. For 2008, China Telecom has earmarked a capex budget of RMB45 billion, down 1.2% from FY07. Excluding the RMB960 million capex spent on reconstruction due to snowstorm, the 2008 capex budget would be 3.3% lower than a year earlier.
- **PAS (Personal Access System) – a sunset business** The fall in subscriber base of the Group's wireless local access service or PAS has been accelerating due to rising client substitution to the two Mainland mobile operators on dropping tariff. China Telecom revealed that it would impose a "two stops" strategy on its PAS business – stop investing in PAS infrastructure and stop subsidising PAS customers. As such, we should see further and more apparent contraction in the PAS segment this year.
- **Continuing voice-subscriber base contraction in Jan-Feb 2008** China Telecom has been recording negative monthly local access line additions since August 2007, dragging its voice client base down in FY07. In Jan-Feb 2008, the Group posted an aggregate drop of 2.24 million local voice subscribers, bringing the subscriber base down to 218.1 million by the end of Feb 2008 from 220.3 million as at the end of 2007.
- **Disappointing broadband net subscriber addition so far in 2008** China Telecom added some 1.3 million broadband users in the first two months of 2008, with the reported figure similar to rival China Netcom. However, it was somehow disappointing given a much larger fixed-line client base of China Telecom (about 2x of that of China Netcom as at the end of 2007) and so a greater business expansion potential. The broadband net addition number in Jan-Feb 2008 might be partly affected by snowstorm in the Southern China. It has to pick up speed in order to meet the full-year net addition target of 8.5 million.
- **Acquiring Beijing Telecom** China Telecom announced along with its FY07 results that it would acquire Beijing Telecom from its parent for RMB5.56 billion. Net profit for Beijing Telecom amounted to RMB470 million, or about 2% of China Telecom's FY07 earnings. Therefore, we expect the acquisition to have limited earnings accretive impact on China Telecom in the near future.
- **Unexciting results with outlook bound to 3G development** Trading at 14.7x FY08E, valuation of China Telecom is slightly higher than rival China Netcom (HKEx: 0906)'s 13.8x forward P/E. Despite the severe mobile substitution on the Mainland and China Telecom's sluggish business performance, we give a "HOLD" recommendation on the counter, as its near-term share prices should be supported by the possible launch of 3G licenses and sector reshuffle in 2008.

**Recommendation: HOLD**



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