

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\$4.43 (28/08/2007)		
HSI	: 23,363.76 (28/08/2007)		
H shares issued	: 13,877 million		
H-share mkt. cap.	: HK\$61,476.9 million		
52 weeks Hi/ Lo	: HK\$5.05 / HK\$2.60		

SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30TH JUNE 2007
Interim Results Highlights

	1H2007	1H2006 (restated [^])	Change
	RMB million	RMB million	
• Operating revenue	88,624	87,345	+1.5%
• Operating expenses	(68,340)	(66,134)	+3.3%
• Operating profit	20,284	21,211	-4.4%
• Profit attributable to shareholders	13,482	14,155	-4.8%
• <i>Upfront connection fees*</i>	1,666	2,494	-33.2%
• <i>Operating revenue (excluding upfront connection fees)</i>	86,958	84,851	+2.5%
• <i>EBITDA (excluding upfront connection fees)</i>	44,551	44,211	+0.8%
• <i>Net profit (excluding upfront connection fees)</i>	11,816	11,661	+1.3%
• Basic EPS	RMB0.167	RMB0.175	-4.8%
• <i>Basic EPS (excl. upfront connection fees)</i>	RMB0.146	RMB0.144	+1.4%
• Interim DPS	-	-	N/A

Remark: (*) Effective from 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 first-half results of FY2006 were restated since the Group acquired on 15th 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 ("the Group") reported a 4.8% y-o-y drop in net profit to RMB13.5 billion for the six months ended 30th June 2007, amid a drop in upfront connection fee and weakened earnings from its core voice business. Excluding upfront connection fees, net profit grew a mere 1.3% y-o-y to RMB11.8 billion in 1H07, as the robust growth of the Group's internet and VAS businesses helped offset the sluggish voice business. EPS (excluding upfront connection fees) rose 1.4% y-o-y to RMB0.146 (1H06 EPS: RMB0.144). No interim dividend was declared (1H06 DPS: Nil).
- Operating revenue (excluding upfront connection fees) grew 2.5% y-o-y to RMB87.0 billion, driven by revenue growth in Internet and VAS businesses. For 1H07, operating expenses was up 3.3% y-o-y to RMB68.3 billion, with interconnection & other costs up by a sharp 11.9%, partly due to higher inter-network traffic amid mobile substitution on the Mainland. EBITDA (excluding upfront connection fees) increased slightly to RMB44.6 billion in 1H07, up 0.8% y-o-y, while EBITDA margin dipped 0.9 percentage point to 51.2% from 52.1% a year earlier.
- As of 30/06/2007, the Group had a total debt of RMB113.8 billion (31/12/2006: RMB125.1 billion). Along with a cash on hand of RMB17.0 billion, the Group's net debt-to-shareholders' equity ratio eased to 46.7% as by the end of 1H07 from 49.8% as at 31/12/2006.

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Business highlights

- Breakdown of turnover by activities

	1H2007		1H2006		Change
	RMB million	%	RMB million	%	
Upfront installation fees	1,411	1.6%	1,458	1.7%	-3.2%
Monthly fees	13,284	15.0%	14,936	17.1%	-11.1%
Local usage fees	21,558	24.3%	23,378	26.8%	-7.8%
Domestic long distance (DLD)	12,194	13.8%	12,889	14.8%	-5.4%
International long distance (ILD)	1,464	1.7%	1,610	1.8%	-9.1%
Interconnections	7,086	8.0%	6,975	8.0%	+1.6%
Subtotal – Voice	56,997	64.3%	61,246	70.1%	-6.9%
Internet	14,641	16.5%	11,198	12.8%	+30.7%
Managed data	1,528	1.7%	1,496	1.7%	+2.1%
Leased line	2,521	2.8%	2,183	2.5%	+15.5%
Value-added services (VAS)	9,115	10.3%	6,805	7.8%	+33.9%
Others	2,156	2.4%	1,923	2.2%	+12.1%
Subtotal – Non-Voice	29,961	33.8%	23,605	27.0%	+26.9%
Upfront connection fees	1,666	1.9%	2,494	2.9%	-33.2%
Total	88,624	100.0%	87,345	100.0%	+1.5%

- Revenue from **voice** services fell by 6.9% y-o-y to RMB57.0 billion in 1H07, due to rising competition from mobile carriers depressing usage and tariff. In 1H07, local voice usage volume dropped 5.2% y-o-y to 202.52 billion pulses, despite a slight increase of 0.7% h-o-h in the number of access lines to 224.5 million. Meanwhile, business performance of the Group's long distance services remained weak during the first half. Revenue from domestic long distance (DLD) services slipped 5.4% y-o-y in 1H07, accelerating from a 1.8% fall in FY06. International long distance (ILD) services fell an even sharper 9.1% y-o-y in revenue in 1H07, compared with a 7.8% fall for FY2006. In fact, the usage of DLD and ILD grew 3.1% and dipped 1.0% y-o-y, respectively in 1H07, which implied the Group experienced serious pressure on long distance service tariff during the first half. Overall, the Group's voice ARPU fell 10.7% y-o-y to RMB42.5 in 1H07 from RMB47.6 a year earlier, compared with RMB46.5 in FY06.
- Revenue from **non-voice** services rose a solid 26.9% y-o-y to RMB30.0 billion 1H07, thanks to rich contribution from Internet related business and VAS. Growth momentum in Internet access revenue stayed intact in 1H07, up 30.7% y-o-y to RMB14.6 billion, amid a 27.4% y-o-y and 13.7% h-o-h rise in broadband subscriber to 32.2 million at end of June 2007. Broadband ARPU stabilized from a downward trend during the last couple of years, up from RMB78 in 1H06 and RMB76 in 2H06 to RMB79 in 1H07. Meanwhile, VAS registered the strongest growth among different segments during 1H07, with revenue up 33.9% y-o-y to RMB9.1 billion. Overall, revenue from non-voice businesses accounted for 33.8% of the Group's total in 1H07, compared with 27.0% a year earlier (1H07: 34.5% & 1H06: 27.8% on exclusion of upfront connection fees).

Outlook & Prospects

- Further drop in client base seen in 2H07** The first half of 2007 was proved to be a hard time for Mainland fixed line carriers, as mobile carriers' rural expansion and launch of quasi-Caller Party Pay (CPP) tariff plan speeded up mobile substitution, creating unprecedented pressure on China Telecom's voice business. The Group revealed that it would focus on high-end customers and let go those price-sensitive and low-end users in order to save its profit margins. Thus, we expect China Telecom's subscriber base and growth momentum would further weaken in the second half.
- Sluggish results, sluggish outlook** Trading at 14.8x FY07E, valuation of China Telecom is not attractive, compared with peer China Netcom (HKEx: 0906)'s 11.5x forward P/E. In fact, China Netcom's first-half results were more or less the same, struggling to transform their business model amid severe mobile substitution. Accordingly, we recommend a "Sell" on China Telecom as we still prefer the Mainland mobile sector.

Recommendation: SELL



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