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HONG KONG RESEARCH
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Analyst: Kelvin Li

CHINA UNICOM LIMITED (中國聯通)

Sector	:	Telecommunications
HKSE Code	:	0762
Market Price	:	HK$17.54 (27/03/2008)
HSI	:	22,664.22 (27/03/2008)
Shares Issued	:	13,653.03 million
Mkt. Cap.	:	HK$239,474.2 million
52 weeks Hi/ Lo	:	HK$20.25 / HK$10.04

Chairman & CEO : CHANG Xiaobing

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2007

Final Results Highlights

	FY2007	**FY2006** *(restated^)*	
	RMB million	RMB million	*Change*
• Total service revenue	94,639	91,094	*+3.9%*
• Total operating revenue	99,539	95,347	*+4.4%*
• *Adjusted EBITDA**	33,005	32,023	*+3.1%*
• **Attributable profit to shareholders**	**9,300**	**3,801**	***+144.7%***
• *Adjusted attributable profit to shareholders**	*7,088*	*6,198*	*+14.4%*
• **EPS – basic**	RMB0.713	RMB0.302	*+136.1%*
• *Adjusted EPS**	RMB0.544	RMB0.492	*+10.6%*
• DPS – final	RMB0.200	RMB0.180	*+11.1%*
• DPS – total	RMB0.200	RMB0.180	*+11.1%*

***Remarks**: **(*)** On 5th July 06, the Group issued a zero-couple convertible bond (CB) to SK Telecom with a principal amount of US$1 billion. SK Telecom converted the CB into 899.7million Unicom shares, enlarging the capital by 6.7%. Losses on change in fair value of derivative component of the CB amounted to RMB567million was booked in FY2007 (FY2006: RMB2.396 billion). As these loss items did not affect Unicom's cash flow, they were excluded in the "adjusted" figures for the sake of like-for-like comparison. Besides, there was a tax refund on reinvestment in a subsidiary of RMB2.78 billion recorded in FY07. As it was a one-off item, the tax refund was also excluded in the adjusted profit figure. **(^)** The FY07 results included the cellular business in Guizhou province, which was acquired in Dec 2007. The FY06 results were restated accordingly, pursuant to HKFRS.*

- China Unicom reported a 144.7% y-o-y jump in net profit to RMB9.3 billion in FY07, thanks to a lower realized/unrealized loss from fair value change of the derivative component of the convertible bonds (CB) issued to SK Telecom, a tax refund related to reinvestment in a subsidiary and higher foreign exchange gain. Excluding the non-cash losses from CB fair value change and the one-off tax refund item, China Unicom's bottom line would have grown by 14.4% y-o-y to RMB7.1 billion, slightly below market expectations.

- Total operating revenue rose by 4.4% to RMB99.5 billion, while service revenue (excluding sales of telecom products like handsets) increased 3.9% to RMB94.6 billion. GSM business and fixed-line operations (data, Internet & long distance calls) continued to support service revenue growth of China Unicom, offsetting a fall in the CDMA contribution. Operating expenses rose 3.7%, in line with the Group's top-line growth. Adjusted EBITDA of China Unicom surged 3.1% to RMB33.0 billion, while EBITDA margin inched down to 33.2% from 33.6% a year earlier.

- EPS for FY07 was RMB0.713, or RMB0.544 if the CB related loss and the one-off tax refund were excluded. A final dividend of RMB0.20 per share was proposed, up from RMB0.18 a year earlier.

- As of 31/12/2007, China Unicom carried a total debt of RMB3.9 billion (31/12/2006: RMB25.6 billion). With a cash on hand of RMB7.3 billion (31/12/2006: RMB12.4 billion), the Group was in a net cash position of RMB3.5 billion by the end of FY07, compared with a net debt of RMB13.2 billion a year earlier.

Business highlights

- Breakdown of revenue (including Guizhou province) by activities

	FY2007		FY2006		
(RMB million)		%	*(restated)*	%	*Change*
GSM	62,775	63.1%	59,882	62.8%	*+4.8%*
CDMA	27,730	27.9%	27,876	29.2%	*-0.5%*
Data & Internet	2,626	2.6%	2,320	2.4%	*+13.2%*
Long Distance	1,508	1.5%	1,015	1.1%	*+48.6%*
Total service revenue	*94,639*	*95.1%*	*91,094*	*95.5%*	*+3.9%*
Sales of telecom products	4,900	4.9%	4,254	4.5%	*+15.2%*
Total	**99,539**	**100.0%**	**95,347**	**100.0%**	***+4.4%***

- Revenue from the **GSM Cellular Business** segment grew 4.8% to RMB62.8 billion in FY07, representing 63.1% (FY06: 62.8%) of the Group's total revenue. As of 31/12/2007, the number of subscribers of China Unicom's GSM business totalled 120.56 million, up 12.7% from a year earlier. Minutes of usage (MOU) per GSM user per month surged 5.2% y-o-y to 250.1, driven by dropping tariff, while the GSM ARPU slipped 6.5% y-o-y to RMB46. GSM value-added services (VAS) generated revenue of RMB13.5 billion, up 16.6% y-o-y, thanks to rising VAS usage. Overall, the segment reported a 4.4% y-o-y rise in EBITDA to RMB27.9 billion in FY07, while EBITDA margin dipped further to 44.5% from 44.6% a year earlier.

- The **CDMA Cellular Business** reported a 0.5% drop in revenue to RMB27.7 billion in FY07, dragged by a fall in average MOU and lower ARPU. Despite robust rise in VAS revenue, the segment's ARPU slashed to RMB58.1 in FY07, down 11.7% y-o-y, as China Unicom kept losing its pricing power in CDMA business. Both usage fee income and monthly fee income of the CDMA operation saw significant drop last year, offsetting a 12.4% y-o-y rise in the number of CDMA subscribers to 41.93 million by the end of 2007. Thanks to continued cost-control effort, the CDMA segment reported an EBITDA of RMB10.3 billion in FY07, up a mild 1.1% y-o-y, while EBITDA margin was little changed at 31.3%, compared with 31.4% a year earlier.

- **Wireless Value-Added Services (WVAS)** reported revenue of RMB20.3 billion in FY07, up 19.4% y-o-y, accounting for more than one-fifth of the Group's total revenue. **Long Distance, Data and Internet Businesses** reported external revenue of RMB4.1 billion in FY07, up 23.9% y-o-y on rising long-distance calls from international destinations and growing broadband usage.

Outlook & Prospects

- ***Profit margin stabilized but still much lower than China Mobile*** Owing to intense competition from bigger rival China Mobile, China Unicom's mobile ARPU dropped (GSM: -6.5%, CDMA: -11.7%) in FY07, compared with a 1% fall in that of China Mobile during the same period. As s result, China Unicom's EBITDA margin (FY07: 33.2%) stood at a much lower level than that of China Mobile (FY07: 54.3%).

- ***Sustained subscriber growth in Jan-Feb 2008*** China Unicom's subscriber growth was stable during the Jan-Feb 2008. For GSM, it added 1.125 million and 1.212 million subscribers in Jan and Feb, respectively, to a total of 122.9 million by the end of Feb 2008. For CDMA, it added 303k and 278k in Jan and Feb, respectively, to a total of 42.5 million. Subscriber growth stayed healthy during the first two months this year, but the pace still lagged behind rival China Mobile.

- ***Focusing efforts in GSM expansion*** China Unicom has set a capital expenditure budget of RMB30.95 billion in FY08, up 20.3% from last year. 60% (FY06: 64.1%) of which or RMB18.7 billion would be allocated to the GSM segment, up 13.4% from FY07.

- ***No definite business strategy for CDMA in 2008*** China Unicom has set out clear business strategy for its GSM operations, including the expansion of its "*WorldWind 156*" brand, strengthening the marketing activities of "*U Power*" and "*Ruyi Tong*" services and rural market expansion. Nonetheless, the Group seemed to have no definite strategy for its CDMA segment, claiming it would increase marketing efforts and strive to retain its mid-to-high-end customers.

- ***Outlook remains challenging*** The Group saw decent subscriber growth in FY07, but it was somehow offset by intense rivalry in the Mainland mobile sector. The adjusted bottom-line growth (excluding CB fair value change and tax refund) of 14.4% was disappointing, as it slowed down apparently from a 34.7% rise in the first half. Profit margins are expected to stay under pressure in 2008, due to competition from China Mobile and dropping market share. Trading at 23x FY08E P/E, we prefer China Mobile to China Unicom, given a less-demanding valuation (18x FY08E P/E), a stronger market position and better competitive edge. Accordingly, we give China Unicom a "SELL" recommendation, versus a "BUY" on China Mobile (HKEx: 0941)

Recommendation: SELL (prefer China Mobile)

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