



Rating  
**Sell**

Asia  
China

Telecommunications  
Telecommunications

Company  
**Dr. Peng Group**

Reuters 600804.SS    Bloomberg 600804.CH    Exchange SHH    Ticker 600804

Date  
29 August 2017

## Forecast Change

Price at 28 Aug 2017 (CNY)	17.87
Price target - 12mth (CNY)	15.00
52-week range (CNY)	23.90 - 16.14
Shanghai Composite	3,363

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## Costs were lower but so was the topline

### Current price not factoring in the significant slowdown

Dr. Peng continues to see pressure in its core broadband business with broadband access revenue down 6% and its net adds slowing to ~100k in 2Q17, the lowest rate in the past 4-5 years. Meanwhile, gross margin and ARPU continue to decline and the business had to cut its opex by 10% in order to deliver a more respectable 3% decline in net profit. Capex slowed sharply in 1H17 and while this is a prudent move, future growth might also slow. With the shares trading on 33x FY17 EPS, this slower future growth does not seem to be factored in; retaining Sell.

### Quarterly data show a deteriorating trend

2Q17 revenue declined 5% while gross profit fell 17%, a deterioration vs. the trends seen in 1Q17. The company cut its 2Q sales and marketing expense by 23% and management expense by 18% in order to deliver a flat profit but this clearly had an impact on customer acquisition with net adds reducing to 100k in the quarter (vs. an average of 700k in the past 2 years). With Dr. Peng's broadband ARPU at RMB42/m, still significantly higher than China Mobile at RMB35/m, and given limited bundling offerings to differentiate its offerings, we think Dr. Peng's business model continues to be challenged. Capex did decline to RMB1.2bn in 1H17 from an average of RMB1.9bn in the previous four halves, but the pace of its network rollout also slowed, adding only 2m households in coverage in the half.

### Earnings changes

We have reduced our earnings forecasts in line with the lower-than-expected 1H17 results. We have removed the equity raising, which increased the EPS.

### Valuation and risks

We value Dr. Peng based on the mid-point of our peer-based valuation and DCF. Risks relate to market share, tax rate, regulation, and margins.

### Key changes

TP	16.00 to 15.00	↓	-6.2%
Sales (FYE)	9,977 to 8,884	↓	-11.0%
Op prof margin (FYE)	10.1 to 11.3	↑	11.6%
Net profit (FYE)	869.7 to 776.0	↓	-10.8%

Source: Deutsche Bank

### Price/price relative



Performance (%)	1m	3m	12m
Absolute	5.8	5.5	-16.2
Shanghai Composite	3.3	8.1	9.5

Source: Deutsche Bank

### Forecasts And Ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	7,925.9	8,849.7	8,883.9	9,748.3	11,412.8
EBITDA (CNYm)	2,365.7	2,879.2	3,235.5	3,645.5	4,076.9
Reported NPAT (CNYm)	716.6	766.6	776.0	882.1	1,018.9
DB EPS FD(CNY)	0.52	0.56	0.54	0.61	0.70
% Change	0.0%	0.0%	-4.3%	3.0%	7.5%
DB EPS growth (%)	34.9	7.7	-3.3	13.2	14.5
PER (x)	52.3	35.8	32.6	28.8	25.1
EV/EBITDA (x)	15.3	9.2	6.6	5.7	4.5
DPS (net) (CNY)	0.16	0.17	0.16	0.18	0.46
Yield (net) (%)	0.6	0.8	0.9	1.0	2.6

Source: Deutsche Bank estimates, company data

<sup>1</sup> DB EPS is fully diluted and excludes non-recurring items

<sup>2</sup> Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except PIB which uses the year end close



Model updated: 29 August 2017

Running the numbers

Asia  
China  
Telecommunications

Dr. Peng Group

Reuters: 600804.SS Bloomberg: 600804.CH

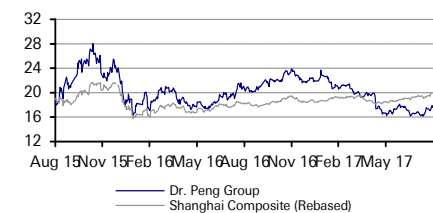
Sell

Price (28 Aug 17) CNY 17.87  
Target Price CNY 15.00  
52 Week range CNY 16.14 - 23.90  
Market Cap (m) CNYm 25,091  
USDm 3,778

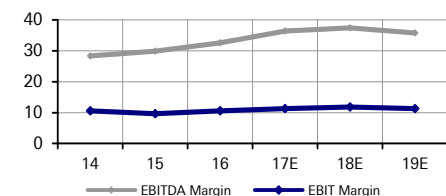
Company Profile

Dr. Peng Group is China's largest non-state owned telecom operator providing last mile broadband connections to retail and business customers, cloud and IDC solutions as well as OTT media boxes. Its subsidiary brands include Great Wall Broadband Network and Beijing Teletron Telecom. It also has a few small overseas subsidiaries which provide broadband and other value add services.

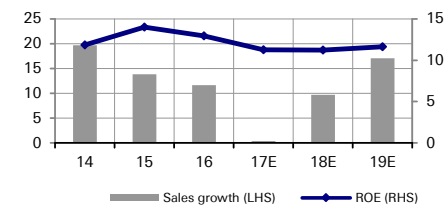
Price Performance



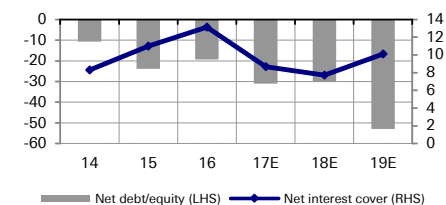
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2014	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	0.38	0.52	0.56	0.54	0.61	0.70
Reported EPS (CNY)	0.38	0.51	0.54	0.54	0.61	0.70
DPS (CNY)	0.12	0.16	0.17	0.16	0.18	0.46
BVPS (CNY)	3.4	3.9	4.5	5.2	5.7	6.4
Weighted average shares (m)	1,389	1,396	1,414	1,426	1,442	1,455
Average market cap (CNYm)	21,129	37,918	28,262	25,091	25,091	25,091
Enterprise value (CNYm)	20,164	36,109	26,537	21,216	20,841	18,158

Valuation Metrics

P/E (DB) (x)	39.6	52.3	35.8	32.6	28.8	25.1
P/E (Reported) (x)	39.6	52.9	36.9	32.3	28.8	25.1
P/BV (x)	5.21	5.97	4.88	3.39	3.07	2.77
FCF Yield (%)	3.8	3.1	2.1	7.9	1.7	10.3
Dividend Yield (%)	0.8	0.6	0.8	0.9	1.0	2.6
EV/Sales (x)	2.9	4.6	3.0	2.4	2.1	1.6
EV/EBITDA (x)	10.2	15.3	9.2	6.6	5.7	4.5
EV/EBIT (x)	27.3	47.2	28.3	21.1	18.1	14.1

Income Statement (CNYm)

Sales revenue	6,963	7,926	8,850	8,884	9,748	11,413
Gross profit	5,367	6,290	7,025	6,813	7,475	8,558
EBITDA	1,974	2,366	2,879	3,236	3,645	4,077
Depreciation	1,221	1,588	1,923	2,211	2,477	2,769
Amortisation	14	12	19	20	16	16
EBIT	739	765	938	1,004	1,153	1,292
Net interest income/(expense)	-89	-70	-71	-116	-150	-128
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinary	0	0	0	0	0	0
Other pre-tax income/(expense)	21	104	60	15	30	30
Profit before tax	671	799	927	904	1,033	1,194
Income tax expense	138	81	168	132	155	179
Minorities	0	1	-8	-4	-4	-4
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	534	717	767	776	882	1,019
DB adjustments (including dilution)	0	8	23	-6	0	0
DB Net profit	534	724	790	770	882	1,019

Cash Flow (CNYm)

Cash flow from operations	3,831	4,658	4,139	4,462	3,170	5,501
Net Capex	-3,024	-3,489	-3,542	-2,480	-2,730	-2,853
Free cash flow	806	1,170	597	1,982	440	2,648
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-244	-278	-339	-109	-235	-266
Net inc/(dec) in borrowings	0	-1	-3	2,993	0	0
Other investing/financing cash flows	-122	-384	-34	-873	0	0
Net cash flow	441	507	221	3,993	205	2,383
Change in working capital	0	0	0	0	0	0

Balance Sheet (CNYm)

Cash and other liquid assets	1,903	2,719	2,630	6,623	6,829	9,211
Tangible fixed assets	8,198	10,217	11,518	11,514	11,761	11,839
Goodwill/intangible assets	2,258	2,276	2,364	2,395	2,395	2,395
Associates/investments	501	539	532	1,588	1,758	2,058
Other assets	2,488	2,838	3,464	3,648	4,032	4,721
Total assets	15,347	18,590	20,508	25,768	26,774	30,224
Interest bearing debt	1,392	1,395	1,399	4,304	4,304	4,304
Other liabilities	9,177	11,644	12,721	13,989	14,147	16,643
Total liabilities	10,570	13,039	14,120	18,292	18,451	20,947
Shareholders' equity	4,731	5,497	6,349	7,443	8,290	9,244
Minorities	47	54	39	33	33	33
Total shareholders' equity	4,778	5,551	6,388	7,476	8,323	9,277
Net debt	-510	-1,324	-1,231	-2,320	-2,525	-4,908

Key Company Metrics

Sales growth (%)	19.7	13.8	11.7	0.4	9.7	17.1
DB EPS growth (%)	29.8	34.9	7.7	-3.3	13.2	14.5
EBITDA Margin (%)	28.3	29.8	32.5	36.4	37.4	35.7
EBIT Margin (%)	10.6	9.7	10.6	11.3	11.8	11.3
Payout ratio (%)	31.2	31.2	30.4	30.0	30.0	65.9
ROE (%)	11.8	14.0	12.9	11.3	11.2	11.6
Capex/sales (%)	43.9	47.0	43.8	28.2	28.0	25.0
Capex/depreciation (x)	2.5	2.3	2.0	1.1	1.1	1.0
Net debt/equity (%)	-10.7	-23.9	-19.3	-31.0	-30.3	-52.9
Net interest cover (x)	8.3	11.0	13.1	8.7	7.7	10.1

Source: Company data, Deutsche Bank estimates



Figure 1: Half-yearly P&L forecasts

Dr Peng Telecom		600804.SS	Analyst	James Wang	+852 2203 6145	james-z.wang@db.com		
<b>Capitalization Summary</b>								
Share Price (\$)	17.87							
Target price (\$)	15.00				1,414			
Upside	-16%				25,266			
Horizon	12 months				EV (RMBm)	23,942		
Rationale	DCF & SoTP							
<b>Income Statement (Y.E. Dec) RMBm</b>								
	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>	<b>1H16</b>	<b>2H16</b>	<b>1H17</b>	<b>2H17F</b>
Revenue	8,850	8,884	9,748	11,413	4,385	4,465	4,250	4,634
Change	11.7%	0.4%	9.7%	17.1%	17.6%	6.3%	-3.1%	3.8%
of which: broadband access	7,467	7,247	7,730	9,006	3,726	3,741	3,504	3,742
Change	8.9%	-2.9%	6.7%	16.5%	15.2%	3.3%	-5.9%	0.0%
of which: internet value add services	1,223	1,433	1,791	2,149	594	630	646	787
Change	34.0%	17.1%	25.0%	20.0%	40.9%	28.1%	8.8%	25.0%
Gross profit	5,084	4,582	4,982	5,773	2,560	2,523	2,198	2,385
Gross profit margin	57%	52%	51%	51%	58%	57%	52%	51%
Opex	(5,971)	(5,648)	(6,103)	(7,336)	(2,960)	(3,011)	(2,674)	(2,974)
Change	7.4%	-5.4%	8.0%	20.2%	15.8%	0.2%	-9.6%	-1.2%
<b>EBITDA</b>	<b>2,879</b>	<b>3,236</b>	<b>3,645</b>	<b>4,077</b>	<b>1,425</b>	<b>1,454</b>	<b>1,575</b>	<b>1,660</b>
Change	21.7%	12.4%	12.7%	11.8%	21.7%	21.7%	10.6%	14.2%
EBITDA margin	33%	36%	37%	36%	32%	33%	37%	36%
Other operating income	60	15	30	30	12	48	(0)	15
D&A	(1,941)	(2,231)	(2,493)	(2,785)	(935)	(1,006)	(1,088)	(1,143)
<b>EBIT</b>	<b>998</b>	<b>1,019</b>	<b>1,183</b>	<b>1,322</b>	<b>502</b>	<b>496</b>	<b>487</b>	<b>533</b>
Change	15%	2%	16%	12%	-3.1%	41.5%	-3.0%	7.3%
EBIT margin	11%	11%	12%	12%	11%	11%	11%	11%
Net interest expense	(71)	(116)	(150)	(128)	(32)	(39)	(34)	(81)
Profit before tax	927	904	1,033	1,194	470	457	452	451
Tax	(168)	(132)	(155)	(179)	(68)	(100)	(64)	(68)
Tax rate	18%	15%	15%	15%	14%	22%	14%	15%
Profit after tax	759	772	878	1,015	402	357	389	383
Non-controlling interests	8	4	4	4	2	5	2	2
<b>Net profit</b>	<b>767</b>	<b>776</b>	<b>882</b>	<b>1,019</b>	<b>404</b>	<b>362</b>	<b>391</b>	<b>385</b>
Change	7%	1%	14%	16%	-3.3%	21.4%	-3.4%	6.3%
EPS	0.54	0.54	0.61	0.70	0.29	0.26	0.27	0.27
DPS	0.17	0.16	0.18	0.21				
Payout ratio	30%	30%	30%	30%				
<b>Key drivers</b>								
	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>	<b>1H16</b>	<b>2H16</b>	<b>1H17</b>	<b>2H17F</b>
Subscribers	13.6	14.8	17.8	21.4	11.8	13.6	14.1	14.8
Change	36%	9%	20%	20%	31%	36%	19%	9%
ARPU	53	43	40	38	57	49	42	43
Change	-17%	-19%	-7%	-3%	-10%	-23%	-20%	-12%
Broadband coverage (m)	108	116	130	144	97	108	110	116
Penetration of coverage area	13%	13%	14%	15%	12%	13%	13%	13%
<b>Balance Sheet</b>								
	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>				
Cash	2,630	6,623	6,829	9,211				
Gross debt	1,399	4,304	4,304	4,304				
Net debt	(1,231)	(2,320)	(2,525)	(4,908)				
Net debt to EBITDA	-0.4	-0.7	-0.7	-1.2				
Total assets	20,508	25,768	26,774	30,224				
Shareholders' equity	6,349	7,443	8,290	9,244				
<b>Return Information</b>								
	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>				
ROIC	9.9%	6.6%	7.0%	7.5%				
ROA	3.7%	3.0%	3.3%	3.4%				
ROTE	18.5%	14.8%	14.5%	14.5%				
ROE	12.1%	10.4%	10.6%	11.0%				
Capex/revenue	44%	28%	28%	25%				
<b>Cashflow</b>								
	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>				
Operating cash flow	4,139	4,462	3,170	5,501				
Capex	-3,876	-2,507	-2,730	-2,853				
Free cash flow (post capex)	263	1,955	440	2,648				
FCF yield	1.0%	7.6%	1.7%	10.2%				
<b>Valuation &amp; Leverage Metrics</b>								
	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>				
P/E	32.8	32.8	29.2	25.5				
FCF yield (post minority div and perpetual)	1.0%	7.6%	1.7%	10.2%				
DY	0.9%	0.9%	1.0%	1.2%				
EV/EBITDA	8.3	7.2	6.4	5.2				
P/BV	3.98	3.45	3.12	2.82				
Payout ratio	30%	30%	30%	30%				
Net debt/equity	-19%	-31%	-30%	-53%				
Net debt/EBITDA	-0.4	-0.7	-0.7	-1.2				

Source: Deutsche Bank, Company Data



# Earnings changes

We have reduced our earnings forecasts to reflect the weaker-than-expected 1H17 result. Our EPS forecasts have increased as we removed the equity raising, which has yet to take place and hence is uncertain.

Figure 2: Earnings changes

	Earnings (RMBm)			Basic EPS (RMB)			DPS (RMB)			EBITDA (RMBm)		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
FY16	767	767	0.0%	0.54	0.54	0.0%	0.17	0.17	0.0%	2,879	2,879	0.0%
FY17F	870	776	-10.8%	0.56	0.54	-3.6%	0.17	0.16	-3.6%	3,292	3,236	-1.7%
FY18F	992	882	-11.1%	0.59	0.61	3.0%	0.18	0.18	3.0%	3,726	3,645	-2.2%

Source: Deutsche Bank estimates, Company Data

The key drivers of our forecasts are shown below.

Figure 3: Key drivers

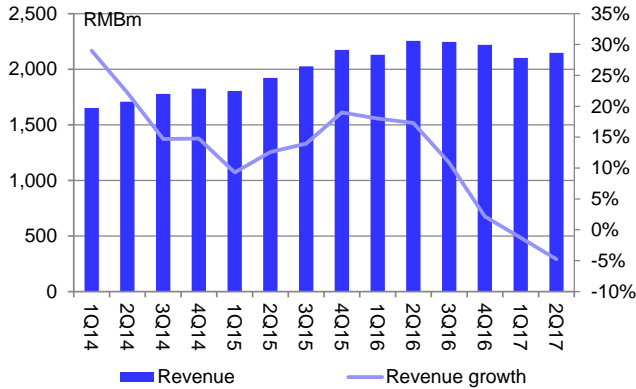
	1H17	2H17F	FY16	FY17F	FY18F	FY19F
<b>Revenue</b>						
Broadband access	-6%	0%	9%	-3%	7%	17%
Value add services	9%	25%	34%	17%	25%	20%
Overall growth	-3%	4%	12%	0%	10%	17%
<b>Cost</b>						
COGS growth	12%	16%	16%	14%	11%	18%
Opex growth	-10%	-1%	7%	-5%	8%	20%
COGS as % of revenue	48%	49%	43%	48%	49%	49%
Opex as % of revenue	63%	64%	67%	64%	63%	64%
<b>Profitability</b>						
EBITDA growth	11%	14%	22%	12%	13%	12%
EBITDA margin	37%	36%	33%	36%	37%	36%
Net profit growth	-3%	6%	7%	1%	14%	16%
Net profit margin	9%	8%	9%	9%	9%	9%
<b>Balance sheet</b>						
Capex as % of revenue			44%	28%	28%	25%
Free cash flow in RMBbn			263	1,955	440	2,648
<b>Returns</b>						
DPS (RMB)			0.17	0.16	0.18	0.21
ROE			12.9%	11.3%	11.2%	11.6%

Source: Deutsche Bank estimates, Company data



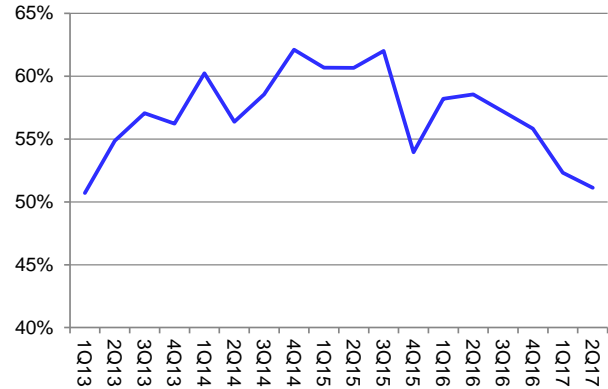
# Key charts

Figure 4: Revenue growth



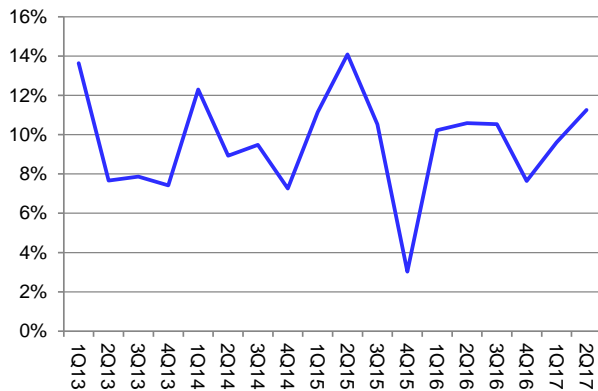
Source: Deutsche Bank, Company data

Figure 5: Gross profit margin



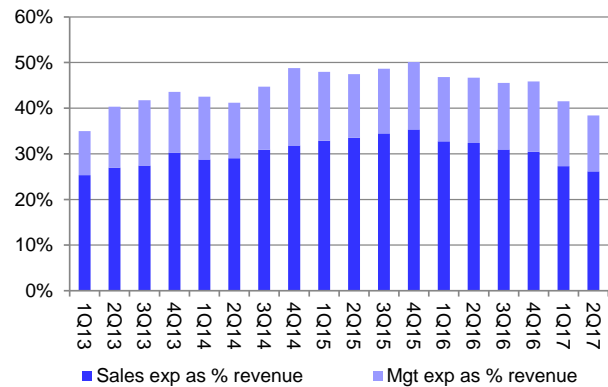
Source: Deutsche Bank, Company data

Figure 6: Operating profit margin



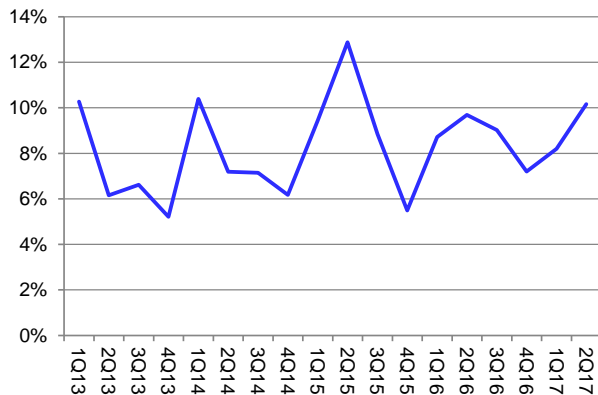
Source: Deutsche Bank, Company data

Figure 7: Sales and marketing expenses



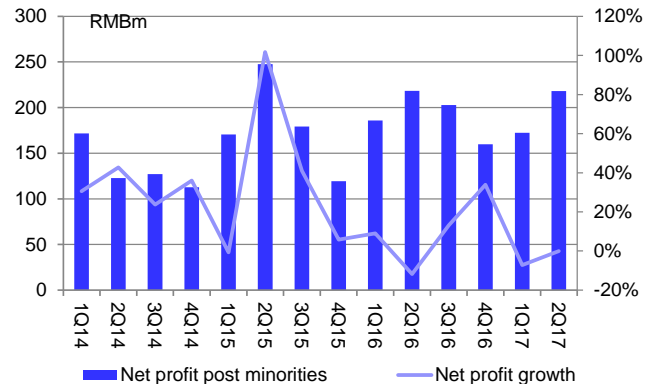
Source: Deutsche Bank, Company data

Figure 8: Net profit margin



Source: Deutsche Bank, Company data

Figure 9: Net profit growth



Source: Deutsche Bank, Company data



# Valuation and risks

We value Dr. Peng based on the mid-point of our peer-based valuation and DCF (WACC of 7.7% and a terminal growth rate of 1% to reflect market share gains, given its smaller size). Our peer-based valuation is based on the average multiples of Dr. Peng's domestic and international peers, adjusted to account for its growth outlook and capex profile.

We have reduced our target price to RMB15/share due to the earnings reduction partially offset by lower capex.

Figure 10: Valuation

	Combined valuation	Implied FY17 PE
Peer based valuation	13	23.9
DCF valuation	17	31.2
<b>Target price</b>	<b>15</b>	<b>27.6</b>

Source: Deutsche Bank estimates

Figure 11: Peer-based valuation

	EV/EBITDA	PE	Average
China Telecom	3.3	13.2	
TPG Telecom	7.7	12.0	
Vocus	6.6	10.5	
Iliad	7.8	28.1	
HK Broadband	10.7	29.4	
M1	6.8	12.2	
Windstream	6.2	N/A	
Frontier	5.1	N/A	
Centurylink	6.2	10.6	
<b>Average</b>	<b>6.7</b>	<b>16.6</b>	
<b>Adopted multiple</b>	<b>7.0</b>	<b>17.0</b>	
Dr. Peng EBITDA/NPAT (RMBm)	3,236	776	
Valuation (RMBm)	22,649	13,192	
Net debt (RMBm)	963		
<b>Value per share (RMB)</b>	<b>17</b>	<b>9</b>	<b>13</b>

Source: Deutsche Bank, Bloomberg Finance LP, FY17 multiples shown

## Upside risks:

- Lessening in broadband competition
- Buyback from the large shareholder
- Larger-than-expected increase in market share gain
- The government opens up the broadband market to private enterprises.



# Appendix 1

## Important Disclosures

\*Other information available upon request

### Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Dr. Peng Group	600804.SS	17.60 (CNY) 29 Aug 17	NA

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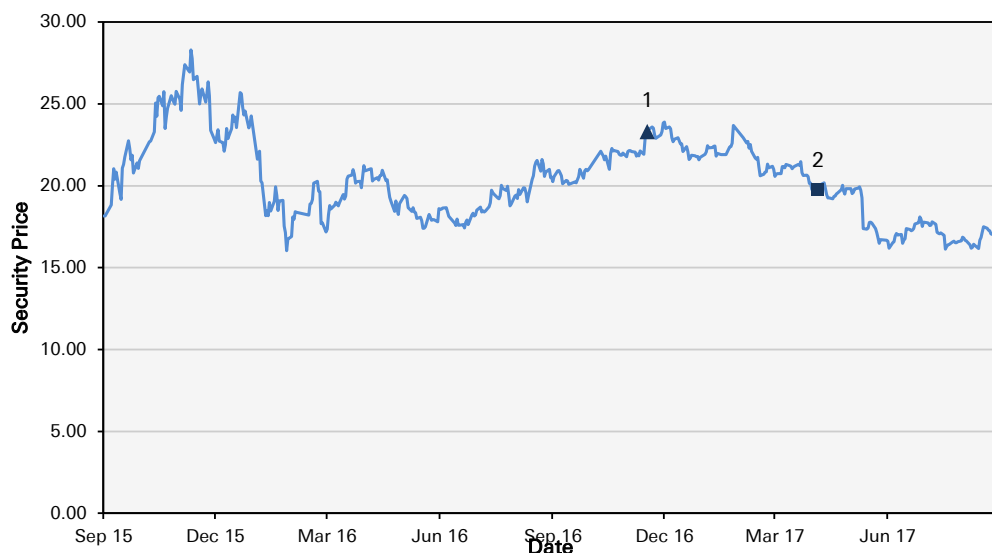
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### Historical recommendations and target price: Dr. Peng Group (600804.SS)

(as of 8/29/2017)



#### Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

#### Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

\*New Recommendation Structure as of September 9, 2002

\*\*Analyst is no longer at Deutsche Bank

1.	17/11/2016:	Upgrade to Sell, Target Price Change CNY18.50	James Wang
2.	05/04/2017:	Sell, Target Price Change CNY16.00	James Wang



### Equity rating key

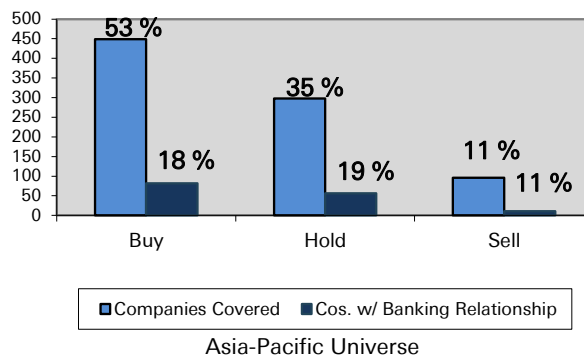
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**Sell:** Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

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### Equity rating dispersion and banking relationships







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