M1 Ltd

Below expectations

Bloomberg | Reuters | POEMS
M1 SP | MONE.SI | MBOA.SG
Industry: Communications Services

Phillip Securities Research Pte Ltd

17 July 2012

Report type: Results

Company Overview

M1 is the 3rd largest Telecommunications company in Singapore. The introduction of NGNBN in Singapore lowered entry barriers to the Fixed Line business, which would allow M1 to venture into the corporate and retail broadband market.

- 12.9% Q-Q decline in Net profits on amortization of handset revenue
- 0.7% Q-Q decline in Service revenue to S$190.4 million
- Maintain Reduce with TP of S$2.38

What is the news?

M1 reported 12.9% q-q decline in Net profits due largely to a 40.9% decline in revenue from sale of handset. This is due to accounting treatment, in which revenue from the sale of non-iPhone handsets are amortized over the 24 months contract. Service revenue was also disappointing with decreases in pre-paid revenue, International call services, and fixed services.

Fig 1. Results Summary

Income Statement (Extract)	2QFY11	2QFY12	y-y (%)	Comments
(S$'mn)				
Revenue	**245.4**	**232.3**	**-5.3%**	**Lower Handset revenue**
EBITDA	79.3	72.4	-8.7%	
EBIT	53.4	45.2	-15.4%	
Net Income	**42.9**	**35.2**	**-17.9%**	**Below expectations**

Source: Company, PSR

How do we view this?

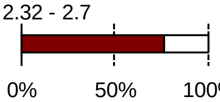
The results were below our expectations, although largely due to the phone's accounting treatment. We note the weak performance in Service revenue and continued slow take up rate of Fibre broadband despite M1's aggressive pricing. Improvements in service revenue or positive developments such as gaining back previously lost market share would be needed to warrant an upgrade.

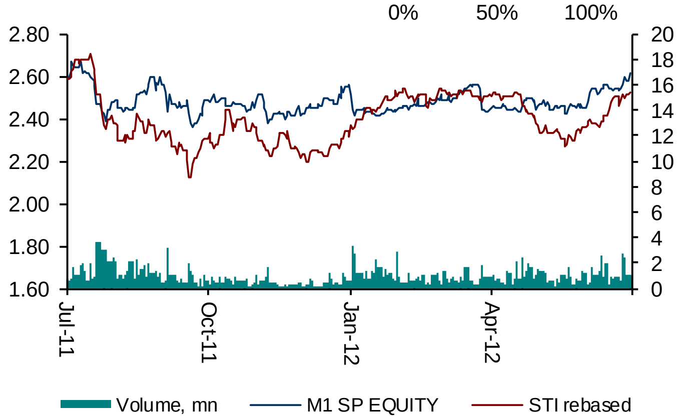
Investment Actions?

We adjust our figures to reflect the lower upfront recognition of revenue from handset and 2Q12 earnings. We maintain our Reduce rating with an unchanged TP of S$2.38.

M1 Ltd

Rating	**4**	**Reduce**
- Previous Rating	*4*	*Reduce*
Target Price (SGD)	**2.38**	
- Previous Target Price (SGD)	*2.38*	
Closing Price (SGD)	2.61	
Expected Capital Gains (%)	-8.7%	
Expected Dividend Yield (%)	5.3%	
Expected Total Return (%)	**-3.4%**	
Raw Beta (Past 2yrs weekly data)	0.25	
Market Cap. (USD mn / SGD mn)	1881 / 2379	
Enterprise Value (USD mn / SGD mn)	2089 / 2641	
3M Average Daily T/O (mn)	1.0	
52 week range (SGD)	2.32 - 2.7	
Closing Price in 52 week range		





Major Shareholders	**(%)**
1. Axiata Investments Ltd	29.1
2. Keppel T & T	19.6
3. SPH Multimedia	13.7

Key Financial Summary

FYE	**12/11**	**12/12F**	**12/13F**	**12/14F**
Revenue (SGD mn)	1,065	1,013	1,028	1,059
Net Profit, adj. (SGD mn)	164	158	166	168
EPS, adj. (SGD)	0.18	0.17	0.18	0.18
P/E (X),adj.	14.4	15.0	14.3	14.2
BVPS (SGD)	0.36	0.39	0.43	0.47
P/B (X)	7.3	6.7	6.0	5.5
DPS (SGD)	0.15	0.14	0.15	0.15
Div. Yield (%)	5.6%	5.3%	5.6%	5.6%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Valuation Method

DCF (WACC: 8.2%; terminal g: 0%)

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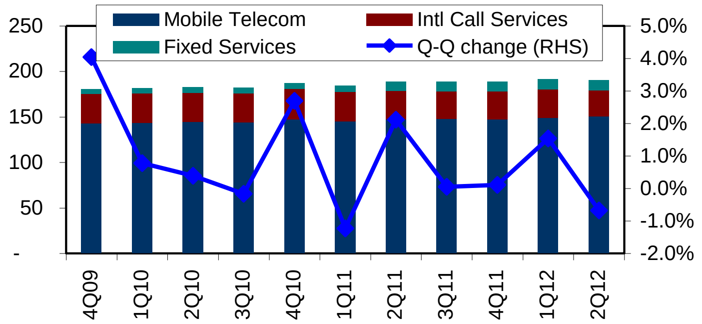
Weaker Service Revenue
Service revenue declined 0.7% q-q to S$190.4 million. The decline was contributed by a weaker International call service due to lower roaming rates primarily with Malaysia, and a decrease in revenue from Fixed services. Although not a main contributor to the total service revenue, the performance of Fixed services was rather disappointing given its previous rapid growth. Management has guided the decrease to be due to a one-time gain from sale of equipment relating to Fixed services. Excluding the effect of this, revenue from Fixed service would have increased.

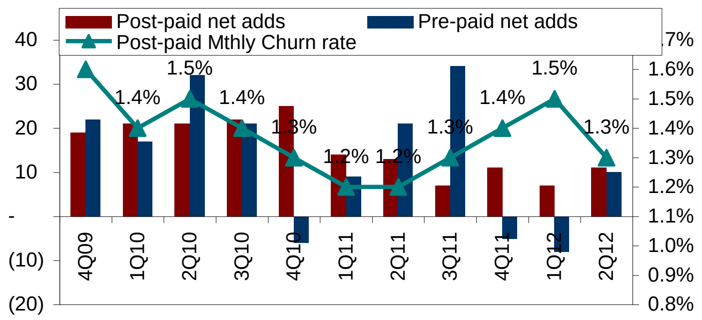
Fig 6: Service Revenue vs Q-Q change in Service Rev



Source: M1, PSR

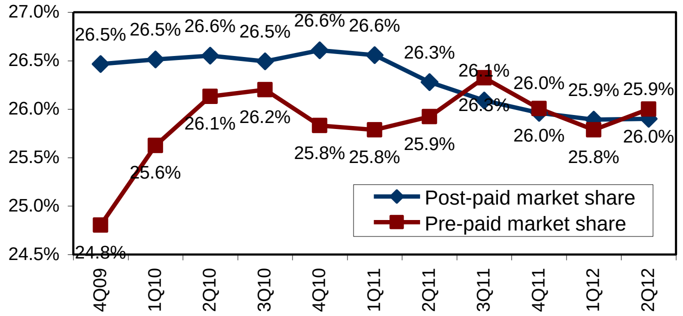
Post-paid revenue only positive q-q revenue line item
Post-paid revenue was the only component of Service revenue that was positive, increasing 1.2% q-q to S$131.2 million due to a larger customer base and an increase in adjusted post-paid ARPU. On a positive note, churn rate decreased from a high of 1.5% to 1.3%, likely contributing to M1's maintenance of Market share in the post-paid segment.

Fig 1: Customer Net Adds ('000) vs Monthly Churn rate



Source: M1, PSR

Fig 2: Market share of Mobile subscribers



Source: M1, PSR

Lower Net profit expected on higher upfront expenses
While revenue from sale of iPhone is partially recognized upfront, other phones such as the current popular Samsung S3 will not have any brought forward revenue. Instead, the revenue will only be recognized over the 24 months of the phone's contract. The hot-selling Samsung S3 contributed to a higher proportion of handsets sold in 2Q12, and this difference in accounting treatment led to a sharp 40.8% q-q decrease in Handset sales to S$41.9 million. Should the popularity of non-iPhones continue, revenue from sale of equipment would likely decrease y-y due to lower brought forward revenue. At the same time, revenue in FY2013 and FY 2014 would be higher as the revenue is recognized over the 24 months contract. We expect the non-iPhones, including Android phones such as the Samsung S3, to increase market share and therefore adjust our forecast accordingly to reflect this.

Fibre broadband growing but slow
Fibre broadband increased 8k customers in 2Q12 to 37k customers. Take up of fibre broadband remains slow but encouraging, as M1 gains customers in a segment it was previously excluded from. Management has guided their aim to be having a market share close to that of their mobile communication market share. Although we expect continued growth of M1's fibre broadband, we note the stickiness of the bundled deals with Pay TV offered by Singtel and Starhub. As M1 has not indicated interest in entering into Pay TV, we therefore forecast a smaller market share. In addition, we expect the aggressive pricing of M1's fibre broadband to likely reduce profit margins.

LTE nation wide roll out this year
M1 has also targeted rolling out nationwide 4G coverage by this year. This nationwide roll-out would however increase expenses, thus further reducing profit margins. Management has guided that margins are expected to improve in 1.5 to 2 years, similar to that experienced with the 3G network rollout. Once the nationwide rollout is ready, M1 would likely come up with tiered data pricing, ending the generous data caps customers currently enjoy. We view the end of generous data caps as necessary so as to match the cost of providing data to that of revenue from data services.

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FYE Dec	FY10	FY11	FY12F	FY13F	FY14F
Valuation Ratios					
P/E (X), adj.	14.9	14.4	15.0	14.3	14.2
P/B (X)	7.8	7.3	6.7	6.0	5.5
EV/EBITDA (X), adj.	8.4	8.5	8.4	8.0	7.7
Dividend Yield (%)	6.7%	5.6%	5.3%	5.6%	5.6%
Per share data (SGD)					
EPS, reported	0.175	0.181	0.174	0.182	0.184
EPS, adj.	0.175	0.181	0.174	0.182	0.184
DPS	0.175	0.145	0.139	0.146	0.147
BVPS	0.337	0.355	0.391	0.434	0.473
Growth & Margins (%)					
Growth					
Revenue	25.3%	8.8%	-4.8%	1.5%	3.0%
EBITDA	1.1%	-0.9%	1.1%	5.3%	3.7%
EBIT	8.1%	3.5%	-3.4%	4.3%	0.6%
Net Income, adj.	4.5%	4.3%	-3.4%	4.7%	1.1%
Margins					
EBITDA margin	32.0%	29.1%	31.0%	32.2%	32.4%
EBIT margin	20.1%	19.1%	19.4%	19.9%	19.5%
Net Profit Margin	16.1%	15.4%	15.6%	16.1%	15.8%
Key Ratios					
ROE (%)	56.2%	52.5%	46.7%	44.1%	40.6%
ROA (%)	17.7%	17.2%	16.4%	17.5%	17.9%
Net Debt/(Cash)	307	292	266	201	134
Net Gearing (X)	101.4%	90.3%	74.6%	50.9%	31.1%
Income Statement (SGD mn)					
Service revenue	733	751	767	776	792
Handset sales	246	314	247	252	267
Revenue	**979**	**1,065**	**1,013**	**1,028**	**1,059**
EBITDA	**313**	**310**	**314**	**331**	**343**
Depreciation & Amortisation	(117)	(107)	(118)	(126)	(137)
EBIT	**196**	**203**	**196**	**205**	**206**
Net Finance (Expense)/Income	(6)	(6)	(6)	(5)	(4)
Other items	0	0	0	0	0
Associates & JVs	0	0	0	0	0
Profit Before Tax	**191**	**197**	**191**	**200**	**202**
Taxation	(33)	(33)	(32)	(34)	(34)
Profit After Tax	**157**	**164**	**158**	**166**	**168**
Non-controlling Interest	0	0	0	0	0
Net Income, reported	**157**	**164**	**158**	**166**	**168**
Net Income, adj.	**157**	**164**	**158**	**166**	**168**

Source: PSR

FYE Mar	FY10	FY11	FY12F	FY13F	FY14F
Balance Sheet (SGD mn)					

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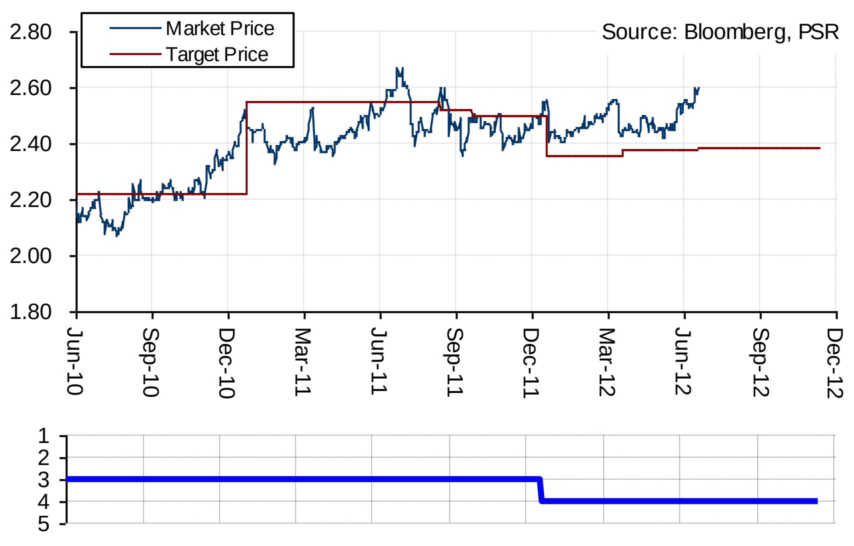
FYE Dec	FY10	FY11	FY12F	FY13F	FY14F
Balance Sheet (SGD mn)					
PPE	601	607	616	599	574
Intangibles	99	111	103	95	87
Associates & JVs	0	0	0	0	0
Investments	0	0	0	0	0
Others	1	1	0	0	0
Total non-current assets	**701**	**718**	**720**	**695**	**662**
Inventories	23	36	25	23	25
Accounts Receivables	195	206	184	186	191
Investments	0	0	0	0	0
Cash	9	12	15	30	47
Others	7	7	9	9	9
Total current assets	**234**	**261**	**233**	**249**	**272**
Total Assets	**934**	**979**	**953**	**943**	**934**
Short term loans	66	53	281	31	31
Accounts Payables	158	196	157	158	164
Others	76	61	60	60	60
Total current liabilities	**300**	**311**	**498**	**249**	**255**
Long term loans	250	250	0	200	150
Others	82	95	99	99	99
Total non-current liabilities	**332**	**345**	**99**	**299**	**249**
Non-controlling interest	0	0	0	0	0
Shareholder Equity	**303**	**323**	**356**	**395**	**431**

Cashflow Statements (SGD mn)					
CFO					
PBT	191	197	191	200	202
Adjustments	124	114	124	131	141
Cash from ops before WC changes	314	311	314	331	343
WC changes	(84)	14	(6)	0	(1)
Cash generated from ops	230	326	308	331	342
Taxes paid, net	(37)	(35)	(32)	(34)	(34)
Interest paid	(6)	(5)	(6)	(5)	(4)
Cashflow from ops	**187**	**286**	**270**	**292**	**304**
CFI					
CAPEX, net	(100)	(103)	(117)	(98)	(101)
Dividends from associates & JVs	0	0	0	0	0
Dividends/Interest from Investments	0	0	0	0	0
Purchase/sale of investments	0	0	0	0	0
Investments in subs & associates	(1)	(1)	0	0	0
Others	(19)	(21)	(3)	(3)	(3)
Cashflow from investments	**(120)**	**(124)**	**(119)**	**(101)**	**(104)**
CFF					
Share issuance	9	16	6	0	0
Purchase of treasury shares	0	0	0	0	0
Loans, net of repayments	47	(13)	(22)	(50)	(50)
Dividends to minority interests	0	0	0	0	0
Dividends to shareholders & capital reduction	(121)	(161)	(132)	(127)	(133)
Others	(0)	0	1	0	0
Cashflow from financing	**(66)**	**(158)**	**(148)**	**(177)**	**(183)**
Net change in cash	**0**	**3**	**4**	**14**	**18**
Effects of exchange rates	0	0	0	0	0
CCE, end	**9**	**12**	**15**	**30**	**47**

Source: PSR

Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
<-20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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