Telecommunications Sector

Results Season Takeaways

Phillip Securities Research Pte Ltd

28 February 2013

Report type: Update

Sector Overview

The Telecommunications Sector under our coverage consists of SingTel, StarHub & M1. StarHub (STH) and M1 are pure plays to the Singapore market, while SingTel (ST) has exposure to the Asia-Pacific region through its regional mobile associates.

- Service revenue remains largely stable q-q
- Telcos remain attractive as long term investments due to high dividend yields, but short term market-weight
- Neutral on SingTel and M1, Reduce on StarHub. We prefer SingTel over M1 and StarHub

Mobile

- Q-Q post-paid net adds across three Telcos, with SingTel marginally gaining more market share
- Post-paid ARPU largely flat q-q
- Positive on 9% of SingTel's and M1's tiered-plan customers exceeding data allowances, data monetizing expected to gain further traction moving forward

Pay TV

- SingTel continues to gain market share, StarHub post 4th consecutive quarter of negative net adds
- StarHub's Pay TV margins expected to decline moving forward, magnitude dependant on acquiring of BPL broadcast rights. We present a detailed analysis below.

Broadband

- Fibre broadband continues to grow rapidly
- SingTel continues to dominate Fibre broadband market

Others

- Handset margins in CY2013 may improve from change in mix of handset brands sold
- However, competition may increase in CY2013
- Capex is expected to be at elevated levels due to LTE roll-out, and 3G enhancements. Upcoming spectrum auction may also require CF provisions to be made

Recommendation

We are neutral on the sector, while maintaining that they remain attractive due to their high dividend yield and stable earnings. We prefer SingTel over M1 and StarHub due to SingTel's overseas exposure leading to higher growth potential. Bharti's declining performance may be turning around, while AIS and Telkomsel continues to post strong results. M1 remains attractive with the highest dividend yield but near term capex requirements may reduce any potential for dividend growth. As discussed above, we see margin pressures on StarHub's Pay TV. Pay TV revenue currently accounts for 17% of StarHub's total Service revenue. The strong surge in share price since Mar 2012 also presents limited upside potential.

Singapore Telecommunications Sector

Company	Rating	Price (S$)	TP (S$)	Upside (%)	M.Cap. (US$'mn)
M1 Ltd	Neutral	2.78	2.41	-13.3%	2,052
Starhub	Reduce	4.13	3.61	-12.6%	5,719
SingTel	Neutral	3.47	3.31	-4.6%	44,632

Source: Bloomberg, PSR

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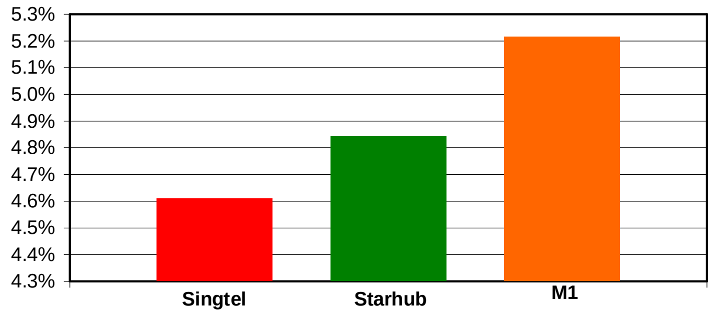
Dividend yield at current price attractive

Dividend yields continue to remain attractive in the current low interest rate environment. Free cash flow and earnings are stable even amidst the uncertainty in the global economy. With current inflation forecasted to be 3.5% to 4.5% for 2013, the Telcos continue to provide positive real return on investments. Furthermore, potential for dividend growth provides further incentives to long-term investors. We note that the lower dividend yield of SingTel is due to its lower core dividend payout ratio.

Fig 1. Forecasted CY2013 Dividend yield (%)



Source: Company data, Phillip Securities Research

Post-paid net adds similar across three Telcos

Post-paid net adds this quarter continued to be in positive territory for the three Telcos, with SingTel gaining higher market share. Q-Q Post-paid ARPU was largely flat, with SingTel posting a marginal increase

Key takeaway: Data monetizing has been gaining good traction. SingTel and M1 both reported an increase in revenue from customers on tiered-plans as approximately 9% of these customers exceeded their data allowances.

Key drivers of net adds: 1) Population growth in Singapore, potentially to 6.9 million by 2030.

Key drivers of ARPU: Monetizing of data from 1) upgrading from low to mid tier plans 2) Increase in revenue from exceeding of data allowances due to higher proportion of tiered-plan customers, and higher usage of data intensive services. 3) potential increase in additional data charges (SingTel has indicated potential upward review in additional data charges from current rate of S$5.35/GB once nationwide LTE roll-out has been completed. New rates may double to S$10.70/GB, based on previously quoted rates.) 4) Gradual increase in tech-savvy population mix. 5) Lower handset subsidies

Fig 2. Q-Q Postpaid Net Adds positive

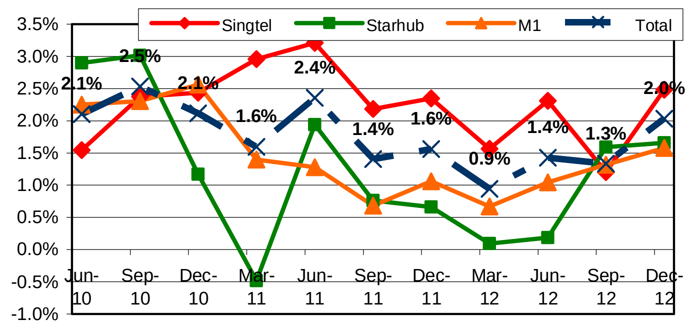


Fig 3. Postpaid ARPU q-q trends largely flat

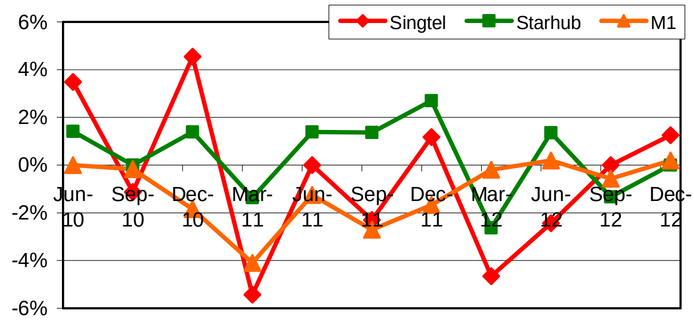
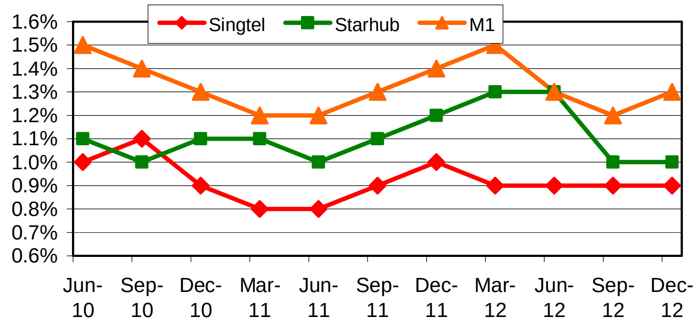


Fig 4. Monthly post-paid churn rate – M1 highest

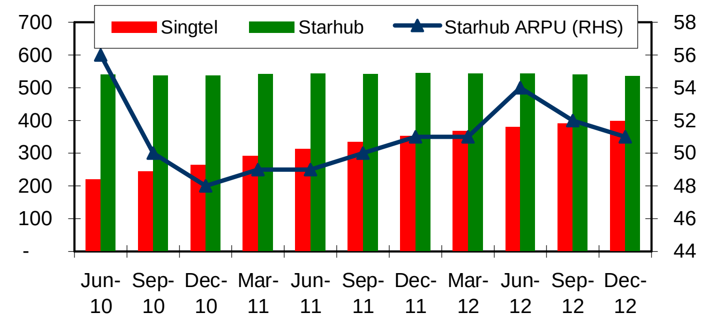


Source: Company data, Phillip Securities Research

Pay TV margins dependant on BPL broadcast rights

SingTel continues to gain market share, while StarHub's subscriber base declined for the 4th consecutive quarter. SingTel's other offerings are also now more attractive, with its increase in contents, such as FOX, providing greater variety to its subscribers. SingTel also recently announced the renewal of BPL broadcast rights for the 2013-2016 seasons on a non-exclusive basis. While previous estimates were S$300 million for the 2010-2013 rights on an exclusive basis, the recent renewal may potentially be lower, due to its non-exclusivity. With little transparency in content cost, we estimate BPL rights to be 15% lower at S$255 million. With the penetration rate for Pay TV at approximately 81%, there may be limited net add potentials. Competition for market share may increase.

Fig 5. Pay TV Subscribers vs StarHub Pay TV ARPU



Source: Company data, Phillip Securities Research

StarHub may be in a loss-loss situation for BPL rights:
Scenario 1 – StarHub signs for BPL rights. With a subscriber base of 536,000 per 31 Dec 12, assuming 30% of subscribers subscribes to BPL package, content cost of S$255 million would imply monthly cost of $44 alone for BPL. With SingTel offering its current Sports package for S$34.90, this may not be profitable for StarHub. Ignoring SingTel's other contents in the Sports package, StarHub would need 203,000 customers to subscribe to BPL to break even. This represents 38% of its current subscriber base. Based on these assumptions, StarHub may therefore face pressures on Pay TV margins should they acquire the BPL rights.

While some subscribers are currently subscribed to both StarHub's and SingTel's Pay TV services, they may terminate one of the Pay TV services should BPL be available on both providers. This is based on the high cost to customer in maintaining both Sports package. Subscriber base for both providers may therefore decrease. On a positive note, StarHub's market share would likely stabilize or improve.

Scenario 2 – StarHub does not sign for BPL rights. Noting that StarHub did not have rights to the 2010-2013 seasons, churn rate would continue to be on slightly elevated levels as SingTel continue to improve on its Pay TV contents. We expect churn rate from current Sports channel subscribers to be high. As mentioned in our previous report dated 8 Feb 13, StarHub raised Sports group package price from S$12.84 to S$19.26 per month, due to the new Star Sports portfolio content. With SingTel also providing this set of content, customers currently subscribed to both Pay TV services may not be willing to pay twice for the same content. This would lead to churn and net loss. In addition, the lower number of customers subscribed to StarHub's Sports package may lead to the new Star Sports content to be loss making and reduce profit margins. The reduction in profit margin may however be of a lesser extend than should StarHub acquire BPL rights based on the above assumptions due to the Star Sports content cost likely being lower.

Based on the above, we expect Pay TV margins for StarHub to decline moving forward.

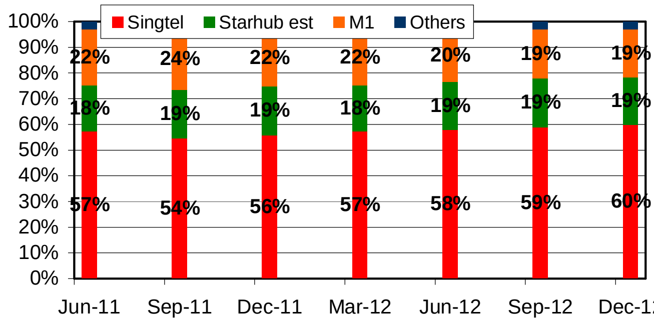
Pay TV provides differentiated services, determining services that households subscribe to – While broadband and telephone services are similar between SingTel and StarHub (M1 competes on lower pricing of broadband) the different Pay TV contents may drive customer decision on which provider to subscribe to for broadband and fixed telephone line services. The increase in revenue from broadband and telephone services may mitigate some of the decline in profit margin under Scenario 1 described above.

SingTel's Pay TV margins negative under Scenario 1, positive under Scenario 2 – Should StarHub acquire BPL rights, SingTel may experience higher competition and churn rates as customers terminate their Sports package and Pay TV services. This reduces revenue from its Sports package, thus decreasing profit margins.
Should StarHub not acquire BPL rights, Profit margins would however improve, due to lesser competition, and expected continued increase in subscriber base. SingTel would also have more pricing power, with the ability to increase its Sports package pricing should SingTel be the only broadcaster for BPL in Singapore.

Broadband

Based on figures from IDA, SingTel and M1, SingTel continues to gain market share in the Fibre Broadband segment with 31k net adds. We continue to see challenges for M1 moving forward due to the lack of cable broadband customer base to promote their fibre broadband to, unlike the other two Telcos. However, we are confident of the fibre broadband contributing significantly to M1's revenue growth in the next few quarters.

Fig 6. Estimated Fibre Market Share (%) – SingTel leads



Source: Company data, Phillip Securities Research

Other areas

CY2013 profit margins on handsets may improve – Based on our sources, Apple products have much lower margins as compared to other brands including Samsung. An expected shift of handset brand mix towards the higher margin Samsung phones in CY2013 may benefit the Telcos.

Competition for mobile revenue low in CY2012, may increase in CY2013 – Per StarHub's management, competition was less intense in CY2012, thus leading to the significant decrease in marketing and promotional expenses. Management expects potentially higher competition in CY2013, leading to an increase in marketing and promotional expenses, and muted revenue growth. This may be mitigated by the better handset margins on non-Apple products per above.

Capital expenditure to remain high – The Telcos are building up on their LTE capabilities, with nationwide rollout of LTE services. Coupled with additional spending to meet the new Quality of Service (QOS) standards and enhancements of existing 3G services, capital expenditure is expected to be at elevated levels. While payments arising from the spectrum auction this year can be paid at a later date, managements would similarly need to make provisions for these substantial payments now.

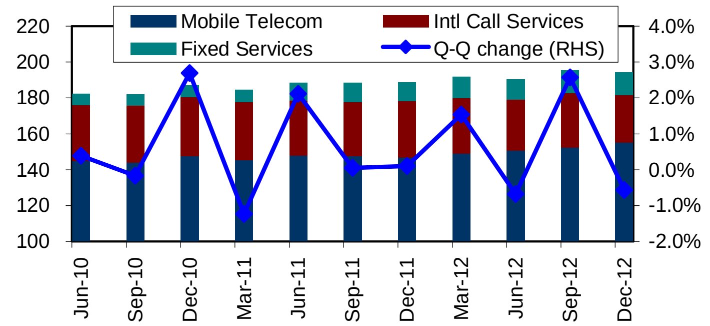
Key upside/downside risk

Key upside risks include the ability of the Telcos to monetize data effectively, such as through a higher number of customers shifting from the lowest tiered plans to the mid tier plans. Similarly, an increase in price plans for the various revenue segments, and lower mobile subsidies would also increase net profits.

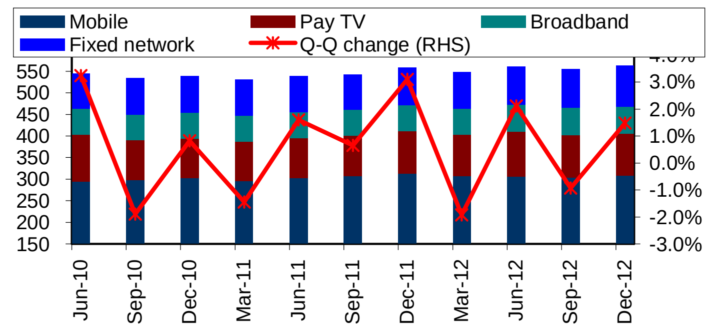
Key downside risks include an unexpected change in the US Fed policies, leading to an increase in Fed rates and shift of investors' preference away from dividend yielding stocks. Irrational competition, though unlikely, may also have an adverse impact on the net profits of the three Telcos.

Fig 7. Q-Q Service revenue growth

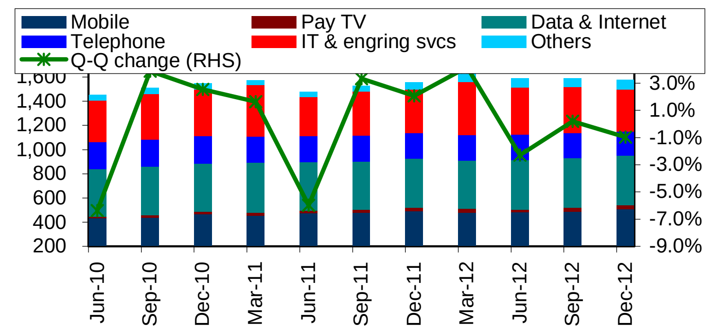
M1 – Marginally down q-q on lower intl call services



StarHub – Higher on digital voice home service charges



SingTel's SG operations – Marginally down q-q on lower IT & Engineering services, and telephone services

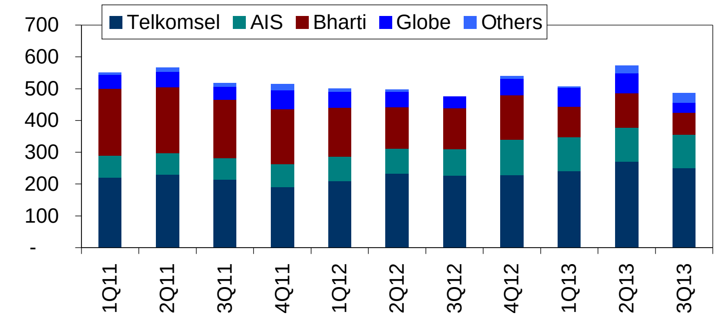


Source: Company data, Phillip Securities Research

Order of decreasing preference: SingTel, M1, StarHub

We are neutral on the sector, while maintaining that they remain attractive due to their high dividend yield and stable earnings. We prefer SingTel over M1 and StarHub due to SingTel's overseas exposure leading to higher growth potential. We note that Bharti, which have been experiencing long periods of q-q decline in pre-tax profit, may be turning around with potentially better revenue growth in India and Africa. 2G Data pricing in India is expected to increase, while business in Africa is improving. Debt financing expenses, which have been increasing, may also improve or stabilize, with a potential upcoming USD bond issuance. AIS and Telkomsel continues to post strong results.

Fig 8. SingTel - Pre-tax contribution of Associates & JVs



Source: Company data, Phillip Securities Research

M1 remains attractive with the highest dividend yield. Key concern on M1 would be increasing capital expenditure requirements, including 3G enhancements, and the upcoming spectrum auctions. While M1 historically incurs less than half of StarHub and SingTel's capital expenditure, in line with the lower revenue, the fixed cost spectrum auction and higher Quality of Service standards, may result in proportionately higher capex as a % of revenue. This also lowers Free Cash Flow, and reduces its ability to increase dividends in the near term.

As discussed above, we see margin pressures on StarHub's Pay TV. Pay TV revenue currently accounts for 17% of StarHub's total Service revenue. The strong surge in share price since Mar 2012 also presents limited upside potential.

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Telecommunications Sector Valuation Comparables

Company Market price as of: 27-Feb-13	Rating	FYE	Price	TP	Upside (%)	Market Cap. (S$'mn)	Ent. Value (S$'mn)	Market Cap. (US$'mn)	Ent. Value (US$'mn)	Equity Multiple (X) Net Income FY11/12	Net Income FY12/13E	Net Income FY13E/14E	Book Value FY11/12	Book Value FY12/13E	Book Value FY13E/14E	Dividend Yield (%) FY11/12	FY12/13E	FY13E/14E
M1 Ltd	**Neutral**	**Dec**	2.78	**3.20**	15.1%	2,543	2,804	2,052	2,265	15.5	17.3	16.2	7.9	7.3	6.8	5.2%	5.3%	5.3%
Starhub	**Reduce**	**Dec**	4.13	**3.20**	-22.5%	7,089	7,465	5,719	6,027	22.4	19.7	18.6	308.2	161.1	112.5	4.8%	4.8%	4.8%
SingTel	**Neutral**	**Mar**	3.47	**3.20**	-7.8%	55,324	62,483	44,632	50,493	15.1	14.7	13.2	2.4	2.3	2.2	4.6%	4.6%	4.8%

Source: Bloomberg, PSR est.

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