Singapore Telecom Sector

Recovering and restructuring

SINGAPORE | TELECOMMUNICATIONS | UPDATE

3 June 2019

- Mobile and Pay-Tv revenues expected to be weak in 2019 and stabilise in 2020.
- Enterprise revenue to surge 20% in 2019 on the back of smart nation initiatives, cyber-security and managed services.
- TPG achieved nationwide outdoor coverage in Singapore. Commercial launch is expected to be in late 2019. ACCC opposes the merger of TPG and Vodafone.
- Singtel and NetLink remain our top picks in the sector. We like Singtel for its recovering regional associates and NetLink for its stable 6% distribution yield.
- Maintain **OVERWEIGHT** on the Singapore Telecom sector.

Recent News

The Australian Competition & Consumer Commission (ACCC) announced their decision to oppose the merger of TPG Telecom (TPG) and Vodafone Hutchison (Vodafone). The ACCC said that the proposed merger will reduce competition and contestability in the sector. This news is negative for Optus as TPG has no option but to roll-out its own network and compete with incumbents operators. TPG's typical aggressive pricing strategy may increase revenue pressures on the Optus's mobile service segment. There is a silver lining, the failure of this would imply that TPG will deploy more resources in its core Australian business and may neglect or withdraw the roll-out of its network in Singapore.

Investment Actions

Upgrade Singtel to BUY with higher TP of S$3.66 (prev. S$3.31). We like Singtel for its recovering regional associates. We are anticipating price hikes in India as Reliance Jio (Jio) seeks a return on their investments after capturing a similar revenue market share with Bharti Airtel (Airtel). Telkomsel is on track to recovery as competition is easing and we foresee growth outside Java. We think Globe will support associates recovery with its positive momentum on data monetisation. A growth driver will be the enterprise segment as Singtel gains better traction on smart nation initiatives and higher demand for Information and Communications Technology (ICT) services. We are optimistic on Singtel's digital business and expect improvements in EBITDA in FY20e. We forecast an EPS growth of 5% YoY. The stock is also supported by a committed dividend of 17.5 cents which translate to a yield of 5.6%. Our higher target price is due to the recent recovery in the valuation of Singtel's regional associates. We maintain our FY20e 7X EV/EBITDA of the Singapore and Australia businesses. There are no changes made to our forecast.

Upgrade StarHub to ACCUMULATE with an unchanged TP of S$1.62. StarHub faces headwinds from mobile and pay-tv segment. We think that the enterprise segment provides some shelter. We expect the enterprise revenues to grow by 8% YoY on the back of higher managed services and cybersecurity. In 1Q19, cybersecurity revenue surged 41% YoY and represented 20% of total enterprise revenue. We are awaiting further clarity on the profitability of Ensign, StarHub's cyber-security arm. We think it may be a potential re-rating catalyst for StarHub. We forecast an EPS decline of 3% YoY in FY19e. Our target price is based on FY19e 6X EV/EBITDA. We assigned a lower multiple to reflect the declining mobile and pay-tv businesses. We upgrade to ACCUMULATE due to recent share price performance.

Upgrade NetLink to BUY with an unchanged TP of S$0.93. We favour NetLink (NLT) because of its dominance in the residential segment which supports 1.33mn fibre end user connections. These connections become the core of NLT's stable and predictable revenue stream. We believe new housing estates such as Punggol, Tengah and Sengkang will provide growth in the residential segment. As a result, we attributed a 10% growth rate in the number of connections. We expect Non-Building Address Points (NBAP) connections to gain traction and non-residential to be stable in FY20e. We expect EBITDA margins to be stable at 70% which translates to a strong cash-flow to support the S$208mn distributions we forecast for FY20e. Our valuation is based on DCF (WACC 6%, Terminal growth 1%). We upgrade to BUY due to recent share price performance.

OVERWEIGHT (Maintained)

Singtel Limited
BUY (Upgraded)

BLOOMBERG CODE	ST SP
CLOSING PRICE	SGD 3.19
FORECAST DIV	SGD 0.18
TARGET PRICE	SGD 3.66
TOTAL RETURN	20.2%

StarHub Limited
ACCUMULATE (Upgraded)

BLOOMBERG CODE	STH SP
CLOSING PRICE	SGD 1.49
FORECAST DIV	SGD 0.09
TARGET PRICE	SGD 1.62
TOTAL RETURN	14.8%

NetLink Trust
BUY (Upgraded)

BLOOMBERG CODE	NETLINK SP
CLOSING PRICE	SGD 0.83
FORECAST DIV	SGD 0.05
TARGET PRICE	SGD 0.93
TOTAL RETURN	18.5%

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Mobile segment

The mobile segment continues to face headwinds. Voice and International Direct Dialing (IDD) cannibalisation persist. Higher data allowances given to consumers prevent the telcos from monetising the increase in data usage as there is less excess data charges. StarHub reported a 100% increase in customer data usage in 6 months from 3GB to 6GB. In 1Q19, Singtel's post-paid and pre-paid ARPU declined 5% and 6% QoQ respectively. Similarly, StarHub's post-paid and pre-paid ARPU shrunk by 5% and 7% QoQ. We took an average of net revenues from all SIM-only plans and handset plans and arrived at the conclusion that SIM–Only plans dilute net revenue by as much as 50%. The low price range plans offer the least dilution to the telcos (Figure 5). Handset replacement cycles are increasing, giving rise in popularity of SIM-only plans. SIM-only plans offers flexibility for consumers holding back handset purchases in anticipation of the launch of their desired handsets. We believe SIM-Only accounts for 10% to 15% of total post-paid subscribers. We think SIM-only plans will not grow and further dilute revenue. Based on this assumption we think that there will be some form of stabilisation in the medium term. We expect industry mobile service revenue to decline 9% YoY in 2019 and to stabilise in 2020 (Figure 1). Mobile Network Operators (MNOs) have been lowering cost (S$) per data to prevent churn and attract price-sensitive subscribers. With the recent price revisions, M1 now offers the most competitive cost(S$)/data followed by StarHub and Singtel (Figure 4). However, using a single metric is not indicative of customer retention or satisfaction. Singtel offers non-price differential packages such as content and other benefits (gojek rewards, amazon prime).

Figure 5: Dilution of net revenues from SIM-Only plans

Range	SIM-Only (S$)	Handset (S$)	Dilution
All mobile plans	1,022	1,534	33%
Premium (S$90 - S$200)	1,788	3,591	50%
Middle (S$36 - S$90)	904	1,110	19%
Entry (S$20 - S$25)	520	586	11%

Source: Company, PSR

Figure 6: Circles.life & Zero have lowered prices

MVNOs In Singapore	Circles.Life		Zero	Zero1	MyRepublic		
Plans	FLEXI	Base	Zero X	Zero1	Smart 35	Mega 55	Xtra 85
Price (S$)	0	18*	50	30	35	55	85
Data (GB)	1	20	Unlimited	Unlimited	9	18	30
Voice (mins)	30	100	Unlimited	200	1,000	1,000	1,000
SMS	10	25	Unlimited	200	1,000	1,000	1,000
MNO Partner	M1		Singtel			StarHub	

*Revert back to S$28/mth after 12mths

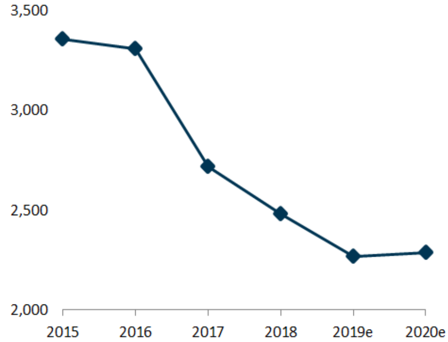
Source: Company, PSR

With the delay of the full commercial launch of TPG, Mobile Virtual Network Operators (MVNOs) have further lowered their price plans. Circles.life lowered their Base plan to S$18/mth (prices will revert back to original S$28/mth after 12mths). Zero increased their Zero X offerings by giving unlimited everything and prices reduced from S$59.95 to S$49.95.

TPG

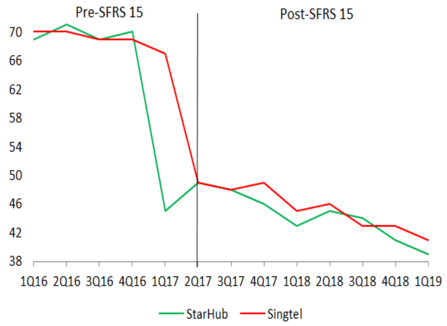
Mobile trial begun late December 2018 for the first 20,000 subscribers, it later expanded to 200,000 subscribers in March 2019. The trial offers unlimited data for the first 12 months. Speeds are capped at 1Mbps after the first 2GB of data per day. TPG surpassed its nation-wide outdoor coverage target (Figure 7) set by IMDA by almost a year reaching 99.18% coverage on 19 March 2019. There was positive feedback on network coverage and quality for outdoors while indoor and underground coverage remains weak at the moment. TPG is expected to launch in late 2019. We continue to believe that the commercial launch of TPG will have marginal impact to the incumbents in the near term. The one year delay of TPG's commercial launch has limited its ability to capture customers as the novelty of a new MNO fades away. Furthermore, the incumbents and MVNOs have had a full year to revise their mobile offerings, ensuring there are no gaps for TPG to target. The recent ACCC decision to oppose the merger between TPG and Vodafone could also mean that there will be fewer resources channelled to Singapore as TPG focuses on rolling out its mobile network in its core market in Australia.

Figure 1: Industry mobile service revenue (S$mn)



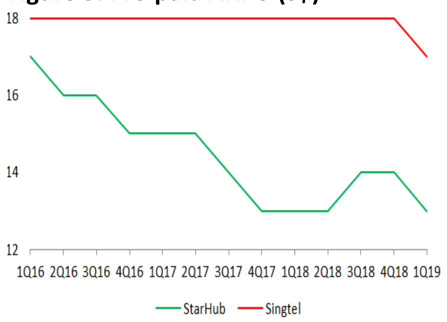
Source: Company, PSR

Figure 2: Declining Post-paid ARPU (S$)



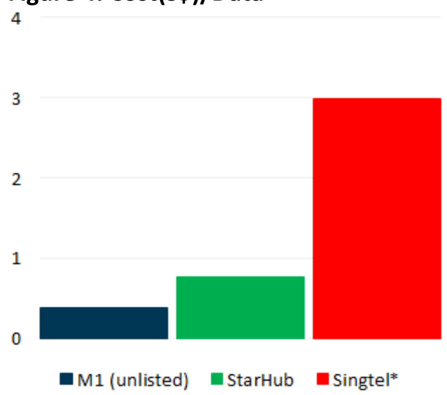
Source: Company, PSR

Figure 3: Pre-paid ARPU (S$)



Source: Company, PSR

Figure 4: Cost(S$)/Data



* according to XO & SIM-only plans

Source: Company, PSR

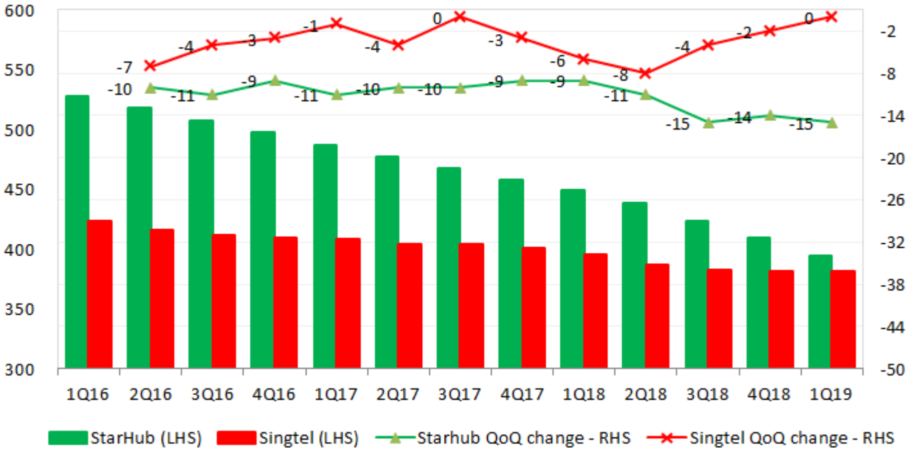
Figure 7: TPG to meet > 99% coverage in tunnels/building by 1 Jan 2020

Coverage area	QoS Standards	Effective Date
Nation-wide outdoor	>95% coverage with signal strength of -109dBm or better	1-Jan-2019
	>99% coverage with signal strength of -109dBm or better (average across all outdoor space)	1-Jan-2020
Tunnels	>99% coverage with signal strength of -109dBm or better in all road and MRT tunnels	1-Jan-2020 (Road tunnels) 1-Jan-2020 (for underground MRT stations/lines)
In-building	>85% coverage with signal strength of -109dBm or better in each building	1-Jan-2020

Source: IMDA

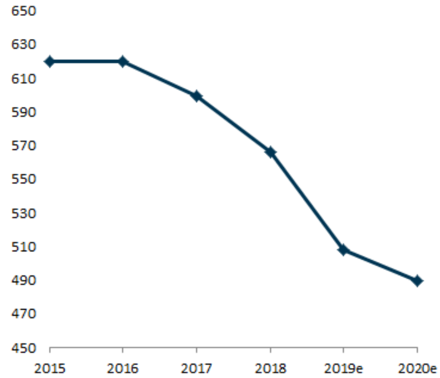
Pay-Tv segment

Figure 8: Declining pay-tv subscribers ('000)



Source: Company, PSR

Figure 9: Industry pay-tv revenue (S$mn) to decline 9% in 2019e



Source: Company, PSR

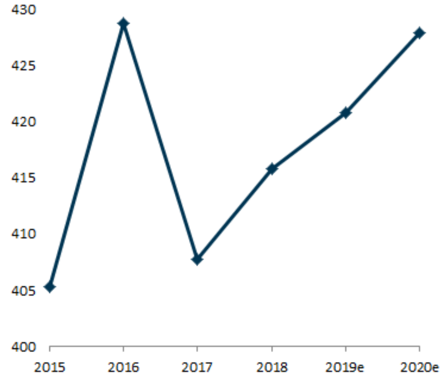
The attrition of pay-tv subscribers to Over-The-Top (OTT) players continues. Industry pay-tv revenue declined by 5.6% in 2018. StarHub's pay-tv subscribers shrunk 55,000 YoY while Singtel's subscribers decreased by 14,000 YoY. We believe StarHub could face a higher attrition rate in the medium term due to the continued migration of cable to fibre. We believe Singtel is able to sustain its subscribers better than StarHub because of certain bundled offerings that include pay-tv (E.g. premium COMBO plans)

We previously emphasized that the telcos are changing their pay-tv business model from a fixed cost to a variable cost model. This is an on-going process and StarHub highlighted that they are left with one major contract renegotiation. Singtel is progressively phasing out unpopular content. Both telcos are improving how content is being consumed, mirroring the OTT players with content on-the-go and giving options to subscribers to pay for content that they view instead of the traditional fixed-bundle content. We expect segment revenue to shrink by 10% and for subscribers to contract by 8% in 2019, while some form of stabilisation should come in 2020. The decline in revenues should be mitigated by the new content cost structure.

Broadband segment

According to IMDA, wired broadband penetration is at 93.5%. There is still some growth till we reach 100% penetration in Singapore. We think competition will intensify from the smaller broadband players such as ViewQwest and MyRepublic. However, the increased competition will be mitigated by growth in new household, corporate additions and dual broadband per household for separate use cases such as gaming. Broadband ARPU has been relatively stable even though the competition is high. We expect broadband segment revenue growth of 1.2% and 1.7%, in 2019 and 2020 respectively. StarHub's decision to expedite the migration of Hybrid Fibre Coaxial (HFC) to fibre benefitted NLT as its residential end-user connection surpassed our expectations. As of 1Q19, StarHub has 46,000 subscribers still on the HFC and the targeted migration from HFC to fibre broadband should complete by 2Q19.

Figure 10: Industry Broadband revenue (S$mn)

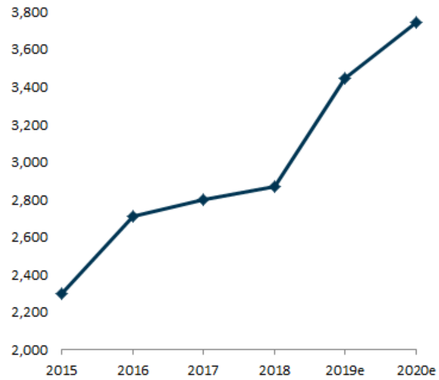


Source: Company, PSR

Enterprise segment

There is still inertia after the resumption of smart nation initiatives. However, we think these activities should progressively gain traction. We maintain our view that the enterprise segment will provide growth to the telcos. There is increased demand for managed services across government, financial services, hospitality, transport, SMEs and healthcare. The enterprise is not spared from the decline of legacy services such as voice and IDD. These core carriage business typically command higher margins as compared to the ICT business. We expect lower EBITDA margin across the enterprise segment because of the stronger contributions of ICT business. We are optimistic on 5G and the potential it brings to the enterprise segment. Opportunities range from industry automation, remote surgery to smart city applications. We expect industry enterprise revenue to enjoy a growth of 20% in 2019. We believe StarHub's new focus in cybersecurity through Ensign will help boost revenues. If we annualise Ensign's 1Q19 revenue, it would have met its target revenue of S$100mn.

Figure 11: Industry enterprise revenue (S$mn)

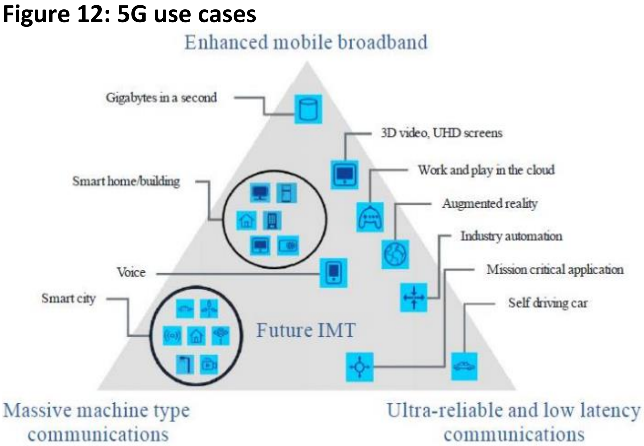


Source: Company, PSR

5G

The Infocomm Media Development Authority (IMDA) published a second consultation paper on the fifth generation network in early May 2019. IMDA maintained its projection for 5G to be commercialised by 2020, with a wider scale of deployment from 2023/2024 onwards. IMDA also indicated its desire for 5G to be a standalone network (minimum two nationwide); which means MNOs will have to roll-out two 5G network. This translates to doubling the number of base stations for the rollout. 5G would also require more base stations because of the use of higher frequency bands. This will be positive for NLT as the telcos will require its extensive fibre infrastructure for the connections in the new base stations. IMDA also encourage network sharing and service-based competition amongst the MNOs. We do not foresee a replacement threat between 5G and fixed broadband at present, barring any discovery of specific use case. We think the two technologies will complement each other. A typical household would have more than 5 devices that will still need to be connected to fixed broadband. We maintain our view that the roll out of 5G will be in phases due to the lack of consumer use case. As a result, CAPEX will be gradual in tandem with the rollout phases.

Figure 12: 5G use cases

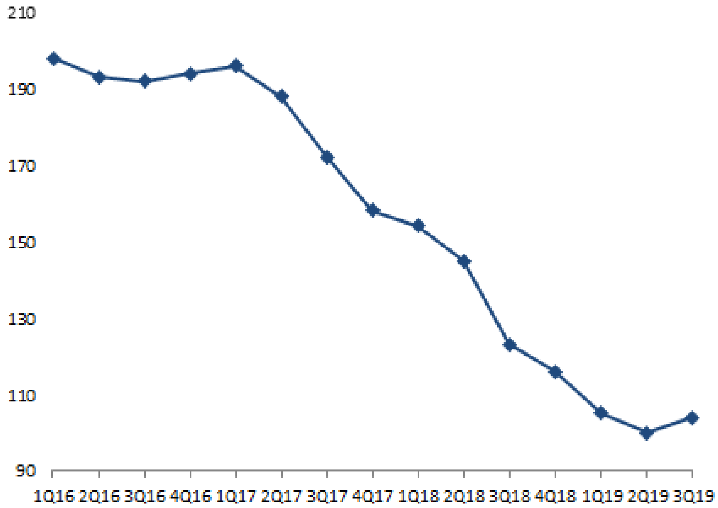


Source: IMDA

Singtel's regional associates

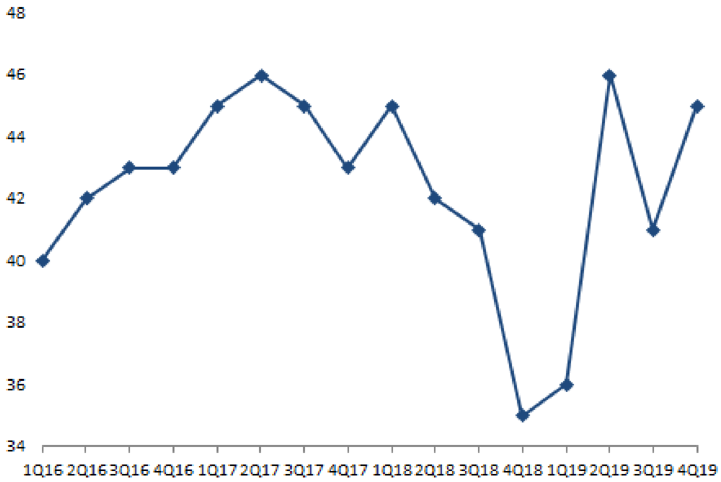
Competition remains intense in India as Reliance Jio (Jio) continues its aggressive pricing strategy to gain market share. However, there has been no downward revision for a year. We are anticipating price hikes from Jio as they seek to gain returns on their investments after achieving similar revenue market share with Bharti Airtel (Airtel). Airtel is now targeting the higher revenue generating subscribers and is investing in the expansion and quality of its 4G mobile network. We observed a 4% QoQ improvement in Airtel's ARPU for December 18 (figure 12). We believe APRU was lifted due to the introduction of the minimum recharge plans (Rs23 for 28days). We expect the Indian market to stabilise in 2019 and to improve in 2020. Over in Indonesia, we think the harsh operating conditions are over. There were positive price revisions across the board after the SIM re-registration chapter. Telkomsel observed a significant increase in mobile broadband traffic. Globe enjoyed a PBT growth of 38% in 1Q19. This is on the back of higher data revenue and increased demand for internet services. There is a surge in consumer spending on mobile data due to the rise in popularity of promotions that provide better value surfing deals. Mobile data continued to boost revenues and now accounts for 61% of gross service revenues as opposed to 47% a year ago. We believe Globe will continue to enjoy upsides in data monetisation. We forecast a PBT growth of 41% in FY20.

Figure 13: Airtel's stabilising ARPU (Rs)



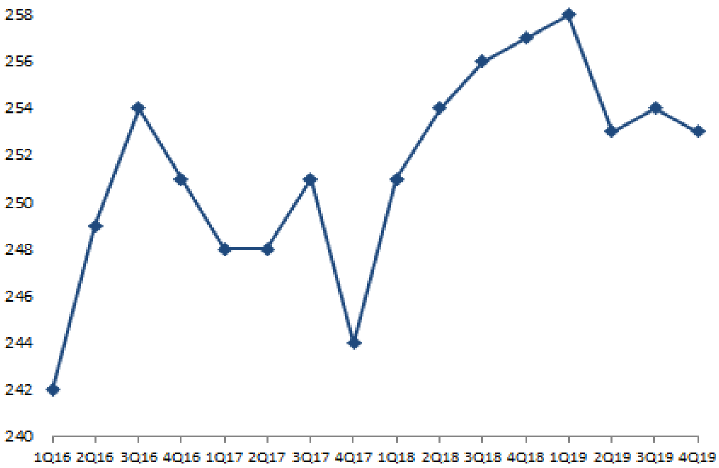
Source: Company, PSR

Figure 14: Telkomsel ARPU (IDR) Recovery post SIM re-registration



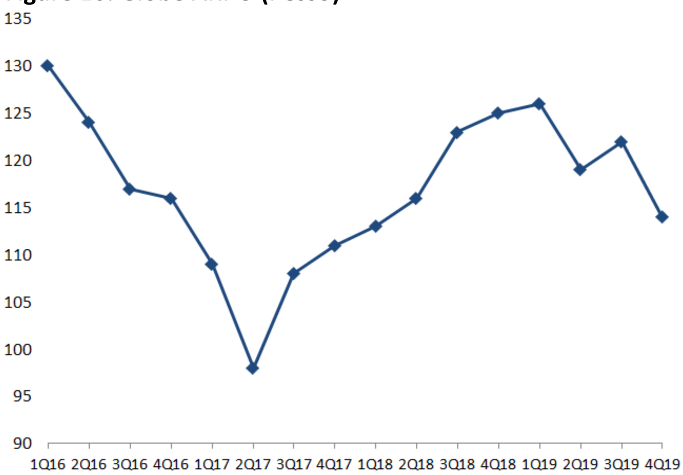
Source: Company, PSR

Figure 15: AIS ARPU (Bhat)



Source: Company, PSR

Figure 16: Globe ARPU (Pesso)



Source: Company, PSR

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