

Singapore Telcos

NEGATIVE [Unchanged]

TPG Scenarios: The Base, The Blue Skies & The Ugly

Not a pretty picture

We review Info-Communications Media Development Authority (IMDA) regulations governing the spectrum rights recently acquired by TPG (TPM AU, Not Rated), to ascertain if there is an avenue for more positive scenarios for Singapore's incumbents. Our conclusion is that the worst case scenario of a more aggressive tariff war cannot be ruled out, thus we maintain our NEGATIVE view on the sector. De-rating catalysts are expected from the start of operations by TPG or any insight into its tariff plans and strategy. Continue to HOLD Singtel and SELL StarHub and M1. Risks to our view include an early exit by TPG and/or robust growth in fixed broadband and enterprise.

Live-&-let-live scenario

We currently assume that TPG's competition will erode incumbents' wireless revenue, though not necessarily by double digits (Figs 3-4). We estimate 2-4% declines for 2017-19E. This assumes that it and the mobile virtual number operators carve out a minority share of less than 10% of industry wireless revenue by 2019E.

Cut-loss scenario

We think this scenario would provide the quickest relief for the incumbents' operations and stock performances. According to Section 15 of the regulations, TPG can surrender or terminate its license with IMDA's approval by giving six months of advance notice. Under Section 17, there will be no compensation or refund of fees already paid. Based on IMDA's schedule (Fig 1), the major licensing fees have already been paid. As any capex and start-up opex will naturally be forgone for TPG, we doubt that it would opt for such an exit without putting up a fight.

Go-all-the-way scenario

As IMDA regulations discourage any sale of its licence before it fulfills all its coverage commitments (Fig 2), TPG may opt for accelerated service rollout and aggressive market-share grab. This could tempt an incumbent to take it out of the market. We have seen such a consolidation in the Philippines in 2012, when PLDT (TEL PM, PHP1,560, HOLD, TP PHP1,440) acquired unlisted Digitel. The prospect of a new entrant motivated the Philippine incumbent to take out a potential competitor in 2016, even before it started commercial operations. The revenue at risk for PLDT from aggressive competition likely provided justification for its acquisition. With Singapore's wireless service revenue at SGD4b in CY2017, a 10% pa erosion over five years would translate to SGD1.6b of present value in potential lost revenue for the incumbents. This amount is higher than TPG's spectrum costs and capex budget of SGD300m for Singapore. Theoretically, somewhere between its costs and the industry's destruction value is a price an incumbent could pay for an acquisition or merger to stem revenue losses.

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| Stock | Bloomberg code | Mkt cap (USD'm) | Rating | Price (LC) | TP (LC) | Upside (%) | P/E (x) | | P/B (x) | | Div yld (%) | |
|---------|----------------|-----------------|--------|------------|---------|------------|---------|------|---------|------|-------------|-----|
| | | | | | | | 18E | 19E | 18E | 19E | 18E | 19E |
| Singtel | ST SP | 42,149 | Hold | 3.39 | 3.69 | 9 | 15.3 | 15.6 | 1.8 | 1.8 | 5.7 | 4.7 |
| StarHub | STH SP | 3,244 | Sell | 2.46 | 2.27 | (8) | 18.2 | 19.5 | 14.3 | 17.8 | 6.5 | 6.5 |
| M1 | M1 SP | 1,277 | Sell | 1.79 | 1.63 | (9) | 13.1 | 17.9 | 5.7 | 6.2 | 6.1 | 4.5 |

Figure 1: Payment schedule for TPG’s spectrum rights

| Year | (SGD m) |
|--------------|---------------|
| 2017 | 129.41 |
| 2018 | 0.11 |
| 2019 | 0.11 |
| 2020 | 0.11 |
| 2021 | 0.11 |
| 2022 | 0.11 |
| 2023 | 0.11 |
| 2024 | 0.11 |
| 2025 | 0.11 |
| 2026 | 0.11 |
| 2027 | 0.11 |
| 2028 | 0.11 |
| 2029 | 0.11 |
| 2030 | 0.11 |
| 2031 | 0.11 |
| 2032 | 0.11 |
| Total | 131.03 |

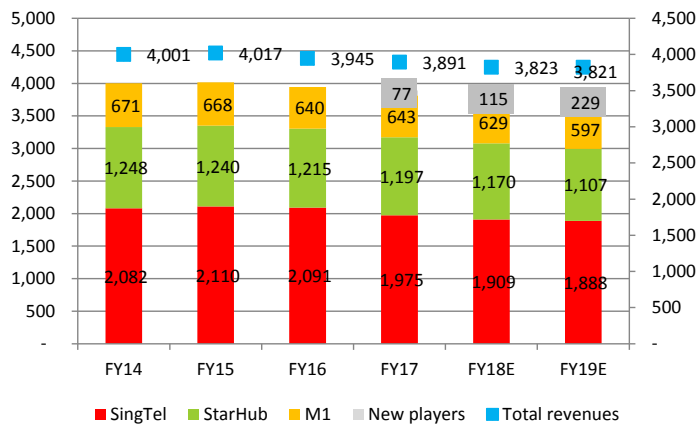
Source: IMDA

Figure 2: TPG’s coverage requirements

| Condition | Time line |
|--|-------------|
| Nationwide outdoor coverage | 31 Dec 2018 |
| Coverage in all road tunnels and in-building areas | 31 Dec 2019 |
| Coverage in MRT underground stations/lines | 31 Dec 2021 |

Source: IMDA

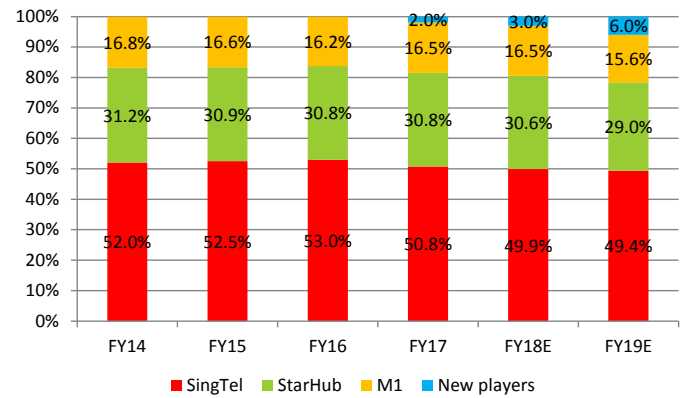
Figure 3: Industry wireless revenue* (SGD m)



Source: Company data, Maybank Kim Eng

*Calendarised to end-Dec

Figure 4: Industry wireless revenue market shares*



Source: Company data, Maybank Kim Eng

*Calendarised to end-Dec

Figure 5: TP methodologies

| Company | Methodology |
|---------|-------------------------------------|
| SingTel | SOTP based on DCF of various parts* |
| StarHub | DCF based, WACC 5.3%, LTG -1% |
| M1 | DCF based, WACC 4.1%, LTG -1% |

Source: Maybank Kim Eng

*Pls refer to Singtel tear sheet for full details

Value Proposition

- Telco conglomerate whose companies have significant, if not leading, shares in their markets.
- High growth phase for wireless segment has passed. Competition is generally on the rise in this segment in most markets.
- Enterprise and digital services to provide next legs of growth while cash is harvested from wireless leadership to support investments and capex.
- Healthy balance sheet backs 60-75% dividend payout commitment on recurring profit. Non-core asset-sale proceeds are partly committed to exceptional payouts.
- Despite its acquisitions in recent years, SingTel continues to generate 14-16% ROIC.

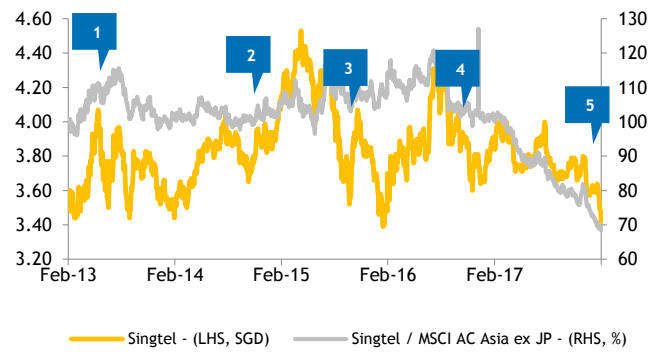
SingTel's SOTP breakdown

| Valuation | Stake (%) | Valuation method | Valuation Per share (SGD m) | Valuation Per share (SGD) |
|-------------------------------------|-----------|---------------------------------------|-----------------------------|---------------------------|
| Consolidated Businesses | | | | |
| SingTel | 100.0 | DCF (5.5% WACC, 0% TG, 0.60 beta) | 6,899 | 0.42 |
| Optus | 100.0 | DCF (5.7% WACC, 0% TG, 0.65 beta) | 15,511 | 0.95 |
| Sub Total | | | 22,410 | 1.37 |
| Associates & Investments | | | | |
| Telkomsel (Indonesia) | 35.0 | DCF (10.8% WACC, 3% TG, 1.0 beta) | 13,736 | 0.84 |
| Bharti Airtel (India) | 38.6 | SOTP (10.5% WACC, 3% TG, 0.9 beta) | 10,479 | 0.64 |
| AIS (Thailand) | 23.3 | DCF (7.0% WACC, 2% TG, 1.0 beta) | 6,234 | 0.38 |
| Globe (Philippines) | 47.2 | DCF (6.7% WACC, 1% TG, 1.05 beta) | 3,811 | 0.23 |
| Intouch (Thailand) | 21.0 | SOTP (AIS TP and mkt cap of THCOM TB) | 1,868 | 0.11 |
| NetLink NBN Trust (Singapore) | 25.0 | Consensus target price | 912 | 0.06 |
| SingPost (Singapore) | 25.8 | DCF (7.6% WACC, 1% TG, 0.95 beta) | 757 | 0.05 |
| Sub Total | | | 37,040 | 2.32 |
| Total Equity Value | | | 59,450 | 3.69 |

Source: Maybank Kim Eng

Price Drivers

Historical share price trend



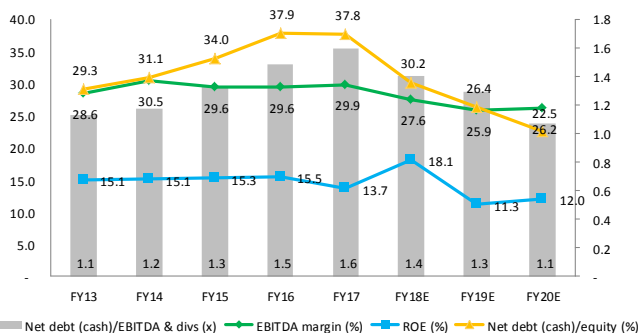
Source: Company, Maybank Kim Eng, Factset

1. Launch of 4G services that ended unlimited data plan competition.
2. All regional associates powered earnings in FY15.
3. Proposal for fourth mobile licence. Bharti's profits started to taper off.
4. TPG won licence in a general spectrum auction.
5. Proposal to increase effective stake in Bharti to 39.5%

Financial Metrics

- Singapore and Australia operational EBITDA forecast to decline by 11% 2-year CAGR on the back of higher equipment subsidies.
- Pretax associate income could soften the blow by growing 15% over the same period.
- We forecast net debt to EBITDA, including associate dividends, forecast to remain healthy at 1.5x in FY18-19E; leaving room for sustainable dividend payout at the upper range of the payout policy and / or acquisitions.

Financial ratios have not succumbed to competitive pressure



Source: Company, Maybank Kim Eng

Swing Factors

Upside

- Strong growth in enterprise and Digital Life to economies of scale.
- Ebbing competitive heat in India.
- Subsidies per smartphone drop.

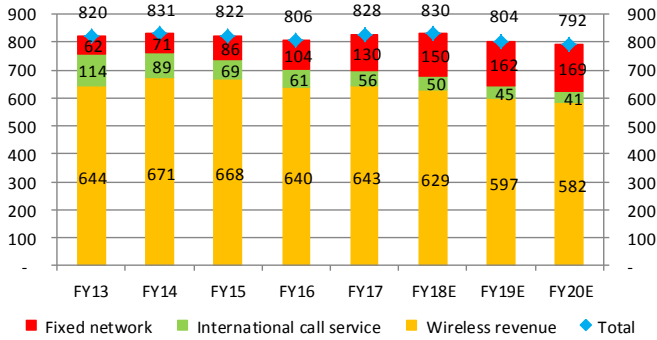
Downside

- Wireless margin compression triggered either by TPG in Singapore and / or Australia or pre-emptive strikes by incumbents. These are not likely in consensus forecasts.
- Long-term capex for 5G rollout not likely priced in.
- Worse-than-expected cannibalisation of wireless voice, SMS and roaming by data.

Value Proposition

- Historically, the purest play in the Singapore wireless sector but has been expanding more meaningfully into fixed broadband and enterprise segments.
- The high growth phase of wireless has passed and wireless data cannibalization of voice and SMS is stifling growth.
- Seeking to tap into Smart Nation projects to enhance its enterprise service revenues and track record.

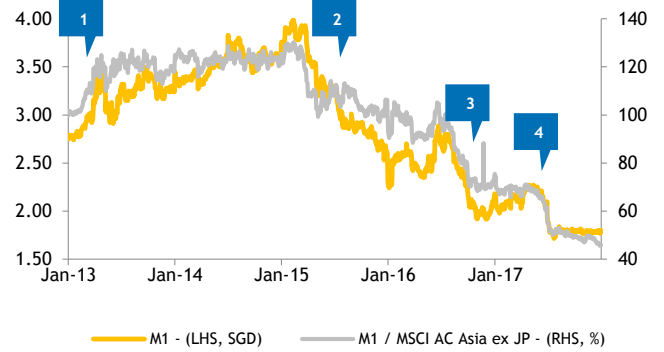
M1's service revenue breakdown (SGD m)



Source: Company, Maybank Kim Eng estimates

Price Drivers

Historical share price trend



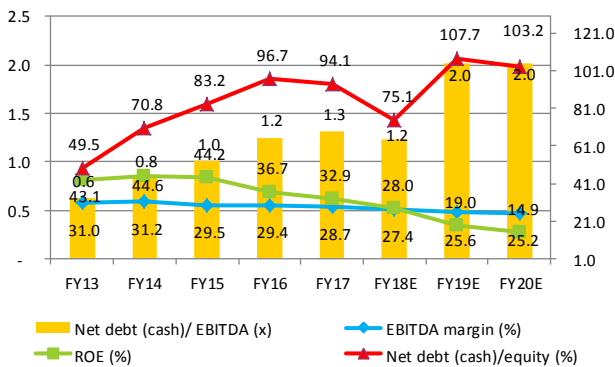
Source: Company, Maybank Kim Eng, Factset

- Industry re-rating on the back of the launch of 4G services that led to the end of unlimited data plan competition and a move to tiered data plans.
- Proposals for fourth mobile license issuance began to drive an industry de-rating.
- New spectrum auction entry of TPG followed by additional frequency won during general spectrum auction (GSA) continues domino effect.
- Soft 2Q17 results and cancellation of shareholder review weaken share price further.

Financial Metrics

- We assume competition from new players will manifest in tariff plan pressure similar to the 3G price war period in 2009-2012. We assume M1's wireless service revenues decrease by a 3% CAGR over 2017-2020E.
- We forecast a positive 9% CAGR over 2017-2020E for fixed network revenue that will help offset wireless and international call revenue pressure.
- Despite our overall service revenue decline assumptions from 2018E to 2020E, the balance sheet is still able to sustain cash dividends at the committed 80% payout level for 2018E-19E and even increase this to 90% in 2020E.

Balance sheet still able to support payout



Source: Company, Maybank Kim Eng estimates

Swing Factors

Upside

- A benign competitive environment or a hasty retreat by new entrants would be an unexpected surprise.
- Growth in fixed network via fixed broadband and/or enterprise could provide earnings surprises in the medium to long term.
- Any takeover interest by a new entrant or TPG could trigger a sector re-rating.

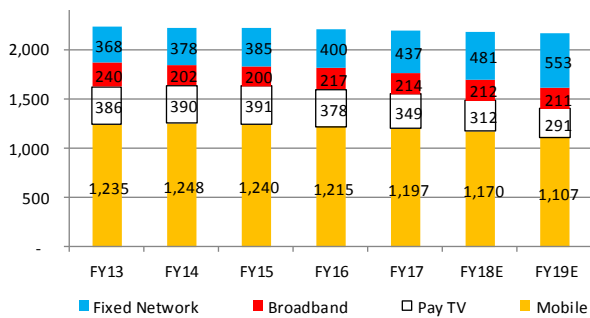
Downside

- Should TPG resort to handset subsidies to poach subscribers an escalation in incumbents' own efforts could take place.
- Higher-than-expected capex pressure as a result of competition and/or 5G rollout.
- Risks of a more rapid decline in wireless voice, SMS and roaming as data adoption gains momentum.

Value Proposition

- Second-largest operator in a mature, high income ASEAN economy. Entrant of fourth operator threatens market share, returns and cost of capital.
- Cyclical EBITDA margin within the calendar year due to smartphone launches and a largely postpaid revenue driven market that values equipment subsidies.
- Network management experience and breadth drives increased initiatives to tap private and public enterprise contracts.
- Dividend yield has been a key investment thesis. Despite reducing payout commitment (from SGD0.20 to SGD0.16), potential for DPS to exceed EPS remains, as in prior years.

StarHub's fixed network services its main bright spot (SGD m)

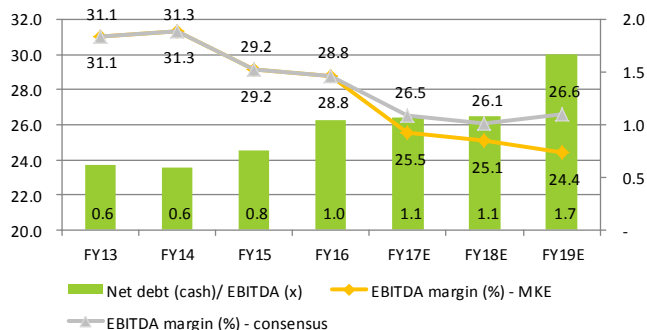


Source: Company data, Maybank Kim Eng

Financial Metrics

- Despite margin pressure the committed SGD0.16 DPS remains within debt covenants.
- Gearing could come under pressure with spectrum payments and competition related capex in the coming months and years.
- Key financial/operating metrics we would be watching for in subsequent quarters are subsidy levels, mobile subscriber recontracting rates, and pay TV churn.

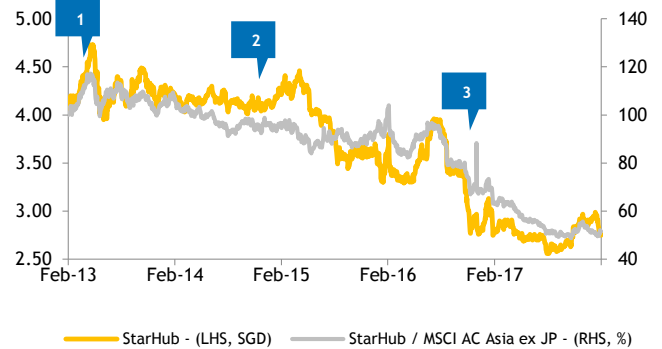
Leverage rising with margins weakening



Source: Company data, FactSet, Maybank Kim Eng

Price Drivers

Historical share price trend



Source: Company, FactSet, Maybank Kim Eng

1. Industry re-rating on the launch of 4G services to help replace unlimited-data 3G plans to pay-as-you-use plans.
2. Consistent dividend payout kept share price generally stable.
3. Expectations of a new entrant initially with a Dec 2016 spectrum auction that led to TPG's entry. Also, dividend payout commitment cut by 20% to SGD0.16 per share.

Swing Factors

Upside

- Enterprise segment targeting, including government contracts revolving around the Smart Nation initiatives provides source of new revenues, despite competition with SingTel.
- Network alliance with M1 to reduce network redundancies and operating expenses, and future joint capex planning is under negotiation.

Downside

- Re-contracting/retention costs likely to rise on the back of new smartphone launches and defensive preparation against TPG's entry.
- Further wireless tariff package pressure on rates and/or data allocations possible with new competition.
- Further investments in enterprise or content space that may have a gestation period before realizing returns.

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