

StarHub (STH SP)

Temasek Team Up

Cyber security JV. Maintain BUY.

StarHub is forming a new JV company (Ensign) with an unlisted wholly owned subsidiary of Temasek (Leone) to grow its cyber security business locally and regionally. We await the finalization of the deal by Oct 2018 and revised contributions from the cyber security business to assess final impact to our forecasts. StarHub remains our only BUY in the Singapore telco space with a DCF based (WACC 5.7%, LTG -1%) TP of SGD1.96. Worse than expected wireless and enterprise competition are the key risks to our outlook.

Deal mechanics: 60% stake initially; 40% in future.

StarHub will use internal cash to pay SGD36m for its initial 60% stake in Ensign. Temasek's indirect wholly owned subsidiary Leone will be the partner. The two parties will inject their respective existing cyber security businesses into Ensign. In year 3 to 5, either party has the option to trigger StarHub's sale of a 20% stake to Leone at a valuation determined by an independent party. If not triggered before year 5, Leone will increase its stake to 60% after year 5.

Not a stretch and a positive contributor in year 1

The SGD36m injection will not stress StarHub's financial covenants significantly; our current FY19E net debt to EBITDA will rise to 2.0x from 1.9x. Ensign targets initial annual revenue of SGD100m. Pro-forma profitability of SGD2.7m will be suppressed by management fees but this will cease after the new entity is formed.

Awaiting completion but momentum is positive

We maintain our current forecasts pending deal finalization and the initial impact of the JV. We currently assume that enterprise/fixed network revenue momentum will improve to 15% in FY19E from 10% (SGD481m) in FY18E. Every 1% improvement in such revenues from FY19E would increase our TP by 1%. We believe a completed deal will enhance StarHub's outlook and will diversify its business risk exposure.

| FYE Dec (SGD m) | FY16A | FY17A | FY18E | FY19E | FY20E |
|------------------------------|-------|--------|--------|-------|--------|
| Revenue | 2,397 | 2,401 | 2,363 | 2,324 | 2,253 |
| EBITDA | 690 | 613 | 588 | 565 | 536 |
| Core net profit | 341 | 259 | 224 | 207 | 165 |
| Core FDEPS (cts) | 19.7 | 14.9 | 12.9 | 11.9 | 9.5 |
| Core FDEPS growth(%) | (8.2) | (24.3) | (13.4) | (7.6) | (20.1) |
| Net DPS (cts) | 20.0 | 16.0 | 16.0 | 10.0 | 10.0 |
| Core FD P/E (x) | 17.4 | 18.6 | 12.6 | 13.7 | 17.1 |
| P/BV (x) | 30.4 | 14.1 | 9.8 | 8.7 | 9.0 |
| Net dividend yield (%) | 5.8 | 5.8 | 9.8 | 6.1 | 6.1 |
| ROAE (%) | 178.5 | 95.8 | 70.7 | 67.8 | 51.9 |
| ROAA (%) | 16.6 | 11.4 | 9.8 | 8.9 | 6.9 |
| EV/EBITDA (x) | 8.1 | 9.1 | 6.2 | 6.9 | 7.1 |
| Net gearing (%) (incl perps) | 360.3 | 181.0 | 290.6 | 328.9 | 322.8 |
| Consensus net profit | - | - | 221 | 193 | 172 |
| MKE vs. Consensus (%) | - | - | 1.4 | 7.2 | (4.2) |

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BUY

| | |
|-----------------------|-----------------|
| Share Price | SGD 1.63 |
| 12m Price Target | SGD 1.96 (+20%) |
| Previous Price Target | SGD 1.96 |

Company Description

StarHub is the second largest wireless service and largest pay TV operator in Singapore.

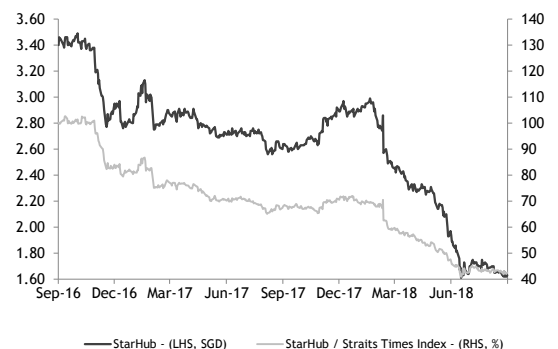
Statistics

| | |
|------------------------|-----------|
| 52w high/low (SGD) | 2.99/1.61 |
| 3m avg turnover (USDm) | 5.3 |
| Free float (%) | 32.4 |
| Issued shares (m) | 1,732 |
| Market capitalisation | SGD2.8B |
| | USD2.1B |

Major shareholders:

| | |
|------------------------------------|-------|
| Asia Mobile Holdings Pte Ltd | 55.9% |
| Nippon Telegraph & Telephone Corp. | 9.9% |
| BlackRock Fund Advisors | 5.0% |

Price Performance



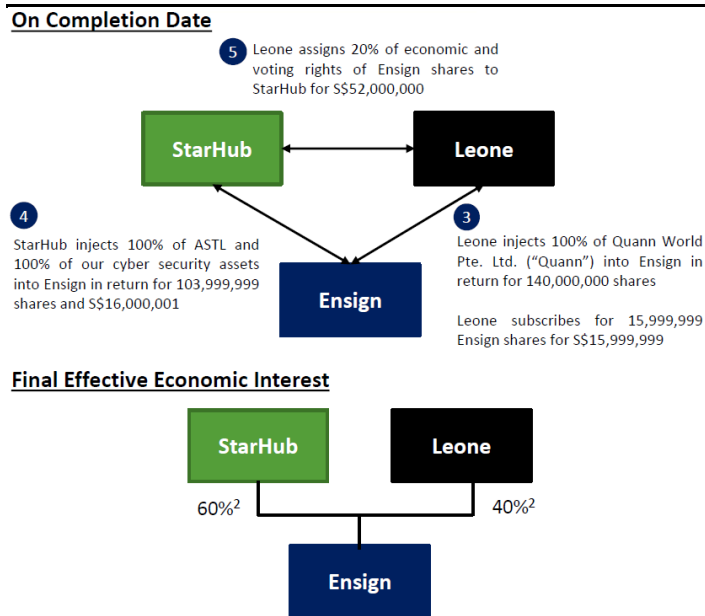
| | -1M | -3M | -12M |
|-----------------------|-----|------|------|
| Absolute (%) | (3) | (17) | (37) |
| Relative to index (%) | (1) | (11) | (37) |

Source: FactSet

Other management call highlights:

- The bulk of Leone’s business is generated by Singapore government related contracts; existing relationships should be transferred to the new entity.
- No other assets from either party will be injected in the future. It will grow organically once launched.
- Ensign will compete for business with existing local and regional players but will particularly focus on deep expertise services and contracts rather than a subscription based model.
- Upon completion there will be 500 staff based in Singapore. The talent pool will be expanded as the business scales up.
- No FY19E dividend payout guidance was given. Management acknowledged FY18E remains intact at SGD0.16 and that FY19E has prospective frequency fee payments along with this transaction.

Figure 1: Proposed transaction structure

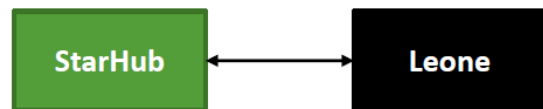


Source: Company data

Figure 2: Structure upon termination of assignment of rights

In event either party exercises its right to terminate the assignment of shares between Year 3 and 5

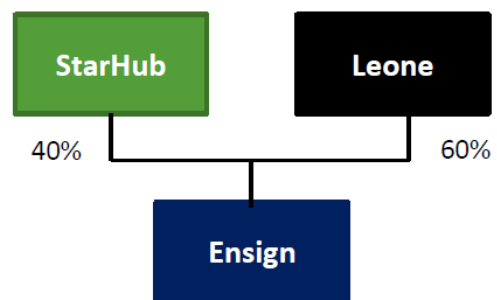
Upon exercise of right to terminate, all assignment of shares will cease and Leone will pay a consideration to StarHub



The consideration payable by Leone shall be:

- In event StarHub initiates the termination, the **lower** of fair market value of the assignments or a reference price
 - In event Leone initiates the termination, the **higher** of fair market value of the assignments or a reference price
- Reference price = 6% annual compounding on consideration paid for the assignments

Final Shareholding Structure after termination



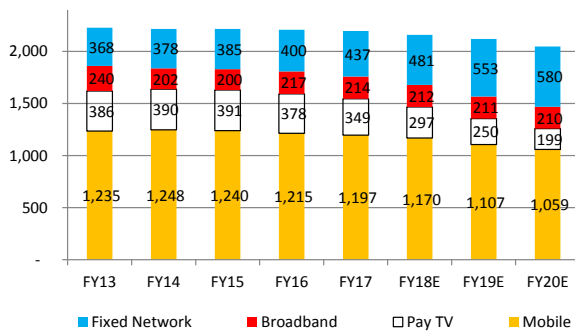
Source: Company data

*Fair market value will be determined by the Big 4 audit firms appointed by StarHub and Leone via an independent valuation exercise.

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.
- High dividend yield (6%) provides share price support. After reducing our absolute dividend assumption by 38% in 2019E, the payout is below 100% but we forecast it to increase to over 100% afterwards. Despite this, StarHub will remain in compliance with its loan covenants.

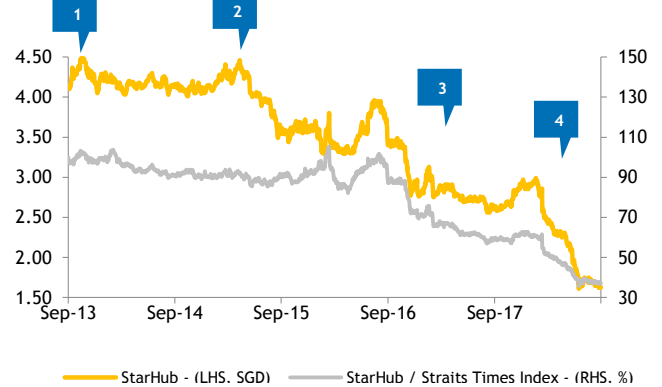
StarHub's fixed network services its main bright spot (SGD m)



Source: Company data, Maybank Kim Eng

Price Drivers

Historical share price trend



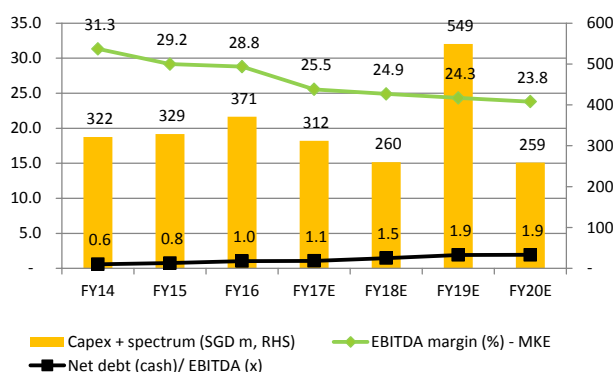
Source: Company, FactSet, Maybank Kim Eng

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.
4. Concerns emerge on weakest incumbent wireless revenue trends and pay TV viability.

Financial Metrics

- Under our revised DPS assumptions, gearing will remain within loan 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

Swing Factors

Upside

- Potential source of new revenues from enterprise segment targeting, including government contracts revolving around the Smart Nation initiatives.
- A strong contribution from leasing fees from the MyRepublic MVNO deal.
- A muted entry by TPG is a potential upside to valuation and market sentiment.

Downside

- Re-contracting/retention costs rising 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 due to new competition or from incumbents.
- Material investments in enterprise or content space that may have a lengthy gestation period before realizing returns.

| FYE 31 Dec | FY16A | FY17A | FY18E | FY19E | FY20E |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Key Metrics | | | | | |
| P/E (reported) (x) | 17.3 | 18.5 | 12.6 | 13.6 | 17.0 |
| Core P/E (x) | 17.3 | 18.5 | 12.6 | 13.6 | 17.0 |
| Core FD P/E (x) | 17.4 | 18.6 | 12.6 | 13.7 | 17.1 |
| P/BV (x) | 30.4 | 14.1 | 9.8 | 8.7 | 9.0 |
| P/NTA (x) | (22.0) | (22.1) | (10.4) | (5.4) | (5.4) |
| Net dividend yield (%) | 5.8 | 5.8 | 9.8 | 6.1 | 6.1 |
| FCF yield (%) | 3.1 | 4.3 | 3.2 | nm | 8.3 |
| EV/EBITDA (x) | 8.1 | 9.1 | 6.2 | 6.9 | 7.1 |
| EV/EBIT (x) | 13.1 | 16.7 | 12.2 | 13.8 | 16.5 |
| INCOME STATEMENT (SGD m) | | | | | |
| Revenue | 2,396.7 | 2,400.7 | 2,363.0 | 2,323.9 | 2,252.9 |
| EBITDA | 690.1 | 613.2 | 588.2 | 565.2 | 536.2 |
| Depreciation | (265.0) | (280.4) | (289.7) | (283.7) | (303.8) |
| Amortisation | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EBIT | 425.1 | 332.8 | 298.5 | 281.5 | 232.4 |
| Net interest income / (exp) | (22.7) | (26.2) | (28.8) | (32.2) | (33.3) |
| Associates & JV | (1.6) | (2.2) | 0.0 | 0.0 | 0.0 |
| Exceptionals | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other pretax income | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pretax profit | 410.3 | 304.4 | 269.7 | 249.3 | 199.1 |
| Income tax | (68.9) | (54.8) | (45.8) | (42.4) | (33.8) |
| Minorities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Perpetual securities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Discontinued operations | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported net profit | 341.4 | 258.6 | 223.8 | 206.9 | 165.3 |
| Core net profit | 341.4 | 258.6 | 223.8 | 206.9 | 165.3 |
| Preferred Dividends | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| BALANCE SHEET (SGD m) | | | | | |
| Cash & Short Term Investments | 285.2 | 345.2 | 140.8 | 60.9 | 104.7 |
| Accounts receivable | 384.4 | 201.5 | 342.6 | 337.0 | 326.7 |
| Inventory | 49.6 | 71.9 | 47.3 | 46.5 | 45.1 |
| Reinsurance assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Property, Plant & Equip (net) | 918.0 | 870.1 | 840.3 | 823.9 | 779.2 |
| Intangible assets | 463.8 | 557.6 | 557.6 | 839.6 | 839.6 |
| Investment in Associates & JVs | 25.9 | 23.7 | 23.7 | 23.7 | 23.7 |
| Other assets | 69.4 | 282.0 | 282.0 | 282.0 | 282.0 |
| Total assets | 2,196.3 | 2,352.0 | 2,234.3 | 2,413.6 | 2,400.9 |
| ST interest bearing debt | 10.0 | 120.0 | 120.0 | 120.0 | 120.0 |
| Accounts payable | 707.9 | 736.5 | 661.6 | 650.7 | 630.8 |
| Insurance contract liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| LT interest bearing debt | 977.5 | 857.5 | 857.5 | 1,000.0 | 1,000.0 |
| Other liabilities | 306.0 | 293.0 | 307.0 | 321.0 | 336.0 |
| Total Liabilities | 2,001.4 | 2,007.1 | 1,946.4 | 2,091.5 | 2,086.4 |
| Shareholders Equity | 194.9 | 344.9 | 287.9 | 322.0 | 314.5 |
| Minority Interest | 0.0 | 4.4 | 0.0 | 0.0 | 0.0 |
| Total shareholder equity | 194.9 | 349.3 | 287.9 | 322.0 | 314.5 |
| Perpetual securities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total liabilities and equity | 2,196.3 | 2,352.0 | 2,234.3 | 2,413.6 | 2,400.9 |
| CASH FLOW (SGD m) | | | | | |
| Pretax profit | 410.3 | 304.4 | 269.7 | 249.3 | 199.1 |
| Depreciation & amortisation | 265.0 | 280.4 | 289.7 | 283.7 | 303.8 |
| Adj net interest (income)/exp | 22.7 | 26.2 | 28.8 | 32.2 | 33.3 |
| Change in working capital | (63.7) | (32.3) | (191.4) | (4.5) | (8.2) |
| Cash taxes paid | (53.7) | (65.3) | (45.8) | (42.4) | (33.8) |
| Other operating cash flow | 0.0 | 0.3 | 1.6 | 2.2 | 0.0 |
| Cash flow from operations | 550.7 | 517.2 | 351.0 | 518.3 | 494.2 |
| Capex | (371.3) | (312.1) | (259.9) | (549.2) | (259.1) |
| Free cash flow | 184.0 | 205.1 | 91.1 | (30.9) | 235.1 |
| Dividends paid | (346.2) | (293.9) | (276.4) | (172.8) | (172.8) |
| Equity raised / (purchased) | (12.3) | 199.6 | 0.0 | 0.0 | 0.0 |
| Perpetual securities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Change in Debt | 274.9 | (10.0) | 0.0 | 142.5 | 0.0 |
| Perpetual securities distribution | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other invest/financing cash flow | 16.0 | (40.8) | (19.1) | (18.6) | (18.6) |
| Effect of exch rate changes | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net cash flow | 111.8 | 60.0 | (204.4) | (79.8) | 43.7 |

| FYE 31 Dec | FY16A | FY17A | FY18E | FY19E | FY20E |
|--|-------|--------|--------|---------|---------|
| Key Ratios | | | | | |
| Growth ratios (%) | | | | | |
| Revenue growth | (1.9) | 0.2 | (1.6) | (1.7) | (3.1) |
| EBITDA growth | (3.2) | (11.1) | (4.1) | (3.9) | (5.1) |
| EBIT growth | (3.7) | (21.7) | (10.3) | (5.7) | (17.4) |
| Pretax growth | (6.8) | (25.8) | (11.4) | (7.6) | (20.1) |
| Reported net profit growth | (8.3) | (24.3) | (13.4) | (7.6) | (20.1) |
| Core net profit growth | (8.3) | (24.3) | (13.4) | (7.6) | (20.1) |
| Profitability ratios (%) | | | | | |
| EBITDA margin | 28.8 | 25.5 | 24.9 | 24.3 | 23.8 |
| EBIT margin | 17.7 | 13.9 | 12.6 | 12.1 | 10.3 |
| Pretax profit margin | 17.1 | 12.7 | 11.4 | 10.7 | 8.8 |
| Payout ratio | 101.2 | 106.9 | 123.5 | 83.5 | 104.5 |
| DuPont analysis | | | | | |
| Net profit margin (%) | 14.2 | 10.8 | 9.5 | 8.9 | 7.3 |
| Revenue/Assets (x) | 1.1 | 1.0 | 1.1 | 1.0 | 0.9 |
| Assets/Equity (x) | 11.3 | 6.8 | 7.8 | 7.5 | 7.6 |
| ROAE (%) | 178.5 | 95.8 | 70.7 | 67.8 | 51.9 |
| ROAA (%) | 16.6 | 11.4 | 9.8 | 8.9 | 6.9 |
| Liquidity & Efficiency | | | | | |
| Cash conversion cycle | na | na | na | na | na |
| Days receivable outstanding | 55.2 | 43.9 | 41.4 | 52.6 | 53.0 |
| Days inventory outstanding | na | na | na | na | na |
| Days payables outstanding | na | na | na | na | na |
| Dividend cover (x) | 1.0 | 0.9 | 0.8 | 1.2 | 1.0 |
| Current ratio (x) | 0.9 | 0.7 | 0.6 | 0.5 | 0.6 |
| Leverage & Expense Analysis | | | | | |
| Asset/Liability (x) | 1.1 | 1.2 | 1.1 | 1.2 | 1.2 |
| Net gearing (%) (incl perps) | 360.3 | 181.0 | 290.6 | 328.9 | 322.8 |
| Net gearing (%) (excl. perps) | 360.3 | 181.0 | 290.6 | 328.9 | 322.8 |
| Net interest cover (x) | 18.7 | 12.7 | 10.4 | 8.7 | 7.0 |
| Debt/EBITDA (x) | 1.4 | 1.6 | 1.7 | 2.0 | 2.1 |
| Capex/revenue (%) | 15.5 | 13.0 | 11.0 | 23.6 | 11.5 |
| Net debt/ (net cash) | 702.3 | 632.3 | 836.7 | 1,059.1 | 1,015.3 |

Source: Company; Maybank

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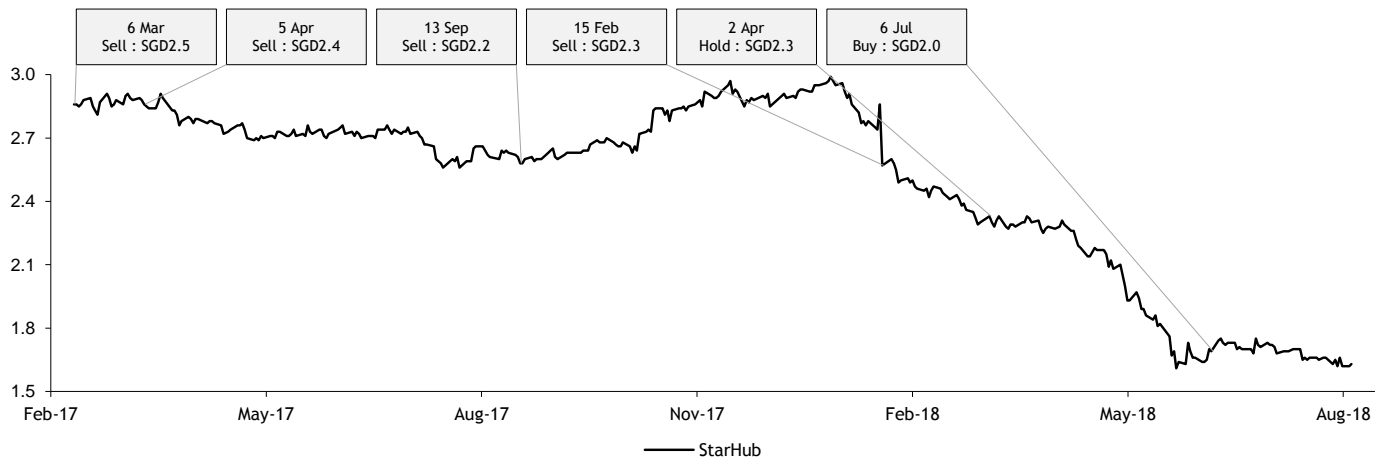
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