

# StarHub (STH SP)

## CEO Briefing Highlights

### Changes from within...

New StarHub CEO Peter Kaliaropoulos hosted an analyst briefing to outline a broad strategy that will be proposed to the Board. The trend of digitalization of enterprises is an external revenue opportunity and a means to improve marketing and cost control internally. We await more concrete details and targets for the strategy but view the overall purpose positively and maintain our view that StarHub's share price is currently assuming a dire scenario and that value has already emerged. Maintain BUY with a DCF-based (WACC 5.7%, LTG -1%) TP of SGD1.96.

### ...to prepare for external threats

The CEO highlighted that MVNO models on average do not last beyond a few years as telco incumbents make the adjustments to their business structures and marketing plans. Meanwhile incoming MNO entrant TPG (TPM AU, Not Rated) will put up a fight but there are few markets where four operators each with significant market shares exist. Also, unlike the past when the MNO incumbents did not react quickly to disruptive promotions, there is not likely to be a long grace period for TPG. Whether via MVNOs or directly, the incumbents will react to bring parity. There is a possibility of industry consolidation two to three years out.

### Aligning costs with new business environments

Costs overall will continue to be managed but with increased utilization of available technology and applications. The content costs for the pay TV business model will be managed ideally to a variable cost system than the current fixed cost model as contract renewal periods come due.

### Worse case implied in share price already

At current levels, the share price is implying extreme scenarios of pay-TV revenues going to zero or wireless service revenues dropping a further c15% from our estimate. Key risk to our BUY is a scenario where the incumbents engage in a price war rather than let their MVNOs fight in the low-price segment against TPG.

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	12.8	13.8	17.3
P/BV (x)	30.4	14.1	9.9	8.9	9.1
Net dividend yield (%)	5.8	5.8	9.7	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	6.3	6.9	7.2
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 1.65
12m Price Target	SGD 1.96 (+19%)
Previous Price Target	SGD 1.96

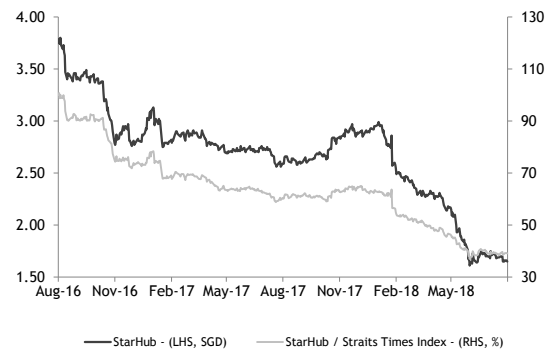
### Statistics

52w high/low (SGD)	2.99/1.61
3m avg turnover (USDm)	8.3
Free float (%)	32.4
Issued shares (m)	1,732
Market capitalisation	SGD2.9B 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)	(24)	(36)
Relative to index (%)	(0)	(16)	(35)

Source: FactSet

### Terms mentioned:

MVNO - mobile virtual network operator  
MNO - mobile network operator  
B2C - business to consumer

## Other briefing highlights

### Wireless segment

\* Subscriber retention will be the focus. From these loyal subscribers the aim will be to generate incremental revenues by meeting their needs beyond just connectivity to other services/conveniences that can be channelled through StarHub's various networks (e.g. micro loans).

\* Network data utilization is well below 85% so it is ready to handle additional volume from competition and organic growth from increased data demand (e.g. StarHub's subscribers in 2Q18 averaged 5.4GB/mo usage but some countries are at 80GB/mo).

\* 4.5G is capable of 1Gbps speeds already so 5G rollout will be tactical and limited until the app and device ecosystem is in place.

\* Multiple device and thus SIM penetration per household and user will continue to grow so the key is to generate incremental revenues from multiple device usage.

### Pay TV

\* The pay TV business on a stand-alone basis does not generate positive returns. In the early days of the industry it was necessary for "hubbing"/bundling from StarHub's end to gain its market share traction in wireless and fixed broadband. On the flip side, it was also necessary for the content providers in the past that needed a delivery system. The rise of the B2C models like Netflix and the end of the high growth phase of traditional services are changing that dynamic.

\* The goal for pay TV content is to switch from fixed cost base to variable cost. Content providers that are willing to meet as middle ground during upcoming re-contracting periods will be renewed. Hard line stances like that of Discovery Channel group may end up with a similar outcome of non-renewal.

### Enterprise

\* Acquisitions in synergistic spaces that utilize StarHub's connectivity (e.g. the cyber security, cloud and managed services) will continue. The bite size will not be at levels that will require equity raising as the company remains within its loan covenants.

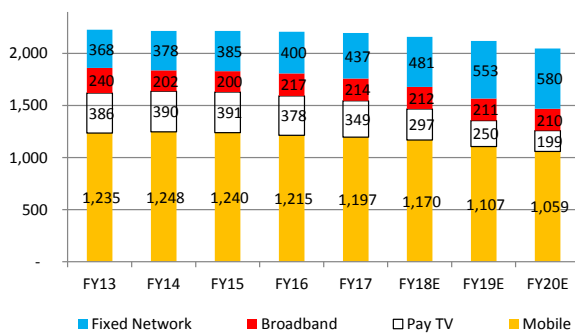
\* Overall margins will be diluted by the acquisition of these types of lower margin businesses but they will generate positive returns to the business as they will primarily utilize existing infrastructure rather than generate any significant additional capex.

\* International investments are not expected.

## 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.

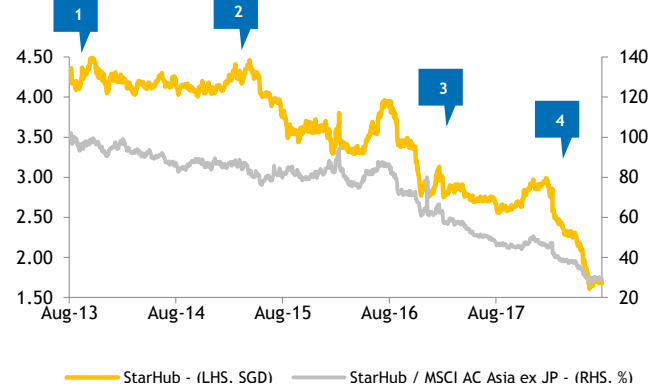
### StarHub's fixed network services its main bright spot (SGD m)



Source: Company data, Maybank Kim Eng

## Price Drivers

### Historical share price trend

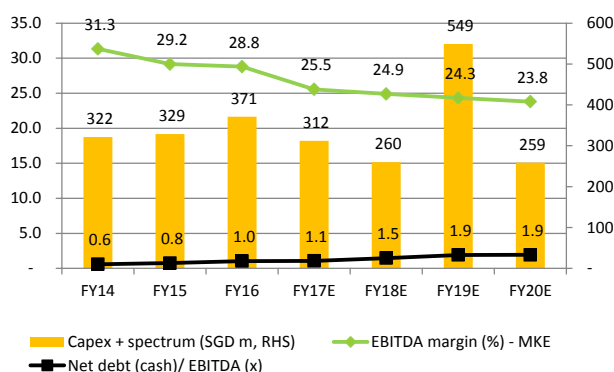


1. Industry re-rating on the launch of 4G services to help replace unlimited-data 3G plans to pay-as-you-use plans.
2. Consistent dividend payout kept share price generally stable.
3. Expectations of a new entrant initially with a Dec 2016 spectrum auction that led to TPG's entry. Also, dividend payout 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
<b>Key Metrics</b>					
P/E (reported) (x)	17.3	18.5	12.7	13.8	17.3
Core P/E (x)	17.3	18.5	12.7	13.8	17.3
Core FD P/E (x)	17.4	18.6	12.8	13.8	17.3
P/BV (x)	30.4	14.1	9.9	8.9	9.1
P/NTA (x)	(22.0)	(22.1)	(10.6)	(5.5)	(5.4)
Net dividend yield (%)	5.8	5.8	9.7	6.1	6.1
FCF yield (%)	3.1	4.3	3.2	nm	8.2
EV/EBITDA (x)	8.1	9.1	6.3	6.9	7.2
EV/EBIT (x)	13.1	16.7	12.4	13.9	16.6
<b>INCOME STATEMENT (SGD m)</b>					
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
<b>BALANCE SHEET (SGD m)</b>					
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
<b>Total assets</b>	<b>2,196.3</b>	<b>2,352.0</b>	<b>2,234.3</b>	<b>2,413.6</b>	<b>2,400.9</b>
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
<b>Total Liabilities</b>	<b>2,001.4</b>	<b>2,007.1</b>	<b>1,946.4</b>	<b>2,091.5</b>	<b>2,086.4</b>
Shareholders Equity	194.9	344.9	287.9	322.0	314.5
Minority Interest	0.0	4.4	0.0	0.0	0.0
<b>Total shareholder equity</b>	<b>194.9</b>	<b>349.3</b>	<b>287.9</b>	<b>322.0</b>	<b>314.5</b>
Perpetual securities	0.0	0.0	0.0	0.0	0.0
<b>Total liabilities and equity</b>	<b>2,196.3</b>	<b>2,352.0</b>	<b>2,234.3</b>	<b>2,413.6</b>	<b>2,400.9</b>
<b>CASH FLOW (SGD m)</b>					
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
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
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)
<b>Profitability ratios (%)</b>					
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
<b>DuPont analysis</b>					
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
<b>Liquidity &amp; Efficiency</b>					
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
<b>Leverage &amp; Expense Analysis</b>					
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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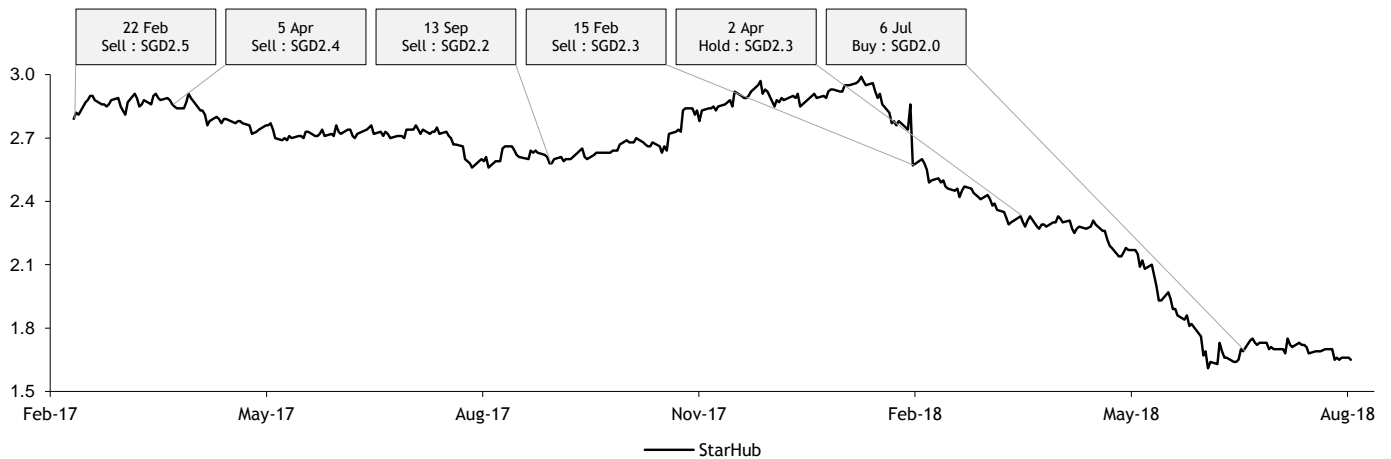
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