

# Singapore Company Guide

## StarHub

Edition 1 Version 1 | Bloomberg: STH SP | Reuters: STAR.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

09 Nov 2015

### FULLY VALUED

Last Traded Price: S\$3.67 (STI : 3,010.47)

Price Target : S\$3.30 (10% downside) (Prev S\$3.70)

**Potential Catalyst:** Quarterly dividends

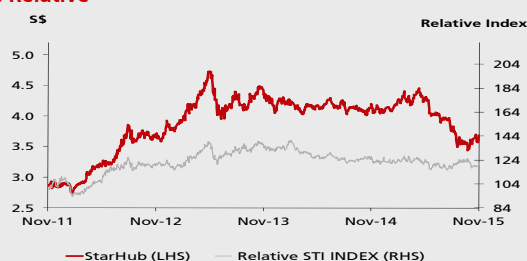
**Where we differ:** In line

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#### Price Relative



#### Forecasts and Valuation

FY Dec (\$m)	2014A	2015F	2016F	2017F
Revenue	2,387	2,407	2,431	2,437
EBITDA	748	759	764	757
Pre-tax Profit	456	469	456	445
Net Profit	371	381	370	361
Net Pft (Pre Ex.)	371	366	370	361
EPS (S cts)	21.5	22.1	21.5	21.0
EPS Pre Ex. (S cts)	21.5	21.3	21.5	21.0
EPS Gth (%)	(3)	3	(3)	(2)
EPS Gth Pre Ex (%)	(3)	(1)	1	(2)
Diluted EPS (S cts)	21.5	22.1	21.5	21.0
Net DPS (S cts)	20.0	20.0	20.3	19.9
BV Per Share (S cts)	8.66	10.8	12.3	13.0
PE (X)	17.1	16.6	17.1	17.5
PE Pre Ex. (X)	17.1	17.3	17.1	17.5
P/Cash Flow (X)	9.6	9.5	9.7	9.8
EV/EBITDA (X)	9.0	8.9	8.8	8.9
Net Div Yield (%)	5.4	5.4	5.5	5.4
P/Book Value (X)	42.4	34.0	29.9	28.2
Net Debt/Equity (X)	2.8	2.2	1.9	1.8
ROAE (%)	319.8	227.7	186.5	166.1
<b>Earnings Rev (%):</b>		3	2	0
<b>Consensus EPS (S cts):</b>		21.2	21.3	21.4
<b>Other Broker Recs:</b>		B: 3	S: 10	H: 12

Source of all data: Company, DBS Bank, Bloomberg Finance L.P

### Two key challenges

**The possibility of 4th mobile player and an online content provider adds uncertainty.** 4G spectrum auction, expected in 1Q16, could result in a 4th mobile player entering the market in 2Q17. Meanwhile, continued decline in roaming revenue (10-15% of mobile revenue) is another concern. Pay TV segment also faces challenges due to the potential entry of online content provider Netflix in 2016.

**One-off gains help bottom line.** 3Q15 net profit of S\$ 118.7m (+21% y-o-y, +20% q-o-q) was above our estimates. This was due to S\$15m one-off gains relating to part divestment of a subsidiary. Excluding the one-off gains the results would have been in line. Lower handset subsidies also helped bottom line.

**StarHub could lose up to 4% of group revenues by 2022 if the 4<sup>th</sup> player is successful.** 4G over 900 MHz spectrum coupled with HetNet technology may lower the capex for the entrant to only S\$250m resulting in a viable business case. We model 4<sup>th</sup> mobile player to capture 7% revenue share by 2022 with StarHub losing 4% of its group revenue. We are less concerned about the potential entry of Netflix as there is a possibility that StarHub may offer access to Netflix through its set-top boxes.

#### Valuation:

We maintain our Fully Valued call on StarHub with a revised TP of S\$3.30. We roll forward our DCF valuation, assume a higher WACC of 7.0% (from 6.5%) and keep terminal growth at 0%.

#### Key Risks to Our View:

**Non-entry of 4<sup>th</sup> mobile player.** The reason could be unsuccessful HetNet trials or an inability to raise adequate funding. Without HetNet, capex requirements could increase significantly while an inability to raise adequate funding by the new entrant could lead to a relief rally for StarHub.

#### At A Glance

Issued Capital (m shrs)	1,728
Mkt. Cap (S\$m/US\$m)	6,894 / 5,131
Major Shareholders	
Asia Mobile Holdings (%)	56.0
Nippon Telegraph (%)	9.9
Free Float (%)	34.1
3m Avg. Daily Val (US\$m)	6.1

ICB Industry :Telecommunications / Mobile Telecommunications

**2Q15 Result Summary**

**One-off gains help bottom line.** 3Q15 net profit of S\$ 118.7m (+21% y-o-y, +20% q-o-q) was above our estimates due to S\$15m one-off gain relating to part divestment of MediaHub. We have adjusted our FY15 forecast to reflect the one-off gain. Excluding the one-off gain, the results would have been mostly in line. Handset subsidies which declined by ~S\$4m q-o-q also helped bottom line.

**Broadband and fixed network service growth promising.**

Broadband revenue rose 4.3% q-o-q to S\$51m, the third quarter of sequential improvement. This was mainly due to expanded subscriber base while ARPU has also shown signs of improvement in 3Q15. In addition, fixed network services has seen healthy growth due to higher subscription in internet and managed services by enterprises.

**Critical Data Points to Watch**

**Earnings Drivers:**

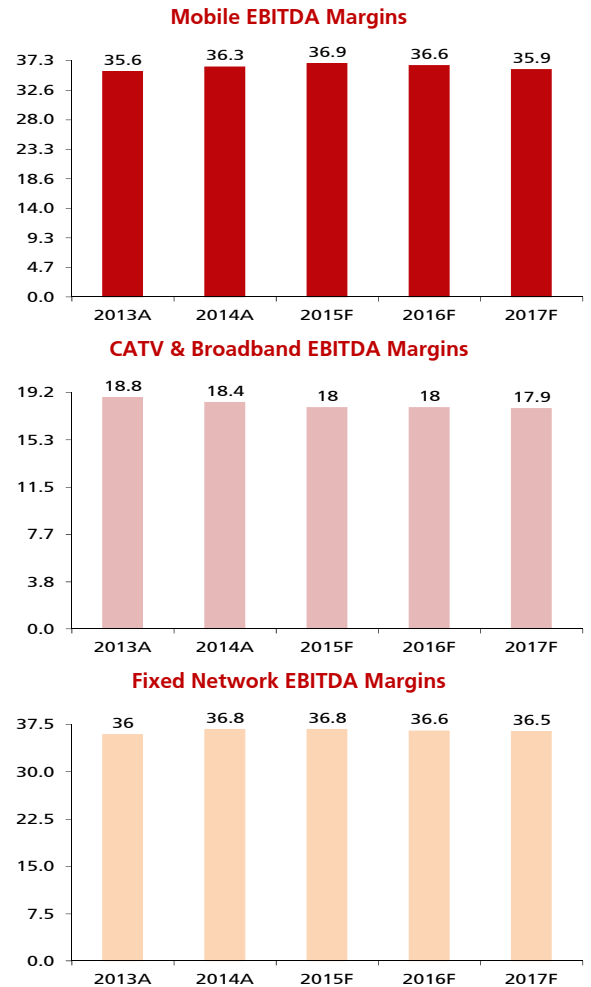
**New SIM-only mobile could impact ARPUs.** StarHub has introduced cheaper SIM-only plans following M1 and Singtel. Both M1 and Singtel introduced cheap SIM-only mobile plans with higher data allowances in 3Q15. StarHub's new SIM-only plans, introduced in early November, are priced at a 50% discount to its 4G smartphone plans and are relatively cheaper for data heavy users than the M1 and Singtel plans. If the plans are popular, the lower price points of the new plans may negatively affect postpaid ARPU while reducing the handset subsidy.

**Mobile roaming revenue could continue to decline.** The abolition of roaming charges in the EU (due to regulations) and the elimination of roaming charges in parts of North America (due to competition) is a matter of concern even for telcos in Asia. Roaming accounts for 10-15% of mobile revenue in Singapore.

**Pay TV business faces threat from entry of a new player.**

Netflix, the US-based online content provider announced in September that it plans to launch its services in the Asian region including Singapore by early 2016. Availability of high-speed broadband and relatively expensive Pay TV subscriptions in Singapore makes a sound business case for OTT players. Netflix revealed that pricing is likely to be set at S\$11 per month, at almost 60% discount to Pay TV subscriptions of StarHub. A strategic partnership between Netflix and StarHub cannot be ruled out. Netflix could benefit from the existing customer base of StarHub while StarHub can minimise the impact of Netflix's entry on its Pay TV business which contributes c.16% to the top line.

**Stabilising fixed broadband business is a positive.** Broadband ARPU is unlikely to return to its previous levels in the near term as StarHub is likely to pursue its current strategy to preserve market share. However, stabilising broadband revenues and ARPU could minimise the drag on earnings in the future. Currently broadband contributes 9% to the top line.



Source: Company, DBS Bank

**Balance Sheet:**

**Balance sheet to remain strong.** Strong cash flow generation has enabled StarHub to maintain a strong balance sheet over the last couple of years. We expect the company's financials to remain strong with relatively stable capex and dividend payout.

**Share Price Drivers:**

**HetNet trials on the way.** HetNet technologies allow consumers to connect to different networks such as Wi-Fi, 4G and 3G networks seamlessly. SingTel, StarHub, M1 and MyRepublic are involved in HetNet trials in Jurong Lake district. The results of HetNet trials are expected towards the end of 2015. HetNet technology may allow telcos to invest 30-40% capex investment compared to traditional technology for similar coverage. This could significantly improve potential 4<sup>th</sup> player's business case by reducing capex.

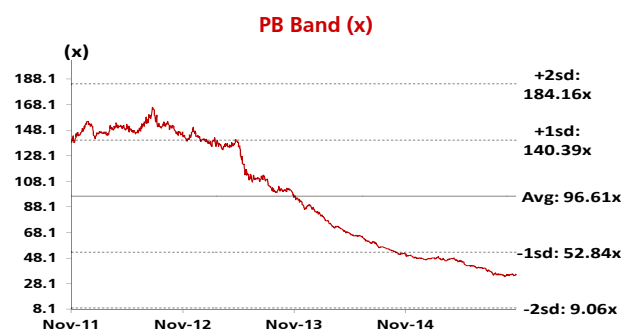
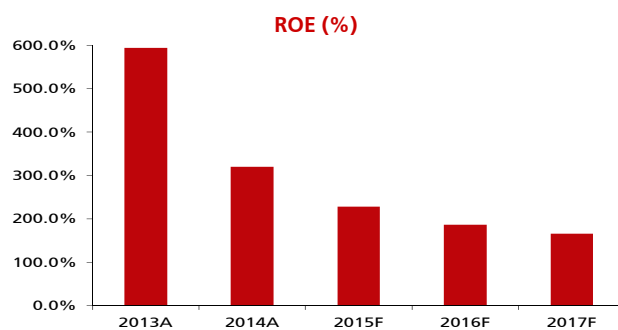
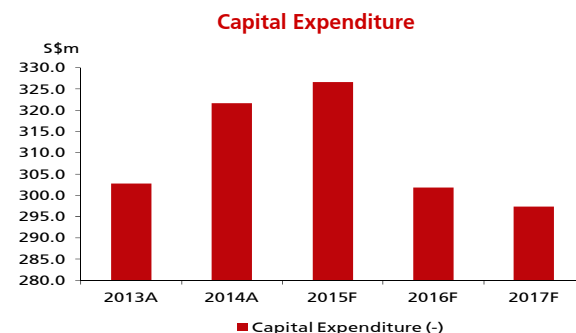
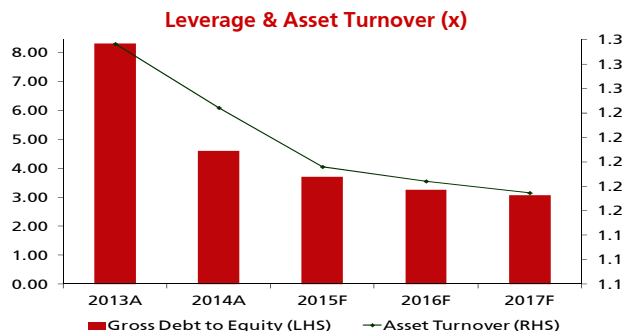
**4th telco adds uncertainty.** Fourth player is likely to face major operational challenges such as getting the sites for rooftop towers. The network capex for the 4th telco could well exceed US\$500m versus US\$250m-300m capex intended by MyRepublic. However, the ability to secure vendor financing and potential success of HetNet trials will encourage MyRepublic's business case. Equipment vendors like Huawei and Ericsson go to the extent of funding 80-100% of the network construction by extending credit, easing the capex requirements. In Malaysia, the 4th mobile player - U Mobile - has captured only 6-7% revenue share after six years. If the 4th telco is able to capture 6-7% market share, we believe StarHub could lose up to 4% of its revenues by 2022 compared to M1's 10%, which we believe is the most vulnerable.

**Key Risks:**

**Non-entry of 4th mobile player.** The reason could be unsuccessful HetNet trails or inability to raise adequate funding. Without HetNet, capex requirements could increase significantly while an inability to raise adequate funding by the new entrant could lead to a relief rally for StarHub.

**Company Background**

StarHub is the second largest of the three telecom operators in Singapore. StarHub provides mobile services, pay TV, fixed broadband and fixed voice services, popularly known as quadruple play services.



Source: Company, DBS Bank

## Key Assumptions

FY Dec	2013A	2014A	2015F	2016F	2017F
Mobile EBITDA Margins	35.6	36.3	36.9	36.6	35.9
CATV & Broadband EBITDA Margins	18.8	18.4	18.0	18.0	17.9
Fixed Network EBITDA Margins	36.0	36.8	36.8	36.6	36.5

## Segmental Breakdown

FY Dec	2013A	2014A	2015F	2016F	2017F
<b>Revenues (\$\$m)</b>					
Mobile	1,243	1,248	1,245	1,256	1,250
Cable TV & Broadband	628	592	594	594	592
Fixed Network	368	378	398	411	425
Equipment sale	130	170	170	170	170
<b>Total</b>	<b>2,370</b>	<b>2,387</b>	<b>2,407</b>	<b>2,431</b>	<b>2,437</b>
<b>EBITDA (\$\$m)</b>					
Mobile	442	453	459	460	449
Cable TV & Broadband	118	109	107	107	106
Fixed Network	133	139	147	151	155
Equipment sale	49.9	46.6	46.6	46.6	46.6
<b>Total</b>	<b>743</b>	<b>748</b>	<b>759</b>	<b>764</b>	<b>757</b>
<b>EBITDA Margins (%)</b>					
Mobile	35.6	36.3	36.9	36.6	35.9
Cable TV & Broadband	18.8	18.4	18.0	18.0	17.9
Fixed Network	36.0	36.8	36.8	36.6	36.5
Equipment sale	38.4	27.5	27.4	27.4	27.4
<b>Total</b>	<b>31.4</b>	<b>31.3</b>	<b>31.6</b>	<b>31.4</b>	<b>31.0</b>

Mobile revenue is expected to stagnate

Fixed broadband will likely stabilize

## Income Statement (\$\$m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Revenue	2,370	2,387	2,407	2,431	2,437
Cost of Goods Sold	(1,946)	(1,957)	(1,979)	(2,002)	(2,020)
<b>Gross Profit</b>	<b>424</b>	<b>430</b>	<b>428</b>	<b>429</b>	<b>418</b>
Other Opng (Exp)/Inc	49.9	46.6	46.6	46.6	46.6
<b>Operating Profit</b>	<b>474</b>	<b>477</b>	<b>474</b>	<b>476</b>	<b>464</b>
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(16.0)	(20.6)	(20.4)	(20.0)	(19.5)
Exceptional Gain/(Loss)	0.0	0.0	15.0	0.0	0.0
<b>Pre-tax Profit</b>	<b>458</b>	<b>456</b>	<b>469</b>	<b>456</b>	<b>445</b>
Tax	(76.5)	(85.6)	(88.0)	(85.5)	(83.5)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>381</b>	<b>371</b>	<b>381</b>	<b>370</b>	<b>361</b>
Net Profit before Except.	381	371	366	370	361
EBITDA	743	748	759	764	757
<b>Growth</b>					
Revenue Gth (%)	(2.1)	0.7	0.8	1.0	0.3
EBITDA Gth (%)	3.4	0.7	1.5	0.6	(0.9)
Opg Profit Gth (%)	6.3	0.7	(0.5)	0.3	(2.4)
Net Profit Gth (Pre-ex) (%)	6.6	(2.8)	(1.3)	1.2	(2.4)
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	17.9	18.0	17.8	17.6	17.1
Opg Profit Margin (%)	20.0	20.0	19.7	19.6	19.0
Net Profit Margin (%)	16.1	15.5	15.8	15.2	14.8
ROAE (%)	594.3	319.8	227.7	186.5	166.1
ROA (%)	20.8	19.3	18.9	18.0	17.4
ROCE (%)	40.5	39.9	37.7	36.4	34.9
Div Payout Ratio (%)	90.4	92.9	90.4	94.3	94.7
Net Interest Cover (x)	29.6	23.1	23.2	23.8	23.8

Source: Company, DBS Bank

**Quarterly / Interim Income Statement (\$\$m)**

FY Dec	3Q2014	4Q2014	1Q2015	2Q2015	3Q2015
Revenue	592	647	618	590	603
Cost of Goods Sold	(419)	(467)	(467)	(404)	(416)
<b>Gross Profit</b>	<b>174</b>	<b>181</b>	<b>151</b>	<b>185</b>	<b>187</b>
Other Oper. (Exp)/Inc	(50.4)	(56.2)	(57.4)	(60.8)	(56.3)
<b>Operating Profit</b>	<b>123</b>	<b>124</b>	<b>93.9</b>	<b>125</b>	<b>131</b>
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	(0.2)
Net Interest (Exp)/Inc	(3.9)	(7.8)	(3.6)	(4.0)	(3.7)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	15.0
<b>Pre-tax Profit</b>	<b>119</b>	<b>117</b>	<b>90.3</b>	<b>121</b>	<b>142</b>
Tax	(21.4)	(22.4)	(16.6)	(21.4)	(23.4)
Minority Interest	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>97.7</b>	<b>94.2</b>	<b>73.7</b>	<b>99.1</b>	<b>119</b>
Net profit bef Except.	97.7	94.2	73.7	99.1	104
EBITDA	191	193	162	195	199

Net profit was helped by one-off gains

**Growth**

Revenue Gth (%)	2.7	9.4	(4.6)	(4.6)	2.3
EBITDA Gth (%)	1.9	0.8	(15.8)	20.1	2.2
Opg Profit Gth (%)	3.7	1.1	(24.5)	32.6	5.2
Net Profit Gth (Pre-ex) (%)	3.6	(3.6)	(21.8)	34.5	4.6

**Margins**

Gross Margins (%)	29.3	27.9	24.5	31.4	31.1
Opg Profit Margins (%)	20.8	19.2	15.2	21.1	21.7
Net Profit Margins (%)	16.5	14.6	11.9	16.8	19.7

**Balance Sheet (\$\$m)**

FY Dec	2013A	2014A	2015F	2016F	2017F
Net Fixed Assets	857	911	953	966	971
Invt in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	381	405	405	405	405
Cash & ST Invt	267	264	271	287	294
Inventory	43.2	42.4	42.8	43.2	43.3
Debtors	124	162	163	165	165
Other Current Assets	178	203	203	203	203
<b>Total Assets</b>	<b>1,850</b>	<b>1,987</b>	<b>2,037</b>	<b>2,069</b>	<b>2,081</b>
ST Debt	0.0	200	200	200	200
Creditor	754	796	802	810	813
Other Current Liab	148	197	187	185	183
LT Debt	688	488	488	488	488
Other LT Liabilities	178	158	175	175	175
Shareholder's Equity	82.7	149	186	211	224
Minority Interests	0.0	0.0	0.0	0.0	0.0
<b>Total Cap. &amp; Liab.</b>	<b>1,850</b>	<b>1,987</b>	<b>2,037</b>	<b>2,069</b>	<b>2,081</b>
Non-Cash Wkg. Capital	(557)	(586)	(580)	(584)	(584)
Net Cash/(Debt)	(421)	(423)	(416)	(401)	(394)
Debtors Turn (avg days)	21.9	21.8	24.6	24.6	24.7
Creditors Turn (avg days)	139.4	167.7	172.2	171.7	171.5
Inventory Turn (avg days)	7.6	9.3	9.2	9.1	9.1
Asset Turnover (x)	1.3	1.2	1.2	1.2	1.2
Current Ratio (x)	0.7	0.6	0.6	0.6	0.6
Quick Ratio (x)	0.4	0.4	0.4	0.4	0.4
Net Debt/Equity (X)	5.1	2.8	2.2	1.9	1.8
Net Debt/Equity ex MI (X)	5.1	2.8	2.2	1.9	1.8
Capex to Debt (%)	44.0	46.8	47.5	43.9	43.2
Z-Score (X)	3.9	3.6	3.6	3.6	3.6

Expect balance sheet to remain strong

Source: Company, DBS Bank

## Cash Flow Statement (\$m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Pre-Tax Profit	458	456	469	456	445
Dep. & Amort.	270	271	285	288	292
Tax Paid	(89.0)	(65.3)	(97.9)	(88.0)	(85.5)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(7.2)	2.50	4.83	6.04	1.55
Other Operating CF	(36.1)	(9.6)	7.00	(10.0)	(10.0)
<b>Net Operating CF</b>	<b>595</b>	<b>655</b>	<b>668</b>	<b>652</b>	<b>643</b>
Capital Exp.(net)	(303)	(322)	(327)	(302)	(297)
Other Invt.(net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	3.40	2.80	0.0	0.0	0.0
<b>Net Investing CF</b>	<b>(299)</b>	<b>(319)</b>	<b>(327)</b>	<b>(302)</b>	<b>(297)</b>
Div Paid	(344)	(345)	(344)	(344)	(349)
Chg in Gross Debt	0.0	0.0	0.0	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	3.30	6.20	10.0	10.0	10.0
<b>Net Financing CF</b>	<b>(341)</b>	<b>(339)</b>	<b>(334)</b>	<b>(334)</b>	<b>(339)</b>
Currency Adjustments	0.50	0.20	0.0	0.0	0.0
Chg in Cash	(45.1)	(2.7)	7.02	15.6	6.71
Opg CFPS (\$ cts)	35.0	37.9	38.5	37.5	37.3
Free CFPS (\$ cts)	17.0	19.4	19.8	20.3	20.1

Source: Company, DBS Bank

## Target Price &amp; Ratings History



S.No.	Date	Closing Price	Target Price	Rating
1:	26 Feb 15	4.31	4.35	HOLD
2:	27 Jul 15	3.97	3.70	FULLY VALUED
3:	10 Aug 15	3.83	3.70	FULLY VALUED
4:	31 Aug 15	3.66	3.70	FULLY VALUED

Note: Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

DBS Bank recommendations are based on Absolute Total Return\* Rating system, defined as follows:

**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return i.e. > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

*Share price appreciation + dividends*

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