Singapore Results Review

7 August 2019

Communications | Telecommunications

StarHub (STH SP)

Neutral (Maintained)

Cyber Security Losses Tapering Off

Target Price (Return)	SGD1.52 (+3%)
Price:	SGD1.48
Market Cap:	USD1,855
Avg Daily Turnover	2.7m/2m

- **Maintain NEUTRAL with adjusted DCF-derived TP (WACC: 7.4%) of SGD1.52 from SGD1.72, 3% upside.** 2Q19/1H19 results were broadly in line. We lower our FY19-21 core earnings forecasts by 5-12%, mainly to factor in higher financing charges and weaker pay-TV and cable revenues. StarHub's prospective EV/EBITDA valuations are at -2SD below its historical mean. Upside risks are stronger-than-expected earnings, an earlier turnaround at its enterprise business, and weaker mobile competition.
- **Broadly in line.** 1H19 core earnings (post-SFRS 16, -25% YoY) made up 50-51% of our/consensus' estimates. Core earnings fell 27% QoQ on lower revenue (-7.5% QoQ), weaker EBITDA margin, and losses from cyber security services. A 2.25 cents 2Q DPS was declared (YTD: 4.5 cents), reflecting a payout of 99% on core EPS.
- **Mobility to remain under pressure.** Mobile service revenue (MSR) was steady QoQ (-10% YoY) after two quarters of contraction, thanks to stronger postpaid net-adds (2Q19: 39,000) with contributions from mobile virtual network operators (MVNO), and its new digital brand, *giga* (launched in May). Postpaid ARPU recovered to SGD41 on some roaming seasonality, after having contracted for the past three quarters. Management expects competition to remain intense with the raft of offerings in the market giving significant value propositions. We continue to see downside risks to mobility ARPU and revenue with more MVNOs expected to join the fray in the coming months.
- **Enterprise segment to breakeven by end-2019.** The enterprise business remains the key growth driver (+5% QoQ, +14.5% YoY), largely driven by the cyber security business (+161% YoY, +37% QoQ) which more than offset the decline in traditional network solutions revenue (-4.2% YoY, -3.4% QoQ). Positively, EBIT losses from the cyber security business trickled down to SGD0.8m from SGD11.4m in 1Q19 (several one-off costs booked). Management expects the cyber security arm to breakeven by end-2019.
- **Cable migration to fibre extended to end-September.** Due to the surge in orders for fibre migration (initially targeted for completion by end-June), customers now have until end-August to register at no additional cost. Management is optimistic about addressing the order backlog and expects the last of the migration cost to be reflected in 3Q19, with the amount being smaller compared to 1HFY19.

Forecasts and Valuations	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (SGDm)	2,411	2,362	2,385	2,421	2,491
Recurring net profit (SGDm)	269	215	177	154	162
Recurring net profit growth (%)	(11.8)	(20.1)	(17.5)	(13.0)	4.8
Recurring P/E (x)	9.4	12.7	14.4	16.6	15.8
P/BV (x)	4.2	4.6	6.8	6.8	6.7
P/CF (x)	4.9	5.7	3.6	5.1	3.1
Dividend Yield (%)	10.8	10.8	6.1	6.1	6.1
EV/EBITDA (x)	5.0	6.0	5.9	6.2	5.4
ROE (%)	44.7	39.0	47.5	41.5	42.8
Net debt to equity (%)	105.1	156.4	171.7	171.9	81.6
Interest coverage (x)	16.2	12.1	9.0	6.1	5.5

Source: Company data, RHB

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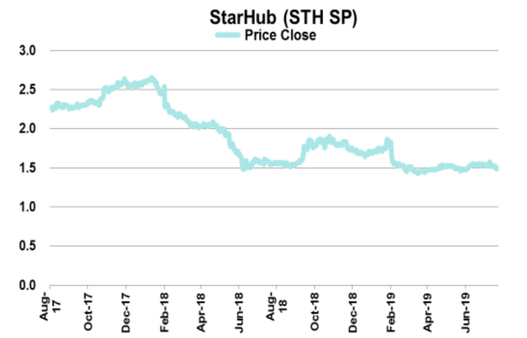
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(14.9)	(3.9)	(5.7)	(18.1)	(11.3)
Relative	(19.2)	1.0	(0.1)	(18.7)	(9.4)
52-wk Price low/high (SGD)					1.46-2.03



Source: Bloomberg

Financial Exhibits

Asia

Singapore

Communications

StarHub

STH SP

NEUTRAL

Valuation basis

DCF methodology (WACC: 7.4%, TG : 1.5%)

Key drivers

i. Aggressive expansion into the enterprise business;
ii. Improved data monetisation;
iii. Higher share of fixed broadband services.

Key risks

i. Weaker-than-expected margin/earnings,
ii. Commercial execution;
iii. Higher-than-expected capex.

Company Profile

StarHub is an integrated telecommunications group offering quad play services. The group has also strengthened its enterprise offerings with the merger of its in-house enterprise business with Temasek's Quann.

Financial summary	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Recurring EPS (SGD)	0.16	0.12	0.10	0.09	0.09
DPS (SGD)	0.16	0.16	0.09	0.09	0.09
BVPS (SGD)	0.35	0.32	0.22	0.22	0.22
ROE (%)	44.73	38.98	47.49	41.48	42.77

Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Recurring P/E (x)	10.0	13.6	15.4	17.7	16.9
P/B (x)	4.51	4.92	7.26	7.28	7.17
FCF Yield (%)	8.17	6.42	15.45	7.32	19.47
Dividend yield (%)	10.1	10.1	5.7	5.7	5.7
EV/EBITDA (x)	5.2	6.3	6.3	6.5	5.7
EV/EBIT (x)	9.3	13.1	13.3	15.0	13.0

Income statement (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover	2411	2362	2385	2421	2491
Gross profit	1,935	1,879	1,812	1,828	1,868
EBITDA (adj.)	586	521	531	509	536
Depreciation & amortisation	(280)	(291)	(286)	(290)	(299)
Operating profit	336	246	215	187	196
Net interest	(26)	(27)	(38)	(38)	(38)
Pre-tax profit	333	245	214	186	195
Taxation	(60)	(45)	(36)	(32)	(33)
Net profit	273	202	177	154	162
Recurring net profit	269	215	177	154	162

Cash flow (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Change in working capital	294	119	180	(17)	295
Cash flow from operations	517	447	718	498	827
Capex	(296)	(273)	(300)	(300)	(300)
Cash flow from investing activities	(327)	(363)	(300)	(300)	(300)
Dividends paid	(294)	(277)	(156)	(156)	(156)
Cash flow from financing activities	(130)	(263)	(197)	(197)	(196)
Cash at beginning of period	(702)	(632)	(863)	(641)	(640)
Net change in cash	70	(230)	221	1	331
Ending balance cash	(632)	(863)	(641)	(640)	(309)

Balance sheet (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total cash and equivalents	345	166	387	389	720
Tangible fixed assets	1,044	1,035	1,013	1,028	730
Total investments	174	141	106	111	111
Total assets	2,636	2,635	2,720	2,740	2,780
Short-term debt	120	50	50	50	50
Total long-term debt	858	978	978	978	978
Total liabilities	2,030	2,048	2,310	2,331	2,366
Total equity	606	588	410	408	415
Total liabilities & equity	2,636	2,635	2,720	2,740	2,780

Key metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Revenue growth (%)	0.6	(2.0)	1.0	1.5	2.9
Recurrent EPS growth (%)	(20.1)	(26.2)	(12.0)	(13.0)	4.8
Gross margin (%)	80.3	79.5	76.0	75.5	75.0
Operating EBITDA margin (%)	31.2	28.4	29.4	27.9	28.6
Net profit margin (%)	11.2	9.1	7.4	6.4	6.5
Capex/sales (%)	12.3	11.5	12.6	12.4	12.0
Interest cover (x)	12.1	9.0	6.1	5.5	5.7

Source: Company data, RHB

Figure 1: Results review

FYE Dec (SGDm)	2Q18	1Q19	2Q19	QoQ (%)	YoY (%)	Comments
Revenue	**597.3**	**596.8**	**552.8**	**(7.4)**	**(7.5)**	Lower equipment sale QoQ
Service revenue	**466.8**	**444.2**	**442.4**	(0.4)	(5.2)	Weaker mobile and pay-TV revenues partially offset by stronger growth in enterprise revenue
EBITDA	**154.3**	**161.9**	**146.4**	**(9.6)**	**(5.1)**	Lower YoY due to shift in revenue mix and investments in enterprise business
Depreciation	(70.1)	(89.8)	**(89.1)**	(0.8)	27.1	
EBIT	**84.2**	**72.1**	**57.3**	(20.5)	(31.9)	
Service EBITDA Margin (%)	30.0	33.7	**31.8**			1H19 margin lifted by SFRS 16 implementation
Net interest expense	(6.6)	(9.4)	**(9.7)**	3.2	47.0	
Associates	(0.3)	0.4	**0.0**	-	-	
EI/Others	0.0	0.0	**0.0**	-	-	
Pretax profit	**77.3**	**63.1**	**47.6**	**(24.6)**	**(38.4)**	
Pretax Margin (%)	12.9	10.6	**8.6**			
Tax	(14.6)	(13.8)	**(8.2)**	(40.6)	(43.8)	
Effective tax rate (%)	18.9	21.9	**17.2**			
Minority Interest	(1.0)	4.7	**0.1**	-	-	
Net Profit	**61.7**	**54.0**	**39.5**	**(26.9)**	**(36.0)**	
Core Profit	**61.7**	**54.0**	**39.5**	**(26.9)**	**(36.0)**	Broadly in line

Source: RHB

Figure 2: Segmental results

FYE Dec (SGDm)	2Q18	1Q19	2Q19	QoQ chg (%)	YoY chg (%)	Comments
Revenue breakdown						
Mobile	213.5	192.3	192.3	0.0	(9.9)	Higher mix of SIM-only plans, weaker usage revenue and handset subsidy amortisation
Pay-TV	84.7	70.7	64.7	(8.5)	(23.6)	
Broadband	46.1	47.1	45.1	(4.2)	(2.2)	Higher migration to fibre services
Enterprise	122.5	134.1	140.3	4.6	14.5	Cyber security revenues up 93% YoY in 1H19
Service revenue	466.8	444.2	442.4	(0.4)	(5.2)	
Sale of equipment	130.5	152.5	110.4	(27.6)	(15.4)	
Total revenue	597.3	596.8	552.8	(7.4)	(7.5)	
% of overall revenue						
Mobile revenue	35.7%	32.2%	34.8%	3%	-1%	
Pay-TV	14.2%	11.8%	11.7%	0%	-2%	
Broadband	7.7%	7.9%	8.2%	0%	0%	
Fixed Network	20.5%	22.5%	25.4%	3%	5%	
Sale of equipment	21.8%	25.6%	20.0%	-6%	-2%	
Key Mobile Metrics						
Prepaid subs (000s)	882.0	789.0	789.0	0.0	(10.5)	
Prepaid-net adds (000s)	(36.0)	1.0	0.0	n.a.	n.a.	
Postpaid subs (000s)	1,376.0	1,438.0	1,477.0	2.7	7.3	
Postpaid-net adds (000s)	11.0	36.0	39.0	8.3	254.5	Includes MVNOs and *giga*
Postpaid ARPU (SGD)	45.0	39.0	40.0	2.6	(11.1)	Diluted by higher take-up of SIM-only plans and weaker excess data charges
Prepaid ARPU (SGD)	13.0	13.0	14.0	7.7	7.7	
Fiber subs (000s)	n.a.	449.0	n.a.	n.a.	n.a.	
Fiber-adds (000s)	n.a.	24.0	n.a.	n.a.	n.a.	
Pay -TV						
Total subs (000s)	438.0	394.0	374.0	(5.1)	(14.6)	Impacted by piracy and alternative viewing platforms
Net-adds (000s)	(11.0)	(15.0)	(20.0)	33.3	>100	
ARPU (SGD)	53.0	48.0	44.0	(8.3)		
Broadband						
Total subs (000s)	471.0	495.0	509.0	2.8	8.1	Migration to fibre services
Net-adds (000s)	2.0	13.0	14.0	7.7	>100	
ARPU (SGD)	32.0	31.0	29.0	(6.5)	(9.4)	
Fixed network services						
Data & Internet	72.4	70.0	68.2	(2.6)	(5.8)	
Managed services	26.3	26.1	24.8	(5.0)	(5.7)	
Voice	9.9	11.6	11.1	(4.3)	12.1	

Source: RHB

Figure 3: DCF valuation – StarHub

(SGDm)									
FYE Dec	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**
EBIT	252.8	225.1	242.0	239.6	237.2	234.9	232.5	227.9	225.6
EBIT (1-t)	207.3	184.6	198.5	196.5	194.5	192.6	190.7	186.9	185.0
Depreciation	286.2	290.5	287.6	284.7	281.9	279.0	276.2	273.5	270.7
Capex	-300.0	-300.0	-300.0	-300.0	-300.0	-300.0	-300.0	-250.0	-250.0
Change in working capital	333.6	16.7	56.3	-6.2	-6.2	-6.1	-6.0	-6.0	-5.9
FCF	527.1	191.8	242.3	175.0	170.2	165.5	160.9	204.4	199.8

DCF valuation

PV of FCF	1622.9
PV of Terminal Value	1632.0
Enterprise Value	3254.9
Net debt	-652.7
Equity Value	2602.2
No. of shares	1715.0
Equity Value/share	**1.52**
Rf	5.0%
Beta	0.5
Risk premia (Rm- Rf)	8.5%
D/(D+E)	27%
Rm	6.6%
Cost of Equity	9.0%
Cost of Debt	4.0%
Tax Rate	18.0%
Terminal growth	1.5%
WACC	7.4%

				WACC			
	5.9%	**6.4%**	**6.9%**	**7.4%**	**7.9%**	**8.4%**	**8.9%**
0.0%	1.48	1.42	1.37	1.31	1.26	1.21	1.17
0.5%	1.55	1.49	1.43	1.37	1.32	1.27	1.22
1.0%	1.63	1.56	1.50	1.44	1.38	1.33	1.27
1.5%	1.72	1.65	1.58	1.52	1.46	1.40	1.34
2.0%	1.82	1.75	1.68	1.61	1.54	1.48	1.42
2.5%	1.95	1.87	1.80	1.72	1.65	1.58	1.52
3.0%	2.11	2.02	1.94	1.86	1.78	1.71	1.64

Source : RHB

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