Market Access

Telco Sector

(Overweight)

"The Awaken of Forgotten Giant"

We maintain our overweight call on telecommunication sector in view of i) stable dividend; ii) steady net addition in both prepaid and postpaid segment; iii) potential wider margin on 4G's impact; and iv) goodies from Budget 2014, HSBB 2.0. Our top pick for the telecommunication sector is Digi with a BUY call and TP of RM6.60 pegged at EV/EBITDA of 14.2x.

Catalysts:
1) Implementation of GST - telcos are able to pass 6% cost back to subscribers
2) Rising affordable smart phones in the market may spur further data revenue
3) The full impact of LTE
4) The introduction of TM's wireless product
5) HSBB2 implementation
6) Stable dividend payment

Negative Catalysts:
1) Competition in data offering may bite telcos' margin
2) High cost to build LTE network/infrastructures
3) Declining SMS revenue

Table 1: Subscribers Overview(1Q15)

Million	Total Subs	Postpaid		Prepaid		Broadband	
		Subs	% of Subs	Subs	% of Subs	Subs	% of Subs
Celcom	14,458	2,739	19%	9,540	70%	1,489	10%
Maxis	12,553	2,823	20%	9,933	77%	440	4%
Digi	11,662	1,758	15%	8,992	83%	241	2%
	Total Subs	**Streamyx**		**Unifi**		**Fixed Line**	
		Subs	**% of Subs**	**Subs**	**% of Subs**	**Subs**	**% of Subs**
Telekom	6,487	1,509	23%	759	11%	4,256	66%

Source: Company: M&A Securities

Table 2: Capex Guidance

FY14 Capex				FY15 Capex
(Million)	Guidance	Spent	Details	
Axiata	RM4.4 bil	RM4.0 bil	Network modernization, IT Initiatives	RM3.85 bil
Maxis	RM1.1 bil	RM1.14 bil	Network modernisation and improvement in customer experience.	RM900 mil
Digi	RM900 mil	RM904	Modernize network equipment	RM750 mil
Telekom	18% of revenue	RM946 mil	Refreshed CDMA with LTE over 850MHz under TMgo, launch 280 sites nationwide by year end.	20% of revenue

Source: Company: M&A Securities

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GST finally. The implementation of GST in the prepaid segment was finally concluded by the government. The new move suggests prepaid reloads value will stay at their original price, however GST is now will be charged on usage based. For illustration, a typical 10sen/minute would be charged at 10.6sen/minute and for data usage, RM30 for 1g data will be charged RM31.60. The implementation of this mechanism is on 1st January 2016. We feel that the time frame is sufficient for telcos and third parties agents to make necessary adjustment to the system and hence, to avoid more confusion. The news is cheered by the prepaid subscribers because they will no longer pay additional cost for the reload value as in the current practice and hence, reducing their existing cost.

Service revenue to rebound. For several quarters, only Digi managed to post consistent growth in service revenue while Maxis and Celcom were at odds with various issues. Of late, we saw Maxis and Celcom’s revamped products have gained popularity in the market, with Maxis positive results can be seen in 1Q15 results. Whilst, Celcom, which is determined to retake its position from Maxis in postpaid segment, has saw the former to introduce new products called First38 plan. Digi has strike back with the latest RM36 smart plan with dual aim to shatter both Maxis and Celcom position in postpaid segment. With all this, we foresee that telco’s service revenue in 2H15 will be in positive territory as a result of affordable and eye-catching package.

Margin largely intact. Despite all the price war to provide affordable data package, we strongly believe EBITDA margin largely will be unaffected despite telcos dedicating large amount in marketing expenses to stimulate sales. However we foresee Maxis’ simple package offering in both prepaid and postpaid segment is likely to be the winner in term of cost management. That said, Maxis will benefit from its sole package of MaxisOne vs. Digi and Celcom which promote various package to cater different segment

Comeback of Maxis and Celcom. Digi’s leading position in prepaid segment is likely under threat with the comeback of Celcom and Maxis. Maxis has been consistently adding 909k subscribers in both postpaid and prepaid for the past 2 consecutive quarters thanks to MaxisOne and #Hotlink products that have been revamped. Whilst, Celcom network issue saw it lost 927k subscribers in both prepaid and postpaid segment and Celcom lost its top position in postpaid segment to Maxis during 1Q15. Nevertheless, we foresee that Celcom latest product offering of First38 in postpaid segment and MagicSim in prepaid segment likely to change Celcom fortune. Based on our checks, Celcom First38 is gaining popularity due to its forward data features and we foresee its competitor may follow similar strategy.

TM banking on P1. Despite recording less than inspired results in 1Q15, management still hopeful to achieve its FY15 kpi. We are less optimistic that TM is able to meet its FY15 kpi as we think P1 needs more time to tweak its product to compete with established telco player and hence, we believe TM performance in FY15 will be weighed by P1. Additionally, during 11th Malaysia Plan (11MP) announcement, the details of High Speed Broadband 2 (HSBB2) has been announced including to cover all state capitals and selected high-impact growth areas that will see 250k ports encompassing 410k premises by end-2016. To recap, TM received a letter of award from the government on 25th March 2015 for the implementation of HSBB2 and the SubUrban Broadband (SUBB) project to deploy the access and domestic core network to deliver end-to-end HSBB infrastructure.

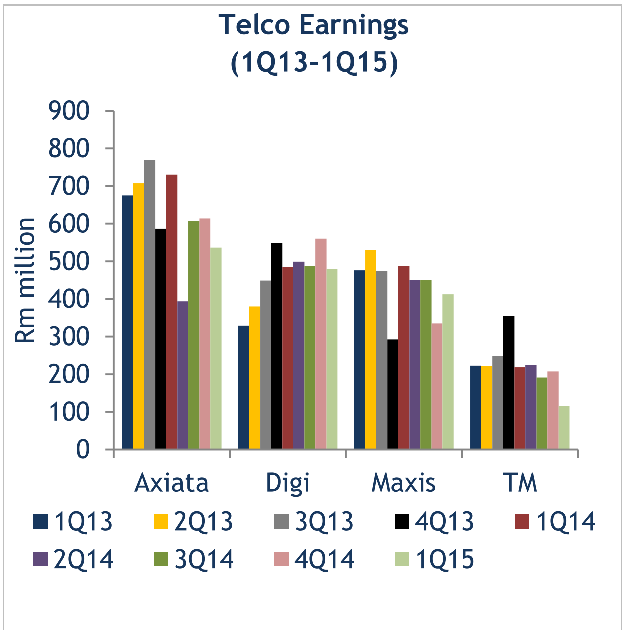
1Q15 results. The recently concluded 1Q15 results seasons showed only two telcos earnings came in line with our full year net profit forecast with Digi and Maxis accounting 22.7% and 22.2% of our full year net profit forecast respectively. Meanwhile, Axiata missed marginally our forecast or at 19% and TM was the least performer at only 12.5%. Axiata weaker earnings were attributed largely to weaker performance by both XL and Celcom, while TM was dragged by its acquisition of loss making, P1 and higher operating costs. Notably, both Digi and Maxis reported steady services revenue with Maxis playing a catch-up game thanks to improving operating trends post-restructuring exercise, while Digi was hampered to some extent by higher marketing costs.

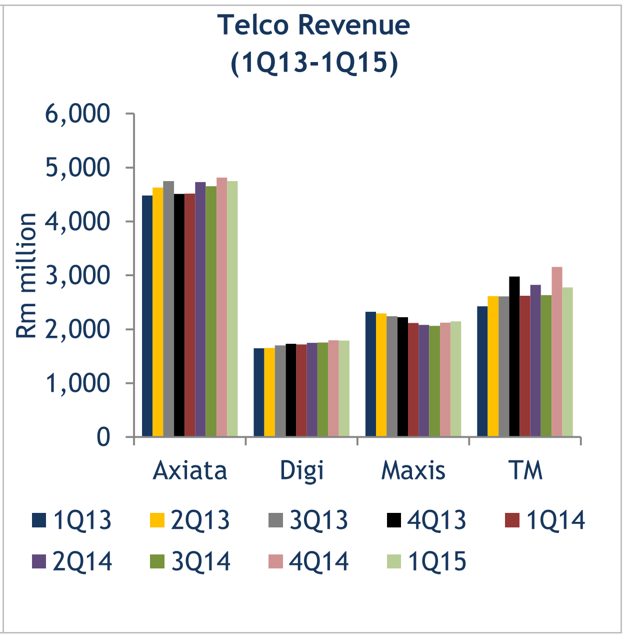
Recommendation. Despite the headwinds in GST implementation, we maintain our **Overweight** call on telecommunication sector. We note that valuation offer by telcos are not cheap, however in view of solid dividend payment in current negative environment may offset the lofty valuation. Attractions on the sector include 1) attractive dividend stream 2) strong broadband initiatives and take up rate and 3) steady postpaid and prepaid net addition. **Digi** is our top pick with a TP of RM6.60 pegged at EV/EBITDA of 14.2x, a 15% premium against its last 3-year average. Digi is a **BUY**.

Table 3: Peers Comparison

Company	FYE	Price (RM)	EPS (RM)		P/E (x)		P/B (x)		ROE (%)	Div Yield (%)	TP	Call
			FY15	FY16	FY15	FY16	FY15	FY16				
Axiata	Dec	6.40	0.31	0.34	23	21	2.8	2.8	11.6	3.1	7.40	Buy
Maxis	Dec	6.36	0.27	0.28	27	25	12.0	12.6	32.1	4.5	7.10	Hold
Digi	Dec	5.36	0.27	0.28	23	22	65.3	62.1	301.5	4.2	6.60	Buy
Telekom	Dec	6.54	0.27	0.29	27	25	3.4	3.4	11.3	3.6	6.87	Hold
Time DotCom	Dec	6.76	0.28	0.32	21	18	1.3	1.2	8.0	1.0	NR	NR
Average					24	22	17.0	16.4				

Source: Bloomberg, M&A Securities





Source: Bursa Malaysia, M&A Securities

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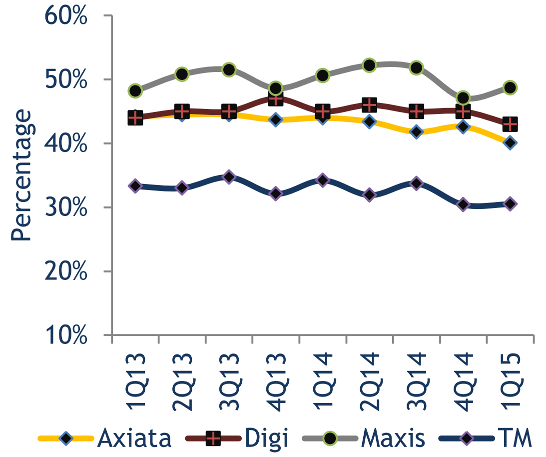
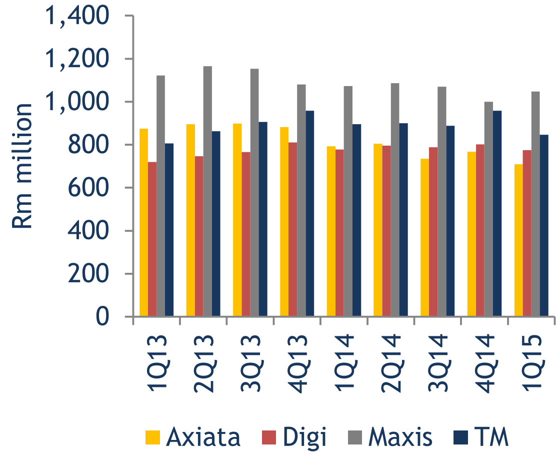
Telco EBITDA Margin (1Q13-1Q15)

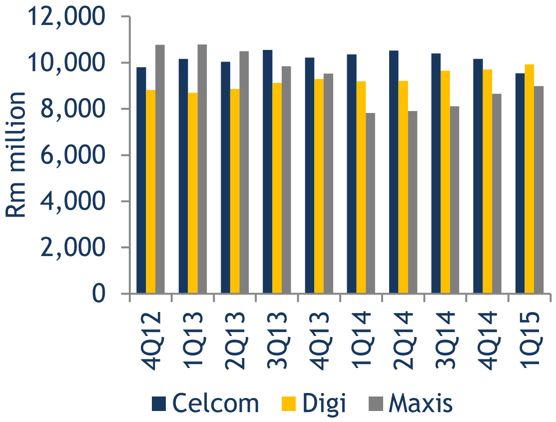


Telco EBITDA (1Q13-1Q15)

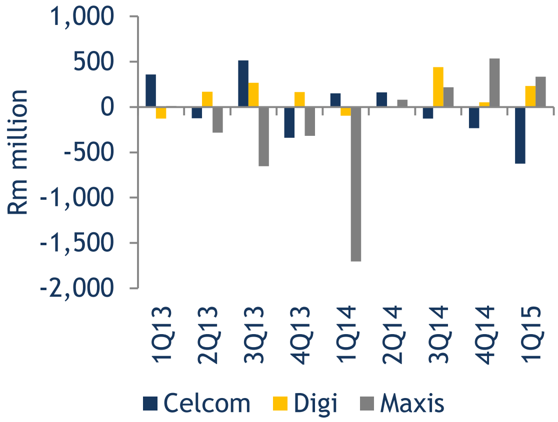


Source: Bursa Malaysia, M&A Securities

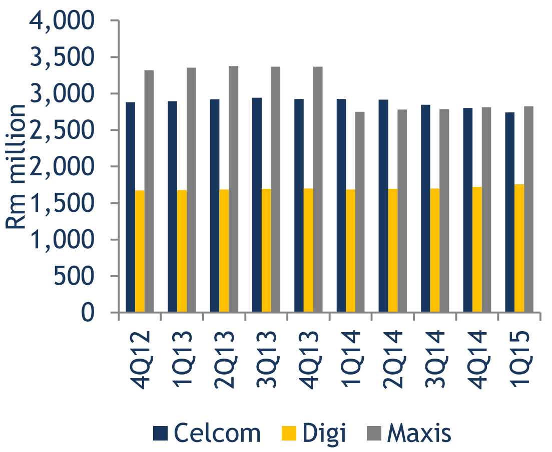
Prepaid Subscriber (4Q12-1Q15)



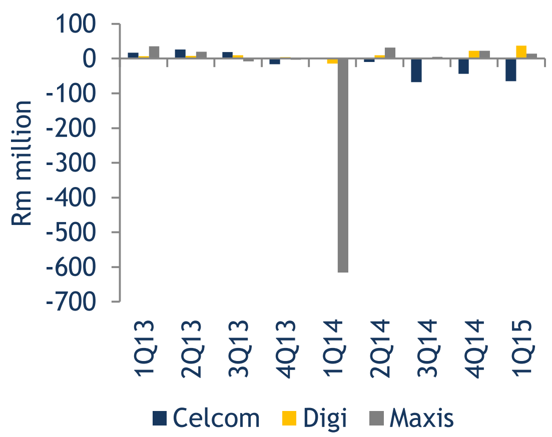
Prepaid Net Add (1Q13-1Q15)



Postpaid Subscriber (4Q12-1Q15)



Postpaid Net Add (1Q13-1Q15)



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STOCK RECOMMENDATIONS

BUY	*Share price is expected to be ≥+10% over the next 12 months.*
TRADING BUY	*Share price is expected to be ≥+10% within 3-months due to positive newsflow.*
HOLD	*Share price is expected to be between -10% and +10% over the next 12 months.*
SELL	*Share price is expected to be ≥-10% over the next 12 months.*

SECTOR RECOMMENDATIONS

OVERWEIGHT	*The sector is expected to outperform the FBM KLCI over the next 12 months.*
NEUTRAL	*The sector is expected to perform in line with the FBM KLCI over the next 12 months.*
UNDERWEIGHT	*The sector is expected to underperform the FBM KLCI over the next 12 months.*

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