Telecommunication

Funnelling Through the Waves

NEUTRAL

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We maintain our NEUTRAL call on the telecommunication sector. The officially launched National Fiberisation and Connectivity Plan (NFCP) with its 5-year plan should keep telco operators busy to achieve the set targets. However, being progressive in enabling the population (especially rural areas) with affordable internet access could bring some hurt to industry players owing to the potentially lower returns on infrastructure capex. On another note, assignment of the 700MHz, 2300MHz and 2600MHz bands for 4Q19 could commence as per the MCMC's initial timeline, with industry-disruptive mergers being out of the way. Matters considered, we highlight AXIATA (OP, TP: RM4.80) to be the sector's top pick. We previously did not price the stock to reflect merger benefits and hence kept our SoP-driven TP unchanged. The sell-down from a deal fall-out with Telenor could have overshadowed the market gains posted by the group's regional operations (namely XL in Indonesia). Further, though much lesser in scale, potential headline merger opportunities would be favourable to the stock if talks materialise.

2Q19 results in line. All companies delivered results per our expectations. For a quick recap; (i) **AXIATA** saw topline boosted by better numbers in its regional operations with profits buoyed by efficiency gains from larger OpCos (Celcom, XL, NCell), (ii) **DIGI**'s revenue and earnings' decline in addition to a downward revision in management's guidance were anticipated with weaker prepaid results but better margin recorded on operational improvements, (iii) **MAXIS** saw flattish sales as poorer service revenue (mainly from lower prepaid) was offset by better device sales but was bashed by higher staff cost and depreciation charges, (iv) **TM**'s weaker turnover (namely from internet and voice) was buffered by its performance improvement plan which translated to a doubling in 1H19 profits, and (v) towerco **OCK**'s flattish topline came in as expected with expectation for a lumpier 2H.

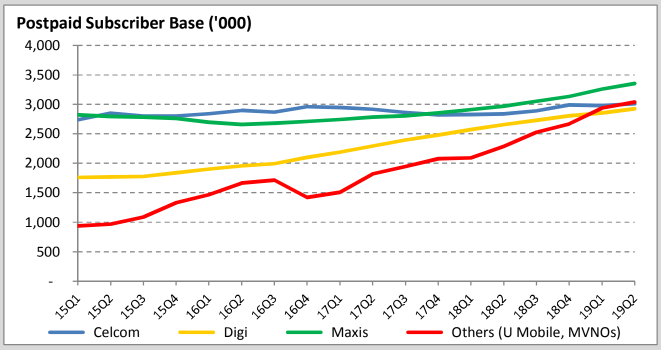
NFCP in motion. 19 Sep 2019 marked the official launch of the 5-year plan to improve internet quality with assessable and affordable connectivity to rural consumers *(refer to the Appendix for the targets and strategies of the NFCP)*. Overall, an expected cost of RM21.6b would be incurred of which RM10-11b would be from the USP fund. On the flipside, we believe there could be loss in economies of scale in rolling out of the NFCP. For one, less densely populated areas would mean less efficient use of infrastructure and lower returns from the investment involved. Secondly, to cater to the lower income areas, plans have been in place to provide more affordable entry-level plans. We reckon this could have a greater dent to ARPU if it sees a meaningful take-up by more well-to-do consumers but with bare bones needs. Similarly, it is up to the telcos to find equilibrium in achieving the goals with minimal adversity towards their financials by keeping running costs as lean as possible.

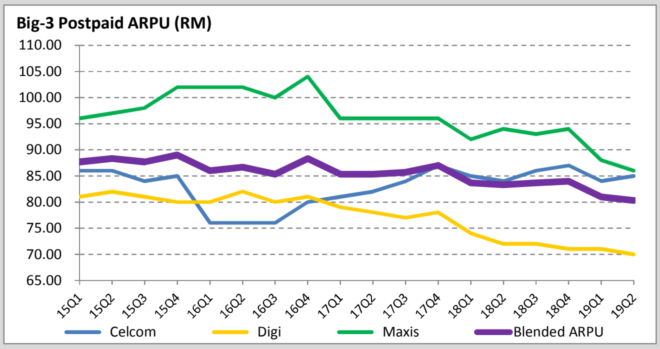
Prepping to look pretty. 4Q19 is slated to be the commencement of the assignment process of the 700MHz and 2300MHz spectrums via a "beauty contest" approach (a.k.a. comparative tender). The 2600MHz band are also earmarked for reassignment. These bands play an integral part in expanding the nationwide coverage for 4G LTE and for later repurposing for 5G. This merit-based method as opposed to auctions was on the hope that only the most capable operators can utilise the spectrums most effectively and efficiently. Post-public inquiry feedback in Aug 2019, there were calls to delay the proceeding for the (re)assignments on the back of the then on-going AXIATA-Telenor Asia merger's due diligence in progress. Now that it has been called off, we do not think there will be any opposition with sticking to the original timeline. Assuming all goes well, MCMC aims to complete the allocation process by 2Q20 (for 700MHz and 2300MHz) and 3Q20 (for 2600MHz) to put them in service in the proceeding quarter. While no mention of an indicative spectrum fee, the previous attempt to allocate the 700MHz spectrum in Oct 2017 came at a price tag of RM987.2m, which some operators expressed should now be discounted.

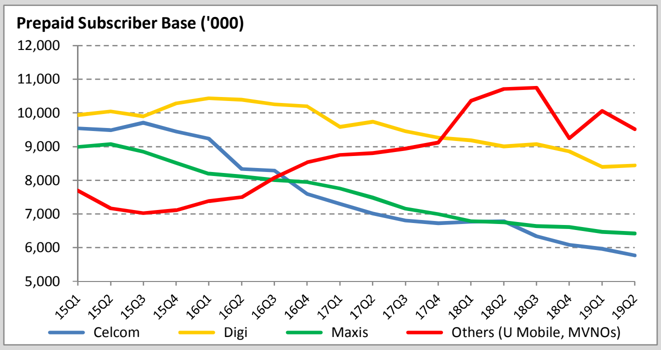
Maintain NEUTRAL. We recently upgraded TM (in 19 Sep 2019) and AXIATA (in 1 Oct 2019) to OUTPERFORM as we see value to be had post their respective sell-downs. TM was thwarted by its intent to expand aggressively in the mobile business, dragged by on concerns that high operating expenses and additional capex spending would not pan out favourably in the face of the highly saturated and intense mobile scene. Meanwhile, AXIATA is still finding its feet post-merger talk cancellation as we believe investors had high hopes for the success of the deal. We stay unfazed by these headlines as: (i) TM could still reap fruit from its cost savings initiatives and developments in the mobile business may not lead to any substantial changes even in the medium term, while (ii) AXIATA's expansion in key markets could be clouded by the fallout of the merger, as Celcom's improving margins and XL's ex-Jawa penetration is registering strong traction. Additional, speculation on a deal between Celcom and TM could be interesting judging by the respective managements' agendas. We reiterate our DCF-driven call for **TM (OP, TP: RM3.95 – WACC: 9.5%, TG: 1.5%)** and SoP-based valuation for **AXIATA (OP, TP: RM4.80)** unchanged with the latter being our top pick for the sector. No changes were made to calls and earnings to the stocks under coverage from this sector piece.

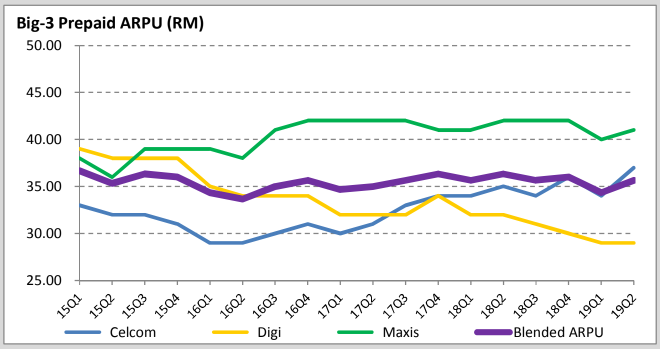
Competition never stopped stirring. From 1H19's reported numbers, consumers are increasingly inclined towards cheaper postpaid packages. We believe this shows a growing ability and willingness to spend more for greater value deals as the new users are suspected to have migrated from prepaid. The current market share breakdown is coming close to a stalemate as the 3-leading celcos presently hold postpaid proportions of between 24%%-27% each. DIGI is the clear leader in the prepaid space (28% share in 2Q19 vs. Celcom's 19%) where internet-based plans have gained market favour. Amidst the unending widespread competition, incumbent celcos look to trim operating costs and redundancies to be sustainable

Est. Postpaid and Prepaid Statistics in 2Q19



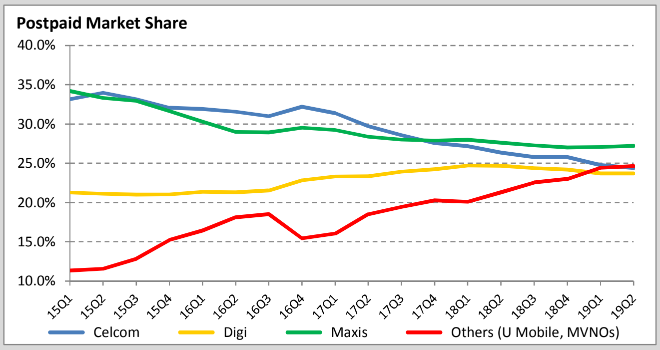


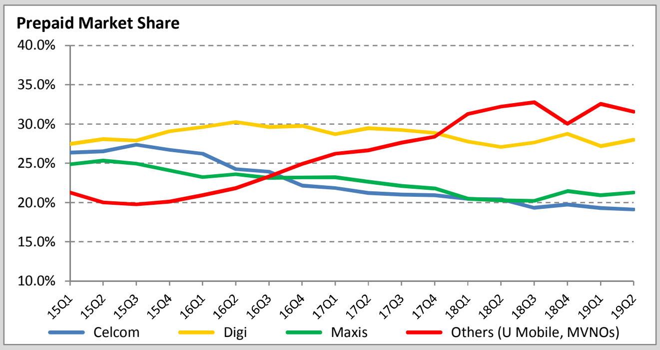


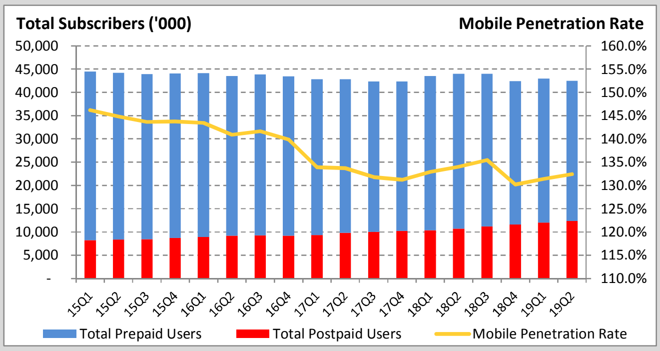


Source: MCMC 2Q 2019 Facts and Figures, Companies, Kenanga Research

Market Share and Mobile Penetration Rate







Source: MCMC 2Q 2019 Facts and Figures, Companies, Kenanga Research

Appendix

NFCP Targets

- Entry-level fixed broadband package at 1% of GNI by 2020
- Gigabits availability in selected industrial areas by 2020 and to all State Capitals by 2023
- 100% availability for premises in State Capitals and selected high impact areas with a minimum speed of 500Mbps by 2021
- 20% availability for premises in sub-urban and rural areas with up to 500Mbps by 2022
- Fibre network passes 70% of schools, hospitals, libraries, police stations and post offices by 2022
- Average speed of 30Mbps in 98% of populated areas by 2023
- Improve mobile coverage along Pan Borneo highway upon completion

NFCP Strategies

Manage funding for NFCP from a variety of sources in a prudent and sustainable manner; and leverage on relevant regulatory policies and instruments where necessary

Action Plan

1. Assessment on suitable funding mechanisms
2. Assessing components that contribute to wider access to broadband services
3. Review of USP Framework
4. Enhance existing competition provisions and other regulatory instruments, such as Codes, Standards etc.

Optimise digital infrastructure development and deployment nationwide, and clear impediments

Action Plan

5. Addressing issues on site acquisition / Right-of-Way (RoW)
6. Upgrading of existing infrastructure and improving deployment of new infrastructure
7. Promote infrastructure sharing
8. Optimum allocation of spectrum
9. Facilitate future services / technology
10. Effective measurement of speed / quality of service for broadband
11. Promote competition and spur investments (in key strategic areas)
12. Strategic review of the communications market

Regional and international networks are connected extensively with domestic networks

Action Plan

13. Promote investments in submarine cables and encourage deployment of landing centres in Malaysia. Significantly enhance submarine cable connectivity between Peninsular, Sabah and Sarawak.

Enhance connectivity in high impact socio-economic sectors such as education, agriculture and health care, small and medium enterprises and underserved areas

Action Plan

14. Promote balanced growth in all states
15. Specific initiatives for Sabah and Sarawak
16. Appropriate technology to ensure nationwide broadband coverage which supports the requirement of high impact socio-economic sectors such as education, agriculture and healthcare, small and medium enterprises and underserved areas
17. Ensuring availability of fibre networks in key areas, such as schools, hospitals, libraries, police stations and post offices

Source: NFCP Website

Peer Table Comparison

Name	Last Price @ 20-Sep-19 (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth 1-Yr. Fwd.	Revenue Growth 2-Yr. Fwd.	Core Earnings Growth 1-Yr. Fwd.	Core Earnings Growth 2-Yr. Fwd.	PER (x) - Core Earnings Hist.	PER (x) - Core Earnings 1-Yr. Fwd.	PER (x) - Core Earnings 2-Yr. Fwd.	PBV (x) Hist.	PBV (x) 1-Yr. Fwd.	ROE (%) 1-Yr. Fwd.	Net DivYld (%) 1-Yr. Fwd.	Target Price (RM)	Rating
Stocks Under Coverage																	
AXIATA GROUP BHD	4.28	39,070.7	Y	12/2019	5.4%	0.2%	4.7%	22.0%	38.4	36.7	30.0	1.7	1.6	4.5%	2.3%	4.80	OP
DIGI.COM BHD	4.67	36,309.3	Y	12/2019	-6.3%	3.1%	-9.2%	0.9%	23.6	25.9	25.7	53.9	52.8	205.7%	3.8%	4.70	MP
MAXIS BHD	5.67	44,342.2	Y	12/2019	-1.7%	0.6%	-11.1%	4.4%	25.1	28.2	27.0	6.2	6.0	21.6%	3.0%	4.90	UP
OCK GROUP BHD	0.615	536.0	Y	12/2019	8.3%	12.5%	15.0%	7.8%	20.1	17.5	16.2	1.1	1.0	6.0%	0.0%	0.630	MP
TELEKOM MALAYSIA BHD	3.50	13,178.6	Y	12/2019	-4.9%	0.6%	34.4%	4.5%	20.9	15.6	14.9	1.9	1.8	11.8%	2.9%	3.95	OP
Simple Average					**0.1%**	**3.4%**	**6.8%**	**7.9%**	**25.6**	**24.8**	**22.8**	**13.0**	**12.7**	**49.9%**	**2.4%**		
Consensus Estimates																	
TIME DOT COM BHD	9.00	5,345.9	Y	12/2019	11.3%	11.2%	11.2%	9.3%	18.5	16.7	15.2	2.1	2.0	12.1%	2.2%	10.31	BUY

Source: Kenanga Research

Stock Valuation Methods

Companies	Target Price (RM)	Rating	Valuation Methodology
AXIATA GROUP BHD	4.80	OP	Sum-of-parts (refer below)
DIGI.COM BHD	4.70	MP	Discounted cash flow (WACC: 7.2%, TG: 1.5%)
MAXIS BHD	4.90	UP	Discounted cash flow (WACC: 8.8%, TG: 1.5%)
OCK GROUP BHD	0.630	MP	Discounted cash flow (WACC: 9.5%, TG: 1.5%)
TELEKOM MALAYSIA BHD	3.95	OP	Discounted cash flow (WACC: 9.5%, TG: 1.5%)

Source: Kenanga Research

AXIATA Sum-of-Parts Valuation

Companies	Methodology	Earnings Multiple	Equity Value (RM'm)	Effective Stake (%)	Effective Value (RM'm)
Celcom (Malaysia)	DCF	WACC: 7.9%, TG: 1.3%	24,288.3	100.0%	24,288.3
XL (Indonesia)	DCF	WACC: 9.9%, TG: 2.5%	14,959.9	66.4%	9,927.4
Robi (Bangladesh)	EV/EBITDA	5.0x	7,763.6	68.7%	5,333.6
Dialog (Sri Lanka)	EV/EBITDA	4.8x	5,208.7	83.3%	4,339.9
Ncell (Nepal)	EV/EBITDA	5.0x	6,889.2	80.0%	5,511.4
Smart (Cambodia)	EV/EBITDA	6.0x	4,369.8	72.5%	3,168.1
edotco	EV/EBITDA	7.0x	4,129.4	63.0%	2,601.5
Vodafone Idea (India)	Market Price		12,068.9	1.6%	195.5
			Total Effective Value		**55,365.6**
			(-) Net Debt		12,098.1
			Total Equity Value		**43,267.5**
			No. of Axiata Shares ('m)		9,058.6
			Value/Share (RM)		**4.80**

Source: Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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