Telecommunication

OVERWEIGHT

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Emerging Growth in Data Transmission

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We maintain OVERWEIGHT on the sector. For the mobile segment, monetization opportunities have emerged from providing 5G and generative artificial intelligence (Gen AI)-powered cloud solutions to enterprise clients. On top of that, looming announcement of the 5G Dual Network policy directive would finally resolve uncertainty that has dragged sentiment. Whereas for fixed players, they will benefit from the recent influx of data center (DC) investments via strong demand for fiber optics backhaul and submarine cables. Lastly, infrastructure players are expected to participate in the rollout of 5G towers in regional markets (i.e. Laos, Vietnam and Indonesia), including Malaysia. Our sector top picks comprise CDB (OP; TP: RM5.97) and TM (OP; TP: RM7.53).

1. Mobile

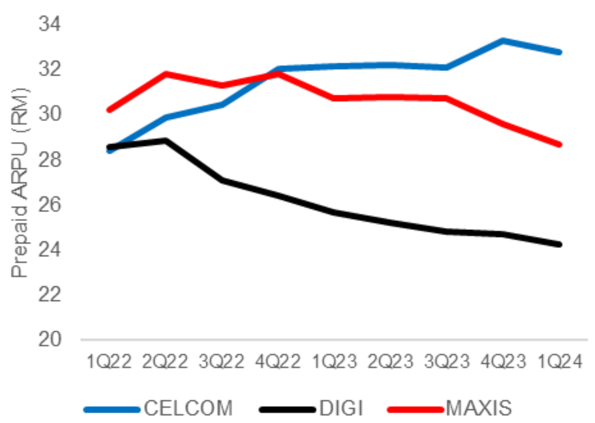
5G dual network may finally crystalize. For mobile players, developments that may materialize in 3QCY24 include unveiling of the official 5G Dual Network (DN) policy directive. Hence, this may finally reveal the final equity stake for each telco player in either entity A or B. Recall that the said entities are being set up to facilitate the Malaysia's transition from the 5G Single Wholesale Network model to DN. Entity A will assume control of the existing first 5G network owned by Digital Nasional Berhad (DNB), whilst B will develop the new second 5G network from the ground up. This follows after the major telco players (i.e. **CDB, MAXIS (OP; TP: RM5.30)**, **TM**, **YTLPOWR (MP; TP: RM5.22)** and U Mobile Sdn Bhd) finalized their respective share subscription agreements (SSA) signed with the Ministry of Finance and DNB, resulting in the telcos collectively owning 70% stake in DNB.

Not to be left out from Gen AI revolution. Mobile players are capitalizing on Gen AI by expanding their integrated cloud solutions to include cloud-based Gen AI tools and applications. For instance, **MAXIS** and Amazon Web Services (AWS) are collaborating to push Gen AI and 5G for **MAXIS'** customers in the retail, manufacturing, logistics and financial services segments. One of the key focuses of this collaboration includes training of a large language model in Bahasa Melayu. Similarly, **CDB** and AWS also aim to offer Malaysian businesses with personalized Gen AI applications spanning various industries. Against this backdrop, we believe that enterprise sales may receive an uplift in 2HCY24 and beyond as industries and enterprises adopt Gen AI-powered cloud offerings. Our beliefs are reinforced by Credence, **TM**'s cloud and digital services subsidiary which believes that the market for cloud services in Malaysia is finally poised for growth. This is mainly catalyzed by the government's recent adoption of these services.

For ARPUs, lower is the new normal. Moving forward, we believe there is upside risk for **MAXIS**' postpaid ARPU as it intensifies its focus to target affluent postpaid customers and families. Meanwhile, **CDB** also expects an uplift in postpaid ARPU on the back of: (i) introduction of converged offerings, and (ii) opening of new channels to serve "corporate individuals". On the back of this, we envisage some relief to postpaid ARPUs after a prolonged period of sequential decline.

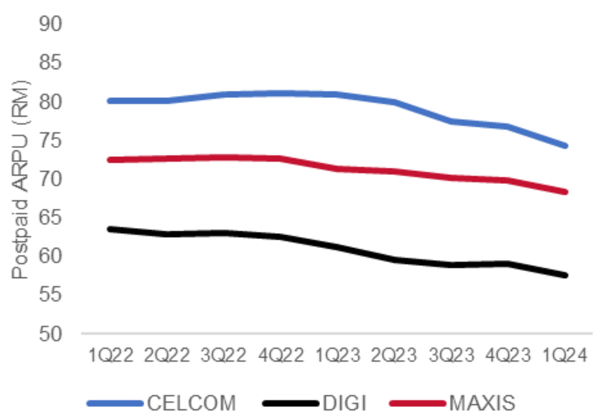
Meanwhile, for the prepaid segment, we expect sustained ARPU weakness as competitive headwinds prevail and pre-to-postpaid migration trends continue. To recap, higher-end prepaid users will likely feel compelled to upgrade to cheaper entry level postpaid plans, priced as low as RM30-RM40 per month. Hence, we expect the remaining prepaid user base and new incoming subscribers to have lower ARPU.

Prepaid ARPU



Source: Companies Kenanga Research

Postpaid ARPU

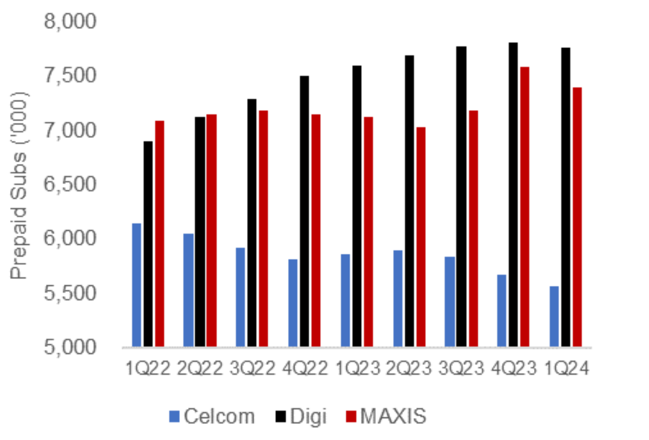


Source: Companies, Kenanga Research

Prepaid churn due to evolved strategy. We believe that prepaid subscriber churn will stretch into 3QCY24 as mobile players continue with their new postpaid subscriber acquisition strategies. To recap, this strategy involves reducing entry-level prices for postpaid plans to target high-end prepaid customers. Hence, this likely resulted in the migration of prepaid customers to postpaid, as reflected in quarterly trends. To recap, in 1QFY24, all operators incurred QoQ subscriber net losses in the prepaid segment, ranging from 55k (Digi) to 192k (**MAXIS**) in 1QCY24. In particular, this translates to the third consecutive quarter of prepaid churn at Celcom, averaging at 110k since 3QCY23.

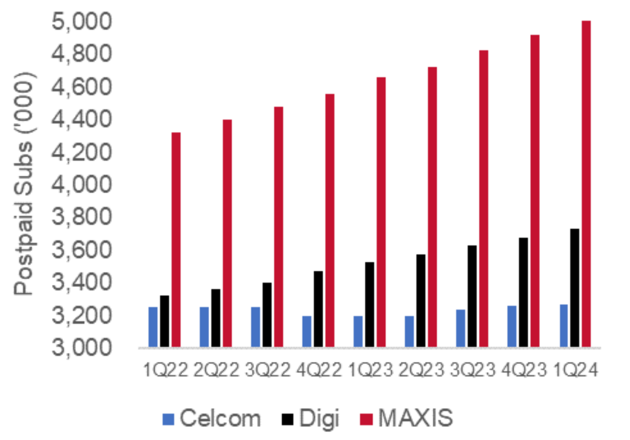
Postpaid subscribers set to continue growth. Premised on the same strategy above, we expect that postpaid net adds momentum will expand in 3QCY24 and beyond. As mentioned, we believe the growth will be driven by **CDB**, as it is now eyeing to mirror **MAXIS** in targeting converged customers and 'corporate individuals', that have higher retention rates. To recap, in 1QFY24, all three major operators achieved quarterly postpaid net adds ranging from 13k (Celcom) to 111k (**MAXIS**). In particular, **MAXIS**' postpaid net adds momentum averaged at an impressive 89k since 1QCY22 due to sustained popularity of its convergence offerings and new Hotlink plans. Meanwhile, Celcom and Digi also achieved commendable net adds since the past three quarters, averaging at 38k per quarter.

Prepaid Subscribers



Source: Companies, Kenanga Research

Postpaid Subscribers



Source: Companies, Kenanga Research

2. Fixed

Retail broadband market maturing. For fixed broadband, we believe that the market will continue to grow steadily moving forward, albeit at a normalized rate after having plateaued in recent quarters. Evidently, in 1QCY24, sequential net adds for **TM**'s Unifi Home subscribers narrowed to 9k (4QFY23: RM19k), implying a sustained downtrend after its peak of 208k back in 3QCY21. Meanwhile, **MAXIS'** home fiber net adds tapered off QoQ to 14k (4QFY23: 20k) in comparison to 25k a year ago. Nevertheless, we expect the market to remain rational on pricing, after a round of regulatory-driven adjustments back in 4QCY23. This was reflected in mixed sequential trends in 1QCY24, where **MAXIS'** ARPU expanded to RM110 (4QFY23: RM108), while Unifi contracted slightly to RM130 (4QFY23: RM131).

Expect strong demand growth for wavelength services. Moving forward, we believe that fixed players will benefit from the recent influx of investments in DC, cloud and AI infrastructure in Malaysia. To recap, over the past month, US-based tech giants, namely AWS, Microsoft, and Google announced investments in Malaysia totaling USD6b, USD2.2b, and USD2b, respectively, for these assets. Nevertheless, even before the onset of generative AI, the proliferation of DCs in Malaysia to host private or public clouds has been ongoing since before 2020. Evidently, according to Structure Research, there is a substantial pipeline of new DC capacity in Johor and Cyberjaya in 2023-28, amounting to 331MW and 255MW, respectively. This translates to a multi-fold expansion from total current live capacity of 141MW for both regions. Moving forward, we expect sustained traction in DC investments as hyperscalers and content providers require higher storage and compute capacity for GenAI cloud offerings.

Against this backdrop, we anticipate sustained strong demand for fiber optics backhaul, network hubs, as well as submarine cables and landings that connect DCs to global networks. On the back of this, TM revealed last month that it has successfully set up managed wavelength services for data transmission between global hyperscale DCs. Additionally, the upcoming completion of the SEA-ME-WE 6 submarine cable system will accommodate increased demand from new DCs in Malaysia. To recap, TM is part of a consortium for the 21,700 km Southeast Asia - Middle East - Western Europe 6 (SEA-ME-WE 6) submarine cable system. It has a capacity of 100 Tbps and connects France and Singapore, with 17 landing points in 15 countries.

3. Infrastructure

5G roll-outs at home and regionally. For infrastructure players, there may be new tower contract awards in 3QCY24 on the back of the roll-out of 5G in regional markets, including Malaysia. In particular, **OCK (OP; TP: RM0.86)** will participate in the nationwide roll-out of 5G towers in Laos by starting off at several site clusters located within the metropolitan area of Vientiane and a few major cities. Additionally, there are also opportunities at Vietnam, where the telco regulator recently awarded two 5G spectrum licenses in March for Viettel and VNPT. Meanwhile, at Indonesia, 5G roll-out is looming on the horizon as the auction for 5G spectrum (700MHz and 26GHz bands) will likely open in 2HCY24, according to XL Axiata. Whereas in Malaysia, following the anticipated completion of DNB's SSAs, we expect sustained deployment of the first 5G network in Malaysia via the roll-out of an additional 2,500 (estimate) sites in 2024 (2023: c. 5,000 sites). In addition, moving forward, as the upcoming second 5G network in Malaysia takes shape, tower operators may participate in its development via: (i) co-location at existing tower sites, and (ii) construction of new build-to-suit (BTS) towers, rooftop structures, in-building solutions etc.

4. Summary

Service revenue expansion opportunities. Moving forward, we believe it is imperative for telco players to diversify and increase their service revenue streams to include recurring subscription revenues from other sources, particularly enterprises. This is in-lieu of recent market trends that allude the risk of service revenue erosion of telcos' bread-and-butter retail business. As illustrated earlier, this is underpinned by: (i) mobile postpaid and blended ARPU compression, (ii) competitive pressure from MVNOs in the mobile prepaid space, and (iii) maturing retail broadband market. On the back of this, telco players are ramping up their businesses in: (i) managed services, (ii) integrated cloud services, (iii) 5G solutions (including internet-of-things (IoT) and private networks,), (iv) enterprise solutions, (v) cybersecurity services, and (vi) wholesale business (bandwidth and infrastructure). We believe that traction in these services will ramp up in the near-to-medium term, on the back of recent trends and developments such as: (i) digitalization of enterprises (including education institutes and government agencies), (ii) deployment of 5G technology, (iii) emergence of Gen AI and smart technologies that leverage on IoT, and (iv) proliferation of data centre investments in Malaysia. We believe there is significant room for growth for: (i) **MAXIS** which enterprise and fixed solutions expanded by 10% YoY in FY23 and merely accounted for 7%/9% of FY22/FY23 total service revenue, and (ii) **TM** which non-Unifi revenues comprise 44%/52% of FY22/FY23 total revenue. Furthermore, traction has been encouraging for **CDB**'s business-to-business segment as revenue from enterprise solutions expanded 7% YoY.

Maintain overweight. We believe investors are more upbeat as monetization opportunities emerge from providing 5G solutions to enterprise clients. On top of that, the looming announcement of the official 5G DN policy directive would finally resolve uncertainty that has dragged sentiment on mobile players. Furthermore, as adoption of Gen AI gains momentum, it could emerge as a future revenue driver via the provision of Gen AI powered cloud solutions to enterprises. Moving forward, we believe that fixed players will benefit from the recent influx of DC investments in Malaysia. This is via strong demand for fiber optics backhaul and global submarine cables that connect DCs to global networks. Lastly, infrastructure players are expected to receive tower contracts from the roll-out of 5G in regional markets (i.e. Laos, Vietnam and Indonesia), including Malaysia. We maintain our **OVERWEIGHT** recommendation on the sector with our top picks being **TM** and **CDB**.

We like **TM** on account of: (i) it being leveraged towards secular data growth on the back of current trends such as digital transformation, proliferation of internet of things (IoT), generative AI cloud-based applications, etc, (ii) it benefitting from JENDELA phase 2 projects via roll-out and monetization opportunities, and (iii) earnings accretion from potential development of new hyperscale data centre and higher data transmission volumes for its network of submarine cables.

We like **CDB** for the following reasons: (i) merger synergies are expected to amount to NPV of RM8b over 5 years – emanating from network (RM5.5b), IT (RM1.1b) and others (RM1.4b), (ii) robust average FCF yield of 7.9% in FY24-25 implies capacity to pay steady dividends, and (iii) leading subscriber base share of 39% and 20% in the postpaid and prepaid segments, respectively, translating to pricing power and economies of scale.

Peer Comparison

Name	Rating	Last Price (14/06/24) (RM)	Target Price (RM)	Upside	Market Cap (RM m)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Net Div. (sen)	Net Div. Yld. (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
<u>Stocks Under Coverage</u>																	
AXIATA GROUP BHD	OP	2.79	3.00	7.5%	25,617.6	Y	12/2024	7.1	7.2	19.6%	1.7%	39.5	38.8	1.4	3.0%	10.0	3.6%
CELCOMDIGI BHD	OP	3.72	5.97	60.5%	43,641.2	Y	12/2024	17.2	18.8	6.4%	9.0%	21.6	19.8	2.6	11.4%	14.0	3.8%
MAXIS BHD	OP	3.63	5.30	46.0%	28,430.4	Y	12/2024	16.7	17.9	6.2%	7.2%	21.8	20.3	5.0	22.7%	20.0	5.5%
OCK GROUP BHD	OP	0.595	0.860	44.5%	634.7	Y	12/2024	4.8	5.2	21.4%	8.1%	12.3	11.4	0.9	7.7%	1.5	2.5%
TELEKOM MALAYSIA BHD	OP	6.52	7.53	15.5%	25,021.8	Y	12/2024	45.6	46.2	-13.2%	1.5%	14.3	14.1	2.5	18.0%	23.5	3.6%
SECTOR AGGREGATE					**123,345.7**					**0.9%**	**5.5%**	**21.4**	**20.3**	**2.5**	**12.6%**		**3.8%**

Source: Bloomberg, Kenanga Research **** (as of 14/06/2024)***

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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