

Singapore Flash Note

Refer to important disclosures at the end of this report

DBS Group Research . Equity

19 Feb 2018

StarHub (STH SP) : FULLY VALUED

Mkt. Cap: US\$3,389m | **3m Avg. Daily Val:** US\$6.0m

Last Traded Price (15 Feb 2018): S\$2.57

Price Target 12-mth: S\$2.20 (14% downside)

Analyst

Sachin MITTAL +65 6682 3699; sachinmittal@dbi.com

Cost escalations a bane

- Excluding one-offs, net profit for 4Q17 was below expectations
- Acquisition-led growth in the enterprise segment helped offset losses in mobile and Pay TV
- The counter is expensive despite a decent dividend yield
- Maintain FULLY VALUED with an unchanged TP of S\$2.20

Forecasts and Valuation

FY Dec (\$m)	2016A	2017A	2018F	2019F
Revenue	2,397	2,401	2,384	2,379
EBITDA	689	612	601	605
Pre-tax Profit	410	304	286	261
Net Profit	341	250	235	214
Net Pft (Pre Ex.)	332	250	235	214
Net Pft Gth (Pre-ex) (%)	(7.1)	(24.6)	(6.2)	(9.0)
EPS (S cts)	19.8	14.4	13.6	12.4
EPS Pre Ex. (S cts)	19.2	14.5	13.6	12.4
EPS Gth Pre Ex (%)	(7)	(25)	(6)	(9)
Diluted EPS (S cts)	19.7	14.4	13.5	12.3
Net DPS (S cts)	20.0	16.0	16.0	14.0
BV Per Share (S cts)	11.3	8.13	5.71	4.06
PE (X)	13.0	17.8	18.9	20.8
PE Pre Ex. (X)	13.4	17.8	18.9	20.8
P/Cash Flow (X)	8.1	8.6	9.1	8.8
EV/EBITDA (X)	7.5	8.6	9.3	9.3
Net Div Yield (%)	7.8	6.2	6.2	5.4
P/Book Value (X)	22.8	31.6	45.0	63.3
Net Debt/Equity (X)	3.6	1.8	3.2	3.5
ROAE (%)	178.5	148.8	196.2	253.0

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

Company Guide



Summary of our point of view, and highlights the relevant data points, which are actively tracked

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What's New

Enterprise segment was the sole bright light. 4Q17 service revenues of S\$571.7m (+0.8% y-o-y, +4.8% q-o-q) was in line with expectations. Revenues from the enterprise segment grew 20.9% y-o-y, largely supported by the acquisition of Accel Systems, offsetting losses in mobile and Pay TV. Mobile service revenues for the quarter declined 3.5% y-o-y with the higher take-up of SIM-Only plans and continuing decline in legacy usage. Pay TV revenues declined 7.4% y-o-y amid the continued loss of Pay TV subscribers.

Earnings excluding one-offs were below expectations. 4Q17 earnings of S\$14.3m (-74% y-o-y, -81% q-o-q) were weighed down by higher cost of sales and one-off staff-related and operating lease expenses. Excluding one-offs, earnings were estimated to be ~S\$37m which was still below our expectations. Earnings were dragged down by higher handset subsidies which grew ~8% y-o-y during the quarter with M1 stirring up competition for premium subscribers in the marketplace. Rising cost of services (+23% y-o-y, +24% q-o-q) driven by higher managed services and fibre broadband costs owing to the migration of cable customers to the fibre network also weighed on earnings. Lower traffic expenses which declined ~35% partially offset the higher expenses.

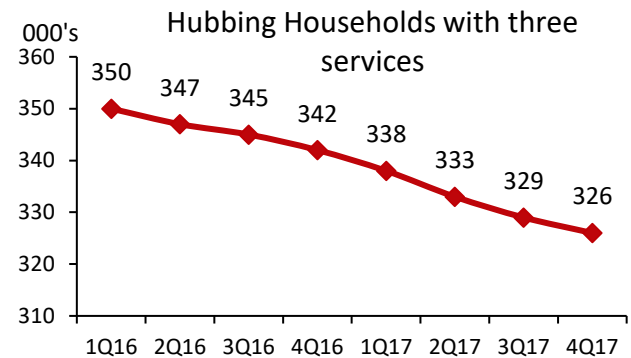
Market seems to be overly optimistic about StarHub's enterprise business. We estimate that the market is currently valuing StarHub on the assumption of ~20% growth in the enterprise business over FY18-21 vs our base-case projections of high single-digit growth. We remain skeptical of StarHub expanding its enterprise business in the double digits as i) market leader Singtel has only recorded 5-6% growth in its enterprise business historically, ii) voice business presently accounts for ~10% of StarHub's enterprise

revenues, and decline in this segment is accelerating, iii) increasing competition from M1 and the entry of specialised solution providers in the enterprise space. These factors could impede StarHub's efforts to expand its enterprise business.

Furthermore, we believe that growth in StarHub's enterprise business primarily stems from its ICT portfolio, a segment that inherently fetches lower margins than traditional enterprise services. Hence, despite the robust growth in enterprise revenues, EBITDA margins in the enterprise segment are likely to edge lower with increasing contribution from ICT services. This could result in StarHub's earnings growth falling short of market expectations.

StarHub's hubbing strategy under pressure. StarHub's go-to-market strategy of bundling mobile, broadband and Pay TV services is under pressure from the proliferation of over-the-top (OTT) TV services. Nearly 24,000 customers with subscriptions to three or more services have downgraded since 1Q16, representing ~7% of subscriptions with three or more services. The majority of these customers are moving away from Pay TV to cheaper alternatives such as Netflix, despite losing the discount available on bundled services in the process. We believe downgrades of hubbing subscriptions would accelerate amid the increasing appeal of OTT TV services among high-end Pay TV customers and rising pressure on the broadband segment from M1 and MyRepublic. As this is a critical success factor for StarHub, there could be near-term impact on the company's share price as the structural decline is unlikely to reverse.

Hubbing strategy under pressure



Source: Company, DBS Bank

The counter is expensive despite a decent dividend yield. On valuation, StarHub is expensive at a forward PE of 21x (versus sector average of 15x) and 10.2x EV/EBITDA (versus sector average of 8.5x) as investors tend to value the company in terms of dividend yield. While StarHub maintained an annual DPS of 16 Scts in 2017 (5.6% yield), its annual DPS could be cut to 14 Scts in FY19F to stay below 2.0x net debt-to-EBITDA.

Maintain FULLY VALUED with an unchanged TP of S\$2.20. We arrive at a DCF-based TP of S\$2.20 with a 6.0% WACC and 0% terminal growth. At current prices, the counter is overvalued by ~15%.

Quarterly / Interim Income Statement (\$m)

FY Dec	4Q2016	3Q2017	4Q2017	% chg yoy	% chg qoq
Revenue	635	580	649	2.2	11.8
Cost of Goods Sold	(504)	(407)	(553)	9.8	35.7
Gross Profit	131	173	96.1	(26.7)	(44.5)
Other Oper. (Exp)/Inc	(62.4)	(71.5)	(70.4)	12.8	(1.5)
Operating Profit	68.7	102	25.8	(62.4)	(74.6)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Associates & JV Inc	(0.2)	(1.5)	(0.3)	(50.0)	(80.0)
Net Interest (Exp)/Inc	(6.6)	(6.3)	(6.2)	6.1	1.6
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Pre-tax Profit	61.9	93.8	19.3	(68.8)	(79.4)
Tax	(7.9)	(17.3)	(4.9)	(38.0)	(71.7)
Minority Interest	0.0	0.0	(0.3)	-	-
Net Profit	54.0	76.5	14.1	(73.9)	(81.6)
Net profit bef Except.	54.0	76.5	14.1	(73.9)	(81.6)
EBITDA	136	175	96.6	(28.7)	(44.7)
Margins (%)					
Gross Margins	20.7	29.8	14.8		
Opg Profit Margins	10.8	17.5	4.0		
Net Profit Margins	8.5	13.2	2.2		

Source of all data: Company, DBS Bank

Target Price & Ratings History



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

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	05 Apr 17	2.86	2.85	HOLD
2:	04 May 17	2.78	2.33	FULLY VALUED
3:	03 Aug 17	2.67	2.33	FULLY VALUED
4:	16 Oct 17	2.69	2.20	FULLY VALUED
5:	03 Nov 17	2.72	2.20	FULLY VALUED
6:	25 Jan 18	2.97	2.20	FULLY VALUED

Source: DBS Bank

Analyst: Sachin MITTAL

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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DBS Regional Research Offices

HONG KONG

DBS Vickers (Hong Kong) Ltd

Contact: Paul Yong
 18th Floor Man Yee Building
 68 Des Voeux Road Central
 Central, Hong Kong
 Tel: 65 6878 8888
 Fax: 65 65353 418
 e-mail: equityresearch@dbs.com
 Participant of the Stock Exchange of Hong Kong

MALAYSIA

AllianceDBS Research Sdn Bhd

Contact: Wong Ming Tek (128540 U)
 19th Floor, Menara Multi-Purpose,
 Capital Square,
 8 Jalan Munshi Abdullah 50100
 Kuala Lumpur, Malaysia.
 Tel.: 603 2604 3333
 Fax: 603 2604 3921
 e-mail: general@alliancedbs.com

SINGAPORE

DBS Bank Ltd

Contact: Janice Chua
 12 Marina Boulevard,
 Marina Bay Financial Centre Tower 3
 Singapore 018982
 Tel: 65 6878 8888
 Fax: 65 65353 418
 e-mail: equityresearch@dbs.com
 Company Regn. No. 196800306E

INDONESIA

PT DBS Vickers Sekuritas (Indonesia)

Contact: Maynard Priajaya Arif
 DBS Bank Tower
 Ciputra World 1, 32/F
 Jl. Prof. Dr. Satrio Kav. 3-5
 Jakarta 12940, Indonesia
 Tel: 62 21 3003 4900
 Fax: 6221 3003 4943
 e-mail: research@id.dbsvickers.com

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DBS Vickers Securities (Thailand) Co Ltd

Contact: Chanpen Sirithanarattanakul
 989 Siam Piwat Tower Building,
 9th, 14th-15th Floor
 Rama 1 Road, Pathumwan,
 Bangkok Thailand 10330
 Tel. 66 2 857 7831
 Fax: 66 2 658 1269
 e-mail: research@th.dbs.com
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