

Telecommunications - Korea

Look beyond policy overhang; expect limited impacts from MDDIA abolition

Industry Overview

Govt plans to abolish MDDIA to abate customer burden

According to local news (Yonhap) dated 22 Jan, the government plans to abolish the Mobile Device Distribution Improvement Act (MDDIA), which prohibits MNOs from offering excessive subsidies to customers since its implementation in 2014. While the Act was introduced to promote market transparency by limiting subsidies that exceeded legal limits, it has faced criticism of reducing price competition among telcos, leading to increased purchase prices for handsets. If the MDDIA is scrapped, the cap on handset subsidies will be removed while maintaining the tariff discount rate of 25%, in our view.

Limited impacts on competitive landscape and earnings

Our initial thought is that the MDDIA's potential removal would have limited impacts on Korean telcos' competitive landscape and marketing costs. With a highly saturated handset market (110% handset penetration, 68% 5G penetration as of end-Nov'23; Exhibits 1 and 2), it has become more effective for telcos to focus on customer retention rate rather than M/S gain (Exhibits 3 and 5). Of note, in 5G era, Korean telcos have spent less marketing costs to secure new subs but rather focused on effective marketing cost control (Exhibit 6) – telcos' marketing costs as a % of service revenue have been stabilized to 21%/20% in 2022/23E vs. 22% in 2019 (5G launch) and 25% in 2014 (LTE era).

Continued cost control in telco & investment in non-telco

Despite MDDIA's potential abolition, we continue to believe that Korean telcos will retain their current strategy of improving earnings with cost control in the mobile market and investing in non-telco areas that have higher earnings growth potential – We expect telcos' enterprise business to be a growth driver in 2024, with DC/Cloud likely to record a top-line CAGR of 21% over 2023-25E backed by rising demand in generative AI vs. flattish top-line growth at mobile revenue (1% CAGR during the same period).

Policy overhang around election; likely to be removed in 2H

We see unabated regulatory risks around the general election in Apr'24, as the government continues to be committed in lowering customers' telecom expenditure by enhancing competition in telcos. We think that uncertainties on the overhang of regulatory risks could increase the sector's share-price volatility until 1H24, but the eventual impacts on telcos from the measures should be limited, in our view. We expect the risks to ease going into 2H, which will be a potential rerating catalyst for the shares.

Prefer names with non-telco exposure; KT top-pick

With less upsides for top-line growth in telco business and potential regulatory overhang ahead of the election, we prefer the names with a larger M/S and diverse initiatives in non-telco biz, which should provide higher earnings growth potential. We favor KT in Korea telco universe, as we expect KT to record EPS growth of 8%/17% YoY in 2024/25 after -4% YoY in 2023 (vs. peers' mid-single-digit growth). Our Buy rating is based on (1) the ongoing effective cost control in telco; and (2) higher growth in non-telco mainly from KT Cloud with growing AI demand, and resilient earnings improvement at KT Estate.

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Equity
Republic Of Korea
Telecommunications

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Acronyms

MDDIA = Mobile Device Distribution Improvement Act
MNO = mobile network operator
DC = data center
MNP = mobile number portability

Related reports

Telecom - Asia: Year Ahead 2024: Remains yield story; Stable competition; Watch for elections/tariffs

[KT: U/G to Buy; lingering concerns with CEO is over, focus on improving fundamentals](#)

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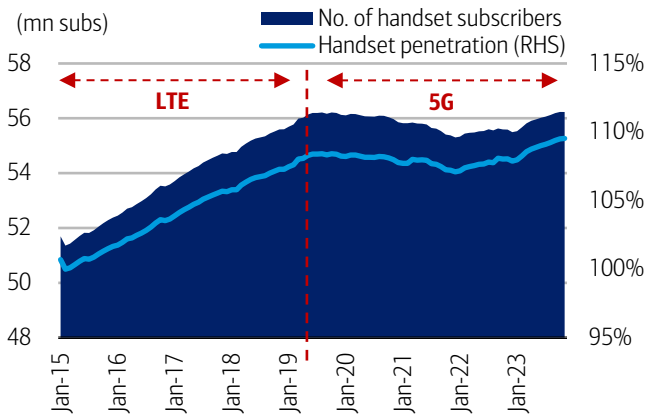
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Timestamp: 23 January 2024 08:44AM EST

Exhibit 1: No. of handset subscribers and handset penetration

In LTE era, the number of handset subs kept increasing, but the growth has halted in 5G era and the number of subs hovers at 55-56mn

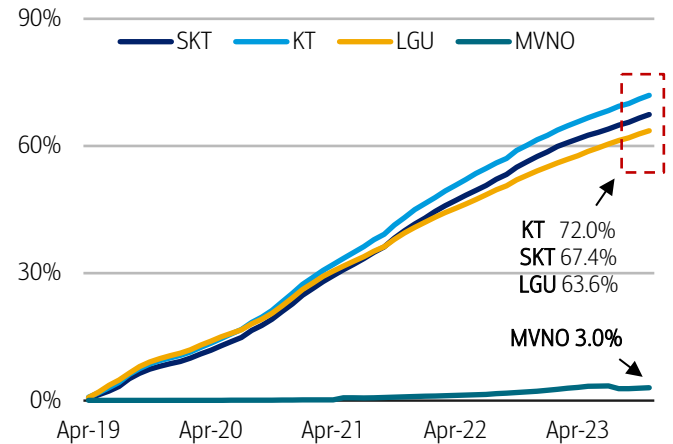


Source: Ministry of Science and ICT (MSIT), BofA Global Research

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Exhibit 2: 5G handset penetration rate

The MNO's handset 5G penetration rate reached 68% as of end-Nov'23

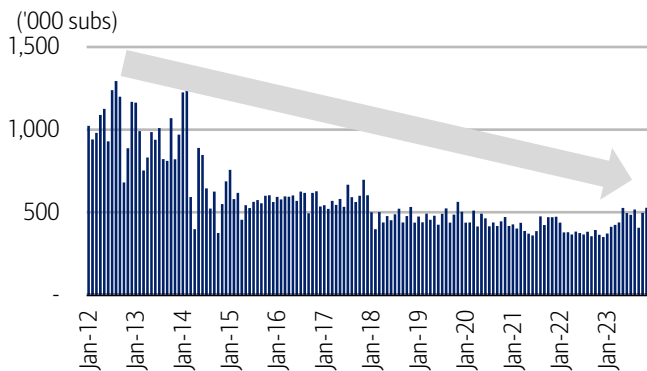


Source: MSIT, BofA Global Research

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Exhibit 3: Korea telcos – MNP subscriber trend

The number of MNP subscribers recorded a downward trend with less intensified competition

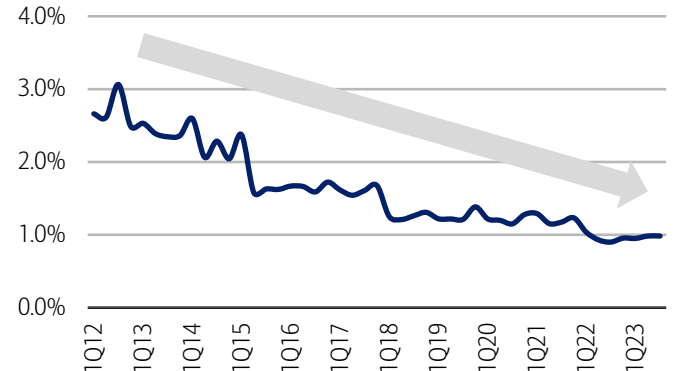


Source: MSIT, BofA Global Research

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Exhibit 4: Korea telcos – monthly churn rate

Korea telcos' monthly churn rate declined to 1% in 3Q23 vs. 3% in 1Q12, as telcos focused more on customer retention rate

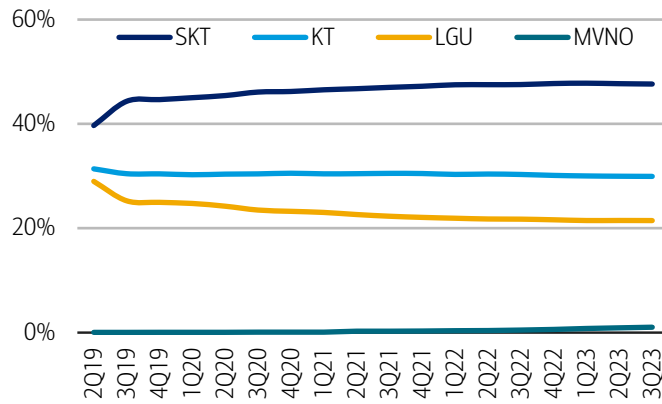


Source: Company data, BofA Global Research

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Exhibit 5: Korea telcos – 5G market share

Korea telcos' 5G market share remains stable at 5:3:2 (SKT:KT:LGU)

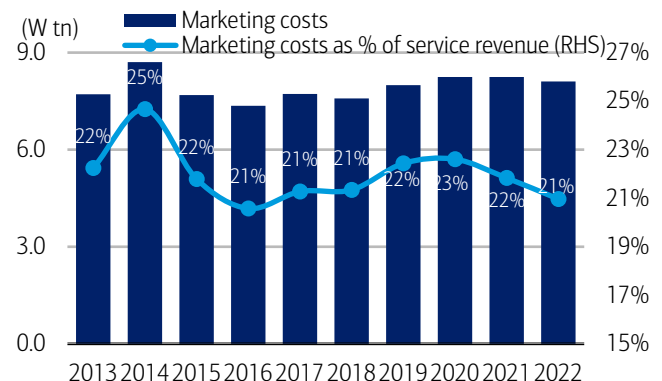


Source: MSIT, BofA Global Research

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Exhibit 6: Marketing costs and marketing costs as % of service revenue

Telcos' marketing costs as % of service revenue have been stabilized to 21%/20% in 2022/23E vs. 22% in 2019 (5G launch) and 25% in 2014 (LTE)



Source: Company data, BofA Global Research

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Price objective basis & risk

KT (KTCNF; W33650; A-1-7 / KT; US\$12.62; B-1-7)

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Upside risks are (1) higher-than-expected growth in non-telco businesses and (2) attractive shareholder returns, including long-term plans for share buybacks.

Downside risks are (1) further regulatory measures, (2) slower-than-expected ARPU growth, (3) higher-than-expected marketing expenses, and (4) increased competitor activity in IDC/cloud sector.

Analyst Certification

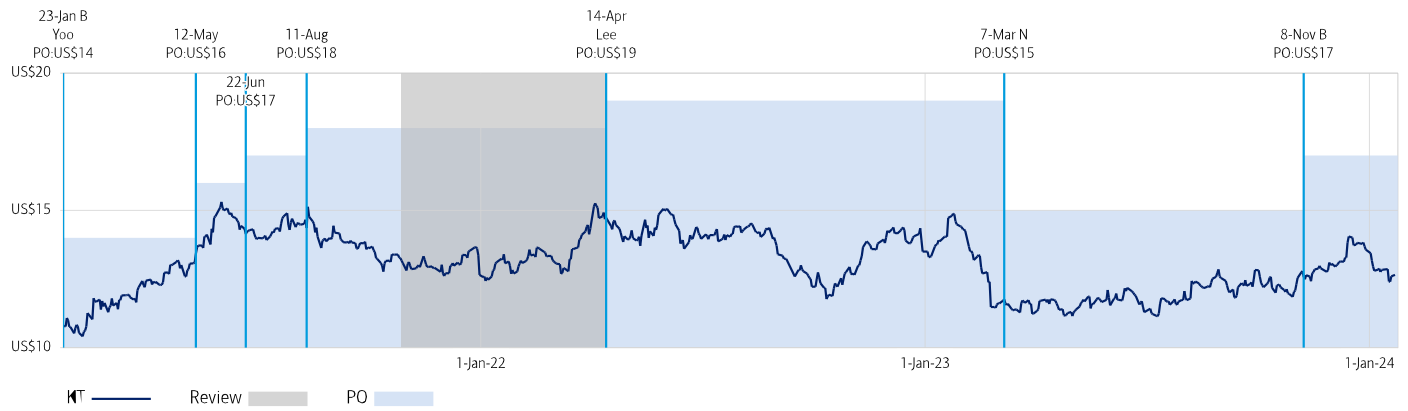
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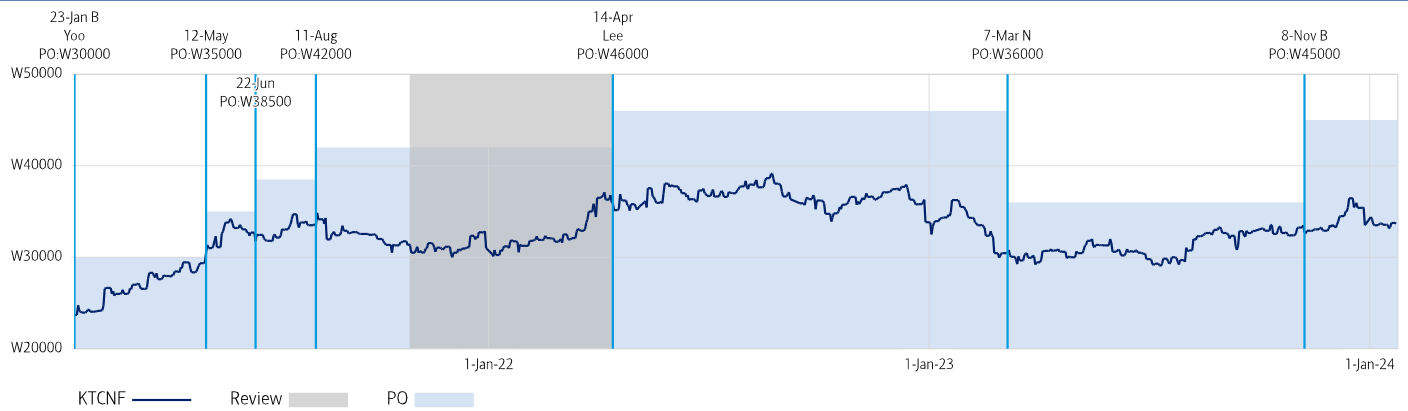
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	Digital Telecommunications Infra Fund	TTCFF	DIF TB	Thitithep Nophaket
	Far EasTone	FEOTF	4904 TT	Brooksley Kang
	GDS Holdings	GDS	GDS US	Daley Li, CFA
	GDS Holdings	XMJFF	9698 HK	Daley Li, CFA
	Indus Towers	XYYAF	INDUSTOW IN	Sachin Salgaonkar
	INTUCH	XHTF	INTUCH TB	Thitithep Nophaket
	KT	KTCNF	030200 KS	Sun Jung Lee
	KT	KT	KT US	Sun Jung Lee
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Hold	27	24.55%	Hold	17	62.96%
Sell	26	23.64%	Sell	12	46.15%

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Sell	807	22.84%	Sell	383	47.46%

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^{R2}Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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