HD Corporate: SingTel sees signs of turnaround at Optus; potential play on India, Indonesia reform

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WC 1,572 words

PD 24 November 2014

SN The Edge Singapore

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Singapore Telecommunications was the standout performer among the three locally-listed telcos this quarter. On Nov 13, the company announced a 3.5% y-o-y increase in its operating revenue to $4.3 billion and a 19.3% increase in earnings to $1 billion for its 2QFY2015 ended Sept 30. Investors greeted the news with cheer, sending shares of SingTel up 1.3%. In fact, the positive sentiment surrounding SingTel boosted the Straits Times Index too. SingTel is the third-largest constituent in the STI, behind DBS Group Holdings and Oversea-Chinese Banking Corp, with a weighting of 10.2%. Over the week ended Nov 14, the STI gained 24.7 points or 0.8%.

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More than half of that gain was contributed by SingTel.

The company's outsized earnings growth is partly due to a net exceptional gain of $59 million, which arose mainly from the dilution of its equity stake in Singapore Post. SingTel owned a 25.4% stake in the postal service operator, which was diluted to 23.2% in July following a placement by SingPost of a 10.3% stake to Alibaba Group Holding for $313 million. SingTel recognised a gain of $65 million from the dilution of its equity interest.

Excluding this gain, however, SingTel's earnings would still have increased 10.8% to $979 million. In comparison, M1 reported a 12.7% increase in earnings to $44.5 million on the back of a 3.5% increase in operating revenue to $250.2 million. StarHub reported a 3% increase in earnings to $98 million on the back of a 2% increase in revenue to $592 million. SingTel's performance this quarter was also a significant improvement from the quarter ended June 30, when it reported a 3.4% decline in operating revenue and a 17.4% decline in earnings.

Among the factors driving the improvement this quarter was a turnaround in the Australian consumer business. Through its wholly-owned subsidiary Optus, SingTel offers mobile and fixed services to both consumer and enterprise customers in Australia. During the September quarter, the Australian consumer business saw a 2% increase in revenue to $1.8 billion. Optus CEO Allen Lew, who took on the role in October, says customers responded well to its "Switch" postpaid mobile offer. Beginning September, Optus offered rebates of up to A$450 for customers on competing carriers to switch to its mobile network. Optus grew its mobile prepaid and postpaid customer base (including enterprise users) by 65,000 customers in the quarter. It also saw a 7% increase in mobile data revenues and a 2% increase in average revenue per user.

"We think Optus is making good headway for the MyPlan — [the] first in the market to offer shared data allowances on multiple devices — which has contributed to the strong pickup in mobile net-adds to 65,000 in 2QFY2015 from 16,000 in the previous quarter, and arresting the quarterly declines in its mobile revenue," says DMG & Partners Research in a report. Optus' mobile revenue increased 4% in Australian dollar terms versus a 2% decline in 1QFY2015.

Some analysts see SingTel continuing to build on its momentum in Australia. DMG's report quotes Lew saying that Optus is currently working on expanding its 4G coverage to 90% of the population from 83% currently. This will plug a coverage gap with incumbent Telstra Corp and should mean bigger revenue opportunities in the months ahead. And, in the meantime, SingTel could also begin benefiting from better numbers at its emerging-market associates.

Emerging-market play

In 2QFY2015, pre-tax earnings from SingTel's regional mobile associates increased 26% to $629 million. This was a marked improvement from the 8% increase recorded in 1QFY2015. Leading the way was Bharti Airtel, SingTel's India-listed associate, which has operations in India, Bangladesh, Sri Lanka and Africa. It reported a 122% increase in pre-tax earnings. Thanks to a 1% increase in the value of the Indian rupee against the Singapore dollar, pre-tax earnings in Singapore dollar terms increased 130% to $203 million.

During the quarter, Bharti Airtel's operating revenue in India, Bangladesh and Sri Lanka increased 12% because of mobile data growth, improvements in voice rates and a larger customer base. Total data traffic rose by 95%. In Africa, its mobile data revenue grew 57%.

CIMB Research expects Bharti's earnings before interest, taxes, depreciation and amortisation (Ebitda) to grow at a compounded annual rate of 11.2% over FY2014 to FY2017, driven by stable tariffs, rising data penetration and higher network utilisation in India. "Bharti India's outlook remains upbeat amid stable voice tariffs and market share gains led by data," the brokerage says in a report. "We believe Bharti is best placed to capture data revenue market share due to its strategic 3G/LTE spectrum portfolio and widest 3G cell site coverage."

In fact, Bharti might well make SingTel an interesting play on the economic reform underway in India. The country's recently elected prime minister Narendra Modi is adopting a business-friendly stance, which is expected to draw foreign direct investment. And, lower oil prices have helped narrow India's current account deficit. As a result, the rupee's steady slide over the past four years appears to be reversing.

India's massive population and its still-low mobile data penetration rates also mean tremendous opportunity for growth. "Telecoms is a very capital-intensive industry. It benefits from scale," says James Gautrey, global equities fund manager at Schroders, at the fund manager's 2014 international media conference. He expects China and India to collectively hit a billion mobile Internet subscribers next year. "These are numbers that even the best-run telcos in the developed world can only dream of."

Indonesia is another big growth market for SingTel that seems to be entering an exciting phase with a new reformist president, Joko Widodo, also known as Jokowi. On Nov 17, less than a month into taking office, Jokowi fulfilled an election pledge to cut fuel subsidies and free up funds for development. Subsidised petrol prices were raised by 30%, sparking a 0.7% gain in the rupiah over the past week. If the rupiah continues appreciating, SingTel could see a strong positive impact.

For 2QFY2015, SingTel's Indonesian associate Telkomsel achieved a 10% rise in pre-tax earnings contributions in local currency terms. However, the rupiah declined 12.3% against the Singapore dollar in the quarter to September. As a result, in Singapore dollar terms, contributions from Telkomsel declined 2% to $247 million.

Like Bharti, Telkomsel is benefiting from rising mobile Internet adoption. Data and digital services rose 31% in the quarter. Its voice revenue also managed a strong 7% growth. "We are optimistic on Telkomsel's outlook as we believe it is in a good position to capitalise on the strong data growth story in Indonesia after having invested heavily in building its 3G network over the last three years," says CIMB. "Telkomsel's smartphone users rose by a strong 13.3% q-o-q and 76.5% y-o-y to 35.4 million, with penetration now at 25.4% versus 15.7% a year ago. We believe penetration will rise substantially over the next three years as entry-level smartphone prices drop further."

Collectively, Telkomsel and Bharti account for 71.5% of pre-tax earnings contributions from SingTel's regional mobile associates, and roughly one fifth of its total Ebitda.

Emerging as a top pick

In a Nov 12 strategy update, Deutsche Bank singled out SingTel as one of its top five picks in the local market for 2015. "SingTel has always performed well when Optus and associates are firing on all cylinders. We believe the group is hitting another such growth stage," says analyst Peter Milliken. "FX headwinds appear to be abating, and structural improvement at Optus should start delivering results from next year. Meanwhile, at associates, we see each being well-positioned with positive pricing trends in place in India and Indonesia still having some room to play out, and generally improved positioning due to market consolidation in India, Indonesia and the Philippines." Milliken has a "buy" rating on the stock with a target price of $4.50. SingTel shares closed Nov 19 at $3.93.

Maybank Kim Eng Research analyst Gregory Yap is similarly positive. He sees SingTel's fortunes turning this year and next with core earnings growth of 3% this year and 8% next year. "Optus is now growing again after its restructuring and is regaining mobile market share. With the completion of 4G network coverage to 90% of Australia's population by April 2015, Optus should be able to further improve its core mobile business," he says. Yap has a "buy" call and a price target of $4.32.

Shares in SingTel are up 7.4% this year, leading the 5.3% gain in the STI. The stock currently trades at 17.2 times earnings and offers a dividend yield of 4.3%. StarHub, which is down 4.2% this year, trades at a slightly higher multiple of 19.6 times earnings but has a higher dividend yield of 4.9%. M1 is up 15.3% this year, and is the most expensive at 20 times earnings. It also has the lowest yield: 3.8%.

CO ovchbk : Oversea-Chinese Banking Corporation Limited | sinpos : Singapore Post Limited | telas : Singapore Telecommunications Limited | opcomm : SingTel Optus Pty Limited | tmasek : Temasek Holdings Pte Ltd

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AN Document EDGESI0020141125eabo00005

