

08 January 2013

Telecommunication

4G LTE services rollout

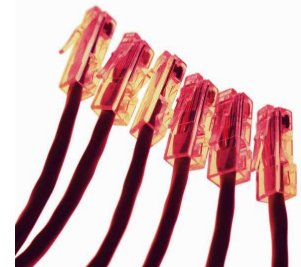
We are raising our rating on the Telecommunication sector to an **OVERWEIGHT**. Mobile operators have launched their 4G LTE services with the key focus being on the wireless broadband segment in the urban areas in the initial stage. 4G revenue opportunities may be limited at first given operators have yet to specify their respective LTE strategies. Nevertheless, some of the uncertainties may be cleared up in mid-2013 when more 4G handsets (that are compatible with Malaysia's 2.6GHz spectrum) would be available in the market. We expect the incumbents to launch their respective LTE bundle packages subsequently, and this should provide a clearer picture of the potential earning upside of this latest technology. Looking back, we observe that the local telco companies' valuations have made a paradigm shift since 2011. As a result, we have standardise all our telcos standard deviation ("SD") base year (which we are using to determine our targeted SD and subsequently derive the target prices for each telco under the EV/forward EBITDA methodology) to year 2011 from various base years previously. This has prompted us to re-rate all our telcos' target prices even though their respective earnings estimates remain unchanged. TM (OP, TP raised to RM6.80 from RM6.50 previously) remains our top pick in the telco sector. Our Maxis target price, meanwhile, has been raised to RM7.20 (from RM7.00 previously) while Digi's fair value is now pegged at RM5.77 (from RM4.95 previously). We are also raising our rating on both the stocks to **OUTPERFORM** from **MARKET PERFORM** previously. We, however, are maintaining our **MARKET PERFORM** call on Axiata albeit the target price has been raised to RM6.81 from RM6.53 previously.

4G LTE plans. Both Maxis and Celcom have unveiled their 4G LTE services during the first week of 2013, paving the way for mobile subscribers to enjoy faster mobile broadband speeds in the future. While both companies kicked off their 4G LTE service in the wireless broadband segment (i.e. through the use of dongles), we believe that they will bundle the technology with smartphones later when more 4G LTE mobile devices (that are compatible with Malaysia's LTE network) are introduced in mid-2013.

How fast could the uptake rate be in Malaysia? There is no clear projection or indication on the country's LTE subscription growth rate at this juncture given that the mobile operators have yet to clearly specify their positions in this latest mobile broadband technology as well as the lack of 4G handsets in the market currently. We believe, mobile operators will need to decide whether their LTE service is just another part of their mobile broadband services or to position the technology as offering significant benefits over 3G. If it is the latter, this suggests that mobile incumbents will need to provide more value-added services rather than just rely on the LTE speed to convince consumers of the value proposition of the using the LTE services. Operators would need to clearly convince to consumers on why should consumers sign up to LTE and what difference does speed to them. We reckon that the uptake rate can only be estimated more accurately once the abovementioned areas are made clearer later.

4G LTE service – an additional new revenue opportunity to mobile operators? At present, the answer is still unclear as the mobile operators have yet to specify their respective 4G LTE strategies. Thus, we have yet to impute any earning contribution from this new 4G service into our Telcos' FY12-FY14 financial models. We believe that mobile incumbents need to build a story out of LTE and not just sell the speed at competitive price if they want to capitalise on the technology. Users will consume more data over LTE if the experience is markedly better than 3G and if so, they are likely to be willing to pay more to use the service. As a result, we are of the view that operators should bundle their LTE service (with smartphone devices) with small amounts of data per month (i.e. 1GB or 2GB) to encourage the uptake of the service later.


A paradigm shift in Telcos' valuations since 2011. We believe the local telcos incumbents have experienced a paradigm shift on their valuations since 2011 given the more generous dividends (in terms of absolute amounts) that had been declared and more importantly, the more active capital management being announced since then. As a result, all the telco players' valuations (i.e. forward PER and EV/forward EBITDA) had seen a much higher expansion rate as compared to the earlier periods. We have standardise all our telcos standard deviation ("SD") base year (which we are using to determine our targeted SD and subsequently derive the target prices for each telco under the EV/forward EBITDA methodology) to year 2011 from various base years previously (please refer to overleaf page for detail explanation).



OVERWEIGHT

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Maxis – the first LTE service provider. Maxis kick started the country’s first 4G LTE service in selected parts of the Klang Valley, including Taman Tun Dr Ismail, Damansara Utama, Desa Sri Hartamas, Bandar Puchong Jaya, Bandar Sunway and Cyberjaya on 1 January 2013. The group’s LTE service enables its customers to enjoy speeds of up to 75Mbps, with typical average speeds of 10 to 30Mbps on its 4G LTE network, by subscribing to monthly wireless broadband packages options starting from RM88 (with the LTE modem priced at only RM400). We understand that Maxis’ LTE service is only available for data service (i.e. dongle) at this juncture while its bundled package with other mobile devices such as smartphones and tablets will only be made available at a later stage.

Celcom – another 4G LTE service provider. Similar to Maxis, Celcom introduced its 4G LTE service four days after Maxis, focusing on both dongles and tablets in the Klang Valley. The group indicated that its 4G LTE modem (model: B593u-12) and dongle will be manufactured by Huawei. A quick check shows that Huawei’s 4G LTE modem is priced at around USD330 each. We think that Celcom is likely to subsidise the cost of the modem under its upcoming bundled packages, which are targeted to be unveiled before the Chinese New Year festival. Although management has refused to further elaborate on its bundle package’s price range at this juncture, we believe that they will likely price their products at par with that of Maxis.

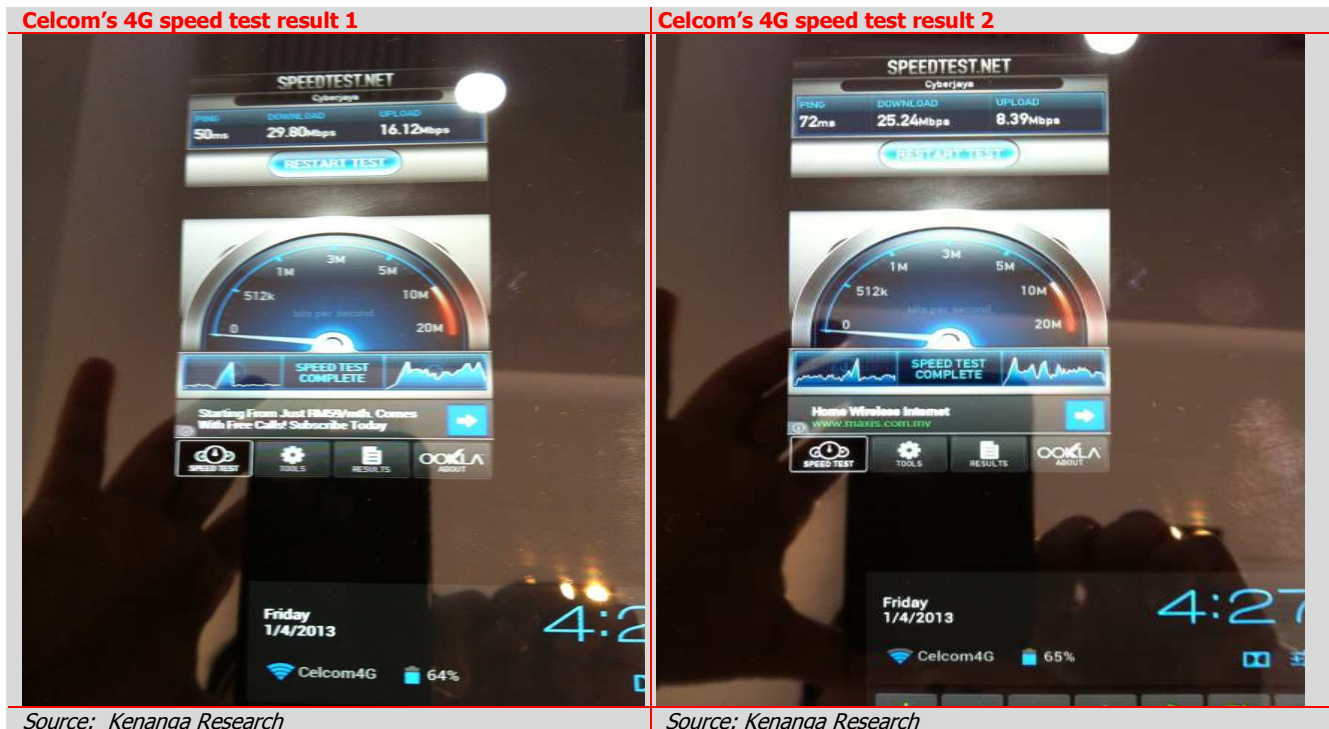
Maxis – 4G USB modem	Maxis – 4G package pricing structure				
	Internet Quota	8am – 2am	2am – 8am	Price	Activation Fee
	20 GB	5GB	15GB	RM88	RM150**
	28GB	7GB	21GB	RM118 / RM128 *	
	48GB	12GB	36GB	RM148 / RM158 *	
<i>*For non-Maxis postpaid customers</i> <i>**Enjoy a rebate of RM10/mth for the first 5-month.</i>					
Source: Maxis, Kenanga Research	Source: Celcom, Kenanga Research				

Celcom – 4G modem	Celcom – 4G modem
	
Source: Kenanga Research	Source: Kenanga Research

Celcom is likely to unveil its 4G LTE service bundled with mobile devices in mid-2013. The current limited smartphones that are compatible with 2600MHz – the bandwidth allocated for the deployment of 4G LTE service by MCMC, has resulted in Celcom having to defer its LTE-enabled device plans. Currently, there are only three devices in the market that are compatible with 2600Mhz namely ASUS Padfone 2, Nokia Lumia 920 and Lumia 820 based on our knowledge. The current popular iPhone 5 (model A1429); iPad mini (model A1455) and iPad 4 (model A1460) models are actually not compatible with Malaysia’s LTE network. Meanwhile, we understand from Celcom’s management that certain versions of Samsung phones, i.e. Galaxy S III (GT-19305) and Galaxy Note II (GT-N7105), and the soon to be released Sony Xperia V, are able to support 2600MHz. Thus, it is not a surprise that Celcom has scheduled to unveil its LTE-enabled device plans a few months later after the launch of its initial 4G wireless broadband packages as it needs to wait for more 2600Mhz LTE compatible devices to be available in the market. Meanwhile, we believe Maxis will have a similar rollout plan as Celcom although it has yet to unveil its schedule.

More value-added services are likely to be introduced in the next 6-18 months. Celcom indicated that video streaming and content services will be the key focus in its 4G LTE service. Thus, one can expect that more value-added services such as high-quality video and music, ‘real-time’ entertainment, etc. could be introduced in stages over the next 6-18 months. On the subscriber uptake rate, while Celcom has yet to firm its own view on its potential 4G subscriber growth rate, Mr. Suresh (Celcom’s COO) personally believes that Celcom could lure 1.0m LTE subscribers from both new users and those from its network migration users over the next 12-18 months.

Speed test results on Celcom's 4G LTE were superb in Blue Cube at Sunway Pyramid. We went to Celcom's Blue Cube store at Sunway Pyramid on 4 January, the launch day of Celcom's 4G LTE service, to experience the group's latest technology. We streamed a 12-minute YOUTUBE video on one of Huawei's tablets and the experience was superb with no network buffering occurring throughout the period. Overall, these two speed-test results were great (first download speed: 29.80Mbps; second download speed: 25.24Mbps) and seemed to be on par with Maxis' 4G LTE average network speed, which the company claims to be around 10 to 30Mbps.



FTTH vs. 4G LTE. While we believe that 4G LTE services will not post an immediate threat to TM's FTTH, at least in the next 1-2 years due to the fact that the former's eco-system is still not well prepared yet, LTE could still potentially cannibalise FTTH's business over the mid to long run in our view. Japan's NTT (Japan's largest telco player with an extensive fiber-to-the-home network) for example, found that its consumers are shifting their demand from fixed networks to LTE mobile networks. As a result, it had to cut its fixed network broadband access prices by 34% from JPY5,460 (USD67) to JPY3,600 recently to cater for the demand shift. According to NTT, the reason for the slowdown in its FTTH subscriber's growth was due to the fact that many of its young subscribers now prefer to have their own personal LTE-based high-speed broadband service rather than paying for a FTTH service. Nonetheless, NTT also noted that users in Japan, who had abandoned FTTH tend to be watching short-form videos and avoid streaming or downloading long form videos that would put pressure on their mobile data plans. Should Malaysian mobile user usage behavior perform differently, we do not discount that TM's FTTH may continue to lead the broadband market going forward. In summary, we believe that while 4G LTE could potential cannibalise FTTH over the mid to long run, it's still too early to draw a conclusion on its effect to TM's UniFi products at this juncture given that celcos would still need to rely on their own backhaul and other network backhaul providers (i.e. TM and TDC) to offload their data and this will limit the pricing & data elasticity as compared to TM's FTTH.

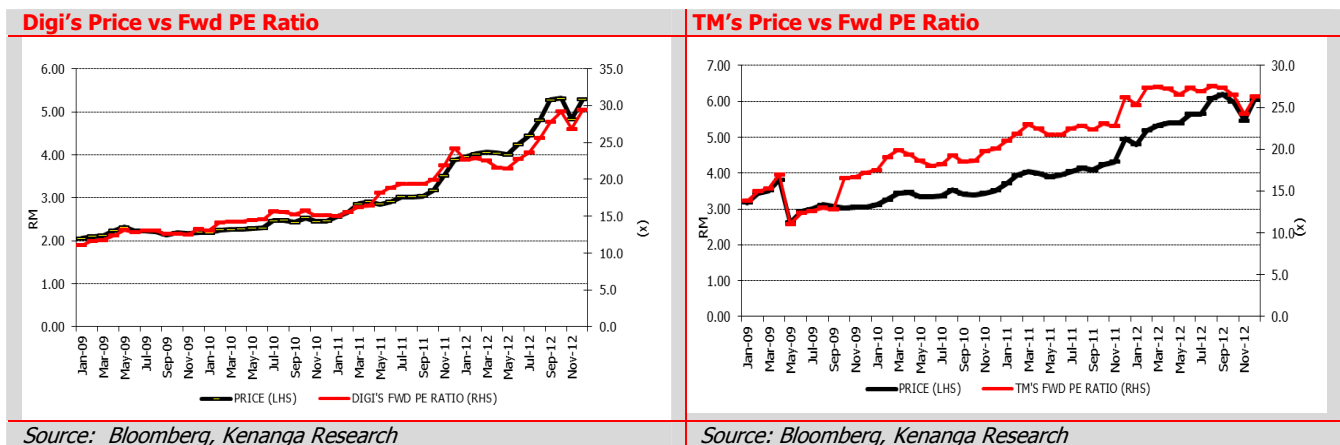
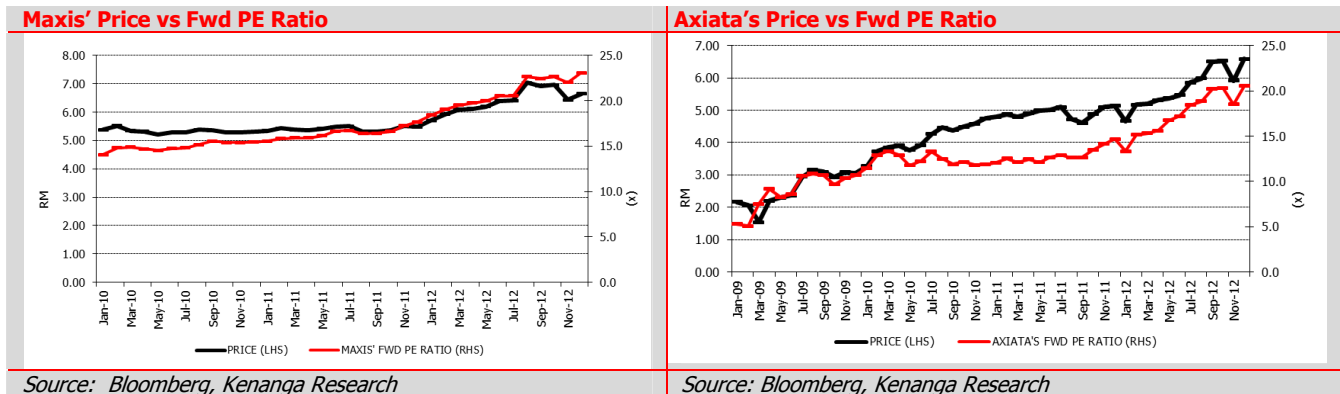
The sector's prospect remains intact. The local telco sector's long-term prospect remains intact given that the consensus and us have yet to fully impute in the new potential upcoming catalysts (i.e. 4G LTE earnings opportunity, infra and network collaborations, the deferment of the proposed prepaid service tax hike and the introduction of a new business model such as business trust and/or to spin off tower infrastructure assets) into the financial models. We had earlier highlighted in our sector report dated 10 October 2012 that the abovementioned catalysts could materialise as early as 4QCY12. In view that some of the abovementioned catalysts have started to emerge, which we believe could provide a re-rating spark again to the sector, **we are raising our sector rating back to an OVERWEIGHT** from NEUTRAL previously.

A paradigm shift in Telcos' valuations since 2011. We believe that the local telcos incumbents have experienced a paradigm shift on their valuations since 2011 given the more generous dividends (in terms of absolute amounts) that had been declared and more importantly, the more active capital management that had taken place since then. As a result, all the telco players' valuations (i.e. forward PER and EV/forward EBITDA) had seen a much higher expansion rate as compared to the earlier periods.

We earlier adopted a different valuation base year for each telco to determine their respective standard deviation ("SD") and subsequently finalised the targeted SD to derive our target price under the EV/forward EBITDA valuation methodology. For Maxis, we had previously adopted December 2009 as the base year, the month after the company was re-listed on

Bursa Malaysia, in our earlier valuations. Meanwhile, we have been applying May 2007 as the base year in our previous Digi valuations given that company obtained its 3G spectrum license via a transfer from Time dotCom during the period. As for Axiata and TM, we used May 2008 as our valuation base year previously, the period when both companies completed their demerger exercise.

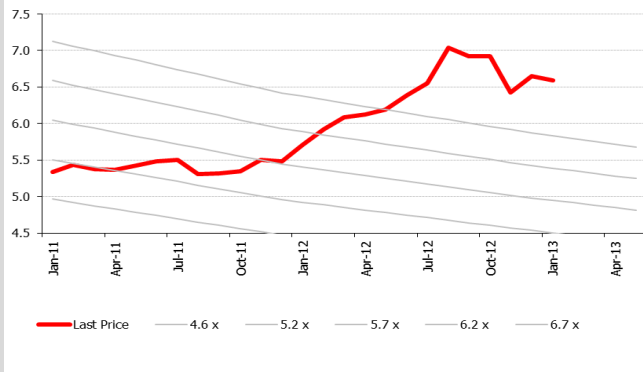
Going forward, we believe this new valuation trend (by using the year 2011 as the base year) will persist given that investors will likely continue to seek decent dividend yield stocks in a volatile market.



Earning's estimate maintained but raising target prices. While we are maintaining all our Telcos FY12-FY14 earning's estimates, we have raised our target prices for all Telcos after changing the valuation base year to year 2011 due to the abovementioned reasons. TM (OP, TP raised to RM6.80 from RM6.50 previously) remains our top pick in the telco sector due to its strong dividend yield, solid presence in the FTTH market and the lesser competition seen in its wholesale and fixed-line segment. On top of that, we also expect the group to declare another capital management plan (which we expect TM to declare another 30.0 sen dividend on top of its regular semi-annual dividend. Please refer to our TM report dated 12 December 2012 for more detail information) at next month, in conjunction to its 4QFY12 result release. Our Maxis target price, meanwhile, has revised to RM7.20 (from RM7.00 previously) while Digi fair value was up from RM4.95 to RM5.77. We also raised our stock rating on both stocks to OUTPERFORM from MARKET PERFORM previously. In addition, we are maintaining our MARKET PERFORM call on Axiata albeit its target price has been raised to RM6.81 (from RM6.53 previously).

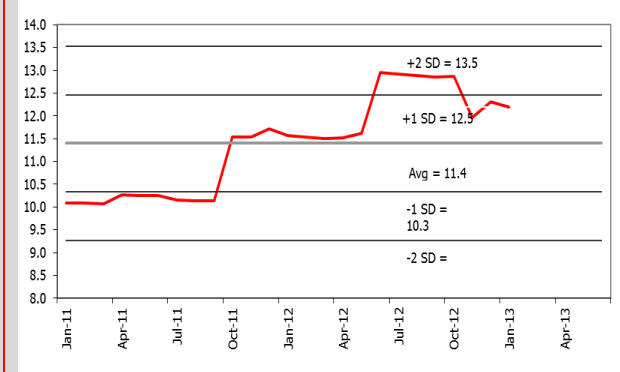
Time to accumulate more local Telco's stocks? We recommend existing investors to continue to hold and ride the upward trend in the sector in view that the abovementioned catalysts are in the midst of crystallising. For those investors who are late to the rally and are more risk averse, we recommend them to trim part of their holdings to lock in profits and to buy in again later at lower prices as the sector is still able to provide decent dividend yields with solid operational performance in the current volatile market. We expect a temporary lull in share prices in the sector during the General Election campaign period, which could provide a good entry opportunity to the latecomers.

Maxis – forward P/BV



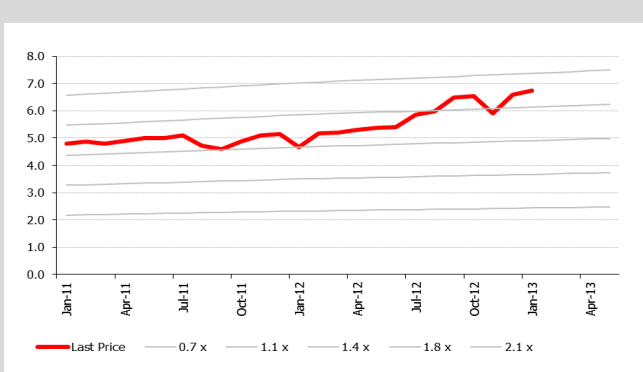
Source: Bloomberg, Kenanga Research

Maxis – EV/forward EBITDA Standard Deviation



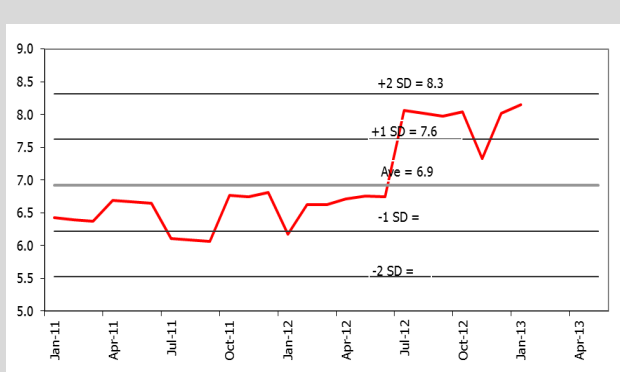
Source: Bloomberg, Kenanga Research

Axiata - forward P/BV



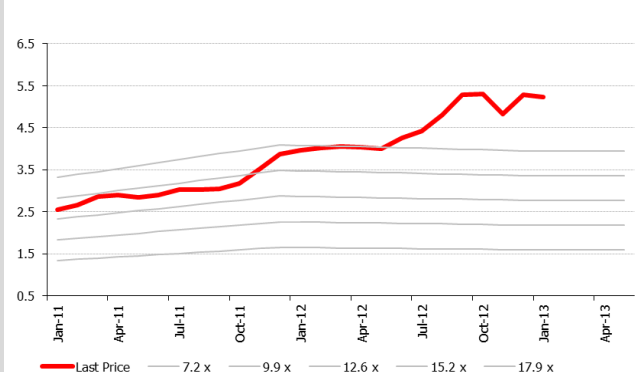
Source: Bloomberg, Kenanga Research

Axiata – EV/forward EBITDA Standard Deviation



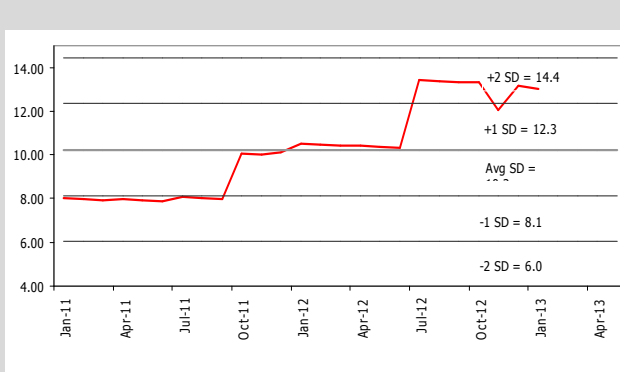
Source: Bloomberg, Kenanga Research

Digi – forward P/BV



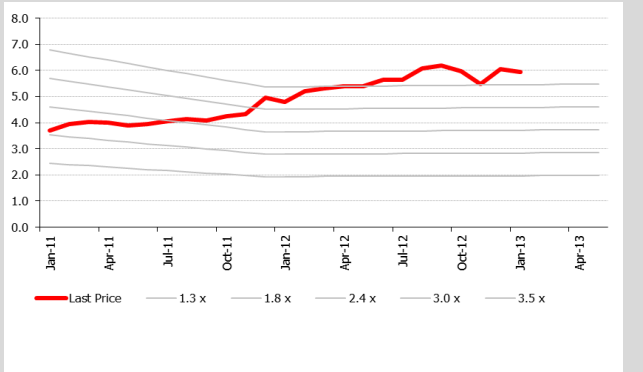
Source: Bloomberg, Kenanga Research

Digi – EV/forward EBITDA Standard Deviation



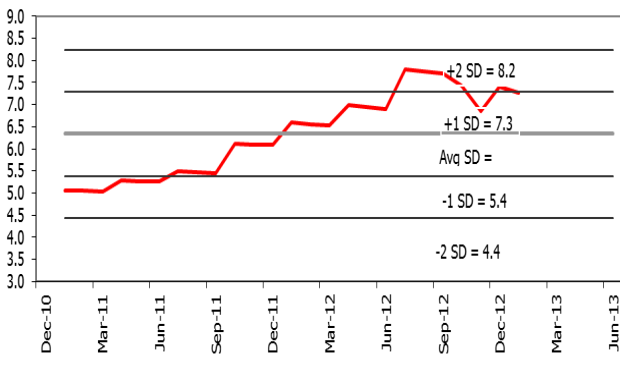
Source: Bloomberg, Kenanga Research

TM – forward P/BV



Source: Bloomberg, Kenanga Research

TM – EV/forward EBITDA Standard Deviation



Source: Bloomberg, Kenanga Research

NAME	Price (7/1/13)	Mkt Cap (RMm)	PER (x)			Est. FY13 Div. Yld. (%)	Historical ROE (%)	Normalised Net Profit (RMm)			FY12 NP Growth (%)	FY13 NP Growth (%)	Target Price (RM)	Rating
	(RM)		FY11	FY12	FY13			FY11	FY12	FY13				
CORE COVERAGE														
Maxis	6.58	49,350.00	22.7	23.1	20.7	6.1	26.9	2,175	2,132	2,387	-2.0%	12.0%	7.20	OP
Axiata	6.71	57,298.28	22.4	20.9	19.7	3.3	11.7	2,539	2,743	2,906	8.1%	5.9%	6.81	MP
Digi	5.24	40,741.00	32.5	31.4	23.7	4.2	88.9	1,254	1,551	1,652	23.6%	6.6%	5.77	OP
TM	5.88	21,035.11	33.1	26.0	25.0	3.6	8.4	635	810	842	27.6%	4.0%	6.80	OP

Source: Bloomberg, Kenanga Research

NAME	Price (7/1/13)	New Target Price (RM)	Potential Capital Upside	New Valuation Methodology	Previous Target Price (RM)	Previous Valuation Methodology
	(RM)					
Maxis	6.58	7.20	9.4%	Targeted FY13 EV/forward EBITDA of 13.5x (+2.0 SD above its mean)	7.00	Targeted FY13 EV/forward EBITDA of 13.1x (+2.0 SD above its mean)
Axiata	6.71	6.81	1.5%	Targeted FY13 EV/forward EBITDA of 8.3x (+2.0 SD above its mean)	6.53	Targeted FY13 EV/forward EBITDA of 8.0x (+2.0 SD above its mean)
Digi	5.24	5.77	10.1%	Targeted FY13 EV/forward EBITDA of 14.4x (+2.0 SD above its mean)	4.95	Targeted FY13 EV/forward EBITDA of 11.8x (+2.0 SD above its mean)
TM	5.88	6.80	15.6%	Targeted FY13 EV/forward EBITDA of 8.2x (+2.0 SD above its mean)	6.50	Targeted FY13 EV/forward EBITDA of 7.9x (+2.0 SD above its mean)

Source: Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

- OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
MARKET PERFORM: A particular stock's Expected Total Return is WITHIN the range of 3% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

Sector Recommendations***

- OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of 3% to 10%
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

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

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