

Telecommunication Sector

(Overweight)

“Overhang Cleared”

We maintain our Overweight call on telecommunication sector in view of 1) stable dividend 2) leaner operating cost 3) impact from stable Ringgit 4) potential wider margin on 4G's roll out. Our top pick for the telecommunication sector is Digi with a BUY call and TP of RM5.75 pegged at EV/EBITDA of 14.5x.

Major overhang removes. On Tuesday, Malaysia Communication and Multimedia Commission (MCMC) has sent letter of offers to Celcom Axiata, Digi, Maxis and UMobile for the spectrum allocation of the 900Mhz and 1800Mhz band that were awarded in February 2016. The letter includes the new spectrum fee that the telcos will have to pay shall they accept the offer. It is of the view that the price charge by MCMC is manageable and hence, telcos are now able to plan for network investment and optimal network design as we understand the fees incurred by telcos are different depending on the spectrum received.

The components. During the announcement in February 2016, MCMC was uncertain about the pricing fee and the mechanism of the pricing. After intense consultation, MCMC announced that the mechanism charged is upfront and there is recurring component where this includes an upfront payment with a recurring annual payment. We foresee the mechanism will allow telcos to continue rolling out their services and not pass on the cost to consumers. The total cost of a 5MHz pair in the 900MHz band would come up to RM499.725 million while for 1800MHz band it will cost RM217.7 million.

Fee charged. The biggest impact to the announcement will be for Celcom and Maxis and these two have to fork out RM1.87 billion each (upfront and maintenance fee) for a 15 years period given their largest spectrum holding in the 900Mhz band. While Digi will incur RM1.37 billion in fee and UMobile at RM1.15 billion and the combined fee for 15 years period is RM6.26 billion. However, what is missing during the announcement is the payment method whether the upfront fee to be paid lumpsum or on staggered basis. We view the upfront fee is significant (about 43% of total cost) as this will impact their cash flow and capex spending ultimately.

Further details. As the prime objective of the exercise is to ensure fair allocation of spectrum, we found that Maxis and Celcom Axiata's spectrums in the 900Mhz were degraded and will experience degrading in the network quality while Digi and UMobile will have 900Mhz band at their disposal and this will ensure better indoor network quality. We reckon that 900 Mhz band has 30-40% better coverage than 1800 Mhz band and this will ensure the LTE coverage is widespread evenly. Post allocation, Maxis and Celcom will receive equivalent spectrum in 900Mhz and 1800Mhz band (2x10

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in 900Mhz, 2x20 in 1800Mhz) while Digi and UMobile will receive equivalent spectrum in 900Mhz band (2x5 in 900Mhz band) while different in 1800Mhz band.

Impact to competitions. We deem post-allocation UMobile may stand a better chance to compete against Celcom, Digi and Maxis as UMobile will have spectrum allocation in each bands. While for Digi, it will able to compete with Maxis and Celcom in terms of network quality and coverage. Nevertheless, we foresee that current competitions in both postpaid and prepaid are cooling down as witnessed in 1H16 results where stiff competitions had eroded telcos ARPU. Post-allocation, we deem telco may launch another round of competitions to secure subscribers with Celcom may challenge Maxis's top mobile subscriber share again.

Impact to earnings. We foresee that there would be an impact to telco EBITDA and its capex spending ultimately. We deem the upfront fee will be financed through internal funds for Celcom, Digi and Maxis while for UMobile, based on announcement, it would pose a challenge as it will create more cost pressure. Based on our projection on the upfront fee and annual maintenance fee, we estimate it would lower telcos' FY16 core PATAMI by c.0.7% to 13.1%, assuming a full-year impact. At this stage, we discount the possibility of fund raising activity though telcos have a capability to do that. In other way, telco may lower the dividend payment in order to preserve their cash.

Table 1: New Spectrum Allocation

New Spectrum			Fee Structure	
Telco	900Mhz	1800 Mhz	Upfront fee (Million)	Annual Fee (Million)
Celcom	2x10	2x20	817	70
Maxis	2x10	2x20	817	70
Digi	2x5	2x20	599	51
UMobile	2x5	2x15	503	43
Total	2x30	2x75	2,735	235

Source: MCMC

Table 2: Spectrum Portfolio

Telco	900 Mhz		1800 Mhz	
	Pre-Allocation	Post-Allocation	Pre-Allocation	Post-Allocation
Celcom	34	20	50 Mhz	40 Mhz
Maxis	32	20	50 Mhz	40 Mhz
Digi	4	10	50 Mhz	40 Mhz
UMobile	nil	10	nil	30 Mhz

Source: Bloomberg

Recommendation. Despite intensified competitions so far, we maintain our **OVERWEIGHT** call on telecommunication sector due to the full impact of LTE network as well as the ability of telcos to convert the current prepaid subscribers into postpaid to stop the sliding ARPU in the prepaid segment. Attractions on the sector include of 1) stable dividend 2) leaner operating cost 3) impact

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from the stable Ringgit i4) potential wider margin on 4G's impact. Our top pick for telecommunication sector is Digi with a **BUY** call and TP of RM5.75 pegged at EV/EBITDA of 14.5x.

Table 1: Peers Comparison

Company	FYE	Price (RM)	EPS (RM)		P/E (x)		P/B (x)		ROE (%)	Div Yield (%)	TP	Call
			FY16	FY17	FY16	FY17	FY16	FY17				
Axiata	Dec	5.49	0.29	0.32	20.4	18.4	2.2	2.1	11.5	3.7	6.12	Hold
Maxis	Dec	6.33	0.26	0.27	24.8	24.0	11.4	10.4	39.1	3.1	6.46	Hold
Digi	Dec	45.01	0.23	0.23	21.5	21.3	73.5	60.5	285.8	4.5	5.75	Buy
Telekom	Dec	6.85	0.24	0.26	27.2	25.4	3.2	3.15	9.1	3.2	7.05	Hold
Time DotCom	Dec	8.07	0.33	0.38	22.3	19.2	2.0	1.9	21.0	0.9	NR	NR
Average			0.27	0.29	23.24	21.6	18.5	15.6	73.3	2.9		

Source: Bloomberg, M&A Securities

M&A Securities

STOCK RECOMMENDATIONS

BUY	Share price is expected to be $\geq +10\%$ over the next 12 months.
TRADING BUY	Share price is expected to be $\geq +10\%$ within 3-months due to positive newsflow.
HOLD	Share price is expected to be between -10% and $+10\%$ over the next 12 months.
SELL	Share price is expected to be $\geq -10\%$ over the next 12 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT	The sector is expected to outperform the FBM KLCI over the next 12 months.
NEUTRAL	The sector is expected to perform in line with the FBM KLCI over the next 12 months.
UNDERWEIGHT	The sector is expected to underperform the FBM KLCI over the next 12 months.

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