Asia Credit Research

OCBC Bank

Singapore Telecommunications Ltd: New Credit Review

Thursday, April 20, 2017

Recommendations Summary

Issuer Profile:	Bond Recommendation:	
Positive	STSP 3.487 '20	**Neutral**
	STSP 2.58 '20	**Neutral**
	STSP 2.72 '21	**Neutral**
Fundamental Analysis Considerations • Regionally diversified leading telecommunications provider • Increasing mobile competition • Solid credit metrics	Technical Analysis Considerations • Good credit rating • Temasek as major shareholder • HoldCo-OpCo subordination	

S&P: A+/Stable
Moody's: Aa3/Stable
Fitch: A+/Stable

Ticker: **STSP**

Treasury Advisory
Corporate FX & Structured Products
Tel: 6349-1888 / 1881
Interest Rate Derivatives
Tel: 6349-1899
Investments & Structured Products
Tel: 6349-1886

GT Institutional Sales
Tel: 6349-1810

Wong Hong Wei
+65 6722 2533
wonghongwei@ocbc.com

Key credit considerations

- **Diversified leading telecommunications provider:** Singapore Telecommunications Ltd ("SingTel") is a leading telecommunications provider in Singapore and Australia. Through several acquisitions since its IPO in 1993, SingTel holds associate stakes in several mobile providers which are market leaders in India, Indonesia, Thailand and Philippines. By LTM pre-tax profit, SingTel's associates were the biggest contributor (55%), followed by Singapore (23%) and Australia (22%).

- **Tackling increasing mobile competition from a position of strength:** With TPG entering the mobile market in Singapore and Australia, competition may heat up. Costs have already increased with SingTel topping the bids for spectrum in Singapore at SGD563.7mn while losing the bid (to TPG, which paid a staggering AUD1.3bn) in Australia. However, we expect SingTel to mitigate the competition from a position of strength (as a market leader in Singapore and in Australia) given its significant capex plans (which exceed capex plans by TPG) that should bolster its mobile network. In any case, we think SingTel can manage with its geographical diversification (through associates) and multiple business segments (e.g. broadband, Pay TV, ICT and managed services for businesses).

- **Solid credit metrics:** SingTel has a healthy net debt/EBITDA of 2.2x, with a manageable net debt/(FCF plus dividends from associates) at 2.4x. While total debt has been increasing since FY2013, we expect some debt to be repaid with the pending divestment of NetLink Trust. SingTel's proven access to the bond markets has allowed it to source its debt via different currencies while maintaining a well-staggered bond maturity profile. Though exposed to foreign currencies via its associates, FX risk is manageable with a healthy credit metrics.

- **Structural Factors**: The majority of SingTel's pre-tax profits and cashflows are contributed by overseas subsidiaries and associates. Although we see HoldCo-OpCo subordination risks, we think SingTel (as a group) is stronger than each of the individual associate. Via the associates, SingTel is more diversified by partaking in their growth while it does not fund its associates' capex. SingTel benefits as the associates (other than Airtel) have been usptreaming the majority of their profits as dividends. We also think that the stakes in the associates and entities may provide a source of liquidity via divestment, including Optus, as there is no assurance that SingTel will remain its majority shareholder. Similarly, our Positive Issuer Profile does not factor the potential support from Temasek.

I) Company Background

Listed on 1 Nov 1993, Singapore Telecommunications Ltd ("SingTel") is the largest listed company in Singapore with a market cap of SGD61bn. SingTel is a communications company, providing various services including mobile, data, fixed, pay television, internet, video, infocomms technology ("ICT") and digital solutions.

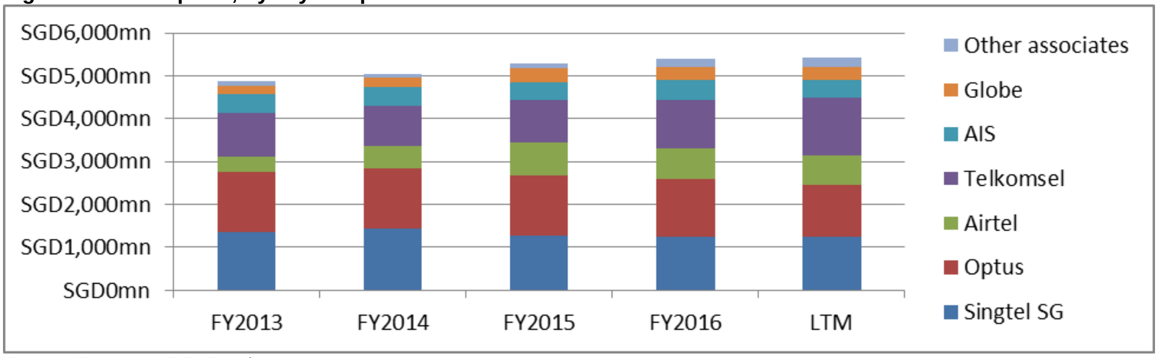
Headquartered in Singapore, SingTel has expanded to Australia (2001), Indonesia (2001), Philippines (1993), Thailand (1999) and India (2000) via acquisitions. SingTel's main operations are in Singapore ("Singtel SG") and in Australia via its wholly-owned Singtel Optus Pty Ltd ("Optus"). In other regions, SingTel holds non-controlling stakes in several leading mobile operators: Bharti Telecom Group ("Airtel"), PT Telekomunikasi Selular ("Telkomsel"), Advanced Info Service PCL ("AIS") and Globe Telecom Inc ("Globe").

Figure 1: Key companies/affiliates

Company	Region	Mobile market share (31 Dec 16)	Stake	LTM[1] pre-tax profit (SingTel's share)
Wholly-owned mobile operator				
Singtel SG	Singapore	48.6% (Rank #1)	100%	SGD1,250mn[2]
Optus	Australia	27.8% (Rank #2)[3]	100%	SGD1,214mn
Associate mobile operator				
Airtel	India, Bangladesh, Sri Lanka, 15 Africa countries	24.3% (Rank #1)[4]	36.5%	SGD673mn
Telkomsel	Indonesia	48.2% (Rank #1)	35%	SGD1,367mn
AIS	Thailand	46.2% (Rank #1)	23.3%[5]	SGD406mn
Intouch[6]	Thailand	-	21%	SGD4mn
Globe	Philippines	50.1% (Rank #1)	47.2%	SGD302mn
Other associates				
NetLink Trust	Singapore	-	100%[7]	SGD148mn
Others	-	-	-	SGD62mn
			Total	SGD5,426mn

Source: Company, OCBC estimates

Figure 2: Pre-tax profit, by key companies/affiliates



Source: Company, OCBC estimates

Since FY2013, the pre-tax profit contribution from Singtel SG and Optus has declined somewhat. However, diversification into other markets has helped SingTel (as a group) achieve continuous growth, with Telkomsel and Airtel contributing a larger share of the growth. As a proportion of LTM pre-tax profit, Telkomsel is the biggest contributor (25.2%), followed by Singtel SG (23.0%) and Optus (22.4%).

[1] Latest 12 months from 1 Jan 2016 to 31 Dec 2016
[2] Includes contributions from non-associates other than Optus
[3] As of 30 Jun 2016
[4] Pertains to India only
[5] Direct equity interest only, excluding Intouch's 40.4% stake in AIS
[6] Acquisition of Intouch Holdings PCL ("Intouch") was completed on 17 Nov 2016
[7] Accounted for as an associate as SingTel does not control it

II) Ownership & Management

Figure 3: Major shareholder as at 31/03/17

Investor	Shares	Stake
Temasek Holdings Pte Ltd	8,538.5mn	52.29%
Capital Group Companies	559.8mn	3.43%
BlackRock	189.4mn	1.16%

Source: Bloomberg, Company

Temasek Holdings Pte Ltd ("Temasek") is the majority shareholder with a 52.29% stake. Temasek is an investment company that is wholly-owned by the Singapore government, with a SGD242bn portfolio as of 31 Mar 2016. SingTel is Temasek's single largest investment at 13% of the portfolio. Temasek's concentration in SingTel may have further increased since 31 Mar 2016, as 386mn new SingTel shares were placed to Temasek[8] in 2016. Prior to listing in 1993 as part of the process to privatise SingTel, SingTel was wholly-owned by the Singapore government under Temasek.

As part of the Singapore Government's Special Discounted Shares ("SDS") Scheme to give Singaporeans a share in the country, Singaporean citizens could purchase shares in SingTel at a discounted price during the 1993 IPO (diluting Temasek's stake to 89%) and during 1996 when Temasek offered the second tranche of shares again at discounted prices to Singaporeans (Temasek's stake: 82%). We note that Temasek subsequently diluted its stake further, for example through the issuance of 2.41bn SingTel shares to partly fund the acquisition of Optus in 2001 (Temasek's stake: 68%), placement of 339mn shares in 2004 (Temasek's stake: 62.7%), placement of 770mn shares in 2006 (Temasek's stake: 56.3%) and placement of 400mn shares in 2012 (Temasek's stake: 51.3%).

We note that Temasek also holds indirect stakes in SingTel's competitors StarHub Ltd (through Asia Mobile / Singapore Technologies Telemdia) and M1 Ltd (through Keppel Corp / Keppel T&T Ltd). However, it is not a certainty that Temasek will continue to hold the stakes (e.g. the major shareholders, including Keppel, are looking to sell M1). Similarly, we would not assume that Temasek would remain a majority shareholder of SingTel, especially with the divestments over the years. While SingTel has a significant market share and provides key telecommunications services for the Singapore government (e.g. G-Cloud platform), consumers and enterprises, we note the shift away from the dependence on SingTel while the Singapore government introduces more competition.

Capital Group is an investment management organization, and holds stakes in SingTel through various companies including Capital Research Global Investor, Capital World Investors, Capital Research and Management, Capital International Inc.

BlackRock is also an investment management company, holding stakes via companies including BlackRock Fund Advisors, BlackRock Group Ltd, BlackRock Advisors LLC, BlackRock Inc.

Ms Chua Sock Koong has been the Group CEO since 1 Apr 2007. Prior positions Ms Chua held at SingTel include Group CFO and CEO, International, and Deputy Group CEO. Ms Chua also sits on the boards of Bharti Airtel Ltd and Bharti Telecom Ltd. Ms Chua graduated from the University of Singapore with a Bachelor of Accountancy (First Class Honours).

Mr Bill Chang is the CEO, Group Enterprise. Prior positions in SingTel include Executive Vice President of Corporate Business and Managing Director, Business Group. Mr Chang is the Chairman of the Singapore Polytechnic Board of Governors and is a Board member of Singapore Post. Mr Chang graduated from Monash University with a Bachelor of Engineering (Honours) in Electrical and Computer Systems Engineering.

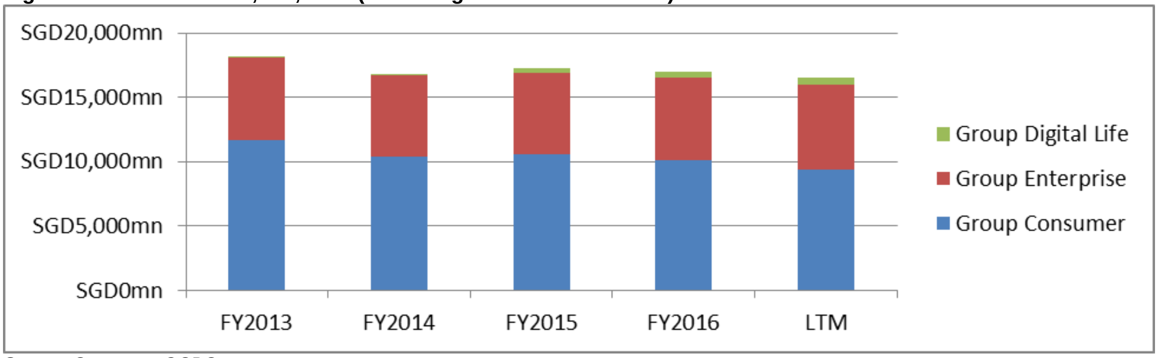
[8] The placement was used to partially fund the purchase of 7.39% stake in Bharti Telecom Ltd and 21% stake in Intouch from Temasek.

III) Business Overview & Analysis

Since FY13[9] (1 April 2012), SingTel has structured its business into 3 main segments: Group Consumer ("GC"), Group Enterprise ("GE") and Group Digital Life ("GDL"). GC comprises SingTel's consumer-related functions in Singapore, Australia and its investments in the emerging markets, mainly through its regional mobile associates. The GE segment targets business customers while SingTel aims to be the leading information communications technology ("ICT") services provider. GDL consists of SingTel's businesses in digital marketing, regional premium Over-The-Top ("OTT") video and advanced analytics and intelligence capabilities.

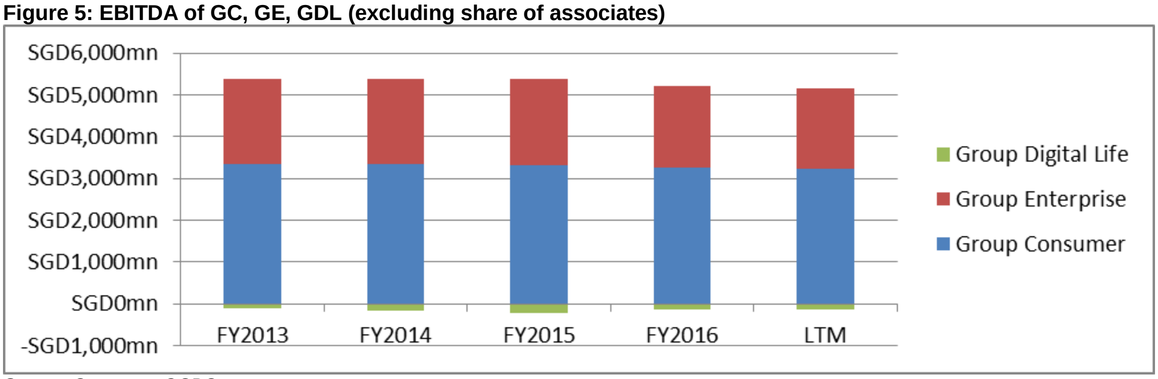
Excluding SingTel's share of associates, GC is the largest contributor to revenue (57%) and EBITDA (64%). GE contributes most of the remainder, at 40% and 38% of revenue and EBITDA respectively. GDL has yet to contribute much to the topline and has been recording negative a EBITDA, though this represents SingTel's nascent stage of investments into the mobile advertising and marketing industry. If the share of revenue from associates were included, LTM revenue would increase by SGD13.7bn – nearly doubling SingTel's reported revenue.

Figure 4: Revenue of GC, GE, GDL (excluding share of associates)



Source: Company, OCBC

Figure 5: EBITDA of GC, GE, GDL (excluding share of associates)



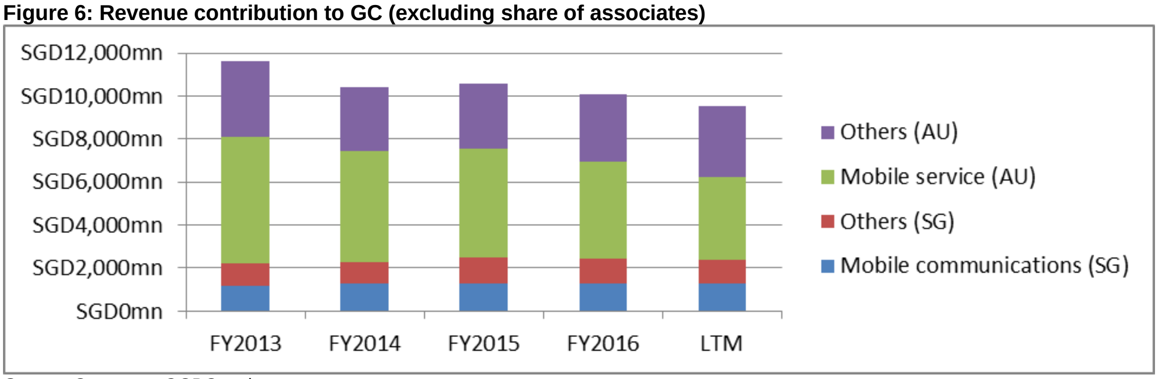
Source: Company, OCBC

Group Consumer

The GC business segment is further structured into 3 main business units: 1) Consumer Singapore, 2) Consumer Australia and 3) International Group. The Consumer Singapore segment operates under the Singtel brand while Consumer Australia operates under the Optus brand. The International Group includes SingTel's stakes in the regional mobile operators Telkomsel, Airtel, AIS and Globe. The GC segment provides mobile voice, messaging, international roaming, mobile data and value-added entertainment and information services for consumers. It is also in the GC segment where SingTel is facing increasing competition in the mobile space, post TPG's entry into the Singapore and Australian market, which could hurt EBITDA generation.

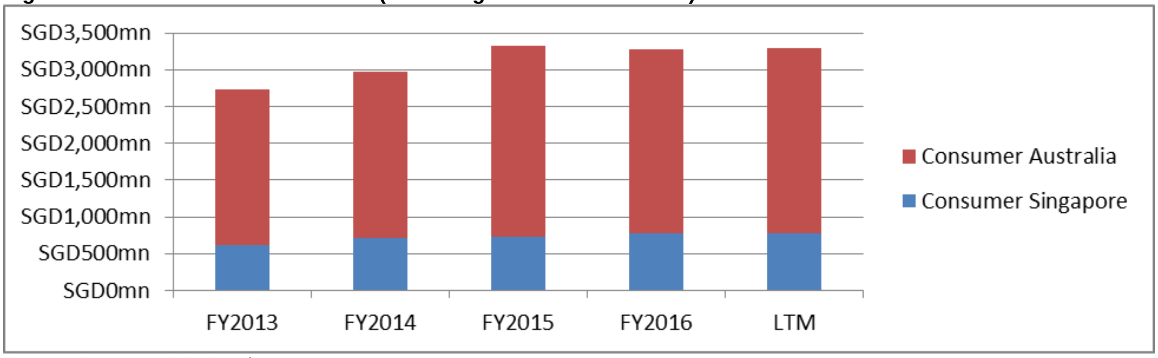
[9] FYE is 31 Mar

Figure 6: Revenue contribution to GC (excluding share of associates)



Source: Company, OCBC estimates

Figure 7: EBITDA contribution to GC (excluding share of associates)



Source: Company, OCBC estimates

Consumer Singapore

Consumer Singapore, which contributes 25% of GC's revenue and 24% of GC's EBITDA, includes the residential telecommunications and multimedia market, mobile, sale of equipment, broadband, pay TV and fixed-line phones. Mobile communications is the largest contributor (55%) to the Consumer Singapore segment's revenue, followed by sale of equipment (13%), fixed broadband (9%) and Pay TV (9%).

Market leader with sticky customers: SingTel is the market leader in the Singapore mobile subscriber market with nearly half the market share, ahead of its rivals StarHub (27%) and M1 (24%) as of 31 Dec 2016. SingTel's market share in 4QFY15 jumped by 3.2pp because prepaid SIM card quota was cut from 10 to 3 per person in Apr 2014, which affected StarHub and M1 more than SingTel. SingTel appeared to be more insulated from the change in regulation as it focused on top-ups rather than selling new SIM cards. Nevertheless, SingTel ceded back some gains in market share as its rivals acquired new subscribers while it maintained its number of subscribers. In the Singapore mobile market, consumers appear to be relatively sticky with SingTel, M1 and StarHub each reporting roughly 1% in monthly churn rates for the post-paid segment. We think the low monthly churn rates may be helped by 1) the post-paid contracts typically featuring a handset subsidy with 2-year lock-in period and 2) bundle promotions discounts for several services such as mobile, broadband, TV and home line.

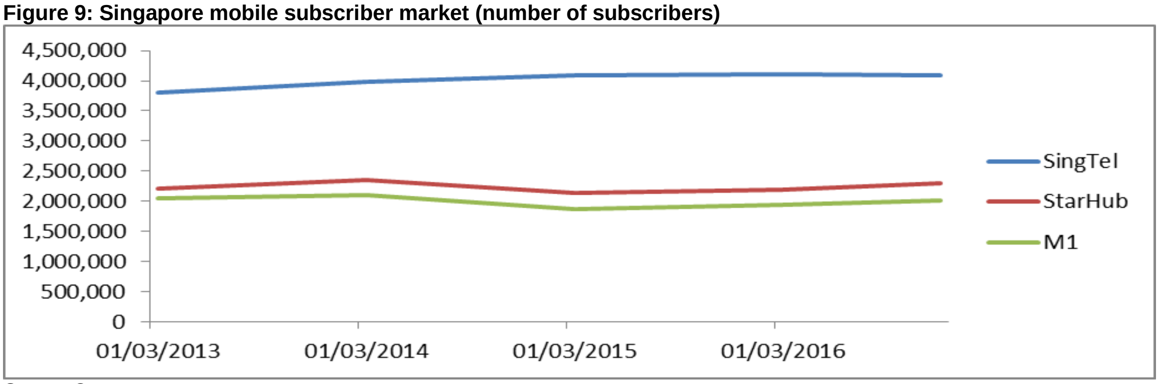
Figure 8: SingTel Singapore mobile key statistics

Singapore mobile	4QFY13	4QFY14	4QFY15	4QFY16	3QFY17
No. of subscribers ('000s)	3,806	3,984	4,088	4,101	4,088
- Postpaid	2,095	2,200	2,266	2,328	2,350
- Prepaid	1,711	1,784	1,822	1,773	1,738
Overall Market share	47.20%	47.20%	50.40%	49.80%	48.60%
Blended ARPU (SGD)[10]	51	50	49	48	48

Source: Company

[10] Average Revenue Per User ("ARPU"), blended between prepaid and postpaid

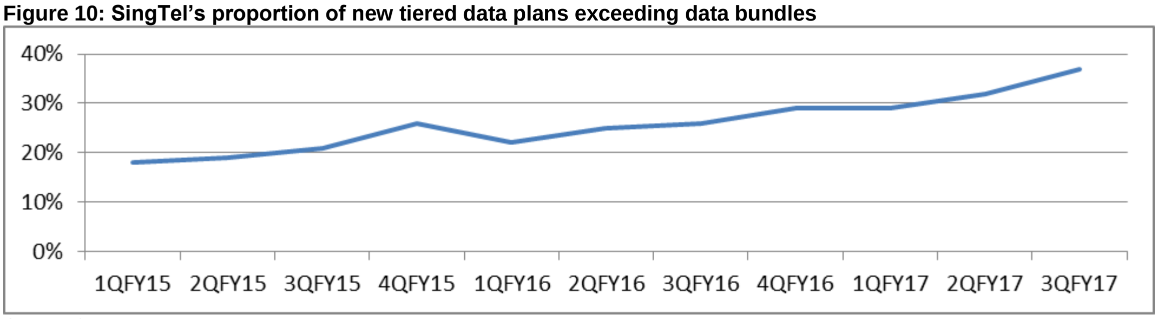
Figure 9: Singapore mobile subscriber market (number of subscribers)



Source: Company

Increasing competition on data from Circles.Life: Looking ahead, competition is set to intensify in the Singapore mobile market. As an operating brand under Liberty Wireless[11], Circles.Life was launched in May 2016 as a new mobile virtual network operator[12] ("MVNO"). Circles.Life offers voice, messaging and data services to postpaid customers in Singapore by tapping on M1's mobile network. Differentiating itself from the existing mobile network operators (SingTel, StarHub, M1), Circles.Life does not focus on handset subsidies that come with binding contracts, but instead focuses on advertising its non-binding contracts for data plans, and appears to be aggressively targeting users with high data-usage needs by offering SGD20/mth for 20GB on top of the base plan. This may appeal to a rapidly increasing proportion of SingTel's customers (3QFY17: 37%) who exceed data bundles – we note SingTel's customers who signed up to SingTel's mobile plans with DataX2 and DataX3, which provide more data, are still exceeding their data bundle.

Figure 10: SingTel's proportion of new tiered data plans exceeding data bundles



Source: Company

On 14 Dec 2016, TPG Telecom Ltd ("TPG") edged out MyRepublic in a SGD105mn bid for 4G spectrum to become Singapore's 4th mobile network operator. TPG is a telco listed in Australia, which became the second largest internet service provider in Australia after acquiring iiNet for AUD1.56bn in 2015. TPG expects to incur SGD200mn-SGD300mn in capex to establish a mobile network by Sep 2018.

Negative impact from the entry of TPG: We think TPG as a new entrant will negatively impact SingTel's business in Singapore. According to TPG, it expects to commence services in 2018 and forecasts that it will become EBITDA positive after snagging a 5%-6% market share, which it believes should be achievable within a short period of time. According to MyRepublic, the new entrant has to achieve higher than 9% market share "to survive and be successful". If TPG is successful in capturing just 5%-6% market share to turn EBITDA positive, we may see SingTel's market share erode to 45%-46%, assuming TPG takes market share proportionally from each of the existing players. It will also be likely for SingTel to face margin pressures on its Singapore mobile segment. If TPG prices aggressively to capture market share, a potential response by SingTel may trigger ARPU to decline from current levels. We believe costs will also increase. For example, from the recently concluded mobile spectrum auction which included TPG, the telcos

[11] Limited Wireless is a Singapore-based telecommunications company
[12] A mobile virtual network operator is a communications provider that does not own its physical network infrastructure

set a record bid of SGD1.14bn, with bids up to 6 times the reserve price. SingTel may be unable to fully pass on the increased costs to consumers due to increased competition from TPG.

Fierce competition in mobile segment mitigated by SingTel's position of strength and diversified operations: Nevertheless, we think the negative impact from the new entrants will be manageable as SingTel will be facing the competition from a position of strength. SingTel has been holding the largest market share in mobile (3QFY17: 48.6%), while the Consumer Singapore segment has seen steady growth of EBITDA in recent years, from SGD609mn in FY13 to SGD783mn in LTM. Even while some grounds have been ceded in the pre-paid segment, SingTel has been acquiring more subscribers in the higher revenue postpaid segment – which commands a higher ARPU (3QFY17: SGD69/mth) than the prepaid segment (3QFY17: SGD18/mth). Existing postpaid customers are also likely to be sticky with binding contracts (typically 21-24mths) and historically have low churn rate. In any case, the overall downside to SingTel will be limited with its diversified operations, with the Singapore mobile communications contributing just 7.9% of the group's revenue, or 4.3% if we include SingTel's share of associates.

Managing well despite the competition in broadband and pay TV: Competition has also heated up in other parts of the Singapore consumer business. In Sep 2008, the Infocomm Development Authority of Singapore[13] ("IDA") selected OpenNet[14] to rollout Singapore's Next Generation National Broadband Network ("NGNBN"), which aims to level the playing field by making broadband available to all industry players. Since then, MyRepublic and ViewQwest have joined the fray as a Retail Service Provider ("RSP") to provide broadband service in Singapore by tapping on the NGNBN. In recent years, SingTel's fibre broadband market share has declined from 57% in 1QFY15 to 48% in 3QFY17. However, the impact has not hit the topline, with revenues from fixed broadband segment holding relatively stable. For SingTel's pay TV segment, revenues have increased by 8.8% y/y for 9MFY16, likely at the expense of its rival (StarHub Pay TV FY16 revenue: -3.4% y/y).

Decline of traditional telephone business: For the traditional telephone business segment (e.g. international telephone, national telephone), there has been a steady decline in revenues as consumers shift to data. LTM revenue contribution for the segment stands at SGD283mn (12% of Consumer Singapore revenue) and moving forward, this segment may decline further as subscribers switch to data for calls. Nevertheless, we are not overly worried as this segment is no longer the main driver of SingTel's revenue and profitability.

Consumer Australia

Consumer Australia contributes the remaining 75% of GC's revenue and 76% of GC's EBITDA. This segment offers a range of telecommunications services and products (e.g. mobile voice and data, fixed voice, fixed broadband, content and application services) to the Australian retail and SME market through the Singtel Optus Group, which includes brands such as Optus, Virgin Mobile and Vividwireless.

Optus's revenue is predominantly mobile: Incoming and outgoing mobile service is the largest revenue contributor, making up 54% of the LTM revenue from GC (without including SingTel's share of associates). Through Optus, SingTel holds the second largest mobile market share in Australia (3QFY17 subscribers: 9.6mn), behind Telstra (17.4mn), but ahead of Vodafone (5.6mn). In recent quarters, there has been a downtrend in ARPU, however, we are not worried because this is mainly due to service credits and lower mobile termination rates[15]. According to SingTel, lower mobile termination rates have not materially impacted EBITDA even though there has been an impact on the revenue line, with incoming mobile revenue plunging alongside traffic expenses. Going forward, management has guided that mobile service revenue from Australia will decline by mid-teens in FY17. Although Optus's market share appears to have softened somewhat in recent quarters, strong growth was recorded in the postpaid segment, which commands a higher

[13] The IDA and the Media Development Authority ("MDA") has since, in 2016, been restructured into two new entities: 1) Infocomm Media Development Authority ("IMDA") and 2) Government Technology Organisation ("GTO")
[14] OpenNet was owned by SingTel, SP Telecommunications, SPH and Axis NetMedia before it was fully acquired by NetLink Trust
[15] Mobile termination rates are the charges that one telco charges another for terminating calls on its network. In Australia, the Australian Competition and Consumer Commission has reduced the wholesale price to 1.7c per minutes to 3.6c per minute.

ARPU of AUD46/mth than the prepaid segment's AUD21/mth. The stronger growth in the postpaid segment is aided by growth in the handset segment, with revenues growing from SGD839mn in FY13 to SGD1.3bn in LTM. This is partly due to an increase in handset prices though higher handset prices have also made subsidised handset postpaid plans more attractive.

Figure 11: SingTel Australia mobile key statistics

Australia mobile	**4QFY13**	**4QFY14**	**4QFY15**	**4QFY16**	**3QFY17**
No. of subscribers ('000s)	9,592	9,432	9,433	9,338	9,573
- Postpaid	5,503	4,452	4,619	4,664	4,864
- Prepaid	4,089	3,617	3,695	3,681	3,679
- Mobile broadband	-	1,363	1,119	993	1,030
Overall Market share	31.00%	29.60%	29.50%	29.70%	27.80%
Blended ARPU (AUD)	40	43	43	36	34

Source: Company, OCBC estimates

Shaking up the mobile oligopoly with increasing competition: While the Australian mobile market had effectively been an oligopoly of 3 players, competition is starting to heat up. Following OECD Economic Surveys on Australia published on March 2017 that recommended the introduction of a fourth mobile operator to raise competition, TPG looks set to fill the role with a AUD1.3bn spectrum bid. Currently TPG operates as an MVNO under the Vodafone network, even though it already holds part of the mobile spectrum (in the 1800MHz and 2600MHz area). In the next 3 years, TPG plans to spend another AUD600mn to rollout the network.

Negative impact likely if competition worsens: If competition steps up, we expect Optus to face pressure similar to what we expect from SingTel in Singapore – potential loss of market share as well as margin compression from lower ARPU and higher capex spending. Even while Optus has been upgrading its networks and spending more (FY17F capex: AUD1.8bn) than TPG's planned capex, the entry of TPG would likely be negative as Optus's revenue is concentrated in mobile (73%). Although it may be preliminary to conclude the extent of the impact of TPG's entry, we note that Telstra's share price has plunged 7% since 11th April 2017 after TPG won the spectrum bid. Further competition may be introduced. On Oct 2016, the Australian Competition and Consumer Commission released a paper looking into regulating domestic mobile roaming service such that operators can access networks of competitors, for a charge. If the regulation were to be passed, this would facilitate new mobile operators to enter, by reducing the upfront costs to invest in infrastructure. Thus far, Optus and Telstra, which have invested the most in infrastructure, have opposed the introduction of this regulation.

Sale of equipment is the next biggest contributor to Australia Group consumer's revenue (19%), though this is likely to be a low margin contributor. While voice (7% of revenue) has seen steady declines in revenue, this is mitigated by the growth in the Pay TV segment and Mass Market Fixed Off-net segment, which includes the migration of customers on Optus' HFC network to the National Broadband Network ("NBN").

International Group

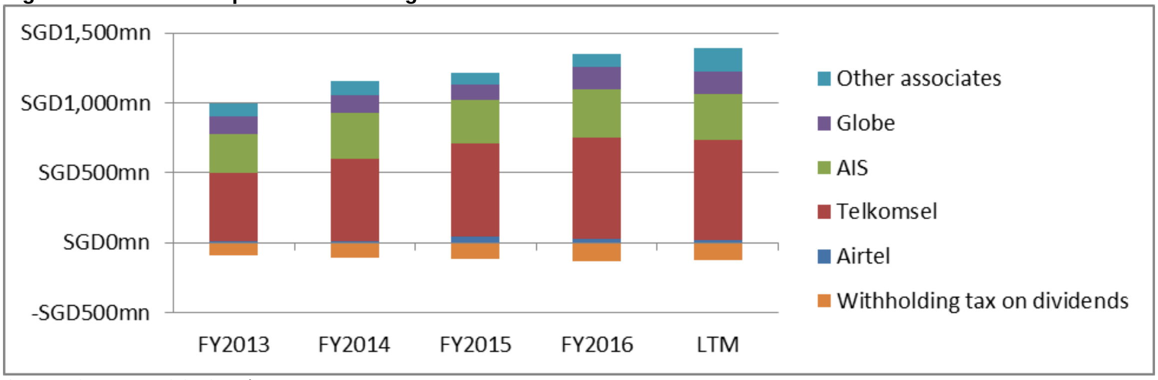
The International Group (comprising Telkomsel, Airtel, AIS and Globe) does not contribute to headline revenue and reported EBITDA of GC and SingTel. However, they are very significant drivers of SingTel's credit profile as they contribute 52% of SingTel's LTM pre-tax profits. They are also the market leaders in their respective markets, and are rated investment grade.

Figure 12: Associate mobile operator

Company	**LTM post-tax profit**	**LTM dividend to SingTel**	**Credit Rating**
Airtel	SGD325mn	SGD17mn	BBB-/Baa3/BBB-
Telkomsel	SGD1,029mn	SGD715mn	BBB-/Baa1/NR
AIS	SGD344mn	SGD330mn	BBB+/NR/BBB+
Globe	SGD218mn	SGD159mn	NR/NR/BBB-
Other associates	SGD174mn	SGD170mn	-

Source: Company, OCBC estimates

Figure 13: Dividends upstreamed to SingTel



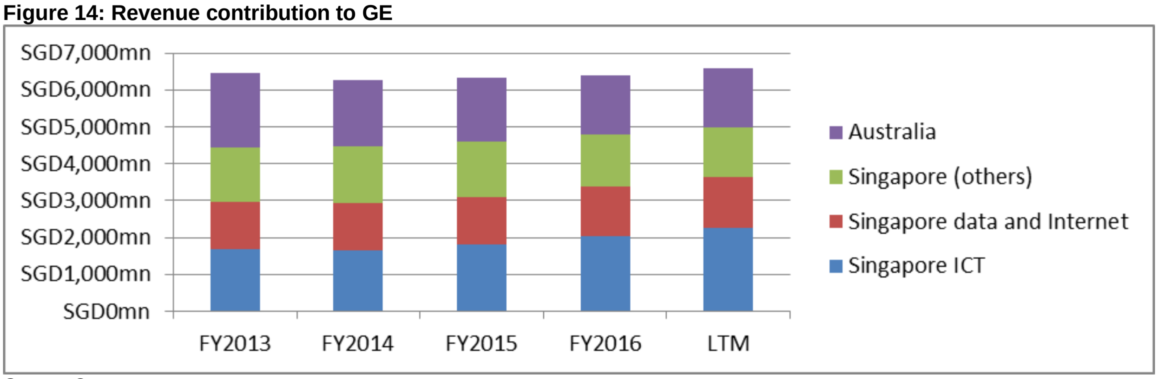
Source: Company, OCBC estimates

Dividends from associate are a key contributor to SingTel's cashflow: Except for Airtel, the rest of the major associates have been contributing a significant (>50%) portion of their net profits to SingTel. The LTM dividends (less withholding tax) totals SGD1.3bn, which is significant compared to SingTel's reported free cash flow of Singtel SG (SGD1.0bn) and Optus (AUD657mn). Dividends from Telkomsel have grown the fastest (+47%) since 2013, and in LTM it accounts for 51% of the total dividends received from associates. There may be room for Telkomsel to increase dividends further as post-tax profit in LTM surged 20% to SGD1bn since FY16. AIS is the next highest contributor (24%), followed by Globe (14%). While Airtel accounts for 23% of pre-tax profits from associates, there does not appear to be a fixed dividend policy.

Group Enterprise

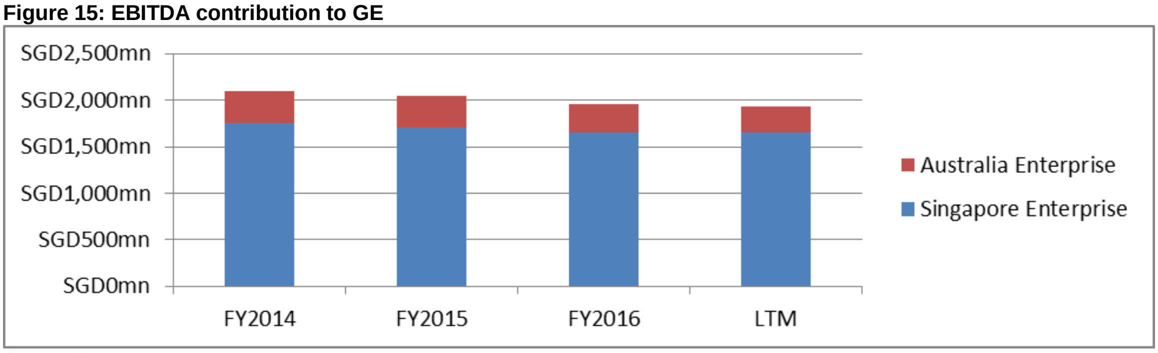
The GE segment comprise several business units – Global Enterprise Business, Business Group, the NCS, Carrier Services, Global Products, Digital Enterprise, Enterprise Data and Managed Services, Optus Business and Trustwave. GE provides mobile and solutions, data, IP and internet for businesses and government. GE also provides ICT solutions, managed security services and satellite services.

Figure 14: Revenue contribution to GE



Source: Company

Figure 15: EBITDA contribution to GE



Source: Company

Singapore Enterprise is the main contributor to the GE by revenue (76%) and EBITDA (86%), while Australia Enterprise contributes the rest. Singapore ICT, comprising managed services[16] and business solutions[17], makes up 45% of Singapore Enterprise's revenue, followed by data and internet (28%) and others (27%) which include mobile communications, telephone and sale of equipment.

ICT as the main contributor, though competition is intensifying: Singapore ICT has been the main revenue driver in recent years, growing to SGD2.3bn in LTM from SGD1.7bn in FY13, with the growth mainly due to cyber security and provision of government infrastructure services (e.g. onboarding of government's agencies to the G-Cloud platform[18]), as well as due to the acquisition of Trustwave. This has more than mitigated the decrease in other revenue, which fell from SGD1.5bn in FY13 to SGD1.3bn in LTM, as SingTel has largely completed the works in fibre rollout & maintenance (FY13 revenue: SGD117mn) while telephone revenues have been steadily declining from SGD429mn in FY13 to SGD355mn in LTM with the switch to data. Meanwhile, revenues from Singapore data and internet have grown from SGD1.3bn in FY13 to SGD1.4bn in LTM. Although SingTel has acknowledged seeing more intense competition in the enterprise segment, SingTel mentioned that it has a strong relationship with its enterprise customers - hence is likely to defend its market. We note that Singapore Enterprise EBITDA has fallen slightly from SGD1.75bn in FY2014 to SGD1.65bn in LTM, with EBITDA margin falling from 39% to 33%, even while revenue has grown.

Challenging enterprise segment in Australia with consolidation of tier 2 players: The Australian enterprise segment has been challenging. Revenue has fallen from SGD1.8bn in FY14 to SGD1.6bn in LTM. While this is partly due to the decline in AUD against the SGD, Optus faces continued price erosion in the data and IP segment due to increased competition from consolidation of tier 2 players (e.g. merger of Vocus and M2 which created Australia's 4th largest telco by market cap, TPG and iiNet merger which created Australia's second biggest broadband provider). As a result, EBITDA has fallen by 20% from SGD346mn in FY14 to SGD276mn in LTM. While SingTel has claimed that there has not really been a loss in key enterprise customers, we may expect intense price competition to continue, leading to further pressure on margins.

Acquisition of Trustwave to bolster cyber security capabilities: To bolster SingTel's suite of ICT services, in Sep 2015 SingTel acquired 98% interest in Trustwave for SGD1.05bn, which was the largest independent provider of managed cyber security services in North America. Trustwave contributed SGD147mn in operating and SGD5mn in EBITDA for 2HFY16, though EBITDA fell to a negative SGD11mn in 3QFY17 due to increase in investments. According to SingTel's management, Trustwave will need a couple more years to turn profitable.

Group Digital Life

GDL targets the market in digital marketing (via Amobee Inc), offers mobile video streaming (via HOOQ Digital Pte Ltd), provides Geoanalytics (via DataSpark) and looks to invest in innovation through a venture fund (via Innov8). Since acquiring Amobee for USD321mn on 5 March 2012, Amobee has in turn acquired its competitors Kontera Technologies Inc (for USD150mn on 1 Jul 2014) and Adconion Pty Ltd (for USD209mn on 1 Aug 2014). Amobee has also made acquisitions of Gradient X, which was the market-leading real-time bidding platform company on 5 Sep 2013 (amount not disclosed), and recently acquired Turn Inc, which is an advertising company, for USD310mn on 23 Feb 2017.

Weak GDL results are a minor drag on credit profile though profitability is improving: Continued acquisitions into the GDL segment, including the USD310mn investments in Turn Inc, may weaken SingTel's credit profile as the GDL segment has yet to turn profitable with a negative

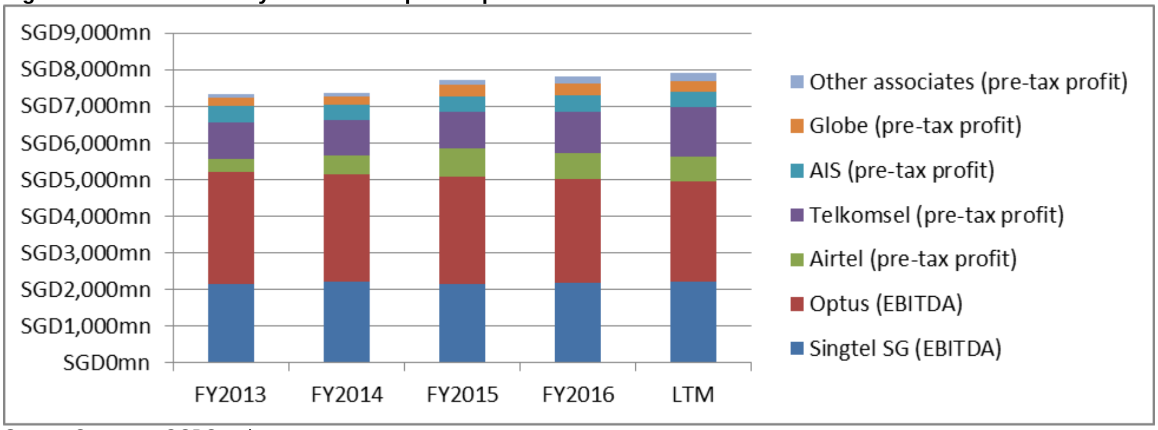
[16] Includes facility management, managed and network services, value-added reselling and services
[17] Include applications management services and outsourcing, system integration and business process outsourcing and communication engineering services
[18] G-Cloud is a private government cloud for government use where security and governance requirements cannot be met by public clouds.

EBITDA of SGD125mn in LTM. Moreover, the acquisitions were priced significantly above book (e.g. Amobee's NAV was -USD0.6mn, Turn's NTA was a mere USD12mn) – which gives rise to increasing intangibles (e.g. goodwill) on the balance sheet. Goodwill may be impaired if the acquired entities do not eventually turn profitable. However, the negative EBITDA in the GDL segment has been narrowing since FY2015 (EBITDA: -SGD216mn), and we recognise that GDL is a relatively new but rapidly growing business segment in SingTel, with revenues increasing from SGD111mn in FY2013 to SGD532mn in LTM (though growth is partly due to acquisitions). While GDL has yet to contribute significantly, we consider GDL as a minor drag on SingTel's credit profile weighing down SingTel's total EBITDA by SGD125mn (2.4% of total).

IV) Financial Analysis

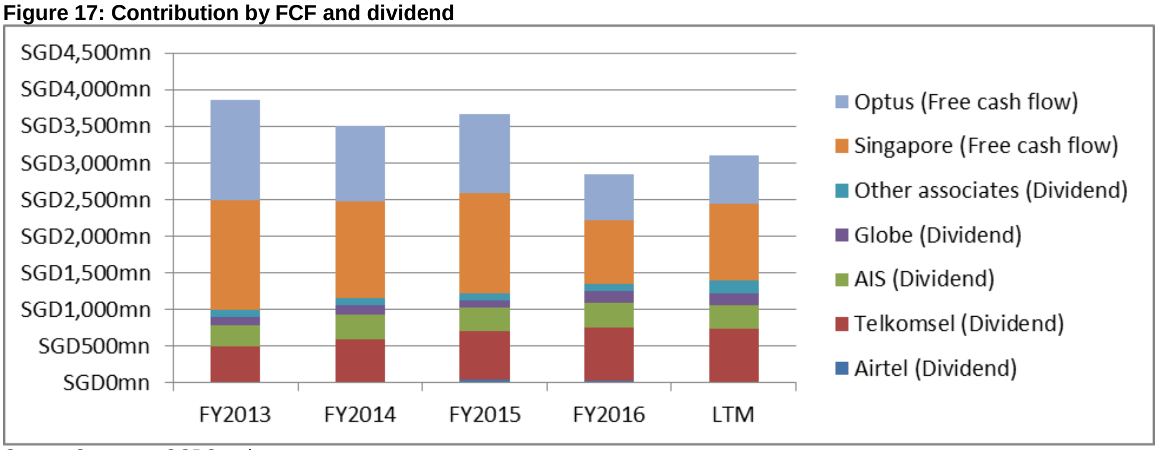
- **Solid credit metrics:** Even while total debt has increased in recent years (from SGD7.9bn in FY13 to SGD11.3bn in 9MFY17), SingTel continues to hold healthy credit metrics with net debt/EBITDA of 2.2x. Including LTM pre-tax profits of SGD3.0bn from its associates, the ratio improves to 1.36x. We focus less on net gearing (9M16: 0.39x) due to the large intangibles (SGD13bn out of SGD48bn total assets), though the book value of the joint ventures (SGD12bn) looks understated as we estimate the stakes in Airtel, Globe and AIS and Intouch (without the unlisted Telkomsel) are already worth SGD21bn based on market value. On a cashflow basis, our calculations of SingTel's net debt/FFO look manageable at 1.7x. Adding the dividends (net of withholding taxes) from associates amounting to SGD1.3bn, net debt/(FCF[19] plus dividends from associates) looks healthy still at 2.4x.

Figure 16: Contribution by EBITDA and pre-tax profit



Source: Company, OCBC estimates

Figure 17: Contribution by FCF and dividend



Source: Company, OCBC estimates

[19] FCF provided by SingTel

- **Sum of parts stronger than each individual part:** While the major associates are rated around the BBB range, we think SingTel (as a group) offers a more resilient credit profile. Acknowledging the HoldCo-OpCo subordination risk, SingTel enjoys diversification across various regions, compared to its associates which have a higher focus in a single country. In any case, SingTel benefits from the dividends from its associates (other than Airtel) as they have been upstreaming >50% profits as dividends. Meanwhile, SingTel does not directly fund its associates' capex and bids for spectrum, which can generate lumpy cash outflows. On the other hand, investments in the associates allow SingTel to partake in the growth of the telecommunications market in the emerging markets. Although SingTel is exposed to various currencies (INR, IDR, PHP, THB, AUD) through its subsidiaries and associates, we think this is manageable given SingTel's healthy credit metrics.

- **Pending divestment of NetLink Trust:** Although NetLink Trust[20] is currently wholly-owned by SingTel, SingTel has to reduce its stake to below 25% by April 2018 as part of the undertaking with IMDA. The pricing is yet to be determined as NetLink Trust has yet to come to the market for IPO. However, we note that the sale of assets to NetLink Trust in Sep 2011 was SGD1.89bn (funded by SGD1.33bn loan from SingTel and issuance of SGD567.4mn in shares to SingTel). As at 31 Mar 2016, the loan principal balance with NetLink Trust was SGD1.1bn. When the loans are repaid, with potential gains from sale of stake in cash proceeds, this may provide SingTel with a boost in liquidity.

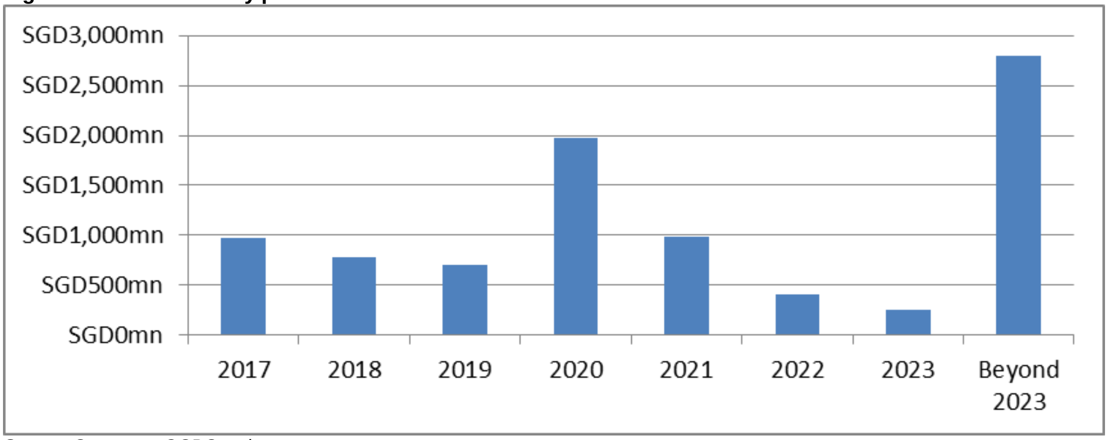
- **Stake in associates and entities may provide a source of liquidity:** In addition to the planned sale of NetLink Trust, we think SingTel can find liquidity from the sale of stake (partial or full) of its listed entities. We would also not rule out the potential for the sale of its unlisted entities. While SingTel had delisted from the Australian stock exchange and dispelled rumours of listing Optus back then, management did not rule out the possibility of selling Optus in the future. Separately, SingTel was contemplating a sale of Optus Satellite in March 2013, though the plan was shelved in Aug 2013 as no agreement was reached on its valuation with investors. While Telkomsel is unlisted, there may be ready buyers if SingTel were ready to sell its stake. In 2011, the Indonesian government initiated plans for Telkom to buy SingTel's stake in Telkomsel, though SingTel said it was not in talks to sell the stake.

- **Capex and spectrum bids:** Costs of operating may increase due to an increase in competition. Following TPG's entry into the Singapore mobile market, SingTel paid SGD563.7mn at the General Spectrum Auction, which is likely to be the largest amount paid with StarHub's CEO commenting that an additional bidder led to the intense competition. In Australia, SingTel's Optus failed to win the bid for spectrum due to the price competition, even when SingTel acknowledged that it needed the spectrum. TPG, on the other than, won the spectrum bids with a staggering AUD1.3bn price tag. For the full FY, SingTel expects cash capex for the group to reach SGD2.4bn – implying that another SGD800mn may be spent in the last quarter, for which SingTel has sufficient cash on hand to fund this. We note that SingTel's Optus has been undertaking significant capex to upgrade the 4G mobile network in Australia – this should also help Optus compete better against Telstra and TPG when it enters the market. However, margins may be pressured if SingTel cannot pass on the cost increase to consumers due to the entry of TPG (in both the Singapore and Australia market). Nevertheless, we think SingTel may manage the potential loss in market share and margins as net and EBITDA margins start from a healthy base at 28.6% and 23.3% respectively. We think cash outflows in terms of dividends (FY16: SGD2.8bn) is sustainable as SingTel generates about SGD3bn of FCF p.a. However, SingTel may have to gear up if it continues the big ticket acquisitions (e.g. acquisition of Intouch, Turn).

- **Proven access to capital markets with staggered bond maturity profile:** SingTel sources most of its debt via bonds by tapping on currencies including USD, AUD, EUR and HKD. Through issuing long-term bonds, SingTel maintains a well-staggered bond maturity profile. We think the liquidity profile will also be helped by a strong credit rating and Temasek as a majority shareholder.

[20] NetLink Trust is a business trust which designs, builds, owns and operates the infrastructure for NBNGN. It acquired OpenNet in 2014.

Figure 18: Bond maturity profile



Source: Company, OCBC estimates

V) Technical Considerations

Positives
- Good credit rating
- Temasek as major shareholder
- Visible retail presence

Negatives
- Holdco-opco subordination
- Low yield spread

Relative Value

Issue	Maturity	Ask YTW	Yield Spread (bp)	Bond Rating	Net Debt/EBITDA
STSP 3.487 '20	08/04/2020	2.02%	39.9	A+/Aa3/NR	2.2x
STSP 2.58 '20	24/09/2020	2.24%	54.6	A+/Aa3/NR	2.2x
STSP 2.72 '21	09/03/2021	2.45%	61.5	A+/Aa3/NR	2.2x
STSP 3.240 '22	29/09/2022	2.68%	71.7	A/A1/NR	1.2x
STHSP 3.08 '22	12/09/2022	2.78%	81.7	NR/NR/NR	3.6x
CAPITA 3.15 '20	18/12/2020	2.29%	55.5	NR/A2/NR	6.5x

*Indicative spreads based on offer prices from Bloomberg on 18/04/17

In the SGD space, the closest comparable is STSP 3.24 '22 (Issued by SingTel's Optus) trading 10bp wider in yield spread compared to STSP 2.72 '21 (Issued by SingTel). We think this is due to 1.5Y extension in tenor. While STSP 3.24 '22 is at the opco level compared to STSP 2.72 '21 which is at the holdco level, the former bond is not guaranteed by SingTel. As there is no assurance that SingTel will remain the majority shareholder of Optus, we prefer STSP 2.72 '21 given SingTel's diversified portfolio while Optus is facing headwinds from the entry of TPG.

We compare to STHSP 3.08 '22, which trades at 20bp wider yield spread than STSP 2.72 '21. We think STHSP 3.08 '22 should naturally trade wider with a weaker Net Debt/EBITDA of 3.6x, compared to SingTel's 2.2x. SingTel is also more diversified regionally than StarHub and is rated.

While CapitaLand Mall Trust is not in the same industry as SingTel, we compare STSP 2.58 '20 with CAPITA 3.15 '20 given that both have strong credit ratings and are Temasek-linked companies, though CAPITA's link is indirect through CapitaLand. Despite SingTel being rated 2 notches higher (Moody's: Aa3), STSP 2.58 '20 trades at similar yield spread. As such, we prefer STSP 2.58 '20 over CAPITA 3.15 '20. We also prefer STSP 2.58 '20 over STSP 3.487 '20 as the former trades at 15bp wider yield spread for a similar duration.

VI) Conclusion & Recommendation

Overall, SingTel offers a solid credit profile. Despite facing increasing competition in the mobile space in Singapore and Australia, we think that SingTel is sufficiently diversified through its associates, which has grown to account for more than half of its per-tax profits. As a market leader in the telecommunications sector and the largest listed company in Singapore, we believe SingTel will manage the competition from a position of strength. Meanwhile, credit metrics have remained healthy even while debt has been increasing due to its strong cashflow generation. We initiate SingTel with a **Positive Issuer Profile**. We initiate SingTel's bonds **with a Neutral recommendation** as we think they are around fair value offering 40bp-62bp over swaps.

Singapore Telecommunications Ltd.

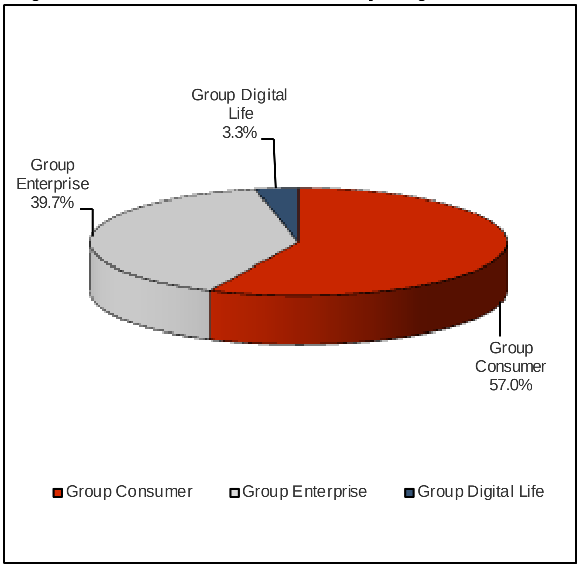
Table 1: Summary Financials

Year End 31st Mar	FY2015	FY2016	9M2017
Income Statement (SGD'mn)			
Revenue	17,222.9	16,961.2	12,403.7
EBITDA	4,939.3	4,864.4	3,545.7
EBIT	2,777.9	2,715.6	1,891.4
Gross interest expense	315.9	360.4	276.8
Profit Before Tax	4,463.0	4,580.8	3,378.7
Net profit	3,781.5	3,870.8	2,889.4
Balance Sheet (SGD'mn)			
Cash and bank deposits	562.8	461.8	847.8
Total assets	42,066.8	43,565.7	47,737.9
Gross debt	9,373.8	9,940.7	11,269.2
Net debt	8,811.0	9,478.9	10,421.4
Shareholders' equity	24,767.9	25,002.5	26,959.9
Total capitalization	34,141.7	34,943.2	38,229.1
Net capitalization	33,578.9	34,481.4	37,381.3
Cash Flow (SGD'mn)			
Funds from operations (FFO)	5,942.9	6,019.6	4,543.7
* CFO	5,786.6	4,647.7	3,898.4
Capex	2,237.6	1,930.0	1,607.8
Acquisitions	449.5	1,274.8	2,476.3
Disposals	15.2	5.7	45.9
Dividend	2,683.2	2,794.1	1,710.3
Free Cash Flow (FCF)	3,549.0	2,717.7	2,290.6
* FCF adjusted	431.5	-1,345.5	-1,850.1
Key Ratios			
EBITDA margin (%)	28.7	28.7	28.6
Net margin (%)	22.0	22.8	23.3
Gross debt to EBITDA (x)	1.9	2.0	2.4
Net debt to EBITDA (x)	1.8	1.9	2.2
Gross Debt to Equity (x)	0.38	0.40	0.42
Net Debt to Equity (x)	0.36	0.38	0.39
Gross debt/total capitalisation (%)	27.5	28.4	29.5
Net debt/net capitalisation (%)	26.2	27.5	27.9
Cash/current borrowings (x)	1.0	0.7	0.3
EBITDA/Total Interest (x)	15.6	13.5	12.8

Source: Company, OCBC estimates

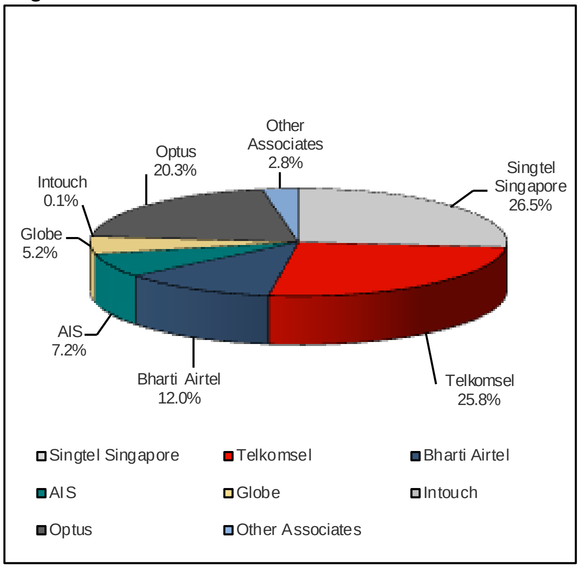
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO after deducting interest expense*

Figure 1: Revenue breakdown by Segment - 9M2017



Source: Company

Figure 2: Pre-tax Profit breakdown - 9M2017



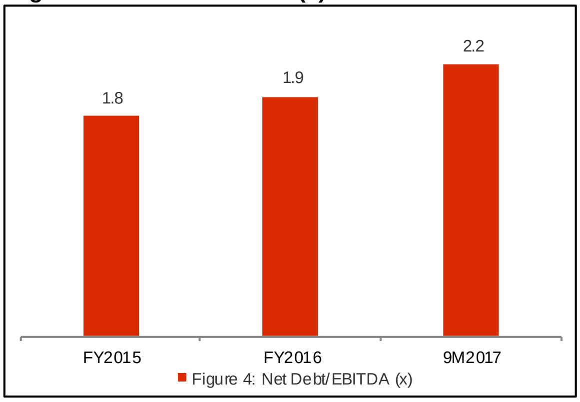
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 31/12/2016	% of debt
Amount repayable in one year or less, or on demand		
Secured	90.8	0.8%
Unsecured	3,087.3	27.4%
	3,178.1	**28.2%**
Amount repayable after a year		
Secured	176.0	1.6%
Unsecured	7,915.1	70.2%
	8,091.1	**71.8%**
Total	**11,269.2**	**100.0%**

Source: Company

Figure 4: Net Debt/EBITDA (x)



Source: Company, OCBC estimates

Co.Reg.no.:193200032W