Asia Credit Research

Earnings Review: StarHub Ltd ("StarHub")

Issuer Profile: Neutral (3)

Ticker: **STHSP**

Background

StarHub Ltd ("StarHub") is a Singapore communications company, providing various services for consumer and corporates including mobile, data, fixed telecommunication, pay television, internet and broadband services. StarHub is 55.8% owned by Asia Mobile Holdings Pte Ltd, which is 75%- owned by STT Communications Ltd, which is in turn a wholly-owned subsidiary ST Telemedia, which is in turn a wholly-owned subsidiary of Temasek.

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Recommendation

- Results continued to disappoint with reported EBITDA falling by 22% y/y to SGD111mn due to intense competition on Mobile segment and declines in Pay TV. We think that the worst is not over with StarHub guiding for weaker results going into 2019 and we see competition continuing to heat up.
- Credit metrics have overall weakened with reported Net Debt to TTM EBITDA at 1.52x in 2018 (2017: 0.98x) due to the decline in EBITDA while net debt has increased. That said, we think credit metrics will begin to stabilize as the net outflow of cash should be stemmed by StarHub cutting its dividends significantly.
- Despite headwinds to the fundamentals, we think the STHSP curve looks largely fair. In fact, we prefer the STHSP curve over the STSP curve given the latter's tight spreads. Within the Neutral (3) Issuer Profile space, we prefer the SIASP 3.16% '23s and FHREIT 4.45% PERP.

Relative Value:

Bond	Maturity date/ Reset Date	OCBC Issuer Profile	Ask Yield to Worst	Spread
STHSP 3.08% '22s	12/09/2022	Neutral (3)	2.98%	98bps
STHSP 3.55% '26s	08/06/2026	Neutral (3)	3.47%	127bps
STHSP 3.95% PERP	16/06/2027	Neutral (3)	4.39%	214bps
STSP 3.4875% '20s	08/04/2020	Positive (2)	2.27%	27bps
STSP 2.58% '20s	24/09/2020	Positive (2)	2.35%	37bps
STSP 2.72% '21s	03/09/2021	Positive (2)	2.44%	45bps
STSP 2.895% '23s	07/03/2023	Positive (2)	2.60%	57bps
SIASP 3.16% '23s	25/10/2023	Neutral (3)	2.94%	88bps
FHREIT 4.45% PERP	12/05/2021	Neutral (3)	4.20%	222bps

Indicative prices as at 26 Feb 2019 Source: Bloomberg, OCBC, Company

Key Considerations

- **Significant headwinds to Mobile and Pay TV…:** StarHub reported 4Q2018 results. Revenue fell by 9.8% y/y to SGD619.5mn, mainly due to declines in service revenues (-6.8% y/y to SGD457.5mn) led by declines in Mobile (-13.7% y/y to SGD194.3mn) and Pay TV (-19.1% y/y to SGD71.3mn). Broadband also saw a small decline of 3.1% y/y to SGD45.7mn. The only outperforming segment was Enterprise Fixed, which delivered +12% y/y growth to SGD146.1mn.
  - **i) Mobile pressured with consumers using more and paying less:** Part of the revenue decline was due to structural trends with the fall in usage of IDD and voice due to the substitution with data. However, even for data, despite y/y increase in usage to 6.1GB (4Q2017: 4.6GB), data usage revenue fell with declines in post-paid ARPU to SGD41/mth (4Q2017: SGD46/mth). Consumers are paying less and using more through higher take-up of DataJump with more data bundled into base plans. In addition, revenue fell as there was a higher mix of SIM-Only plans (which has a lower ARPU) and for the plans that come with device, StarHub offered higher phone subsidies.
  - **ii) Pay TV losing channels and subscribers:** The revenue fall was unsurprising given the continuous decline in subscriber base, which has fallen y/y to 409k (4Q2017: 458k) with a fall in ARPU to SGD48/mth (4Q2017: SGD51/mth). As a recap, StarHub had lost the rights to air 11 channels from Discovery which contributed to the fall in subscribers; more content providers are reaching directly to the market instead of distributing content through StarHub. In addition, the segment continues to be challenged by alternative viewing options (e.g. Netflix) and piracy.
  - **iii) Broadband should be broadly stable:** We believe the small decline is just a short term blip, perhaps due to promotions undertaken in 4Q2018 and the switch to fibre broadband (from cable as cable is decommissioning). Residential broadband customers increased to 482k

(4Q2017: 467k) while ARPU has remained stable at SGD32/mth.

iv) **Enterprise as the only engine of growth:** Managed services (+42.2% y/y to SGD61.5mn) was the main contributor to the increase with higher demand for cyber security, cloud, cryptographic and digital security solutions. This also includes revenue from Ensign (consolidated from Jul 2017) and D'Crypt (consolidated from Jan 2018).

- **… leading to declines on results:** Reported EBITDA fell by 22% y/y to SGD111mn, more than the fall in revenue as costs did not fall sufficiently. Operating expenses fell by only 4.2% y/y to SGD590.1mn and cost of sales fell by only 7.7% y/y to SGD304.0mn. Meanwhile, other operating expenses was flattish y/y at SGD286.2mn. The decline in cost of sales was mainly due to (1) decline in cost of equipment sold (-10.8% y/y to SGD156.8mn) as sale of equipment fell 17.3% y/y to SGD162.0mn and (2) 5.8% y/y decline in cost of services to SGD129.6mn with lower TV content, likely due to the loss of 11 channels from Discovery. For other operating expenses, staff costs declined 10.6% y/y to SGD75.7mn, which we think is in-line with StarHub's plans to slash 300 employees over 2019-21. Marketing and promotions increased (+12.8% y/y to SGD30.7mn) due to new product launches.

- **Unpromising outlook with competition still heating up:** Going forward, we expect the results to continue deteriorating. StarHub expects service revenue to decline up to 2% y/y, with service EBITDA margin declining to 26%-28% (2018: 28.4%) before the adoption of SFRS(I) 16 – this will be adopted the next quarter (1Q2019) and StarHub expects EBITDA margin at 30-32%. We note intense competition with the entry of TPG (which offered free mobile as a trial) and increased MVNOs like VivoHub (offering SGD1 mobile plan) while StarHub (SGD20 for 50GB) and other incumbents, such as M1 (SGD5 for 25GB), are not shying away from outright price wars. The decline of Pay TV will impact StarHub despite not being a significant EBITDA contributor as StarHub had previously marked Pay TV as part of bundling to increase customer stickiness and achieve cross-selling between products. The only relatively brighter spots in Broadband and Enterprise are unlikely to fully mitigate the declines in Mobile and Pay TV; Broadband will likely remain stable while the bulk of the growth in Enterprise is in managed solutions which offers lower margins (low double digit) compared to Mobile.

- **Credit metrics has deteriorated though the pace of decline should slow:** Reported net debt to TTM EBITDA was 1.52x in 2018 (2017: 0.98x), mainly due to increase in net debt with cash use (e.g. capex, dividends) outweighing cash proceeds from operations while EBITDA has fallen. That said, we expect the deterioration in credit metrics to slow as StarHub will be cutting dividends from 4.0cts a quarter (~69mn) to 2.25cts a quarter (~SGD39mn). Based on management's EBITDA guidance, we expect EBITDA to fall to ~SGD515mn (2018: SGD567mn). This should still be sufficient to cover (1) capex at SGD260mn (assumed to be 11% of 2018's revenue), (2) dividends of ~SGD156mn and (3) ~SGD39mn interest and perpetual distribution. We have not factored in the SGD282mn spectrum payment given expiry of the spectrum rights in 2033 while StarHub does not think the payment will be incurred in 2019. This leaves ~SGD60mn in adjusted free cashflow which StarHub may deploy for 5G networks expenses in the future or invest in its business. As such, despite the deteriorating results, we continue to hold StarHub at Neutral (3) Issuer Profile as credit metrics should begin to stabilise on the expectation that continuous net cash outflow should be stemmed following the dividend cut.

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Explanation of Issuer Profile Rating ("IPR") / Issuer Profile Score ("IPS")

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings ("IPR") into a 7 point Issuer Profile Score ("IPS") scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration
The analyst(s) who wrote this report and/or her or his respective connected persons did not hold financial interests in the above-mentioned issuer or company as at the time of the publication of this report.

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