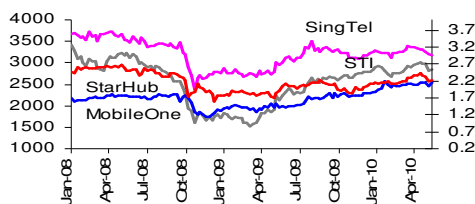


19 May 2010

Overweight

Telecom Sector

1QCY10 Scorecard; Maintain Overweight



1QCY10 results show margin compression. All three telcos - MobileOne (M1), SingTel and StarHub - showed signs of margin compression in their 1QCY10 results recently, no doubt hit by higher handset subsidies for highly sought-after "smartphones" like the Apple iPhone 3GS. Still, the stronger-than-expected demand for these smartphones saw revenue coming in ahead of our estimates.

Review of operations. As a result of the higher handset subsidies, acquisition costs for all the three telcos have risen quite sharply, and they are expected to remain relatively high as smartphones remain hotly sought after. Meanwhile, consumer spending (ARPU) has dipped slightly in 1QCY10 but we note that this is mainly due to the shorter Feb month as well as the Chinese New Year festivities. On the broadband front, while both SingTel and StarHub have managed to increase their subscriber base, the ARPUs have declined. For Pay TV, StarHub continued to add new subscribers, as did SingTel, but StarHub's ARPUs have come down and may continue to decline in 2HCY10.

Major Pay TV revamp. Still on Pay TV, the government initiated a major revamp in the industry by requiring Pay TV providers to cross-carry each other's content that is acquired or renewed on an exclusive basis. In short, Pay TV customers will be able to watch all Pay TV content with their preferred operator and need not pay any extra fees for doing so. Given StarHub's much larger installed base, we believe the latest development is slightly more positive for StarHub. We also think that the move may provide an opening for other players like M1 to enter the market without having to spend too much on building their own Pay TV infrastructure.

Stable outlook for 2010. Going forward, all three telcos expect their Singapore operations to remain stable or show slight growth, but most note that EBITDA margins are likely to decline slightly this year; StarHub for example, expects its EBITDA margin to hover around 28% vs. the historical average of 32-35%. Nevertheless, due to their strong cashflow-generating businesses, the telcos have largely kept their dividend payout guidance: M1 to pay at least 80% of underlying net profit; SingTel to pay 45-60% of underlying earnings; StarHub to pay S\$0.20/share, or S\$0.05/share per quarter.

Maintain Overweight. In light of the increased volatility in the market due to the ongoing uncertainties in Europe, we continue to like the telcos' defensive earnings and relatively attractive dividend yields. Maintain **OVERWEIGHT**.

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1QCY10 results show margin compression. All three telcos - MobileOne (M1), SingTel and StarHub - showed signs of margin compression in their 1QCY10 results recently, no doubt hit by higher handset subsidies for highly sought-after "smartphones" like the Apple iPhone 3GS.

Exhibit 1: Summary of 1QCY10 Results

Mar 10 Quarter (\$\$ m)	SingTel	StarHub	M1
Operating Revenue	1640	557.2	249
EBITDA	579	118.4	77
Net Profit	341	42.7	39.3
Service EBITDA Margin	43.30%	22.50%	42.40%

*Singapore Operations Only

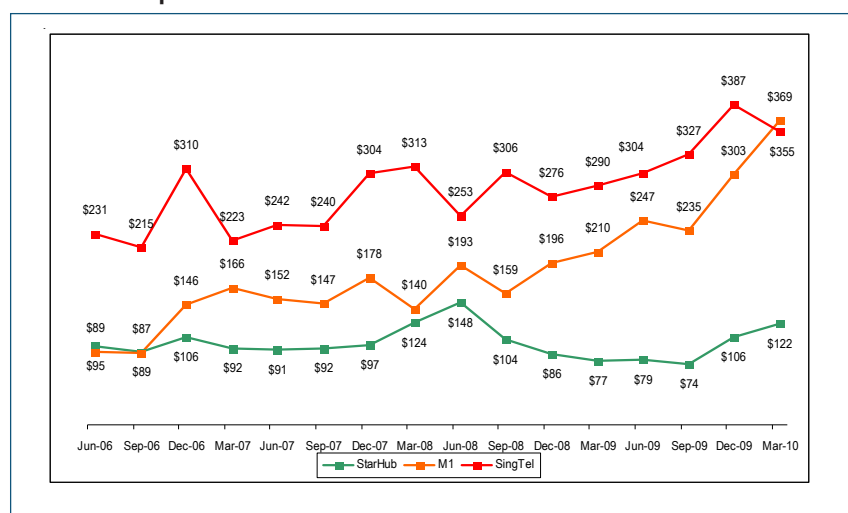
Source: Companies, OIR

StarHub suffered the largest drop in service EBITDA margin, which eased from the typical 32-35% range to just 22.5%. According to management, it is because its practice is to fully expense the handset subsidy at the point of sale rather than amortize it over the contract period. It adds that the take-up of smartphones - especially the iPhone - was stronger than expected. Nevertheless, it remains confident of a recovery in margin in the subsequent quarter.

Overall, the stronger-than-expected demand for these smartphones saw revenue for all the three telcos coming in ahead of our estimates.

Review of operations. As a result of the higher handset subsidies, acquisition costs for all the three telcos have risen quite sharply, and they are expected to remain relatively high as smartphones remain hotly sought after.

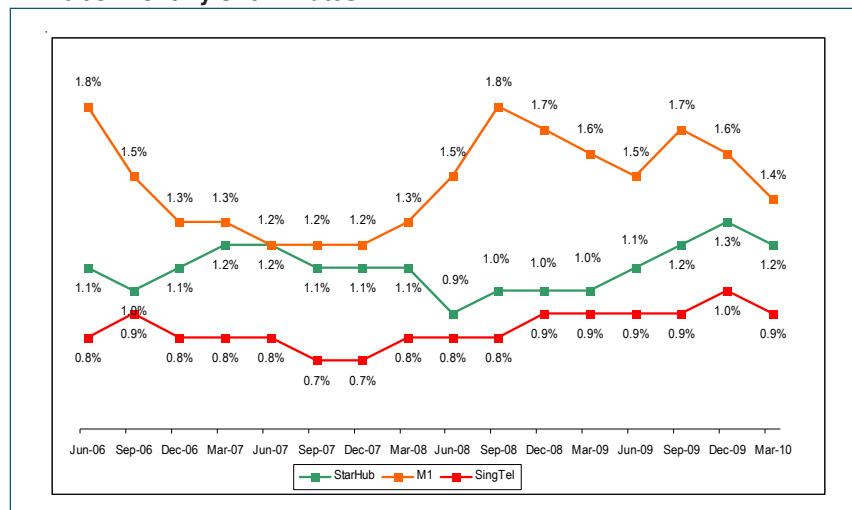
Exhibit 2: Acquisition Cost Trends



Source: Telcos, OIR

Interestingly, we note that M1's acquisition cost has risen above SingTel's and is currently the highest of the three. But it was expected as we had earlier highlighted the need for M1 to sustain higher acquisition costs due to the lack of its bundling ability. However, we believe this should improve for M1 once the NBN (National Broadband Network) becomes fully operational end 2012.

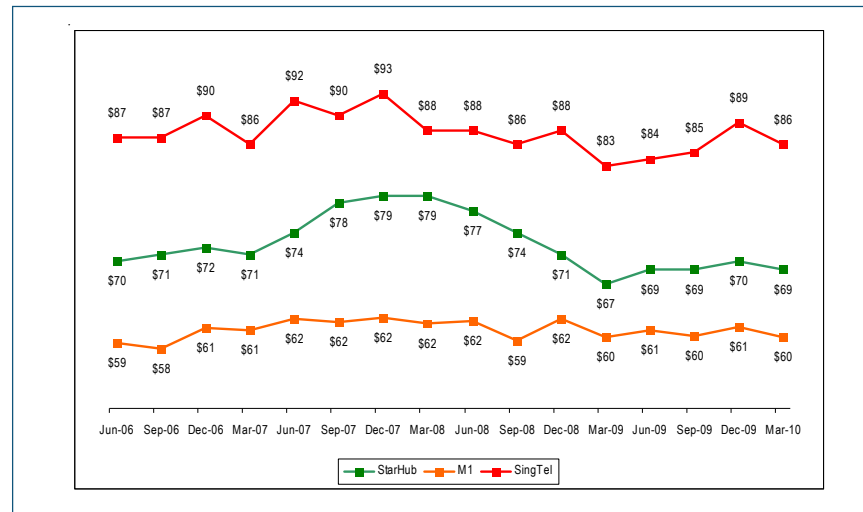
Exhibit 3: Monthly Churn Rates



Source: Telcos, OIR

On the other hand, thanks to the sharp increase in acquisition cost, M1 was able to bring its churn rate down to 1.4% from a high of 1.8% in 3Q08. As for the other two telcos, their monthly churn rate was relatively stable at 0.9% and 1.2% for SingTel and StarHub respectively.

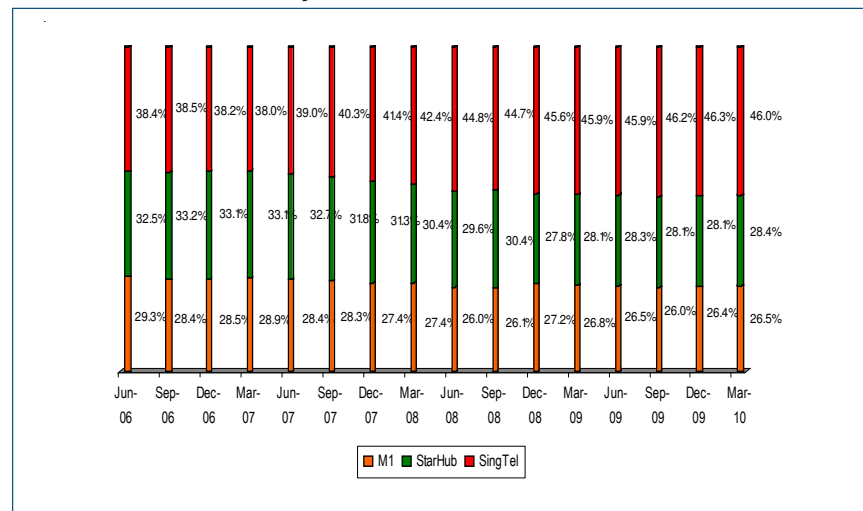
Exhibit 4: Post-Paid ARPU Trends



Source: Telcos, OIR

Meanwhile, consumer spending (ARPU) has dipped slightly in 1QCY10 but we note that this is mainly due to seasonality because of the shorter Feb month as well as the Chinese New Year festivities.

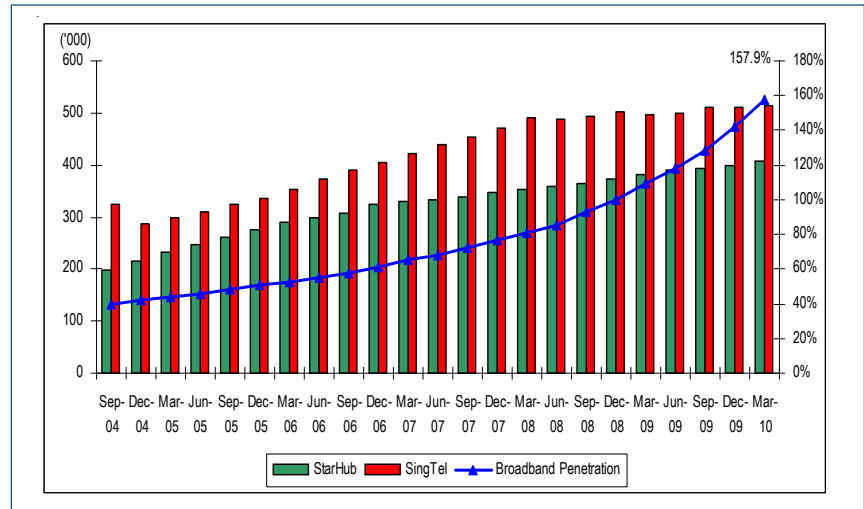
Exhibit 5: Market Share Dynamics



Source: Telcos, OIR

Since M1 and StarHub started to distribute the iPhone in mid-Dec 2009, both their post-paid market shares have improved slightly.

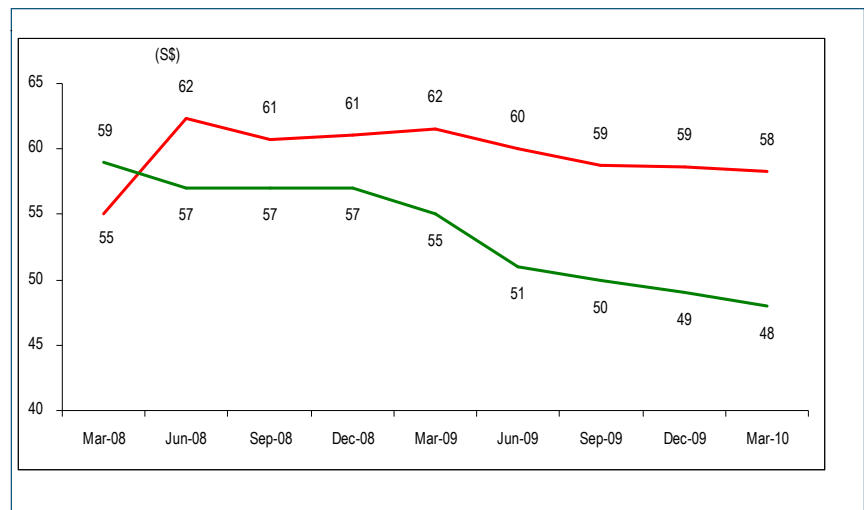
Exhibit 6: Broadband Growth and Market Penetration



Source: Telcos, OIR

On the broadband front, the penetration rate has surged from 109.5% in 1Q09 to 157.9% in 1Q10, but we note that the growth came mainly from the wireless broadband segment. As such, both SingTel and StarHub only managed to increase their fixed line subscriber base marginally.

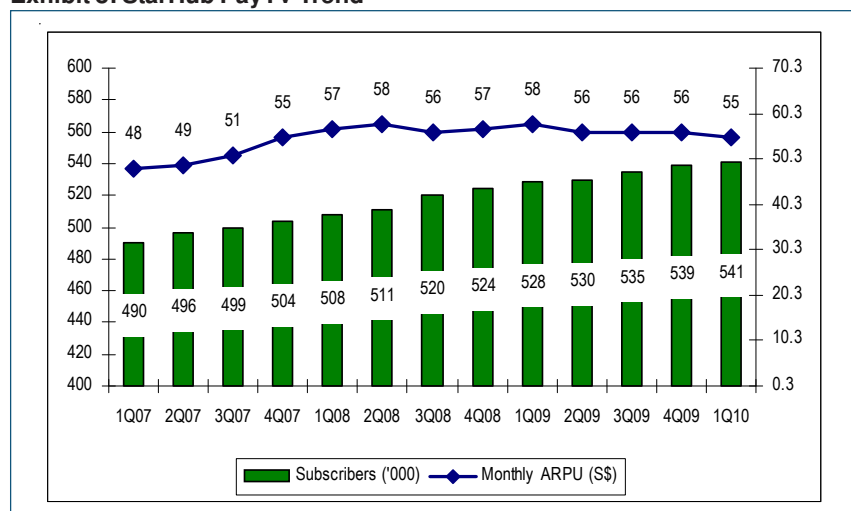
Exhibit 7: Broadband ARPU Trends



Source: Telcos, OIR

Despite the economic recovery, we note that broadband ARPUs have continued to slide further as subscribers continue to opt for the cheaper lower speed packages. However, we may start to see a potential reversal in 2011 and 2012 as subscribers may switch over to the higher speed packages offered by the NBN.

Exhibit 8: StarHub PayTV Trend



Source: Telcos, OIR

On the PayTV front, StarHub has managed to modestly grow its subscriber base to some 541,000 customers (penetration rate of 46.7% of all Singapore homes). While the monthly ARPU has remained fairly stable, we expect to see a slide in both APRU and subscribers in 2H10 following the loss of the 2010-2012 Barclays Premier League (BPL) and ESPN-Star Sports exclusive broadcast rights to SingTel.

Separately, SingTel disclosed that its mio TV subscriber base has hit the 200k mark recently from 155k (as of end-2009). While SingTel did not provide any details about its Pay TV segment, we believe that the bulk of its new subscribers may be paying nothing until the actual broadcast of the BPL in Aug 2010.

Major Pay TV revamp. Still on Pay TV, the government initiated a major revamp in the industry in Mar by requiring Pay TV providers to cross-carry each other's content that is acquired or renewed on an exclusive basis. In short, Pay TV customers will be able to watch all Pay TV content with their preferred operator and need not pay any extra fees for doing so. Given StarHub's much larger installed base, we believe the latest development is slightly more positive for StarHub. As for SingTel, the latest ruling may mean that it would not be able to use its strong balance sheet to pay more for exclusive content to grow its fledging mio TV segment.

Nevertheless, we believe that there is still merit in being the original broadcaster of the content as all revenues will accrue to that party. As such, we may still see some fairly aggressive bidding for popular content. And because of the common carriage, we also think that the move may provide an opening for other players like M1 to enter the market without having to spend too much on building their own Pay TV infrastructure.

Minimal World Cup impact. Another major event happening in Jun 2010 is the World Cup in South Africa; both SingTel and StarHub have managed to secure the broadcast rights for all 64 matches. The two telcos did not reveal how much they paid for the rights, but we believe that it is probably several times higher than the US\$5m that StarHub reportedly paid for the 2006 World Cup event. Looking at the current packages, which cost (pre-GST) a minimum of S\$66 before 31 May and S\$88 thereafter, we note these are around four times more expensive than the packages of S\$15 and S\$25 that StarHub charged in 2006.

Exhibit 9: World Cup Pricing Details

Category	Pricing Plans
Consumers	S\$66 (before GST) for sign ups before 31 May
	S\$88 (before GST) thereafter
Businesses Commercial Establishments	TV Screens Under 50 inches S\$2888 for first TV set (screen under 50 inches) S\$1888 for each subsequent set
	TV Screens Above 50 inches S\$4888 for first TV set S\$2888 for each subsequent set
Hotels and Hospitals	S\$24 per TV screen/room

Source: Telcos, OIR

Media reports suggest that the pricing may be the sticking point for home viewers. Still, a dip in the take-up from home viewers could see, conversely, a better response from the business segment, as F&B establishments are likely to use the "live" telecasts to attract viewers who will not be subscribing for the event.

As the pricing for businesses ranges from S\$2888 (for the first TV set under 50 inches) to S\$4888 (for the first TV set above 50 inches), a business customer is worth at least 44 to 55 home customers. Assuming that the telcos paid a total of S\$20m for the rights and that the average subscription price is S\$70/subscriber, the telcos would probably need to sell 280k packages to break even - we think that this is achievable.

Stable outlook for 2010. Going forward, all three telcos expect their Singapore operations to remain stable or show modest growth in operating revenues, aided by the ongoing economic recovery in Singapore and the higher expected tourist arrivals with the opening of the two integrated resorts.

Exhibit 10: Updated Guidance after 1QC10 Results

Company	Latest Guidance
M1	2010 earnings to improve YoY Maintains EBITDA margin of 43-45% is sustainable Dividend payout of at least 80% of net profit
SingTel	SG operating revenue to see mid single digit growth Modest SG EBITDA growth; margin to ease to 35% from 36-38% Dividend payout of 45-60% of underlying net profit
StarHub	Service revenue to see low single digit growth Reduces service EBITDA margin to 28% from 32% Dividend target of S\$0.20/share, or S\$0.05 per quarter

Source: Telcos, OIR

But due to the growing acceptance of smartphones, most telcos also note that EBITDA margins are likely to decline slightly this year; StarHub for example, expects its EBITDA margin to hover around 28% vs. the historical average of 32-35%.

Nevertheless, due to their strong cashflow-generating businesses, the telcos have largely kept their dividend payout guidance: M1 to pay at least 80% of underlying net profit; SingTel to pay 45-60% of underlying earnings; StarHub to pay S\$0.20/share, or S\$0.05/share per quarter.

Maintain Overweight. Based on our review of the 1QCY10 results, we believe that the telcos have done reasonably well and their outlook for the rest of 2010 remains upbeat. Although most of the telcos are guiding for further declines in service EBITDA margins, we are not overly perturbed as we see this as a natural progression in a maturing market.

On the other hand, the roll-out of the NBN from mid-2010 onwards (completion by 2012) is likely to provide different opportunities (and challenges) to all three telcos and these opportunities should allow them to offer new services to grow their margins.

Last but not least, in light of the increased volatility in the market due to the ongoing uncertainties in Europe, we continue to like the telcos' defensive earnings and relatively attractive dividend yields. Maintain **OVERWEIGHT**

Exhibit 11: Our Recommendations

	Price	Our Recommendation	Fair Value	Div Yield
M1	S\$2.15	BUY	S\$2.40	6.50%
SingTel	S\$2.97	BUY	S\$3.40	5.40%
StarHub	S\$2.27	BUY	S\$2.32	8.80%

Source: OIR

SHAREHOLDING DECLARATION:

The analyst who wrote this report holds shares in Spore Telecoms.

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Carmen Lee
Head of Research

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