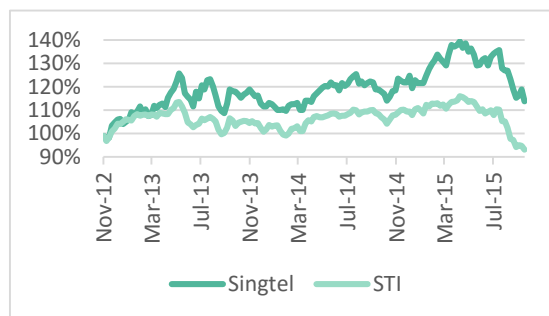


Last Closed Price:	3.80 SGD
12M Target:	4.19 SGD
Upside Potential:	10.26%
GICS Sector:	Communications
GICS Sub-Industry:	Telecom Carrier
Bloomberg Ticker	ST SP Equity

## 3Y Price v. Relative Index



Source: Company Data

## Company Description

Singapore Telecommunications Limited (SingTel), is a communications group listed on Singapore Exchange. The group engages in a diverse range of communication services including fixed, mobile, data, internet, pay television, infocommunications technology (ICT) and digital solutions. Singtel is Asia's leading communications group with more than 550 million mobile customers across Asia, Australia and Africa.

## Key Financials

Market Capitalization (bil)	60.585 SGD
Shares Outstanding (bil)	15.94
Free float (%)	48.8
52-Wk High	4.57 SGD
52-Wk Low	3.58 SGD
Beta	0.97
P/E (ttm)	15.57

(USD mil)	FY14A	FY15A	FY16E	FY17E
P/E (x)	15.7	17.6	15.91	12.81
P/B (x)	2.4	2.7	2.42	2.38
ROE (%)	15.3	15.6	-	-
ROA (%)	9.2	9.3	-	-
ROIC (%)	11.6	12.1	-	-
Net PM (%)	21.7	22	-	-

## Key Executives

CEO / Executive Director	Chua Sock Koong
CFO	Lim Cheng Cheng
CIO	Wu Choy Peng

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## Expanding out of Singapore

### Strategic Priorities for each Business Segment

Moving forward, Singtel has identified the key drivers behind the growth of its three business segment. With strategic priorities for each segment, Singtel aims to be an all-rounded service provider in improving its core consumer and enterprise business as well as enhance customer experience. Singtel has also taken steps to improve the competitiveness of Optus in Australia and improving the operating business model of its regional associates by sharing its expertise and technology.

### Strong Financial Ratios

Singtel and its regional associates have shown consistent increasing net profit in the past years. Although revenue of Optus has remained uninspiring, Singtel has invested heavily in improving mobile networks and other core infrastructures in Australia to increase market share. Among its competitors, Singtel has the highest net profit margin of 21.94% and also stable profitability margins.

### Diversification across Markets and Services

Singtel is diversified across different regional markets, with 74% of their revenue coming from its overseas business in Australia and regional associates. As such, they are less exposed or vulnerable to any possible upsets in specific markets. In addition, Singtel has also taken a step towards diversifying its services with the recent acquisition of Trustwave, an information security company.

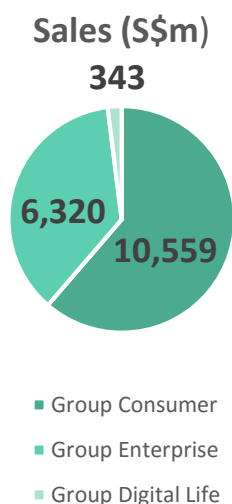
### Growth in Associates/Joint ventures

Singtel's associates and joint ventures comprise of about 45% of the Group's underlying net profit in the first quarter of 2015. Given the rather stagnant growth in Singapore, this opens up room for growth when Singtel diversifies into these countries. Most of these countries have low mobile data penetration which places Singtel in a good position to tap on this potential growth and expand its business.

### Valuation

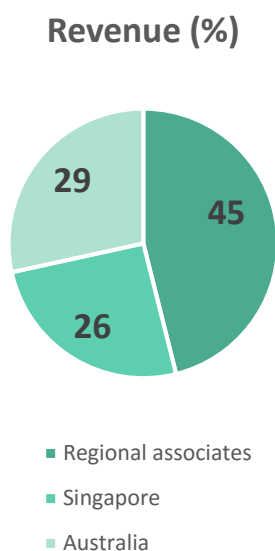
Sum of the parts (SOTP) valuation is used to value Singtel. We have projected the cash flows to NOPAT from each individual segment of their business in Singapore and in Australia, and discounted such cash flows to a present value, assuming a risk free rate of 2.5%, beta of 0.97, market risk premium of 6.5% and a WACC of 8.5%, for a warranted price of **\$4.19**.

Figure 1. Revenue by Division



Source: Company Data

Figure 2: Revenue by Geographical Segment



Source: Company Data

## Company Overview

Singapore Telecommunications Limited (SingTel) was founded in 1992 and is based in Singapore. It has also established presence in Asia and Africa through its investments in regional mobile operators. The company operates through three business segments: Group Consumer, Group Enterprise, and Group Digital Life. Singtel also operates a venture capital fund that focuses its investments on technologies and solutions; and provides mobile advertising solutions to the mobile operators, publishers, and advertisers.

### Revenue Breakdown

Singtel derives a large part of its revenue from its Group Consumer. Based on Figure 1, 62% of its revenue comes from the consumers in Singapore, Australia and other emerging markets while Group Enterprise account for another 36% of its revenue. The remaining 2% comes from Group Digital Life. Figure 2 shows the geographical breakdown of the company's revenue. The combined revenue of Singtel's regional associates make up 45% of the total revenue. Australia contributed 29% of the revenue while Singapore make up the remaining 26%.

### Group Consumer

Under the Group Consumer segment, SingTel is involved in carriage business, including mobile, pay TV, fixed broadband, and voice, as well as equipment sales. The key driver for this segment is data demand. Singtel wants to provide higher customer satisfaction through faster speeds, greater coverage and more innovative products.

### Group Enterprise

This segment offers mobile, fixed voice and data, managed services, cloud computing, IT services, and professional consulting services. The demand for info-communications technology is driving the business for this segment. Singtel has three key priorities for this segment which is to be a global cyber security provider, providing a comprehensive suite of cloud services and lastly to play an integral role in developing smart city solutions.

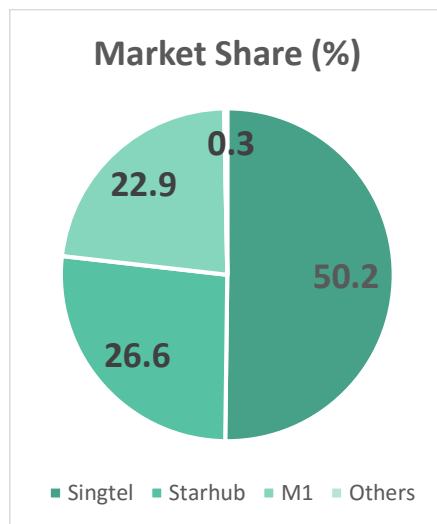
### Group Digital Life

For this segment, Singtel engages in digital marketing, data analytics, mobile banking payment, e-commerce, concierge, and hyper-local services. The advancement in technology and content in Asia has increased the needs for such services. Moving forward, Singtel aims to expand this business by concentrating on premium over-the-top videos, digital marketing as well as advanced analytics and intelligence.

### Corporate Venture Fund

Singtel also owns a corporate venture fund, Innov8, which identifies the latest innovation and enables Singtel Group to gain access to these technologies. Innov8 currently has a fund size of US\$250 million and is headquartered in Singapore. Innov8 works with partners of diverse backgrounds such as developers, investors, government bodies, research bodies and higher-learning institutions. By working hand in hand with start-ups to get early access to tomorrow's technologies, this has helped Singtel shape a creative approach to innovation in Singapore, Southeast Asia and beyond.

**Figure 3: Subscriber Market Share**



Source: Company Data

## Industry Analysis

### Singapore

In Singapore, Singtel is the leading telco ahead of Starhub and M1, with 50.2% of the wireless subscriber market share as seen in Figure 3. Singapore is also a mature market, with high mobile penetration rates and a relatively similar network quality and coverage between telcos. In addition, the IDA has recently lowered the bidding price for a fourth telco license from \$100m to \$40m. The current market situation is viewed as relatively stagnant, with the three telcos seemingly content with current levels of market share. The move to discount is aimed at reinvigorating competition within the market.

### Australia

The situation in Australia is similar to that in Singapore, with three main players in the mature telecommunications market: Telstra, Optus and Vodafone. The market leader is Telstra, which has 16.7m subscribers, while Singtel's Optus comes in second with 9.38m and lastly Vodafone with 5.25m (per Australian Financial Review). In 2013, Telstra invested in heavy capital expenditure to upgrade its networks and offer 4G, while Optus did not. This resulted in Optus losing mobile subscribers, and thereby losing revenue in the next few years. However, we believe that the situation will improve. Recently, Singtel has announced plans to increase its capital expenditure in Optus to \$1.9bn to upgrade its networks' coverage and quality, in an attempt to make up for lost ground. We are optimistic that this move will put it on par with Telstra in terms of quality of services, and lead to an increase in mobile subscribers.

### Associates

Singtel has associates in many markets across the region, which can be characterized by their common developing nature. These are developing markets for mobile data, with smartphone penetration rates only at: Africa (39.8%), The Philippines (38.7%), Thailand (31.0%), India (16.8%) and Indonesia (14.0%). This can be contrasted to more developed and mature markets like Singapore (71.7%). In this age of mobile data, low smartphone penetration is a strong indication of room for data growth, as the world grows more connected. In the last year, these markets have shown promising growth in mobile data revenue (YoY): Africa (68.2%), The Philippines (44.0%), Thailand (57%), India (70%) and Indonesia (36%). These growing regions account for about half of Singtel's total revenue.

## Porter's 5 Forces

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### Competitive Rivalry

In both Singapore and Australia, Singtel's business faces strong competition. Both markets can be characterized as oligopolistic, with three main players in each field. Stiff competition is mainly due to the telecommunication companies supplying relatively undifferentiated products. Over the years, this has resulted in price wars and competitor trends being closely followed.

### Threat of New Entry

There is a low threat of new entry due to the high barriers to entry. Such barriers include high infrastructural costs, such as telecommunication towers for mobile consumers and data centers for managed cloud storage. In addition, companies in the industry can capitalize on economies of scale to further lower prices and keep out new entrants. For example in the context of mobile subscribers, after the high initial costs are incurred to set up the required infrastructure, the marginal cost of adding each additional subscriber is reduced, bringing down unit cost. Therefore, new entrants will find it difficult to stay competitive.

### Threat of Substitutions

In the consumer division, there is a high threat of substitutions due to the low switching costs and limited differentiation between mobile service providers. Consumers are highly price sensitive, and will generally switch the lower cost providers if they can. In terms of enterprises, the threat of substitutions might be relatively lower. This is due to the uniqueness of each tailored business solution that makes finding the exact same working parameters more difficult, resulting in high switching costs.

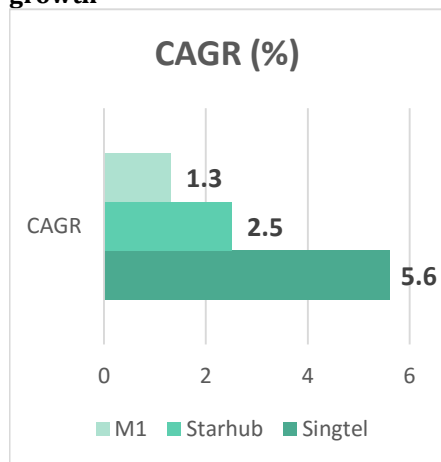
### Buyer Bargaining Power

There is a high bargaining power for consumers, considering their relatively ease of switching. In addition, there is often a great deal of transparency in this field, which allows price sensitive consumers to have a good assessment of the available options in the market, and make an informed decision. This concept also applies to new enterprises looking for business solutions, as their switching costs remain low relative to more entrenched businesses. For existing businesses customers, their bargaining power is low due to high switching costs they must incur if they choose to move to a competitor.

### Seller Bargaining Power

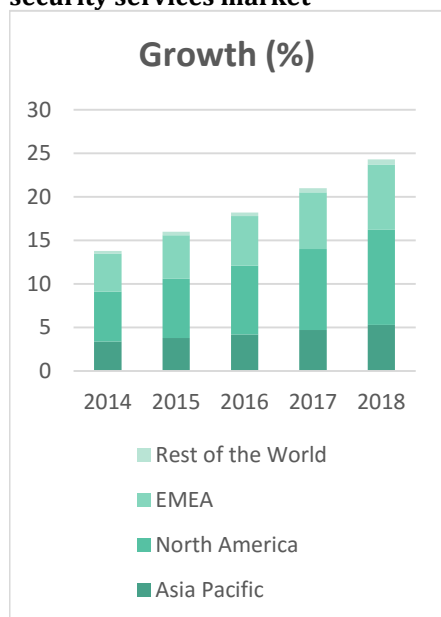
For sellers of the latest technological and mobile devices, bargaining power is high. Companies in the industry cannot afford to lose out to competitors on this front, because majority of their mobile subscribers determine purchases based on these devices. Also, sellers of such specific items are often limited. In terms of any other hardware, however, the bargaining power of sellers is low, for there are many contractors willing to supply the goods.

**Figure 4: 5-year CAGR of subscriber growth**



Source: Bloomberg

**Figure 5: Growth of managed security services market**



Source: Market Research, Gartner 2014

## SWOT Analysis

### Strengths

One clear strength for Singtel, is their strong position in Singapore market. It is the market leader, and still continues to outperform its competitors in terms of subscriber growth. Figure 4 shows that in the last 5 years, Singtel's CAGR of subscriber growth has been 5.6%, which is stronger than Starhub (2.5%) and M1 (1.3%). It also has a strong global presence through its business in Australia and other regional associates, which sets them apart from their other more localized competitors. Regional diversification allows Singtel to tap into regional growth, and protects them from unexpected downturns in any one market.

### Weaknesses

A potential weakness lies in Optus' lack of a clear brand positioning. Telstra, the market leader, commands the best network quality and Vodafone is known for offering the most affordable prices. However, Optus' current directions aims at improving network quality and coverage, in an attempt to wrestle prices from Telstra. Also, another weakness is the possible dent in short term profits due to heavy capital expenditure needed to upgrade its infrastructure.

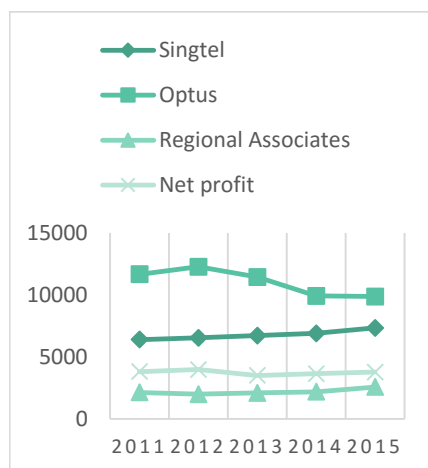
### Opportunities

In 1Q15, 77% of mobile data traffic growth came from developing countries. Singtel's share in regional associates in such countries, which constitute about half of their revenue, allows them to capitalize on such growth. In addition, its heavy capital expenditure in improving Optus' infrastructure, has opened up the possibility of regaining its market share. In the most recent quarter, Optus has added 102 000 new post-paid subscribers, while Telstra and Vodafone have only added 32 000 and 35 000 respectively. Lastly, with their recent acquisition of Trustwave, we can expect to see Singtel's development in the Cyber Security space, and the weaving of Cyber Security into its consumer and business solutions. The managed security services market is expected to grow at a 15% CAGR till 2018 as seen in Figure 5.

### Threats

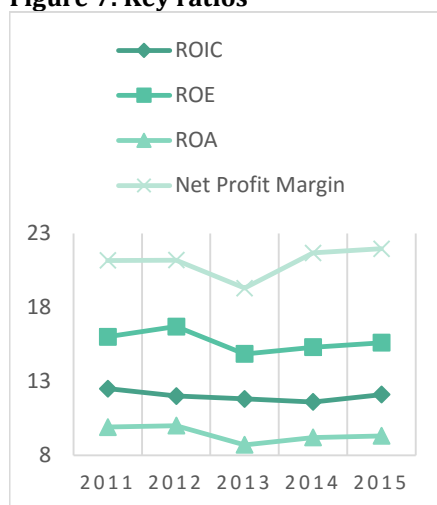
There is the minor threat of a possible new telco in Singapore, which could attempt to wrestle market share from existing telcos. However, this threat is mitigated by Singtel's focus on its overseas business, and also the potential barriers that the new telco will have to overcome. Another threat involves Telstra's move to match Singtel's increase in Capital Expenditure, in order to fend off advances. However, we see Telstra's expenditure having limited effects, because of their current position being already at the forefront of technological and network coverage.

**Figure 6: Operating revenue and net profits**



Source: Company Data

**Figure 7: Key ratios**



Source: Company Data

## Investment Thesis

### Strategic Priorities for each Business Segment

As mentioned earlier, Optus was facing difficulty in the Australia market. However, Singtel have put in major capital investments in the past year to improve mobile networks and other core infrastructures to match up with Telstra. Thus, we are optimistic that the improvement in quality of services will help Optus regain market share and thus, increase revenue for Group Consumer. For the Group Enterprise segment, Singtel is trying to incorporate cyber security in its business to provide an all-rounded solution. It has also formed a strong partnership with Microsoft to enable businesses and government better access to Microsoft application and services. Lastly, for Group Digital Life, Singtel has identified the increasing demand for premium over-the-top video. HOOQ, a joint venture with Sony Pictures Television and Warner Bros. Entertainment, was launched at the start of the year to develop new revenue streams and to cater to customers' demand. With a strategic business plan based on the different key drivers, we believe that Singtel is in a good position to capture growth in its three business segments.

### Consistent Financial Ratios

Singtel has shown a consistent increasing trend in operating revenue and its regional associates for the last 5 years (Figure 6). In addition, Optus, revenue has picked up for the past year. Overall, net profit margin has also been relatively consistent with an exception of a dip in 2013. It is also the highest among its competitors at 21.94%. As shown in Figure 7, return on invested capital, equity and total assets have also been relatively stable. We are confident that Singtel Group will continue to maintain its growth in net profit and continue to generate a stable flow of revenue in the future.

### Diversification across Market and Services

One key advantage Singtel has to its main local competitors, is its strength in diversification. Singtel is diversified across different regional markets, with 74% of their revenue coming from its overseas business in Australia and regional associates in Indonesia, India, Africa, Thailand and the Philippines. In addition, with their recent acquisition of Trustwave, they now have a presence in North America as well. As such, they are less exposed or vulnerable to any possible upsets in specific markets, such as the potential entrant of 4th main telecom carrier in Singapore. Also, they are well positioned to capitalize on growth in any of these regions, in particular the emerging markets. In addition, Singtel has also taken a step towards diversifying its services. With the recognition of the growing prevalence of cyber threats, Singtel's move towards cyber security is surely a move in the right direction. Furthermore, this move looks to boost its Managed Services division, which currently only accounts for 9% of its total revenue.

### Growth in Associates/Joint ventures

The good progression of Singtel' associates and joint ventures can help to propel its business forward. These associates and joint ventures comprise of about 45% of the Group's underlying net profit in the first quarter of 2015. By diversifying into these countries, Singtel is able to latch itself onto more opportunities for growth given the rather stagnant growth in Singapore. Furthermore, most of these associates and joint ventures are leaders in their respective countries. In India (Airtel), only 32% of customer base uses data. This places Singtel at a sweet spot to tap on this potential growth. Given the imminent proliferation of mobile data in these countries, we believe Singtel is in an excellent position to maximize the opportunities and expand its business.

**Figure 8: Assumptions**

<b>Risk Free Rate</b>	2.5%
<b>Market Risk Premium</b>	6.5%
<b>Beta</b>	0.97
<b>Discount Rate</b>	8.5%
<b>Price</b>	\$ 4.19
<b>Growth</b>	2%

Source: Based on own estimates

**Figure 9: Bear Case**

<b>Growth Rate of Singapore</b>	1%
<b>Growth Rate of Australia</b>	1%
<b>Revenue by Joint Associates</b>	-5%
<b>Discount Rate</b>	9%
<b>Price</b>	\$ 3.59
<b>Growth</b>	1%

Source: Based on own estimates

**Figure 10: Bull Case**

<b>Growth Rate of Singapore</b>	2.5%
<b>Growth Rate of Australia</b>	2.5%
<b>Revenue by Joint Associates</b>	+5%
<b>Discount Rate</b>	8.0%
<b>Price</b>	\$ 4.75
<b>Growth</b>	2.5%

Source: Based on own estimates

## Valuation

For the valuation of Singtel, we split up the valuation of their different business segments to accurately reflect their business' value. We have projected the revenues of Singapore (Singtel) and Australia (Optus) to accurately reflect the managerial decisions of Singtel regarding their expansion plans in those countries. We then added the equivalent stakes of their joint ventures to arrive at a warranted price.

### Base Case

Figure 8 shows the assumptions made for discounting the cash flows back to present value. We have split up the Singapore revenue streams into Australia and Singapore. We assume that the revenue for Singapore grows steadily at a CAGR of 2%, and Australia with an initial decline of 1% before stabilising at 2%. Using that, we discount each year's cash flow back at a rate of 8.5%. Through that we get a present value of SGD 87,197 million. The present value for each individual segment is summed up to present value and thus represented on the left. We then arrive at a warranted share price of **\$4.19**.

To get a sense of the risk to reward ratio of the investment, we performed a bull and bear case based on different assumptions, which can be seen in Figure 9 and 10.

### Bear Case

Our Bear case assumes that due to the entry of a new telco in Singapore, as well as problems with the NBN (Next generation broadband network) in Australia will lead to a YOY increase of 1% in Singapore as well as Australia. Furthermore, we assume that the regional associates are not able to tap on the growth of emerging markets as well as they could, leading to a 5% decrease in the free cash flow they generate. Furthermore, we assume that WACC for Singtel has been underestimated and is now 9%. Terminal growth rate will be at 1%. These values can be seen in Figure 9. This will lead to a warranted price of **\$3.59** per share.

### Bull Case

Our Bull Case assumes that revenue growth in Singapore and in Australia will be stellar at 2.5% YOY. Furthermore, our regional associates have managed to tap onto the emerging markets quite well, leading to an increase in their free cash flow by 5%. We also assume that we have overestimated the WACC, and the discount rate is now 8%. Furthermore, we assume terminal growth rate to be 2.5%. These values can be seen in Figure 10. This will lead to a warranted price of **\$4.75** per share.

## Financial Analysis

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	Profit Margin	Asset turnover	Equity Multiplier	ROE
Singtel	19.3%	42%	167%	15.04%
M1	13.9%	107%	255%	44.39%
Starhub	15.0%	123%	1491%	285.44%

By referring to Figure 7, we can note that the ROE of Singtel has been consistent. Although its ROE is the lowest among the 3 major telcos in Singapore, it is unrealistic to expect such a large company to continue growing and generate a high ROE, which is evident in most large companies.

Using the Dupont analysis, we can see that Singtel's profit margin exceeds that of its competitors, M1 and Starhub. This places Singtel in a favourable position regarding the profitability of the company.

However, it is notable that Singtel's asset turnover is way below that of the rival companies. It can be observed from the balance sheet that intangible assets comprises of 29% of Singtel's total assets. Looking deeper, we can see that this mainly a resultant of goodwill on acquisitions of Singtel's subsidiaries. We feel that the large amount of goodwill from acquiring its associates and joint ventures is acceptable because of telecommunications being a service industry, thereby branding and reputation plays a big role in its business model. Apart from that, Singtel is the only company among the 3 to have a significant stake in overseas companies. Although the asset turnover does not reflect well regarding the turnover of these acquisitions, we believe that the potential growth from its acquisitions will be reflected in the time to come. Thus, we feel that the comparatively lower asset turnover to its peers is not of a major concern given the positive outlook of its subsidiaries and joint ventures.



## Key Investment Risk

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### Regulatory Risk

The extensive government regulations in Australia is likely to limit flexibility for Optus to expand. Australia is having significant reform in its fixed-line telecommunications sector, including the rollout of a National Broadband Network (NBN) which is to be operated on a wholesale-only open access basis. Also, the regulatory reforms of the government, including legislation and the deployed NBN and commercial transactions relating to the NBN, might lead to a sub-optimal or negative outcome for Optus.

### Consumer Risk

The potential entry of the fourth telco in Singapore will increase competition in the industry. This will put pressure on prices and bring down profit margins. As for Australia, other competitors have made large investments which are sunk costs, therefore exposing Singtel to the risk of introduction of irrational pricing.

### Foreign Exchange Risk

Singtel Group has operations in many countries, making them susceptible to currency fluctuations. It is mainly exposed to Aus, Euro, HKD, Rupee, Rupiah, Peso, Pound, Baht, USD, Yen. Borrowings which are denominated in foreign currencies are hedged using cross currency swaps. Apart from that, foreign currency purchases and forward currency contracts are used to reduce the foreign currency exchange rate fluctuations.

### Interest Rate Risk

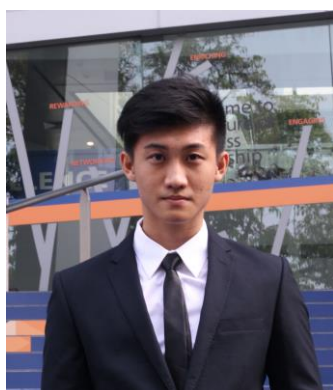
Singtel manages this by placing cash balances on varying maturity and interest rate terms. It also enters into interest rate swaps over the duration of its borrowings. In doing so, it lets them to exchange, at specified intervals, the difference between fixed and variable interest amounts calculated by reference to an agreed-upon notional principal amount.

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