midf RESEARCH

23 May 2018 | 1QFY18 Results Review

Telekom Malaysia Berhad

Net profit margin eroded

***Downgrade to* NEUTRAL**
(*previously* BUY)
***Revised* Target Price (TP): RM4.09**
(*previously* RM7.72)

INVESTMENT HIGHLIGHTS

- **1QFY18 normalised earnings came in below expectation in view of lower revenue from voice, data and other segments, while operating expenses remain elevated**
- **Slight contraction (-2.7%yoy) in 1QFY18 total broadband customer base due to the decline in Streamyx users**
- **1QFY18 capital spending focuses on expansion of network development for convergence**
- **Downgrade to NEUTRAL with a revised target price of RM4.09 base on DDM valuation methodology**

Weaker profit margin. Telekom Malaysia Bhd's (TM) 1QFY18 normalised earnings came in at RM105.3m. This translates into a decrease of -54.2%yoy as compared to 1QFY17. The reduction in normalised earnings was mainly led by the decline in voice, data and other telecommunication-related services revenues (*Refer to Appendix*). On the contrary, the group's operating expenses remain elevated. As a result, the group's 1QFY18 profit margin contracted to 3.7% as opposed to 7.8% achieved in 1QFY17. All in, TM's 1QFY18 financial performance came in below ours and consensus expectations, accounting for 11.2% and 12.2% of full year FY18 earnings estimates respectively.

Broadband. As at 1QFY18, the total broadband customer base dwindled by -2.7%yoy to 2,306k customers (1QFY17: 2,370k customers). This was mainly caused by -18.8%yoy reductions in Streamyx customer base to 1,129k customers. Fortunately, unifi customer base expanded to 1,177k customers (+20.2%yoy) as more customers are moving up the value chain with convergence. At present, the convergence/TM households are at 45%. Meanwhile, unifi ARPU remained resilient above RM190/mth.

Capital expenditure (capex). TM eased its 1QFY18 capex to RM327m (-7.1%yoy). This led to lower capex-to-revenue ratio of 11.5% as compared to 11.9% recorded in 1QFY17. Bulk of the capex was utilised for expansion of network development for convergence. Currently, more than three million highspeed ports have been delivered. Breakdown on 1QFY18 capex includes core network (17%), access (65%) and support systems (18%).

RETURN STATS	
Price (22nd May 2018)	RM4.20
Target Price	RM4.09
Expected Share Price Return	-2.6%
Expected Dividend Yield	+3.1%
Expected Total Return	+0.5%

STOCK INFO	
KLCI	1,845.03
Bursa / Bloomberg	4863 / T MK
Board / Sector	Main/ Services
Syariah Compliant	Yes
Issued shares (mil)	3,757.9
Market cap. (RM'm)	15,783.3
52-wk price Range	RM4.12 – RM6.69
Beta (against KLCI)	0.70
3-mth Avg Daily Vol	3.1m
3-mth Avg Daily Value	RM16.7m
Major Shareholders (%)	
Khazanah	26.21
PNB and its associated funds	20.63
EPF	17.74
KWAP	4.10

Impact. We are reducing FY18 and FY19 earnings estimates to RM510.0m and 541.3m respectively as we are assuming a more conservative earnings contributions from voice, data and others segments. Consequently, our FY18 and FY19 dividends estimates have been reduced to 12.1sen and 12.9sen respectively.

Target price. We are rolling forward our valuation base year to FY19 and derive a new target price of **RM4.09** (previously RM7.72). This based on Dividend Discount Model valuation methodology.

Downgrade to NEUTRAL. The challenging market environment has negatively impacted the group's voice, data and other revenues. Fortunately, the internet revenues continue to record good traction which is mainly attributable to higher mix of unifi customers and resilient unifi ARPU. However, we are concerned on the group's ability to manage its operating expenses efficiently. The cost as a percentage of revenue has increased steadily beyond 90% for the past few quarters. Due to the earnings pressure and the group's commitment capex commitment for long-term growth, we expect the dividend payment to decline as well. At this juncture, we view that dividend yield to hover around three percent only. Given the lack of strong positive catalysts, we are downgrading our call recommendation to **NEUTRAL** from buy previously.

DIVIDEND DISCOUNT MODEL ASSUMPTIONS

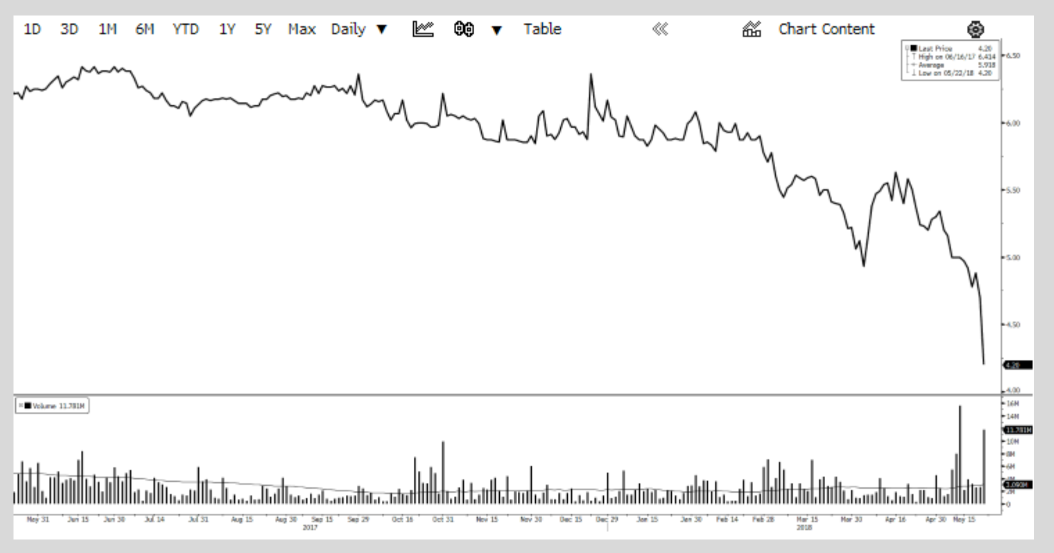
Expected market return	10.0%
Risk free rate	4.0%
Beta	0.7
Terminal growth	5.0%
Cost of equity	8.4%

INVESTMENT STATISTICS

FYE 31st Dec	2016	2017	2018F	2019F
Revenue (RM'm)	12,060.9	12,085.1	11,631.5	12,179.7
EBIT (RM'm)	1,185.4	1,092.7	732.8	767.3
PBT (RM'm)	1,018.0	1,048.0	584.0	619.9
Normalised PATAMI (RM'm)	847.9	863.2	510.0	541.3
Normalised EPS (sen)	22.6	23.2	13.6	14.4
EPS growth (%)	-6.6	2.5	-41.4	6.1
PER(x)	18.6	18.1	30.9	29.2
Net Dividend (sen)	21.5	21.1	12.1	12.9
Net Dividend Yield (%)	5.1	5.0	2.9	3.1

Source: Company, MIDFR

DAILY PRICE CHART



Martin Foo Chuan Loong
martin.foo@midf.com.my
+603 2173 8354

TELEKOM MALAYSIA: 1QFY18 RESULTS SUMMARY

(All in RM'm unless stated otherwise)	**Quarterly Results**				
FYE 30th June	**1QFY18**	**1QFY17**	**YoY (%)**	**4QFY17**	**QoQ (%)**
Revenue	2,848.0	2,964.6	-3.9	3,199.9	-11.0
Normalised EBITDA	777.7	957.7	-18.8	922.3	-15.7
Normalised EBIT	206.6	311.9	-33.8	299.1	-30.9
EBIT	195.6	303.8	-35.6	270.3	-27.6
Other gains/losses	-1.7	-4.7	n.m.	14.0	n.m.
Net finance cost	-5.2	-41.7	-87.5	18.0	-128.9
Associate income	5.5	6.3	-12.7	5.3	3.8
PBT	194.2	263.7	-26.4	307.6	-36.9
Taxation	-86.6	-79.3	9.2	-85.4	1.4
MI	49.5	46.0	7.6	54.8	-9.7
PATAMI	157.1	230.4	-31.8	277.0	-43.3
Normalised PATAMI	105.3	229.8	-54.2	222.0	-52.6
EPS (sen)	2.79	6.10	-54.3	5.87	-52.6
			+/- ppts		+/- ppts
Normalised EBITDA margin (%)	27.3	32.3	-5.0	28.8	-1.5
Normalised EBIT margin (%)	7.3	10.5	-3.3	9.3	-2.1
Normalised PATAMI margin (%)	3.7	7.8	-4.1	6.9	-3.2
Effective tax rate (%)	44.6	30.1	14.5	27.8	16.8

Source: Company, MIDFR

APPENDIX

Table 1: 1QFY18 revenue breakdown by product category

Product	Revenue (RM'm)	% YoY	Remarks
Voice	753	-6.7	- Lower traffic minutes and lower cumulative customers
Internet	1,019	+5.2	- Higher contribution from unifi mobile in line with higher customer base as well as higher content
Data	622	-5.3	- Lower domestic leased bandwidth and other data services
Others	451	-15.7	- Lower USP revenue recognition and lower contribution from ICT and BPO

Source: Company, MIDFR

Table 2: 1QFY18 revenue breakdown by customer clusters

Cluster	Revenue (RM'm)	% YoY	Remarks
Unifi	1,333	+2.0	- Higher contribution from unifi mobile in line with higher customer base
TM ONE	963	-9.7	- Lower USP revenue recognition and lower contribution from ICT and BPO
TM GLOBAL	425	-6.8	- Lower traffic minutes and lower contribution from domestic leased revenue
Others*	124	-21.0	- Lower tuition fees at UTSB

Source: Company, MIDFR

** Others comprises other telco and non-telco services (i.e. ICT_BPO, UTSB tuition fees, customer projects)*

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.