

Hong Kong Telecom Sector

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DBS Group Research . Equity

16 Jan 2024

Shifting preference from mobile to fixed-line

- **Fixed-line players prioritise maximising ARPU over subscriber growth, driving a robust 4.5% residential market growth in FY24**
- **Enterprise business resumes growth post-COVID, riding the wave of enterprise digitalisation**
- **Mobile roaming revenue is on track to reach 85-90% of pre-COVID level in FY24, but largely priced in**
- **BUY fixed-line names; prefer [HKBN \(1310 HK\)](#) for its attractive yield of 12% and pure fixed-line exposure**

Fixed-line players have transitioned to ARPU maximisation, from previous "subscriber gain" strategy in the residential broadband market. We now expect the market to grow by a faster 4.5% and 3.5% y-o-y in FY24 and FY25 respectively, from a 2.4% growth in FY23, as operators started to lift broadband prices in 2H23. We anticipate a favourable pricing landscape in FY24 and beyond, as operators aim to recover from muted revenue growth induced by the earlier price war.

Enterprise business back to growth trajectory post COVID. We expect the market to grow steadily by 5.7%, 4.9%, and 5.3% y-o-y in FY23, FY24 and FY25, respectively, compared to flattish growth recorded in FY22. The key driver will be rising demand for bandwidth and value-added services such as system integration. We expect the momentum will continue, riding on increasing IT spending and enterprise digitalisation.

Mobile roaming business recovery is on track. Roaming revenue recovered to 58-66% of pre-COVID level recently (1H23 for HKT and Hutchison Telecom; FY6/23 for Smartone). We expect roaming revenue to recover to 85-90% of pre-COVID level and contribute 10-17% of mobile service revenue in FY24. While this will support earnings growth for mobile operators, we reckon that this trend has been largely priced in, as evident from the mobile sector's outperformance in 1H23 under the re-opening theme (share prices of mobile names increased by c.1%, v.s. -7%/-16% for fixed-line names during the period).

Prefer fixed-line to mobile, for long term sustainability in earnings growth. Fixed-line players also offer more attractive yields of 9-12%, which is 2-4 SD above historical average. Mobile names are trading at 7-8% yields, at c.1 SD above. We prefer HKBN over HKT for its attractive 12% yield and pure fixed-line exposure. We downgrade Smartone to HOLD and maintain Hutchison Telecom's HOLD rating as mobile roaming recovery is largely priced in.

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Recommendation & valuation

Company	Price	Target Price	Recom	Mkt Cap	PE 24F	Yield 24F
	HK\$	HK\$		US\$m	x	%
HKT Trust 6823 HK	9.52	13.10	BUY	9,227	14.5	8.3
Hutchison Telecom 215 HK	1.10	1.00	HOLD	678	31.0	6.8
Smartone 315 HK	4.13	4.20	HOLD	583	9.8	8.0
HKBN 1310 HK	3.41	5.70	BUY	572	38.6	12.1

Source: Thomson Reuters, DBS Bank (Hong Kong) Limited ("DBS HK")

Closing price as of 15 Jan 2024

Introduction

We are shifting our preference from mobile to fixed-line for 2024, following the mobile sector’s share price outperformance in 1H23. Mobile roaming revenue will continue to recover in 2024, considering that revenue has only recently reached 58-66% of pre-COVID levels. However, we believe this trend has been largely priced in, and the mobile sector lacks catalysts for further rerating.

Fixed-line players are poised to deliver sustainable revenue growth in 2024 and beyond due to two key factors: (1) operators have shifted to focus on average revenue per user (ARPU) maximisation in the residential broadband market, a move away from the subscriber gain strategy in the past two years, and (2) enterprise business has regained its growth momentum post COVID-19.

Overall, the abovementioned factors would support adjusted fund flow (AFF) and dividend growth for HKBN (1310 HK) and HKT (6823 HK) in FY24, underscoring dividend yields of c.12% and c.9%, respectively. These two stocks are attractive yield plays with a sustainable growth outlook and limited downward risk from interest rate impact.

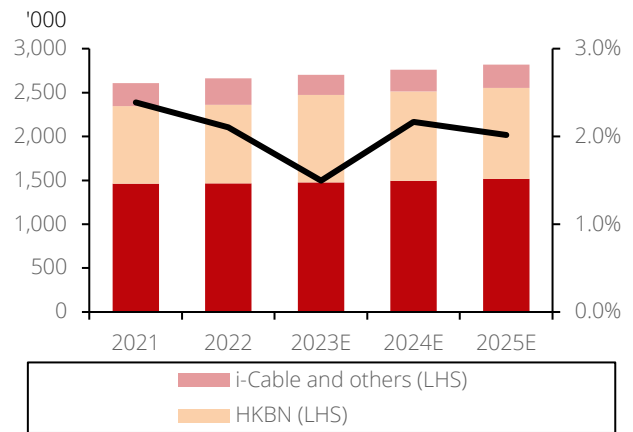
Fixed-line market outlook

Residential broadband: Stable subscriber growth

We expect residential broadband subscribers to grow by 2.2% and 2.0% y-o-y in FY24 and FY25, respectively, mainly driven by the launch of new housing units, including first-hand residential properties, public rental housing, and other subsidised flats.

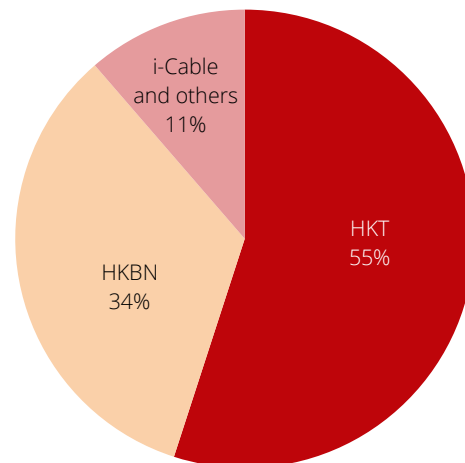
The Hong Kong residential broadband market is almost saturated, with penetration at 98% as of September 2023, according to the OFCA. Industry growth will mainly come from new housing units. There will be 107k potential first-hand private residential properties and 99k public rental housing and other subsidised flats in the next four years, according to the Transport and Housing Bureau and Housing Authority, respectively. We expect total residential broadband subscribers to grow at a CAGR of 1.9% in 2022-2025F, increasing from 2,664k in 2022 to 2,818k in 2025.

Hong Kong residential broadband subscriber base



Source: Companies, OFCA, DBS HK

Hong Kong residential broadband market share by number of subscribers (2022)



Source: Companies, DBS HK

Residential broadband: Shifting focus to ARPU maximisation

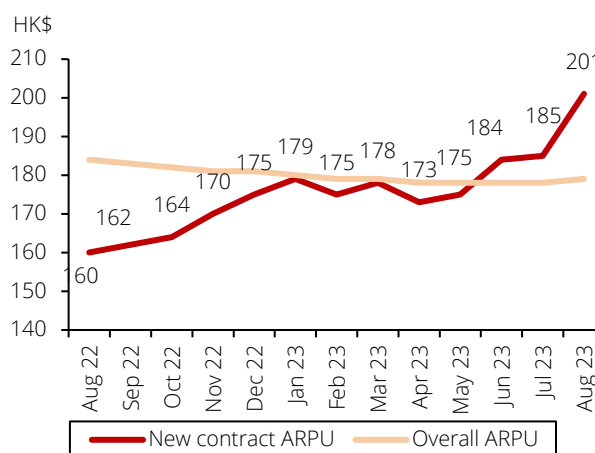
We expect residential broadband revenue to grow by 4.5% and 3.3% y-o-y in FY24 and FY25 respectively, accelerating from 2.4% growth in FY23 and a decline of 1.6% in FY22, as operators have started to focus on “ARPU maximisation” instead of “subscriber gain” in 2H23.

Considering the well-penetrated Hong Kong residential market, operators are now prioritising to maximise ARPU. We do not anticipate either of the two operators initiating a price war again to attract subscribers, as both experienced subdued revenue growth in the past year. Therefore, we expect a benign or a steady improvement in the pricing environment in 2024 and beyond.

At the start of 2022, HKBN had set an aggressive target of reaching 1 million residential broadband subscribers, a significant increase from its 886,000 subscriber base at the end of 2021. Despite offering aggressive price cuts, such as introducing a HK\$99 monthly plan for 1000M broadband service, to lure new subscribers, its subscriber base only increased by 11,000/23,000 or 1%/3% y-o-y in FY8/22 and FY8/23, respectively. In response, HKT also offered similar discounts at specific time points during the period.

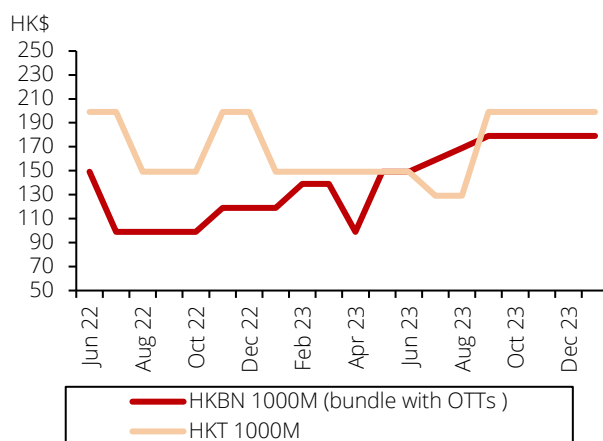
From the second half of 2023, both operators initiated substantial hikes in their broadband prices. HKBN revealed that its new contract ARPU (including customer acquisition and retention) is steadily increasing, reaching HK\$201 in Aug 2023, which is 12% higher than overall ARPU and 26% higher than the new contract ARPU in Aug 2022. Meanwhile, HKT also increased its price for the 1000M broadband plan by more than 50%, to c.HK\$200 per month recently. Additionally, the HGC 1000M broadband price has remained largely stable at HK\$179 over the past year, and the i-Cable 1000M broadband price continues to stay low at HK\$88. However, we do not expect i-Cable to gain subscribers significantly with its low-price strategy, given its limited customer mindshare and the high customer stickiness nature in the Hong Kong residential broadband market.

HKBN's new contract and overall ARPU



Source: Company, DBS HK

HKBN's and HKT's 1000M broadband price

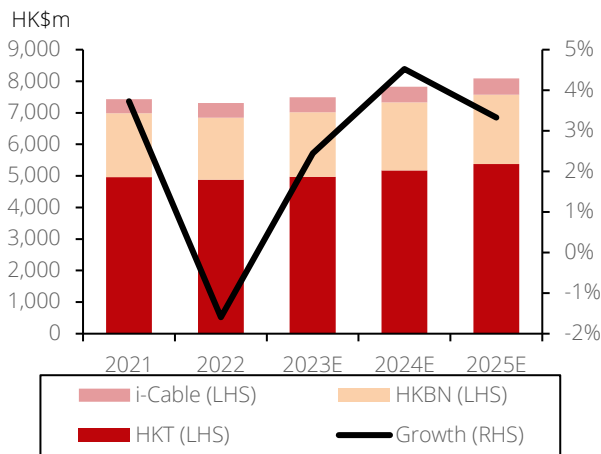


Source: Company, DBS HK

Broadband users in Hong Kong continue to demand higher bandwidth. The percentage of broadband internet access lines with downstream speeds of 1Gbps+ has increased by 5 ppts y-o-y, reaching 66% in Sept 2023.

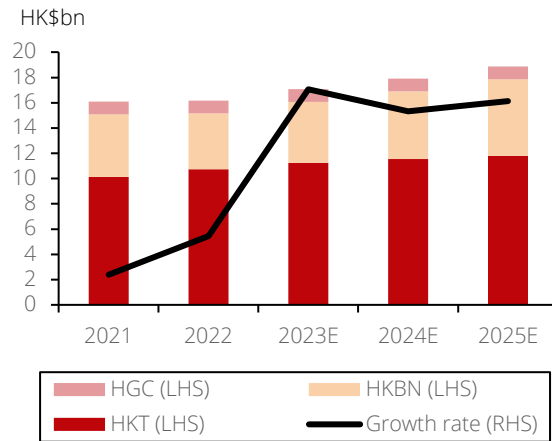
Overall, we anticipate overall residential ARPU of fixed-line operators to return to a growth trajectory in 2024 and onwards, supported by price increases and bandwidth upgrades. We forecast overall residential broadband revenue to increase by 2.4%, 4.5%, and 3.3% for FY23, FY24, and FY25, respectively.

Hong Kong residential broadband revenue



Source: Companies, DBS HK

Enterprise telecom market



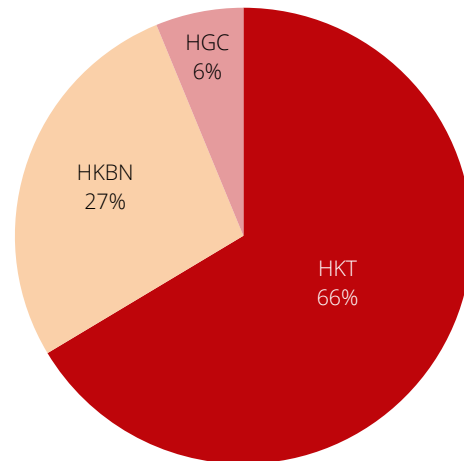
Source: Companies, DBS HK

Enterprise market: Back to growth trajectory post COVID

We expect the enterprise market to grow 5.7%, 4.9%, and 5.3% in FY23, FY24 and FY25, respectively, compared to flattish growth in FY22. Demand for telecom services such as broadband and VPN had been impacted during the past 2 years, especially for SMEs (due to IT cost cutting measures and bankruptcies) as a result of the challenging business conditions amid COVID-19. Looking ahead, we expect this segment will return to growth trajectory amid an improving business environment and ongoing enterprise digitalisation.

We expect the growth driver for the enterprise market will be mainly on increasing spending per customer, for example, more bandwidth needs and value-added services such as system integration. According to the OFCA, business broadband subscribers declined by 3% y-o-y, reaching 310k in September 2023. However, the percentage of business lines with downstream speeds of 100Mbps+ has expanded by 3ppts since September 2020 to 71% in September 2023. According to GlobalData's survey, most of the enterprises in Hong Kong had increased their ICT Information and Communication Technology budget for 2023 with more than 70% of respondents from their recent survey claiming the same.

Enterprise telecom market share (FY22)



Source: Companies, DBS HK

Mobile market outlook

Mobile roaming: Recovery largely priced in

Before the COVID outbreak, 12-20% of Hong Kong mobile operators' revenue was from the mobile roaming segment, but this dropped to 4-8% in FY21. Roaming revenue of mobile operators recovered to 58-66% of pre-COVID level based on their latest results announcement (1H23 for HKT and Hutchison Telecom; FY6/23 for Smartone), suggesting that mobile roaming business recovery will continue in FY23 and FY24.

Hong Kong Telecom Sector

In FY24, riding on expanding flight capacity, we expect roaming revenue to recover to 85-90% of pre-COVID level and contribute 10-17% of mobile service revenue. While this will support ARPU and earnings growth for mobile operators, we believe the mobile roaming recovery trend is well anticipated by the market.

Mobile roaming estimation summary

		FY19	FY22	FY23E	FY24E
HKT	Roaming revenue (\$HK, m)	1,010	505	707	909
	% of mobile service revenue	12%	6%	8%	10%
	% of pre COVID level	-	50%	70%	90%
SMT*	Roaming revenue (\$HK, m)	725	285	424	616
	% of mobile service revenue	16%	6%	9%	13%
	% of pre COVID level	-	39%	58%	85%
HT	Roaming revenue (\$HK, m)	738	297	517	664
	% of mobile service revenue	20%	9%	15%	17%
	% of pre COVID level	-	40%	70%	90%

*FY6/23 actual and FY6/24 estimates for Smartone

Source: Companies, DBS HK

Local mobile service: Flattish growth amid competition

The growth of local mobile service revenue remained largely flat in FY22, due to intense competition, despite the steady uplift in 5G adoption rate.

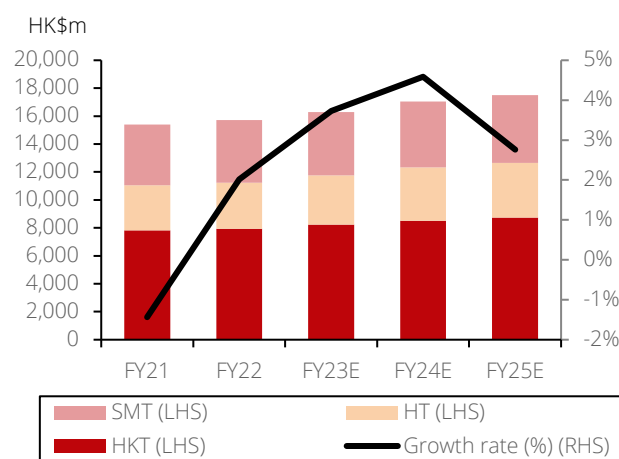
Smartone and HKT's 5G pricing remained largely stable compared to one year ago, while Hutchison Telecom cut its 60GB 5G mobile pricing by 10% recently. CMHK also cut its 200G and 300GB 5G mobile pricing aggressively by 20-50% compared to one year ago. We expect the competitive environment in Hong Kong's mobile market to maintain in FY24 and beyond given the crowded market with 4 operators. Overall, we forecast total mobile service revenue to grow by 3.7%, 4.6%, and 2.8% y-o-y in FY23, FY24, and FY25 respectively, largely riding on the mobile roaming business recovery trend.

5G mobile price plans – Oct 2023

5G (HK\$/month)	Oct 2023				
	SMT	3HK	csl.	1010	CMHK
8GB			198		
10GB					
12GB			298		
20GB				299 (16GB)	125
30GB	220	124		389	
50GB	238 (42GB)		358		149
60GB		168		419	
65GB					
80GB		228	398		
100GB		288	468		
110GB	298			459	
150GB			498		
200GB	398 (180GB)			559 (180GB)	199
250GB					
300GB			698	759 (330GB)	399
Unlimited			998	1010	

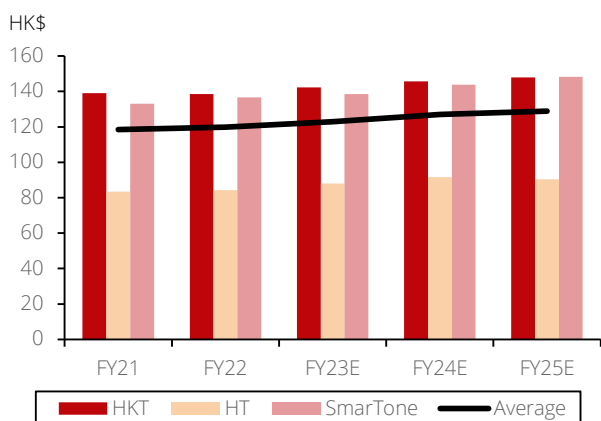
Source: Companies, DBS HK

Mobile service revenue



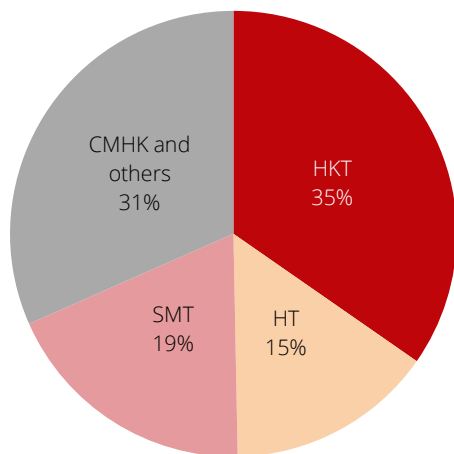
Source: Companies, DBS HK

Mobile blended ARPU



Source: Companies, DBS HK

Mobile post-paid sub market share (FY22)



Source: Companies, OFCA, DBS HK

Interest rate sensitivity analysis

Fixed-line telecom operators, such as HKT and HKBN, are characterised by a higher net debt-to-EBITDA ratios. HKBN has the highest net debt-to-EBITDA ratio of 4.3x as of end-FY8/23, followed by HKT's 3.0x as of end-FY22. Smartone and Hutchison Telecom have net cash of HK\$1,237m and HK\$3,700m as of December 2022, respectively.

Both HKT and HKBN have paid out dividends to shareholders from their free cashflow generated. In the recent interest rate upcycle, they faced significant pressure on earnings and dividends. Interest rates are expected to peak out and gradually decline in the coming two years, therefore, there is very limited downside risk on dividends in terms of interest cost impact. If we assume that companies maintain their current floating/fixed rate loan mix, we estimate that every 1% change in interest rate would increase or decrease interest cost by HK\$164m and HK\$109m, respectively for HKT and HKBN, impacting dividends by 3% and 21%. HKBN is most sensitive to interest rate change.

Floating/fixed rate mix of debt

FY22	Floating rate	Fixed rate
HKT	41%	59%
HKBN*	95%	5%
SMT*	0%	100%
HT	0%	0%

*FY8/23 for HKBN, FY6/23 for SMT

Source: Companies, DBS HK

Interest rate sensitivity analysis

	Net debt to EBITDA as at the end of FY22*	Total borrowings (HK\$m) as at end of FY22*	% of Total borrowings		1% int. rate impact (floating only)		1% int. rate impact (assume all floating)	
			Fixed-rate	Floating-rate	Dollar amount (HK\$m)	% change of dividend in FY22*	Dollar amount (HK\$m)	% change of dividend in FY22*
HKT	3.0x	39,944	59%	41%	164	2.9%	399	7.1%
HKBN*	4.3x	11,503	5%	95%	109	20.8%	115	21.9%
SMT*	Net cash	66	100%	0%	-	0.0%	-	0.0%
HT	Net cash	-	0%	0%	-	0.0%	-	0.0%

*FY8/23 for HKBN, FY6/23 for SMT

Source: Companies, DBS HK

Hong Kong Telecom Sector

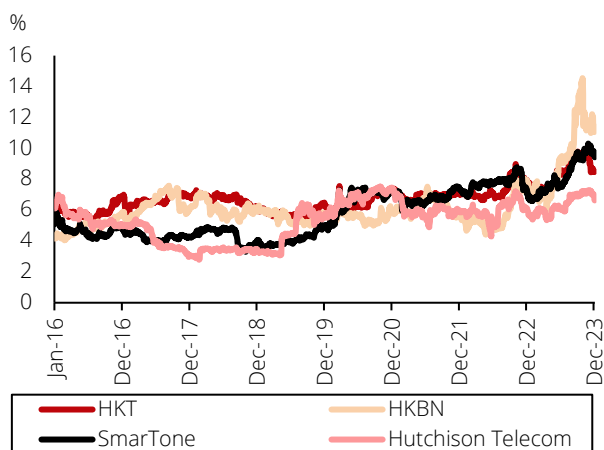
Valuation and recommendations

We prefer fixed-line operators to mobile operators, as the former enjoys sustainable earnings growth supported by (1) their strategy to maximise residential broadband ARPU, and (2) enterprise business recovery post-COVID. In addition, we believe downside risk from the impact of interest cost is very limited given the general expectation that interest rates are likely to decline going forward.

In terms of valuation, fixed-line operators offer more attractive dividend yields of 9-12%, which is 1.9-3.9 SD above their respective historical average. On the other hand, mobile operators are trading at 7-8% dividend yields, which is only 1.2-1.3 SD above the mean. All in, we believe it is now a good time to BUY the fixed line names for their attractive dividend yields and a more sustainable growth outlook. We prefer HKBN over HKT for its attractive dividend yield of 12% and its pure fixed-line exposure. Even though HKT offers a similar dividend yield to Smartone (HKT's 9% vs Smartone's 8%), we prefer HKT over Smartone, as the former is an integrated telecom service provider with c.65% fixed-line business revenue exposure, as opposed to Smartone being a pure mobile play.

We expect the competitive environment in the mobile market to maintain and believe mobile roaming recovery has been largely priced in by the market and related stocks lack meaningful catalysts for further rerating. Therefore, we are downgrading Smartone to HOLD and maintaining our HOLD rating for Hutchison Telecom.

Historical rolling dividend yields (%)



Source: Thomson Reuters, DBS HK

HKBN (1310 HK, BUY). We lifted our adjusted free cash flow (AFF) forecasts by 7%, 7%, and 6% for FY8/24-FY8/26 respectively, on higher residential broadband and enterprise business assumptions. We expect AFF to grow by 3.1%, 9.6% and 6.4% for FY8/24-FY8/26 respectively. We maintain our BUY call with a new TP of HK\$5.7 (previously HK\$5.5) for its attractive dividend yield of 12% with an ARR CAGR of 6.3% in FY8/23-FY8/26. Our TP is based on dividend discount model (DDM) and assumes 9.9% cost of equity and 1% terminal growth rate.

HKT (6823 HK, BUY). Our AFF forecast is unchanged. We expect AFF to grow by 2%, 4%, and 4% for FY23, FY24, and FY25, respectively. We maintain our BUY call with TP of HK\$13.1 (unchanged) for its attractive dividend yield of c.9% with stable AFF growth y-o-y of c.3% in the next few years. Our TP is based on DDM, assuming cost of equity of 7.2% and 1% terminal growth rate.

SMT (315HK, HOLD). We have cut our earnings forecasts by 9%, 11%, and 12% for FY6/24, FY6/25 and FY6/26, respectively, to reflect lower ARPU assumptions due to the intensifying competition environment and higher cost of inventories and services assumptions. We forecast earnings to grow by 73.7%, 9.8%, and 9.6% in FY6/24, FY6/25 and FY6/26, respectively. While the company is currently trading at an c.8% dividend yield, we downgrade the stock to HOLD as (1) we believe the positive impact from mobile roaming recovery has been largely priced in and (2) we expect the competitive environment in mobile market to maintain, and the stock lacks a catalyst for further rerating. Our revised TP of HK\$4.2 (lowered from HK\$7.1) is based on 10x FY26/24 PE (lowered from 15x), 1SD below its historical average.

Hutchison Telecom (215 HK, HOLD). We lifted earnings forecasts by 82%, 9%, and 26% for FY23-FY25, on higher interest income assumptions (offsetting the lower ARPU assumptions due to the competitive environment in mobile market). We forecast earnings to grow by HK\$234m to turn positive at HK\$76m in FY23, and to grow by 127% and 67% in FY24 and FY25, respectively. We maintain our HOLD rating with a lower TP of HK\$1.0 (previously HK\$1.2), which is based on sum of the parts: (1) HK\$0.1 per share for the mobile business at 10x FY24 PE (lowered from 15x FY24 PE as we believe the positive impact from mobile roaming recovery has been largely priced in and expect the competition environment to maintain), in line with the target multiple for its major peer, and (2) net cash of HK\$0.8 per share.

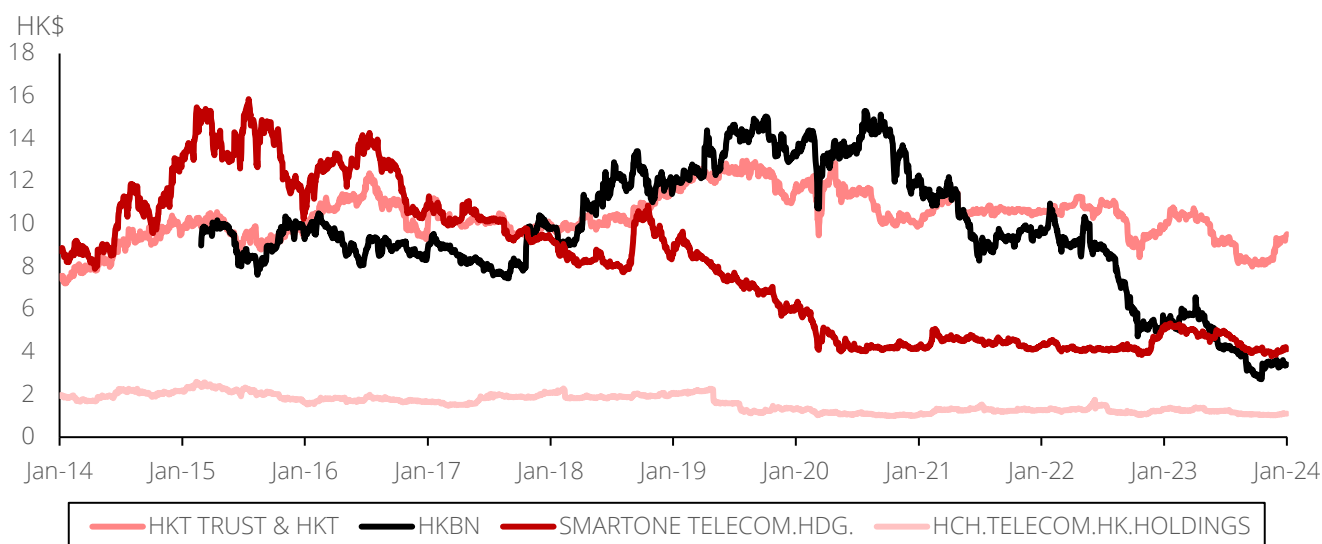
Hong Kong Telecom Sector

Price Performance

	1-wk	2-wk	1-mth	2-mth	3-mth	6-mth	1-yr	YTD
HKT Trust (6823 HK)	(1.3)	1.2	5.1	13.8	12.7	1.5	(6.3)	(3.7)
HKBN (1310 HK)	(7.2)	1.2	(1.8)	5.0	14.3	(18.6)	(34.8)	(33.2)
SmarTone (315 HK)	0.0	2.7	5.6	5.6	1.0	(17.4)	(20.2)	(12.5)
Hutchison Telecom (215 HK)	(1.8)	3.8	5.8	4.8	2.8	(9.8)	(16.7)	(9.8)

Source: Thomson Reuters

Relative Performance



Source: Thomson Reuters

Peers comparison

Company Name	Code	Currency	Target			Mkt Cap	Fiscal	PE Yr	PE Yield				P/Bk				ROE	
			Price Local\$	Price Local\$	Recom				23F	24F	23F	24F	23F	24F	23F	24F	23F	24F
HKT Trust*	6823 HK	HKD	9.52	13.10	BUY	9,227	Dec	14.6	14.5	8.0	8.3	2.1	2.1	8.6	8.5	13.8	14.3	
Hutchison Telecom*	215 HK	HKD	1.1	1.00	HOLD	678	Dec	70.1	31.0	6.8	6.8	0.5	0.5	1.4	0.7	0.7	1.7	
Smartone*	315 HK	HKD	4.13	4.20	HOLD	583	Jun	17.0	9.8	7.7	8.0	0.9	0.9	1.4	1.2	5.3	9.1	
HKBN*	1310 HK	HKD	3.41	5.70	BUY	572	Aug	n.a.	38.6	11.7	12.1	1.5	1.7	6.3	5.8	(31.8)	4.1	

FY23: FY24; FY24: FY25

Source: Thomson Reuters, *DBS HK

Hong Kong Telecom Sector

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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Hong Kong Telecom Sector

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