Telecommunications Sector Outlook: Slow and steady growth

Pricing competition has subdued. According to both PLDT and Globe, pricing pressure has subdued in 2013 and we expect this to continue in 2014, especially as both PLDT and Globe are looking to offer longer duration and higher denominated pricing points. This should allow average revenue per unit to remain stable and wireless revenues to grow, albeit slightly. For 2014E, we forecast service revenues to grow by around 1.3%.

Postpaid still has room to grow. The postpaid segment still has room to grow especially as Filipinos become more affluent. One of the key drivers for the segment's growth is the BPO sector which is expected to create 372,000 additional jobs by 2016. As of 9M13, total postpaid subscribers have reached 4.3Mil, up by 12% from the same period last year. According to Globe, it expects to double its postpaid subscribers in the next 4-5 years. However, the increase in postpaid subscribers comes at the cost of higher subsidy and re-contracting expenses.9M13 subsidy expenses of Php11.3Bil increased by 41% from the same period last year.

Broadband revenues should also continue to grow in 2014, as a result of the increase in postpaid subscribers and the availability of more affordable smartphones. During 9M13, broadband revenues grew by 22%. We expect this trend to continue as both telecommunication providers push more internet browsing and broadband offerings to their subscribers. We forecast that aggregate broadband revenues to grow by 16% in 2014.

Completed modernization programs to reduce costs. We expect both telcos to experience an improvement in service quality and lower cost as PLDT continues to integrate Digitel and as Globe completes the last stages of its modernization program. TEL expects to co-integrate around 800 Sun Cellular sites and save Php8Bil in capex. On the other hand, Globe expects to complete its IT transformation in 2014 and save US$388Mil in capex and US$180Mil in operating expenses after completing all the phases in the modernization program.

Upcoming third player not yet a concern. ABS Mobile recently launched its sim cards, aiming to attract the market that watches ABS-CBN related shows and movies. ABS will provide their content such as soap operas, old movies and other shows for free to subscribers, and will profit from mobile browsing data usage as subscribers watch shows on the go. Although ABS' business model seems attractive, we doubt whether ABS will make a dent on the telecommunication industry given that its content is still viewable over WI-FI connection, and it has yet to launch post-paid sims (note that post paid subscribers are heavier broadband users). Finally, ABS is just leasing network capacity from Globe. We believe that it is still too early for ABS to be a threat to the duopolistic industry.

TEL is our top pick. We continue to like both and PLDT and Globe as profitability should improve as both enjoy higher revenues and lower costs. However, TEL is our top pick for the sector due to valuation. Based on our FV estimate of 3,260/sh for TEL, capital appreciation remains substantial at 20% while at the same time dividend yield is at 6.6%, a premium to the 10-year government yield of 3.6%.

We currently have a HOLD rating Globe as the stock is trading at par with our fair value estimate of 1,470/sh.

SHARE DATA

Rating	**BUY**
Ticker	TEL
Fair Value (Php)	3260.00
Current Price	2700.00
Upside (%)	20.74

Rating	**HOLD**
Ticker	GLO
Fair Value (Php)	1470.00
Current Price	1710.00
Upside (%)	-14.04

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Investment Rating Definitions

BUY	HOLD	SELL
Stocks that have a **BUY** rating have attractive fundamentals and valuations, based on our analysis. We expect the share price to outperform he market in the next six to twelve months.	Stocks that have a **HOLD** rating have either 1.) attractive fundamentals but expensive valuations; 2.) attractive valuations but near term earnings outlok might be poor or vulnerable to numerous risks. Given the said factors, the share price of the stock may perform merely inline or underperform the market in the next six to twelve months.	We dislike both the valuations and fundamentals of stocks with a **SELL** rating. We expect the share price to underperform in the next six to twelve months.

Important Disclaimers

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