

FPT TELECOM JSC (UPCOM: FOX)

Initiation

January 13, 2017

Rating	BUY
Price target (VND)	78,000
Upside	46%
Cash dividend	20.0%
Dividend yield	3.70%
Stock dividend	0.0%

Stock data

Reference price (VND)	54,000
Outstanding shares	137,078,609
Market cap (Bil. VND)	7,402

A cheap member of FPT

- The third in Vietnam's telecom market in terms of market share. FOX has determined in upgrading Vietnam's internet technology from xDSL to FTTx from 2014. Aggressive investment costs have dragged the bottom line, but now they nearly come to an end.
- **Action:** Initiating coverage of **FOX with a BUY rating and** a 12-month price target of **VND 78,000**.

Financial indicators

VND billion	2014	2015	2016F	2017F	2018F
Revenue	4,825	5,568	6,692	7,542	8,542
of which					
<i>Telecom</i>	<i>3,876</i>	<i>5,192</i>	<i>6,219</i>	<i>7,020</i>	<i>7,968</i>
<i>Digital content</i>	<i>852</i>	<i>375</i>	<i>473</i>	<i>522</i>	<i>574</i>
Net profit	736	828	840	1,023	1,251
Diluted EPS (VND)	4,835	5,434	5,514	6,716	8,213
<i>Growth (%)</i>	<i>1.6%</i>	<i>12.4%</i>	<i>1.5%</i>	<i>21.8%</i>	<i>22.3%</i>
PE	11.2	9.9	9.8	8.0	6.6
ROE (%)	39.3%	34.7%	29.5%	29.8%	30.1%

(Source: FOX, MBS Research)

Investment thesis

We are initiating coverage of FPT Telecom JSC (FOX) with a BUY rating and a price target of **VND 78,000** (46% upside from the reference price) based on these following:

- **Amazing future top-line growth.** Vietnam's fixed-broadband internet subscribers enjoyed a double-digit CAGR of 17% in 2012-2016. Beyond that, given the low internet penetration by household of just 33% at the current compare with the world figure of 46.4%, there should be more room for another double-digit growth.
- **Aggressive investment period in Telecom seems coming to an end, signaling a turning point in profit.** The final costs for fiberization in Hanoi and HCMC had finished being allocated in July 2016 and PBT margin in 3Q2016 immediately widened by ~2% compare to the previous quarter. For 2017, the costs for tier-2 cities should equal to only one-third of in Hanoi and HCMC; thus, another widening of FOX's bottom line margin is foreseeable. In our opinion, 2017 net profit, thanks to that, may grow amazingly at 21.8% y-o-y.
- **Attracting price at the first day.** We expect EPS in 2016 and 2017 to be at VND5,514 and VND6,717, implying a P/E ratio of 9.8x and 8.0x at the first-day reference price, largely lower than the current P/E of VN-Index of 15.0x. FOX is so tasty – good stock with attracting valuation.

Key Risks:

Liquidity risk: SCIC and FPT's stakes in FOX total at 95.8%, leaving its free-float at maximum only 4.2% and implying its high liquidity risk.

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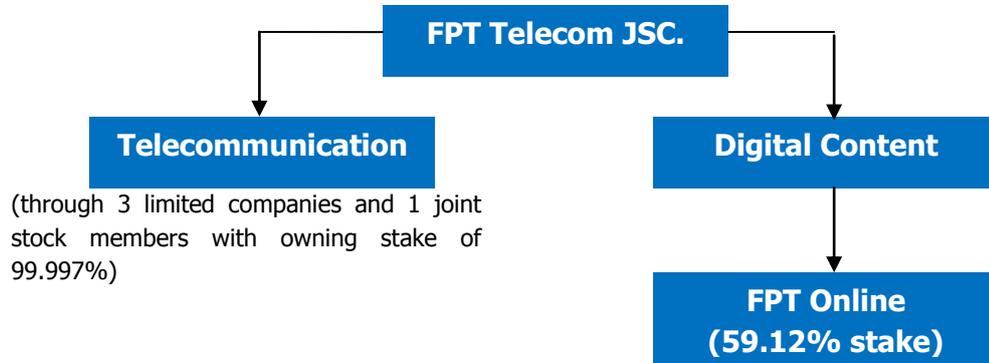
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TWO-ARMED BEAST IN TELECOMMUNICATION AND DIGITAL CONTENT

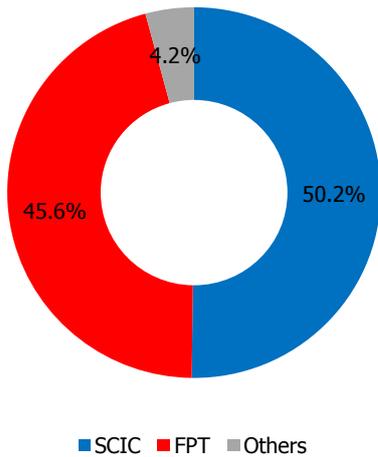
FOX is one of the members of FPT Corporation (HSX: FPT), operating in telecom (directly) and digital content (indirectly through its subsidiary FPT Online).



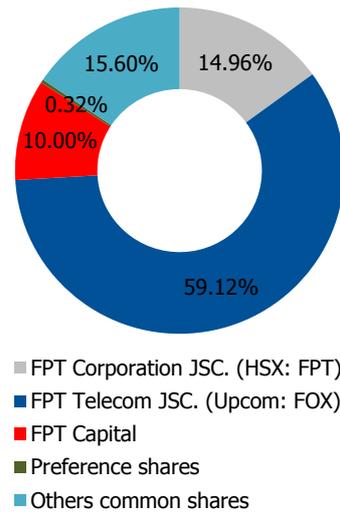
(Source: FOX, MBS Research)

Figure 1: Holdings structure

FOX's holdings structure



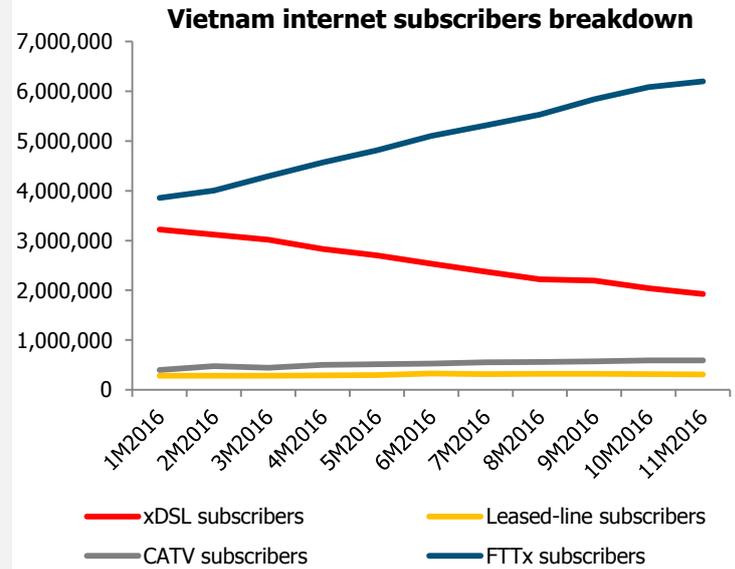
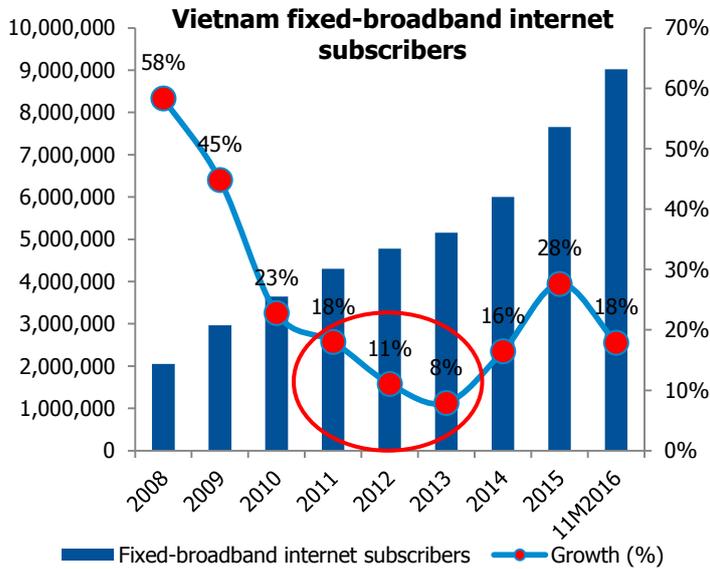
FPT Online's holdings structure



(Source: FOX, FPT Online, MBS Research)

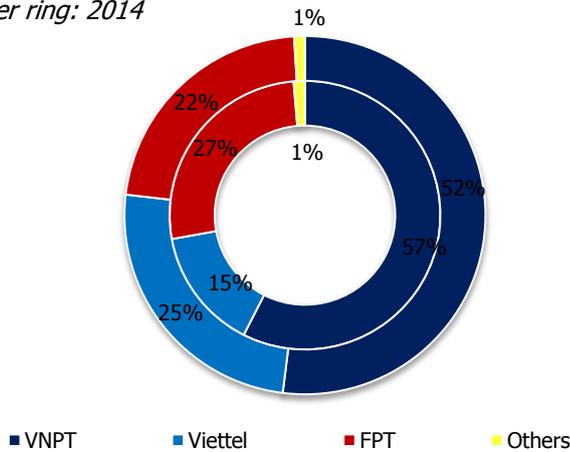
CASH IN FIBERIZATION TO ACCELERATE SUBSCRIBER GROWTH

Figure 2: Vietnam fixed-broadband internet subscribers

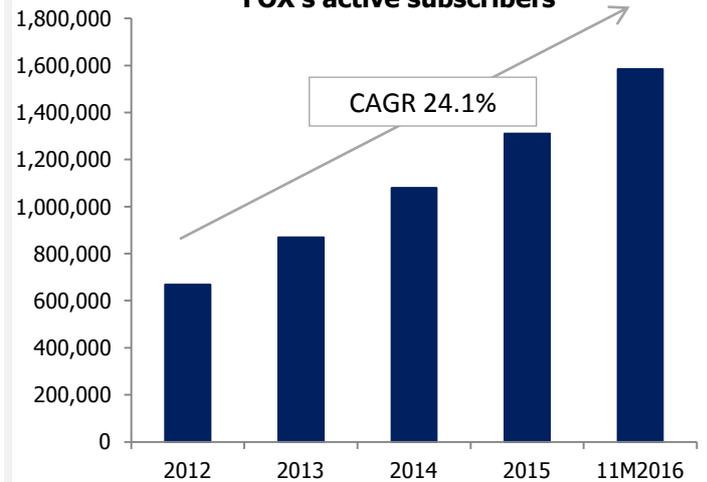


xDSL + FTTH market share

The outer ring: 2015
The inner ring: 2014

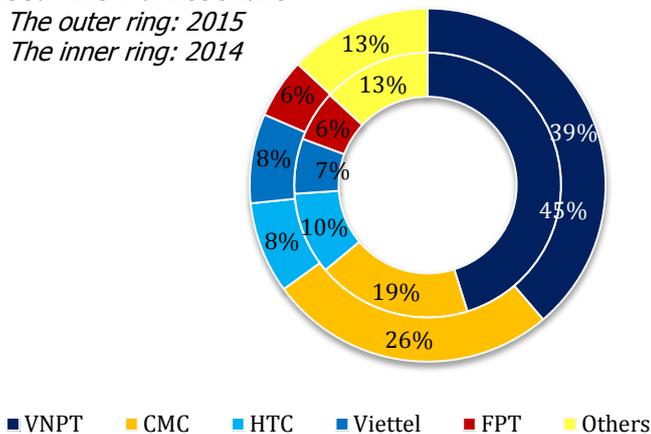


FOX's active subscribers

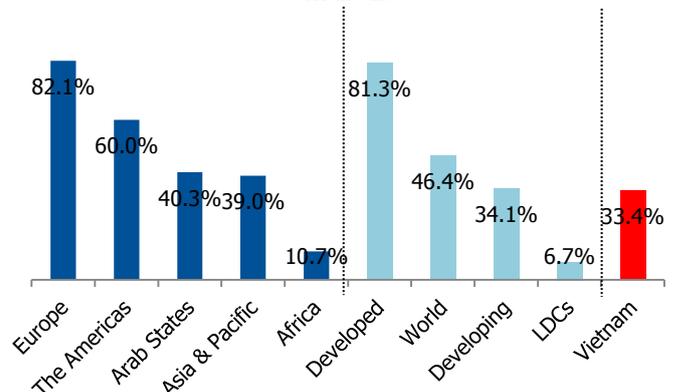


Leased-line market share

The outer ring: 2015
The inner ring: 2014



Percentage of households using internet in 2015



(Source: ICT, VNPT, FOX, MBS Research)

Vietnam’s internet subscriber number did slow down in 2011-2013 after 10 years of xDSL domination. Fiberization, thus, emerged as a key catalyst for new growth and in 2014, FOX invested in the fiberization project to swap its internet service from xDSL to FTTx, following the demand about a faster and more modern technology, similar timeline to its competitors.

After 2 years, as of November 2016, Vietnam had 9 million internet fixed-broadband subscribers, up by 18% y-t-d, mostly attributing by the amazing growth of FTTx subscribers number (VNTA’s data). About FOX, its subscribers increased by 21% as of 11M2016.

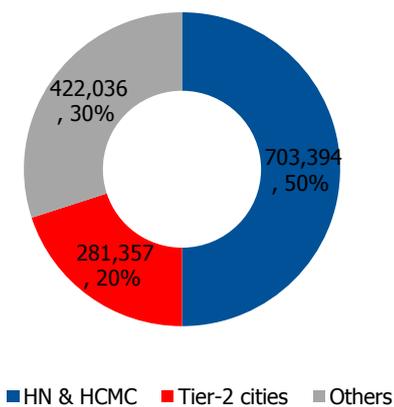
We expect this good growth to sustain in the near future considering Vietnamese households’ low internet penetration of ~33% at the current time. VNTA expects Vietnam’s fixed-broadband internet subscribers to reach 18 million by 2020, or a CAGR of 19% per annum. In our opinion, we conservatively expect the internet penetration by household at 50% by 2020 (13% CAGR), little bit lower than that of Malaysia and Brunei as of 2015 given Vietnam slower urbanization.

The likely risk for telecom companies may only be ARPU decreases following their approach to lower-income regions. In 2016, we estimate annual ARPU of FOX to be down ~4-5% y-o-y. However, the volume growth should be large enough to offset the price risk.

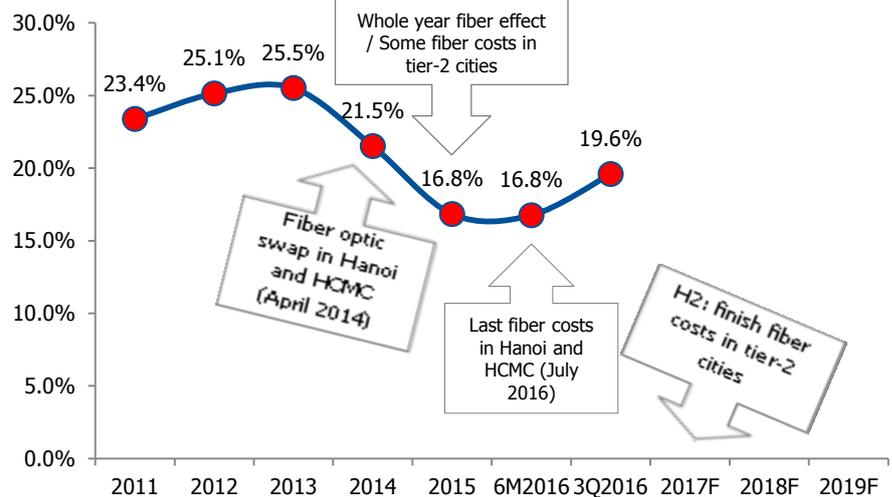
BEING IN THE HARVESTING PHASE

Figure 3: FOX’s Telecom analysis

FOX’s subscriber breakdown by geography



FOX’s PBT margin



(Source: FOX, MBS Research)

First phase of fiberization was in Hanoi and Hochiminh City starting in April 2014. Of which, the costs relating to last-mile cable and modem were allocated from April 2014 to July 2016 (27 months). The company’s margin, as such, was hurt in 2014, 2015 and in early half of 2016.

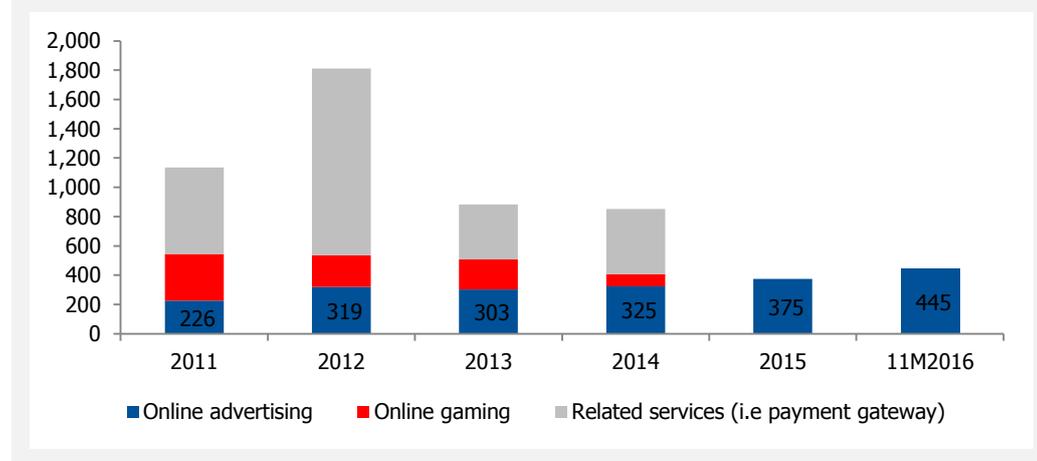
The second phase – applying for subscribers in five tier-2 cities, then, continued to be executed beginning in September 2015. We expect this second phase to finish in the late half of 2017, equivalent to the timeline of the first phase. The cost amount in the second phase is expected to be around one-third of that in the first one, given the smaller number of subscribers to be swapped. This was also the reason for the recovering margin during the second half of 2016.

We estimate the depreciation cost registering in 2016 to be ~VND400 billion, which will be down to ~VND200 billion in 2017.

FPT said that its fiberization will continue in more cities of Vietnam; however, the investment cost may be much humble comparing to the past given the smaller number of subscribers.

DIGITAL CONTENT – BETTER GROWTH AFTER DIVESTING THE ONLINE GAME

Figure 4: FPT Online's revenue (VND billion)



(Source: FPT Online, MBS Research)

Digital content is operated through FPT Online, a subsidiary of FOX. FPT Online currently owns numbers of website including VnExpress.net, Ngoisao.net, Sohoa.net, iOne, Gamethu.net, Vitalk.vn and online advertising system named eClick.

Online advertising registered a CAGR growth on revenue of 14% during 2011-2016. In 9M2016, net profit was VND141 billion, up by 52% y-o-y. Excluding the irregular financial gain from selling stake owned by FPT Online in a member company to a strategic investor the earnings also delivered an impressive 30% y-o-y growth.

Considering the demand in online advertising, which has been raised by the booming of internet, we expect a double-digit growth for FPT Online's revenue, at 10% per annum.

We would like to note that FPT Online will be soon listed in the Upcom exchange. December 25, 2016 was the last trading day on the OTC of this stock.

EARNINGS MODEL AND VALUATION

- Number of fixed-broadband internet subscribers to grow by 13% y-o-y, equivalent to the expectation growth of the industry.
- ARPU to decrease by 2-3% per annum.
- Digital content, as mention, is expected to grow at 10% per year.
- Net profit margin will likely be up following the decreasing depreciation expenses, to 13.6% in 2017 and 14.6% in later term from 12.5% at the current.

Table 1: Forecast Income Statement

Income statement (VND billion)	2013	2014	2015	2016F	2017F	2018F	2019F	2020F
Net revenue	4,302	4,825	5,568	6,692	7,542	8,542	9,496	10,383
Growth (%)	-5.7%	12.2%	15.4%	20.2%	12.7%	13.3%	11.2%	9.3%
COGS	2,182	2,597	2,919	3,560	3,946	4,402	4,893	5,350
Gross profit	2,119	2,228	2,648	3,132	3,596	4,141	4,603	5,033
Growth (%)	18.7%	5.1%	18.9%	18.3%	14.8%	15.2%	11.2%	9.3%
Margin (%)	49.3%	46.2%	47.6%	46.8%	47.7%	48.5%	48.5%	48.5%
Selling expenses	302	364	530	647	717	800	889	972
G&A expenses	867	983	1,064	1,297	1,438	1,604	1,783	1,950
EBIT	950	881	1,054	1,189	1,441	1,737	1,931	2,111
Growth (%)	12.7%	-7.3%	19.7%	12.8%	21.2%	20.6%	11.2%	9.3%
Margin (%)	22.1%	18.3%	18.9%	17.8%	19.1%	20.3%	20.3%	20.3%

Financial profit	18	39	(19)	(10)	(16)	(21)	(28)	(34)
Other profit	0	14	6	6	6	6	6	6
Profit from associates	-	(3)	-	-	-	-	-	-
EBT	969	930	1,040	1,080	1,296	1,573	1,748	1,912
Growth (%)	8.3%	-3.9%	11.8%	3.8%	20.0%	21.4%	11.2%	9.3%
Margin (%)	22.5%	19.3%	18.7%	16.1%	17.2%	18.4%	18.4%	18.4%
Net profit	725	736	828	840	1,023	1,251	1,391	1,521
Growth (%)	8.6%	1.6%	12.4%	1.5%	21.8%	22.3%	11.2%	9.3%
Margin (%)	16.9%	15.3%	14.9%	12.5%	13.6%	14.6%	14.7%	14.6%
Adjusted diluted EPS (VND per share)	4,759	4,835	5,434	5,514	6,716	8,213	9,135	9,985
Growth (%)	8.6%	1.6%	12.4%	1.5%	21.8%	22.3%	11.2%	9.3%

(Source: MBS Research)

Table 2: Forecast income statement and balance sheet

Balance sheet (VNDbn)	2013	2014	2015	2016F	2017F	2018F	2019F	2020F
Current assets	1,100	2,519	4,070	5,535	6,469	7,610	8,914	10,306
Cash & cash equivalents	349	1,056	735	1,336	1,893	2,590	3,445	4,418
S-T investment	4	12	1,066	1,066	1,066	1,066	1,066	1,066
Receivable	583	740	1,106	1,558	1,756	1,989	2,211	2,418
Inventory	119	265	506	731	811	904	1,005	1,099
Other current assets	45	446	658	857	976	1,119	1,277	1,434
Long – term assets	2,145	2,622	3,894	3,941	4,068	4,296	4,544	4,797
L-T investments	11	11	7	7	7	7	7	7
Net fixed Assets	1,689	2,175	3,150	3,197	3,324	3,552	3,800	4,053
Other L-T assets	444	436	737	737	737	737	737	737
Total assets	3,245	5,142	7,964	9,490	10,570	11,965	13,548	15,231
Total liabilities	1,582	2,776	5,208	6,093	6,488	6,960	7,472	7,946
S-T liabilities	1,582	2,730	4,703	5,633	6,072	6,589	7,146	7,664
L-T liabilities	0	46	504	460	415	371	327	282
Owners' equity	1,536	2,208	2,569	3,130	3,736	4,570	5,545	6,649
Minority interests	126	158	187	266	346	434	531	637
Total liabilities & equity	3,245	5,142	7,964	9,490	10,570	11,965	13,548	15,231
BVPS (VND per share)	15,415	17,720	18,483	22,865	27,327	33,452	40,602	48,697

(Source: MBS Research)

VALUATION

Discounted cash flow methodology

We use discounted cash flow methodology hereby FCF to value the ticker FOX. Target price is VND88,368. Assumptions are as follows:

- Forecast period starts from 2017 to 2020 before going into stable period.
- WACC is 10.5% and terminal growth rate of 0%.

Table 3: FCF Valuation method

VNDbn	2017F	2018F	2019F	2020F
FCF	869	976	1,119	1,263
WACC	10.5%			
Forecast Year	1	2	3	4
Discount factor	0.91	0.82	0.74	7.07
PV of FCF	786	800	830	8,952
Total PV of FCFF	3,264	Discount factor		
PV of Terminal value	8,104	Beta		0.68

Enterprise value	12,058	Risk – free rate	6.34%
(+) Cash & S-T investments	2,406	Cost of equity	12.7%
(-) Short and long – term debts	-2,351	Cost of debt	3.3%
Equity value (VNDbn)	12,113	WACC	10.3%
Outstanding shares (Mil. shares)	137.1		
Price per share (VND)	88,368		

(Source: MBS Research)

Comparables using P/E ratio methodology

Other telecom companies in emerging markets are trading at a relative P/E of 1.0x. Following this figure and a fair P/E of Upcom of 10x, FOX's intrinsic value is calculated at VND67,235 per share.

Table 4: Comparables

Company name	Country	Market Cap	LTM P/E	LTM P/B	LTM Relative P/E	ROA	ROE	3Y Avg sales growth
Telecom		(USDmn)						(%)
Jasmine Intl Public Co Ltd	Thailand	875	12.1	2.3	0.6	5.6	20.1	10.5
Kazakhtelecom	Kazakhstan	344	4.3	0.3	0.9	18.1	25.2	3.0
China Telecom Corp Ltd-H	China	35,563	11.5	0.8	1.1	3.4	6.8	5.5
Maxis Bhd	Malaysia	10,395	23.1	9.9	1.3	10.3	41.8	(1.3)
Median		5,635	11.8	1.5	1.0	7.9	22.7	4.2
Average		11,794	12.7	3.3	1.0	9.3	23.5	4.4
FPT Telecom JSC.	Vietnam	7,402	n/a	n/a	n/a	9.6	29.5	15.9

(Source: Bloomberg, MBS Research)

Valuation summary

Table 5: Valuation summary

Method	Weighted	Result
DCF	50%	88,368
P/E	50%	67,235
AVERAGE	100%	78,000

(Source: MBS Research)

Combining all methods, we value FOX at **VND78,000** per share, equivalent to an upside of 46% from its first reference price on Upcom of VND54,000.

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STOCK RATING: The recommendation is based on the difference between the 12-month target price and the current price:

Rating	When [(target price – current price) + dividend]/current price
BUY	>=20%
OUTPERFORM	From 10% to 20%
HOLD	From -10% to +10%
UNDERPERFORM	From -20% to -10%
SELL	<= -20%

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