nra capital

TeleChoice International Limited

Company update
12 July 2016

Overweight

Current Price	**S$0.280**
Fair Value	S$0.340
Up / (downside)	21.4%

Stock Statistics

Market cap	S$127.2m
52-low	S$0.230
52-high	S$0.300
Avg daily vol	22,907
No of share	453.43m
Free float	29.5%

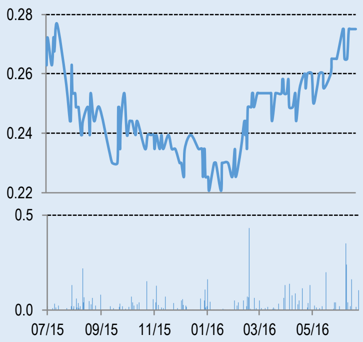
Key Indicators

ROE 16F	14.2%
ROA 16F	5.6%
P/BV	1.68
Net gearing	Net cash

Major Shareholders

STT Communications Ltd	50.5%
Leap International	19.7%

Historical Chart



Source: Bloomberg

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Recent Acquisition Reveals Growth Ambitions

- **Raising longer term growth expectations.** We decided to update on TeleChoice, having missed out on the previous 1Q16 update. We are generally heading into the 2Q16 results reporting season with muted expectations. Earnings are likely to be similar to that of 1Q16, assuming similar performance at the ICT and Engineering segments. However, our review of TeleChoice also suggests that longer term growth drivers such as media and virtual reality technology are taking shape. In turn, these growth drivers will help the company to deliver higher growth in spite of limitations imposed by existing services.

- **Existing services – operating in a mature market.** The downside for TeleChoice is that each new model introduced by its key principals are less likely to result in high growth as smart phone penetration in Singapore is relatively high and TeleChoice's exposure to the Malaysian retail market is relatively small. Within the ICT and Engineering segments, competition is relatively steep for contracts, and growth will likely come in 3Q/4Q16 when new contracts kick start.

- **Profit accretive investment** The recent acquisition of 25.19% of MVI Systems Limited has caught our attention. This investment is potentially profit accretive as implied by the condition where TeleChoice will be entitled to a larger stake of MVI if MVI does not generate a 12-month net profit of S$1.84m (or about S$0.46m accruing to TeleChoice.

- **Leveraging on new growth drivers.** MVI is promising as its products offer enhanced user experience such as "content everywhere and on every device", e.g. the delivery of content from a central point to provide continuous viewing experience from the TV to the iPad and from anywhere within a hotel. Already, MVI has been partnering with Starhub to install its products in hotels in Singapore.

- **Virtual reality to help retail business over time.** We also see potential for virtual reality technology to gain mainstream use three to five years later. Companies like Samsung are planting flags in this market with the roll out of VR headsets (to the extent of giving out free headsets for selected periods). In turn, wider availability of headsets may encourage more VR content to be generated for consumption, e.g. e-commerce via VR shops. For now, adoption will have to be driven by supply-side initiatives as users continue to rely on smartphones for productivity needs.

- **Valuation revised higher – taking a long term view.** In this update, we lowered our full year net profit forecast for TeleChoice to S$11.1m, but raised our valuation to S$0.340 based on a higher P/E multiple of 13.86x on FY16 EPS of 2.45 Singapore cents, as opposed to 2.3 Singapore cents in 2015.

Key Financial Data

(S$ m, FYE Dec)	2014	2015	2016F	2017F	2018F
Sales	516.8	580.7	589.8	610.9	632.9
Gross Profit	42.5	43.1	43.6	45.2	46.8
Net Profit	9.4	10.3	11.1	12.0	12.5
EPS (cents)	2.1	2.3	2.4	2.6	2.7
EPS growth (%)	(3.1)	9.5	7.8	8.4	3.9
PER (x)	13.6	12.4	11.5	10.6	10.2
NTA/share (cents)	12.8	13.5	14.4	14.9	15.5
DPS (cents)	1.6	1.6	1.6	1.8	2.0
Div Yield (%)	5.7	5.7	5.7	6.4	7.1

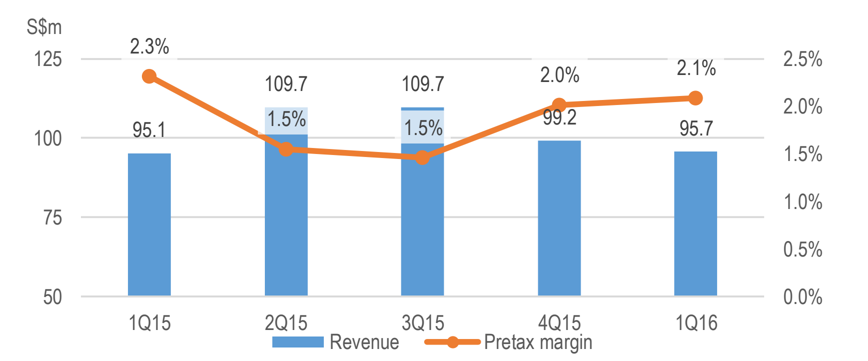
Source: Company, NRA Capital forecasts

TeleChoice International Limited

1Q16 results review. During 1Q16, TeleChoice reported a 55.4% increase in PATMI from S$0.77m in 1Q15 to S$1.2m in 1Q16. Growth was driven by the absence of S$0.41m of loss on disposal of a joint venture that was incurred in 1Q15, and lower amortisation expenses which fell from S$0.39m a year ago to S$0.15m in 1Q16. Gross profit fell by S$0.13m even as revenue rose by 6.1% year-on-year. Gross margin had fallen from 7.2% a year ago to 6.7% in 1Q16.

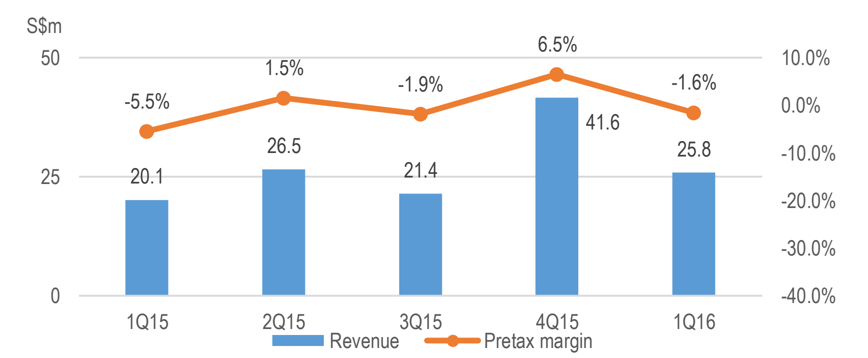
Lower margin in the engineering segment explained for results. Although the company has reported that the drop in gross margin was common across all business segments, we observed that the pre-tax margin for the Personal Communications Solutions (PCS) business has actually remained stable quarter-to-quarter at around 2% to 2.1%. Conversely, the network engineering services (Engineering) segment appears to be the hardest hit. Its pre-tax margin fell from 5.4% in 1Q15 and 7.4% in 4Q15 to 2.4% in 1Q16. As a result, profit before tax from this segment fell by S$0.3m year-on-year.

Figure 1: PCS Revenue and Pre-Tax Margin



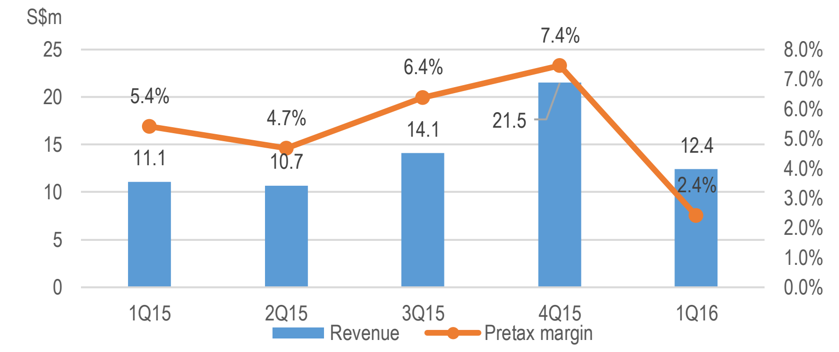
Source: Company, NRA Capital

Figure 2: ICT Revenue and Pre-Tax Margin



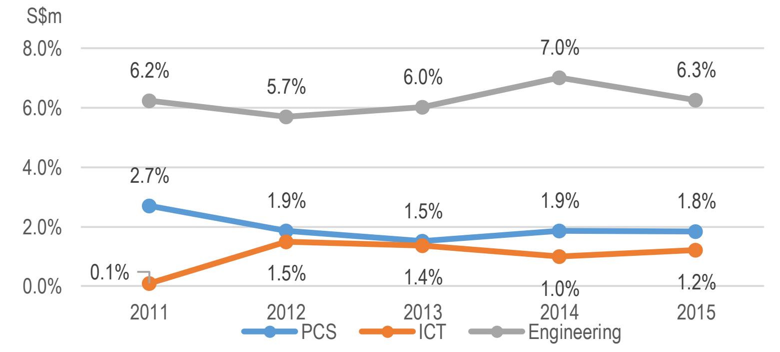
Source: Company, NRA Capital

Figure 3: Engineering Revenue and Pre-Tax Margin



Source: Company, NRA Capital

Figure 4: Pre-tax Margins, by Segments

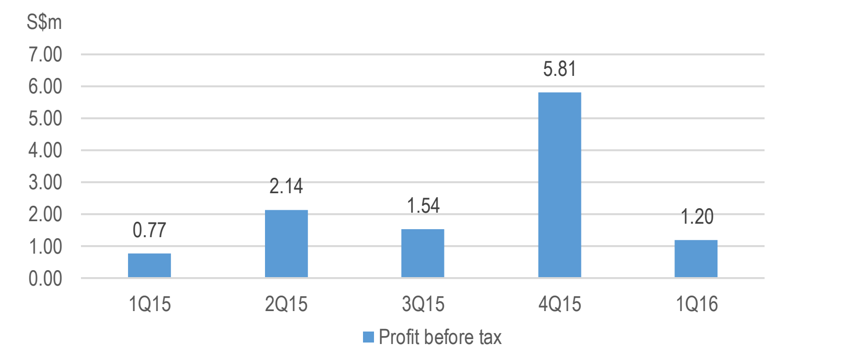


Source: Company, NRA Capital

ICT tends to perform better in 2H. The Info-Communications Technology Services (ICT) segment suffered a pre-tax loss of S$0.4m. However, we are unfazed by this loss. The ICT segment's performance is conditional on project completion and revenue recognition can be unevenly spread throughout the year. In 2015, ICT earned 38% of its revenue and pre-tax profit of S$2.7m in 4Q15 against full year pre-tax profit of S$1.3m. Therefore, the 1Q results is not fully representative of the ICT segment's performance. As shown in Figure 2, TeleChoice's margins are relatively stable year-to-year for each segment.

What to expect for 2Q16? In 2Q15, TeleChoice made S$2.1m of PATMI. For 2Q16, we can expect TeleChoice to report similar results as 1Q16, assuming that both the ICT and engineering segments will deliver similar revenue and margins quarter-to-quarter. The PCS segment may deliver better performance than that of 1Q16 due to the launch of new Samsung products (which contributed one month of revenue in 1Q16). However, year-on-year, PCS revenue will likely be lower as the new Samsung handset launch was brought forward in 2016. We reiterate that TeleChoice's quarter-to-quarter performance may not be reflective of full year results. In 2015, TeleChoice made S$10.3m of PATMI, of which S$5.8m was earned in 4Q15.

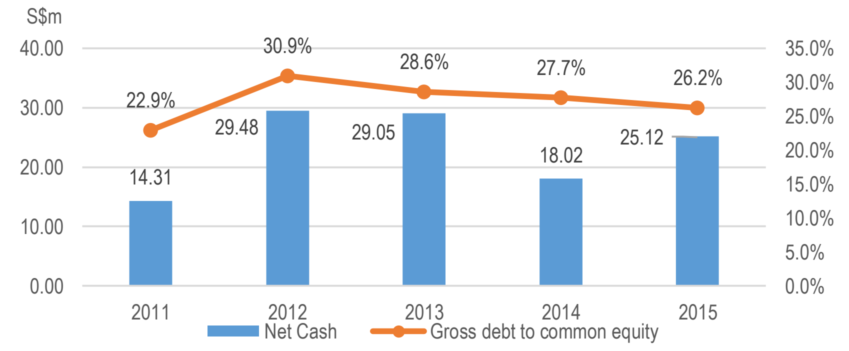
Figure 5: Group Quarterly PATMI



Source: Company, NRA Capital

But dividends should remain intact, supported by strong balance sheet. TeleChoice has maintained annual dividend at 1.6 Singapore cent per share since 2011 or approximately S$7.3m per year even when PATMI was S$6.6m then. As of end 1Q16, TeleChoice remained in a net cash position of S$10.3m. Negative net operating cash flow of S$13.7m, mainly due to S$16.5m of cash out flow incurred in working capital. On an annual basis, TeleChoice has enjoyed total positive net operating cash flows of S$73.0m since 2011 to 2015. From this perspective, TeleChoice's dividend payment is not at risk, with the option of leveraging its balance sheet for cash.

Figure 6: Net Cash, Gross Debt to Common Equity



Source: Company, NRA Capital

Planting the seeds for future growth. What catches our attention is TeleChoice's recent acquisition of 25.19% of MVI Systems Limited for HK$11.64m (S$2.03m) as announced on 16 May 2016. MVI has a negative net tangible asset of HK$7.0m as of 31 March 2016. However, this investment is potentially profit accretive to TeleChoice. The consideration per MVI share is conditional upon MVI's average 12-month net profit after tax being HK$10.57m (S$1.84m) during the 24-month period from completion in May 2016. For TeleChoice's 25.19% stake, this translates to contribution of S$0.46m to the company.

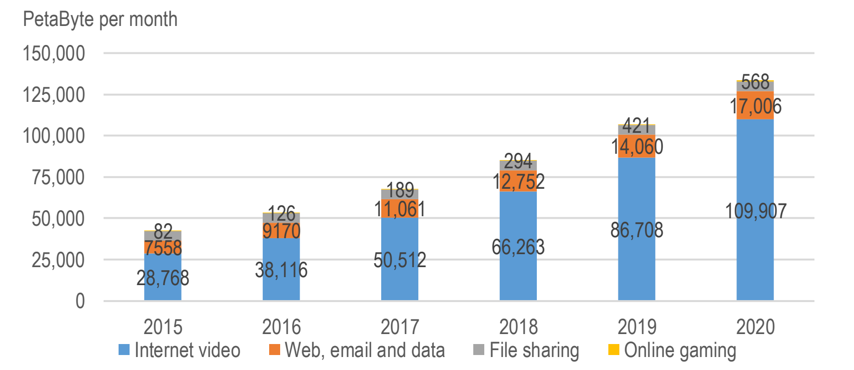
If MVI's net profit after tax falls below HK$10.57m, TeleChoice will be able to increase its stake in MVI. If MVI performs poorer than expected or turns out to be loss making over the next 24 months, we reckon that TeleChoice will be able to gain majority control over MVI at a low cost of S$2.03m.

Leveraging on interactive media growth. The interesting part about MVI is actually its IP video gateway that allows hotels and multi-dwelling unit operators to offer high quality video services to end customers. So-called high quality video services typically refer to high definition video ("HD") that may come with enhanced features such as "content everywhere and on every device", multi-language subtitles, advertisements and in-screen real time comments by users, etc.

MVI does not disclose its technology in detail. However, we understand that interactive features can be inserted into original media content by segmenting the large media file into smaller parts for the insertion of ads and by utilizing additional "streams" over the audio and video data streams.

The crux of the issue is that interactive video viewing, including the viewing of the same content across multiple devices and the insertion of complementary media or information, will become more common as systems adapt to emerging trends such as consumers holding on to multiple devices.

Figure 7: Global Consumer Internet Traffic



Source: Cisco VNI 2015-2020, NRA Capital

As shown in Figure 7, internet video is expected to grow at a rate of 31% CAGR globally, to make up for 82% of total internet traffic by 2020, as opposed to 68% in 2015. Hence, demand for media delivery solutions like those MVI can be expected to increase with internet video occupying a larger share of internet traffic.

Consumers will get increasingly used to and demand for interactive HD content. In Singapore, the mainstream media has been transmitting high definition free-to-air channels in digital format since December 2013 and the roll out of high definition broadcast is expected to be completed by end 2016. MediaCorp will cease to broadcast the existing analogue TV signals by end 2017. The implication of this move is that slow adopters of high definition TV sets will likely purchase one the next time they buy a TV, and consumers will become increasingly be used to viewing feature rich content in high definition (even on their computer screens in the future).

Figure 8: MediaCorp Digital TV broadcast rollout as of 15 June

Source: http://www1.mediacorp.sg/digitaltv/

Collaboration and cross-selling synergies. Existing clients of MVI include hotels in Hong Kong and China, as well as hotels in Singapore such as The Mandarin Orchard Hotel, The Fullerton Hotel and the Fullerton Bay Hotel. In hotels in Hong Kong and China, MVI has worked with IBM, while MVI works with Starhub for projects in Singapore. Hence, the relationship between Starhub, MVI and TeleChoice becomes obvious. TeleChoice runs the Starhub retail stores in Singapore, making revenue from equipment sales and line activations.

Some of the recent related initiatives by Starhub for its Pay TV customers include

1) the “HubLife” internet of things trail and

2) support for full HD Netflix content.

TeleChoice is able to extract synergies out of this investment in MVI by cross selling its unified communication services with that of MVI and vice versa. As such, both companies will be able to share clients in their respective industry. One obvious target is MVI’s access to the hospitality industry.

Virtual Reality – a longer term driver. On the other hand, PCS is a major revenue and earnings driver for TeleChoice. However, the outlook for this sector is less exciting based on line activations and handset sales alone. The mobile market in Singapore is saturating with more than 100% mobile line penetration. In previous years, the transition from feature phones to smart phones have benefited TeleChoice who also distributes Samsung, Huawei, LG, Sony and OPPO handsets.

More recently, Samsung has started selling virtual reality headsets or VR gear and 360 degree cameras for the recording of virtual reality videos. The adoption of VR headsets is slower than that of smart phones. This is because current use of VR technology remains substantially in the realm of entertainment. Most software and applications that Samsung has bundled with VR are for gaming purposes. In a slower economy, consumers will likely be more cost conscious and be less willing to spend on new gadgets. To encourage adoption, Samsung has relied on bundling strategies such as giving out free VR headsets to new mobile phone purchasers for a limited time.

To conclude, we can expect rising consumption of media to help drive demand for TeleChoice's ICT services via collaborations with companies such as MVI. Solutions that enhance the media viewing experience, such as the addition of new features will help to create opportunities for TeleChoice. The PCS segment will slow as a growth contributor, but will provide upside from the sale of devices such as VR headsets once adoption crosses critical mass. These two trends and opportunities, media followed by VR technology at a later stage, suggest longer term potential for TeleChoice to deliver growth and raise dividends, thus unlocking value.

Valuation and Recommendation. TeleChoice's peers trade at 7.1x P/E to 21.08x P/E (average of 13.86x) based on data extracted on 7 July 2016. The larger network operators such as Starhub trade at 15.08x to 17.21x P/E. In terms of return on equity and yield, TeleChoice is clearly more profitable than its peers and provides a healthy yield of about 5.7%. We decided to peg our valuation of TeleChoice at the peer average of 13.86x, translating to a valuation of S$0.340 per share based on forecast net profit of S$11.1m in 2016. Based on the current share price of S$0.28, our valuation translates to a healthy upside of 21.4%. While TeleChoice has kept dividend per share flat over the last five years, we are of the view that longer term catalysts such as the growth of IP TV and Internet of Things in the home environment and the gradual adoption of VR technology will help to drive growth and support longer term dividend yield expansion.

Figure 9: Peer Comparison Table*

Company Name	Mkt Cap (S$m)	P/E	P/BV	ROE	1-YR EPS Growth	Total Debt to Equity	Dividend Yield
Nera Telecommunications Ltd	247.90	19.94	4.20	20.2%	-17.4%	29.1%	5.2%
CSE Global Ltd	227.10	7.10	0.95	13.7%	-6.4%	23.0%	6.3%
Declout Ltd	137.35	21.08	1.42	7.7%	100.0%	55.4%	NA
Addvalue Technologies Ltd	45.91	NA	3.14	-44.4%	23.1%	59.3%	NA
Captii Ltd	15.66	7.30	0.49	7.7%	18.4%	0.0%	5.1%
CMC Infocomm Ltd	7.14	NA	NA	-6.9%	NA	0.0%	NA
Service providers	**113.51**	**13.86**	**2.04**	**-0.3%**	**23.5%**	**27.8%**	**5.5%**
M1 Ltd/Singapore	2,547	15.08	5.95	39%	1.1%	85.6%	5.4%
StarHub Ltd	6,486	16.70	23.24	154%	0.0%	366.5%	5.3%
Singapore Telecommunications Ltd	66,166	17.21	2.67	16%	2.4%	39.8%	4.2%
Network operaters	**25,067**	**16.33**	**10.62**	**69.6%**	**1.1%**	**164.0%**	**5.0%**
TeleChoice International Ltd	124.71	11.28	1.59	14.3%	9.7%	26.2%	5.7%

*Extracted on 7 July. *Source: Bloomberg, NRA Capital*

TeleChoice International Limited

Profit & Loss (S$ m, FYE Dec)	**2014**	**2015**	**2016F**	**2017F**	**2018F**
Revenue	516.8	580.7	589.8	610.9	632.9
Operating expenses	(501.8)	(565.1)	(573.8)	(594.5)	(615.9)
EBITDA	15.0	15.5	16.0	16.5	17.0
Depreciation & amortisation	(3.4)	(2.9)	(2.6)	(2.6)	(2.6)
EBIT	11.6	12.6	13.4	13.9	14.4
Net interest & invt income	(0.2)	0.2	(0.2)	0.4	0.5
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Exceptional items	0.0	(0.6)	0.0	0.0	0.0
Pretax profit	**11.4**	**12.2**	**13.2**	**14.3**	**14.9**
Tax	(2.2)	(2.1)	(2.4)	(2.6)	(2.7)
Minority interests	0.2	0.2	0.2	0.2	0.2
Net profit	**9.4**	**10.3**	**11.1**	**12.0**	**12.5**
Shares at year-end (m)	454.4	454.4	454.4	454.4	454.4

Balance Sheet (S$ m, as at Dec)	**2014**	**2015**	**2016F**	**2017F**	**2018F**
Fixed assets	3.3	3.7	4.2	4.6	5.1
Intangible assets	14.0	13.0	12.3	11.7	11.1
Other long-term assets	7.0	7.7	8.2	8.6	9.2
Total non-current assets	**24.3**	**24.4**	**24.7**	**25.0**	**25.4**
Cash and equivalents	38.0	44.6	45.8	48.1	46.0
Stocks	32.7	51.3	52.2	54.0	56.0
Trade debtors	91.7	73.6	74.8	77.4	80.2
Other current assets	0.0	0.0	0.0	0.0	0.0
Total current assets	**162.4**	**169.5**	**172.7**	**179.5**	**185.7**
Trade creditors	85.6	89.3	92.8	96.2	99.6
Short-term borrowings	20.0	14.5	8.8	9.2	9.5
Other current liabilities	5.8	5.8	7.2	7.4	7.5
Total current liabilities	**111.4**	**109.6**	**108.9**	**112.7**	**116.6**
Long-term borrowings	0.0	5.0	5.9	6.1	6.3
Other long-term liabilities	3.1	5.1	4.9	4.6	4.4
Total long-term liabilities	**3.1**	**10.1**	**10.8**	**10.7**	**10.7**
Shareholders' funds	**72.1**	**74.2**	**77.9**	**79.3**	**81.5**
Minority interests	0.2	0.0	(0.2)	(0.5)	(0.7)
NTA/share (S$)	0.13	0.13	0.14	0.15	0.15
Total Assets	**186.7**	**193.9**	**197.3**	**204.5**	**211.1**
Total Liabilities + S'holders' funds	**186.7**	**193.9**	**197.3**	**204.6**	**211.1**

Cash Flow (S$ m, FYE Dec)	**2014**	**2015**	**2016F**	**2017F**	**2018F**
Pretax profit	11.4	12.2	13.2	14.3	14.9
Depreciation & non-cash adjustments	1.9	10.2	3.7	2.6	2.6
Working capital changes	(10.0)	3.7	2.4	(1.0)	(1.0)
Cash tax paid	(1.9)	(1.3)	(1.0)	(2.4)	(2.6)
Cash flow from operations	**1.4**	**24.7**	**18.2**	**13.6**	**13.9**
Capex	(3.0)	(2.3)	(3.1)	(3.1)	(3.1)
Net investments & sale of FA	0.0	(5.9)	0.0	0.0	0.0
Others	(1.3)	(0.3)	(0.5)	(0.6)	(0.6)
Cash flow from investing	**(4.3)**	**(8.4)**	**(3.6)**	**(3.7)**	**(3.7)**
Debt raised/(repaid)	0.1	(0.5)	(4.7)	0.5	0.5
Equity raised/(repaid)	(0.2)	0.0	0.0	0.0	0.0
Dividends paid	(7.3)	(7.3)	(7.3)	(7.3)	(8.2)
Cash interest & others	(0.6)	(1.9)	(1.4)	(0.9)	(0.9)
Cash flow from financing	**(8.0)**	**(9.7)**	**(13.4)**	**(7.6)**	**(8.5)**
Change in cash	**(10.9)**	**6.6**	**1.2**	**2.3**	**0.8**
Change in net cash/(debt)	**(11.0)**	**7.1**	**5.9**	**1.7**	**0.2**
Ending net cash/(debt)	**18.0**	**25.1**	**31.0**	**32.8**	**29.8**
Cash Flow (S$ m, FYE Dec)	**2014**	**2015**	**2016F**	**2017F**	**2018F**

KEY RATIOS (FYE Dec)	**2014**	**2015**	**2016F**	**2017F**	**2018F**
Revenue growth (%)	(7.1)	12.4	1.6	3.6	3.6
EBITDA growth (%)	2.2	3.7	2.8	3.2	3.2
Pretax margins (%)	2.2	2.1	2.2	2.3	2.4
Net profit margins (%)	1.8	1.8	1.9	2.0	2.0
Effective tax rates (%)	19.3	17.6	18.0	18.0	18.0
Net dividend payout (%)	77.6	70.9	65.8	73.0	73.0
ROE (%)	13.0	13.8	14.2	14.1	15.0
Free cash flow yield (%)	(1.3)	17.6	11.9	8.2	8.5

Source: Company, NRA Capital forecasts