

19 September 2012

REDtone International

A turnaround story in the making?

Redtone, a stock that used to be one of investors' favourite stocks in its heydays, is expected to show a turnaround should the Maxis factor comes into the picture. The company is expected to receive a handsome recurring income from Maxis following the signing of an infra and spectrum sharing agreement. While Redtone is reluctant to elaborate on the quantum, we project the company could receive a total recurring income of RM295m over the next 10 years. This will boost its FY13 net profit to RM21.1m (~10 folds YoY) followed by RM24.5m (+16% YoY) in FY14. Under such a scenario, we believe the group's fair value should be pegged at RM0.50 based on a targeted FY13 PER of 11.4x. However, Redtone's existing businesses are expected to continue to underperform in the next few financial years due to persisting high operation costs and stiff competitions. As such, without the Maxis factor and solely based on its existing businesses, we would have valued Redtone at RM0.18, similar to the group's latest net asset per share.

Some cost savings but The group's prior poor financial performances were partially contributed by its non-core and loss-making subsidiaries. Followed the completion of the divestment of a number of its non-core and loss-making subsidiaries, Redtone's total SG&A expenses are expected to be lower by 10% YoY to RM36.0m in FY13. To recap, the sold divisions accounted for about 11% of the group's FY12 total SG&A cost of RM39.9m with barely any contribution to the top line. Going forward, the group's FY13 bottom line however, is still expected to underperform due to persisting high operating costs and stiff competitions. We expect Redtone to narrow its net loss to RM3.2m in FY13 from RM8.7m core net loss (ex-deconsolidation gain of RM10.9m) a year ago, based on the existing businesses.

Riding on Maxis networks. The recent infra and spectrum sharing agreement ("NSA agreement") signed by Redtone and Maxis is expected to benefit both parties. The combined spectrum will allow both companies to offer the fastest 4G broadband speed across the country of up to 150Mbps. While Maxis is expected to benefit from the enlarged spectrum capacity, Redtone on the other hand is expected to have significant cost-savings on capex of about RM390m.

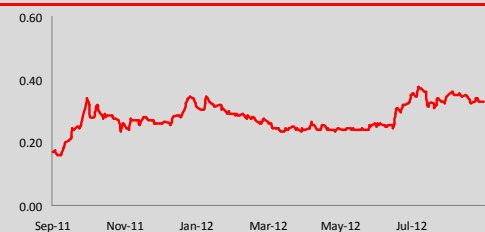
The "Maxis factor". The NSA agreement will allow both parties to maximise the usage of the scarce combined 2.6GHz spectrum, albeit the respective AA (Apparatus Assignment) for the 4G spectrum have yet to be assigned by MCMC. In return, Maxis will pay Redtone an upfront payment in FY13 followed by a series of payments over the next 10 years. We understand that management is expecting the recurring income (from Maxis) to boost its financial performance significantly. Although Redtone is reluctant to divulge the exact quantum, we project that Maxis could be value Redtone's 4G spectrum at RM295m based on our observation (please refer the inside of this report for more details).

Valuation. In view of the company's bottom line still expected to post a loss in FY13, Redtone is likely to be fairly valued at its net asset per share of RM0.18. Nevertheless, **should we include the "Maxis factor" into our financial model; Redtone's FY13 is expected to record a net profit turnaround of RM21.1m. This will provide a strong rerating catalyst for the stock and raise our Redtone target price to RM0.50 based on a targeted FY13 PER of 11.4x.**

NON-RATED

Price: RM0.33
Target Price: RM0.18/RM0.50

Share Price Performance



KLCI	1,640.33
YTD KLCI chg	7.2%
YTD stock price chg	17.9%

Stock Information

Bloomberg Ticker	RIB MK Equity
Market Cap (RM'm)	157.8
Issued shares	478.3
52-week range (H)	0.38
52-week range (L)	0.15
3-mth avg daily vol:	2,945,114
Free Float	48%
Beta	1.1

Major Shareholders

INDAH PUSAKA S/B	32.7%
BERJAYA GROUP	10.4%
BERJAYA CORP	9.5%

Summary Earnings Table

FYE May (RM'm)	2012A	2013E	2014E
Turnover	107.0	111.3	116.3
EBIT	4.0	(2.2)	(1.8)
PBT	3.2	(2.8)	(2.3)
Net Profit (NP)	2.1	(3.2)	(2.5)
Core NP	(8.7)	(3.2)	(2.5)
Consensus (NP)	-	-	-
Earnings Revision	-	-	-
EBITDA Margin	11.5%	5.8%	6.2%
Core EPS (sen)	-1.8	-0.7	-0.5
EPS growth (%)	31.2	63.5	20.6
DPS (sen)	-	-	-
NTA/Share (RM)	0.2	0.2	0.2
Core PER	N.M.	N.M.	N.M.
Reported PER	71.0	N.M.	N.M.
Price/NTA (x)	1.7	1.8	1.9
Net Gearing (%)	(0.2)	(0.2)	(0.2)
Dividend Yield (%)	0.0	0.0	0.0

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Deconsolidation gain of RM10.9m in FY12. The group has divested its entire stake in Redtone Software S/B in 3Q12 followed by an 80% interest in Redtone Multimedia S/B (which previously was a wholly-owned company) in 4Q12 on top of its 65% divestment in Redtone Mobile S/B during 1Q12. The successful removal of these unprofitable businesses have led the group to record an exceptional gain of RM10.9m in FY12, raising the full year reported net profit to RM2.1m as opposed to a net loss of RM11.7m a year ago. Although the group still recorded a core net loss of RM8.7m in FY12 (ex-deconsolidation gain of RM10.9m), the bottom line number has shown a 25.6% improvement on a year-on-year basis.

Current tender book stood at RM700m. Redtone has tendered total contracts that worth RM700m thus far, of which RM500m is tender for the T3 project (the universal service provider project under MCMC to provide data in the rural areas in Malaysia). We understand that MCMC is likely to segregate the above mentioned project to few parties given the sizeable of the project value and management believe they will be one of the front runners to the project due to its industry knowledge expertise. For prudence, we, however, have yet to impute any potential project received from its tender book into our financial model.

Price of Redtone's 4G spectrum. IDA (Info-Communications Development Authority) Singapore has lately issued a consultation paper in April 2012. The key purpose of the consultation paper was to consult members from the industry and the public on the parameters for the reallocation of the 2.3GHz and 2.5GHz spectrums for 4G telecommunication services in Singapore. Based on the paper, IDA would determine the reserve price for each spectrum lot closer to the date of the auction.

To arrive at the reserve price, IDA considers estimates of the market value of the relevant spectrum bands, which include international benchmarks reflective of the value of these bands. IDA has noted the following table valuations in spectrum auctions were recently concluded in the region, which we believe is likely to be used as a benchmark when Singapore authority determines the reserve price.

Recent spectrum valuations auctions concluded in the region

Date	Country	Spectrum (MHz)	Band	Price	*Price @ (RMm)	Per MHz (RMm)	20 MHz (RMm)
Feb-12	HK	90	2.3 GHz	HKD470m (S\$75m)	188	2.1	42
Feb-12	Switzerland	575	800Mhz, 900 MHz, 1800 MHz, 2.1 GHz and 2.5 GHz	CHF 996m (S\$1.4b)	3,500	6.1	122
Sep-11	France	140	2.5 GHz	EUR936m (S\$1.5b)	3,750	26.8	536
Aug-11	Korea	20	1.8 GHz	KRW995b (S\$1.1b)	2,750	137.5	2,750
Jan-09	HK	90	2.5 GHz	HKD1.5b (S\$240m)	600	6.7	133
Simple Average						11.8	236
Simple Average - Asia						17.7	354

*Based on RM1 = RM2.50 exchange rate

Source: Singapore's IDC, Kenanga Research

Based on the above valuations, the average price for the 20MHz spectrum was set at between RM236m-RM354m. We believe that local telco companies may likely take the above valuation into their consideration when they enter into any collaboration with their peers in the future. While management is reluctant to further elaborate on the quantum (i.e. upfront fee and recurring income) of its 4G spectrum that it may receive from Maxis, we project that the fee is likely to come in within the abovementioned valuation range. We have projected a total of RM295m (average of the RM236m-RM354m range) in 4G spectrum fee that Redtone will likely receive from Maxis over the next 10 years into our financial model together with a 5% upfront fee (or RM15m) that it may receive in FY13. Should this scenario happen, this will boost Redtone's net profit significantly to RM21.1m in FY13 (vs. the +RM2.1m in FY12 and -RM3.2m in FY13 based on just the existing businesses) and will also serve as an immediate catalyst to its share price.

Redtone's Profit & Loss account pre and post Maxis factor

FYE May 31 (RMm)	FY13	FY13 (with Maxis Factor)
Sales	111.3	140.3
EBIT	(2.2)	28.4
PBT	(2.8)	27.8
NP	(3.2)	21.1
Core EPS	-0.7	4.4
PER	NM	7.3
Margin		
EBIT	-2.0%	20.2%
PBT	-2.5%	19.8%
NP	-2.9%	15.0%

Source: Kenanga Research

Valuation. The company is currently trading at a historical PER of 71.0x, way above its FY12 net asset per share of RM0.18 as of FYE12. We believe the group's fair value should be close to its net asset per share based on its existing businesses given that Redtone results are still expected to underperform in the next few financial years. Nonetheless, should we impute in the potential recurring income from Maxis, we project Redtone will post a turnaround to record a net profit of RM21.1m (~10 folds YoY) in FY13 followed by RM24.5m (+16% YoY) in FY14. Should this turnaround scenario happen, Redtone will likely deserve a higher PER in our view.

Time dotCom ("TDC"), a company which had turned around previously with a market capitalisation of RM2b now, is currently trading at 16.3x FY13 PER. The PER valuation is about a 27% discount to the consensus' large local mobile telco companies' (with an average market capitalisation of RM46b) average FY13 PER of 22.3x. In view of the group's small market capitalisation of RM155m, with is approximately 13x smaller than TDC, we are applying a similar PER discount to our valuation. Our Redtone fair value of RM0.50 is hence based on a targeted FY13 PER of 11.4x, or at a 30% discount to TDC's FY13 PER.

Appendix

Company Overview

Redtone International Bhd ("Redtone") was founded in 1996 and listed in ACE Market in January 2004. Since the inception over a decade ago, the group has evolved and expanded from a simple discounted voice service provider into a full-fledged international telecommunications company. Today, Redtone is providing a comprehensive range of offerings, from Broadband & data services, Voice and E-Purse technology solutions to IPTV.

Apart from its operations in Malaysia, the group has also formed an operation in both Shanghai and Singapore. In FY12, the group generated most of its revenue (75.5%) from Malaysia, while the remaining from China (24.5%) and Singapore (<1%). Redtone's China operation in Shanghai is under its 92.3% owned- REDtone Asia Inc, which is listed on the US OTC Bulletin Board. Redtone's China operation is mainly focus on e-sales and distribution of prepaid services. These services includes 1) prepaid mobile airtime and game reload; 2) prepaid discounted consumer call services; and 3) prepaid shopping pass and card business. We understand that Redtone has a plan to pare down its stake to about 70% from the current 92.3% through a share placement exercise to further boots its coffers and results.

Business Overview

Since established, Redtone has evolved and expanded from a simple voice service provider into a full-fledged international telecommunications company by offering comprehensive range of products from Broadband & Data services, Voice and E-Purse technology solutions to Internet Protocol television (IPTV).

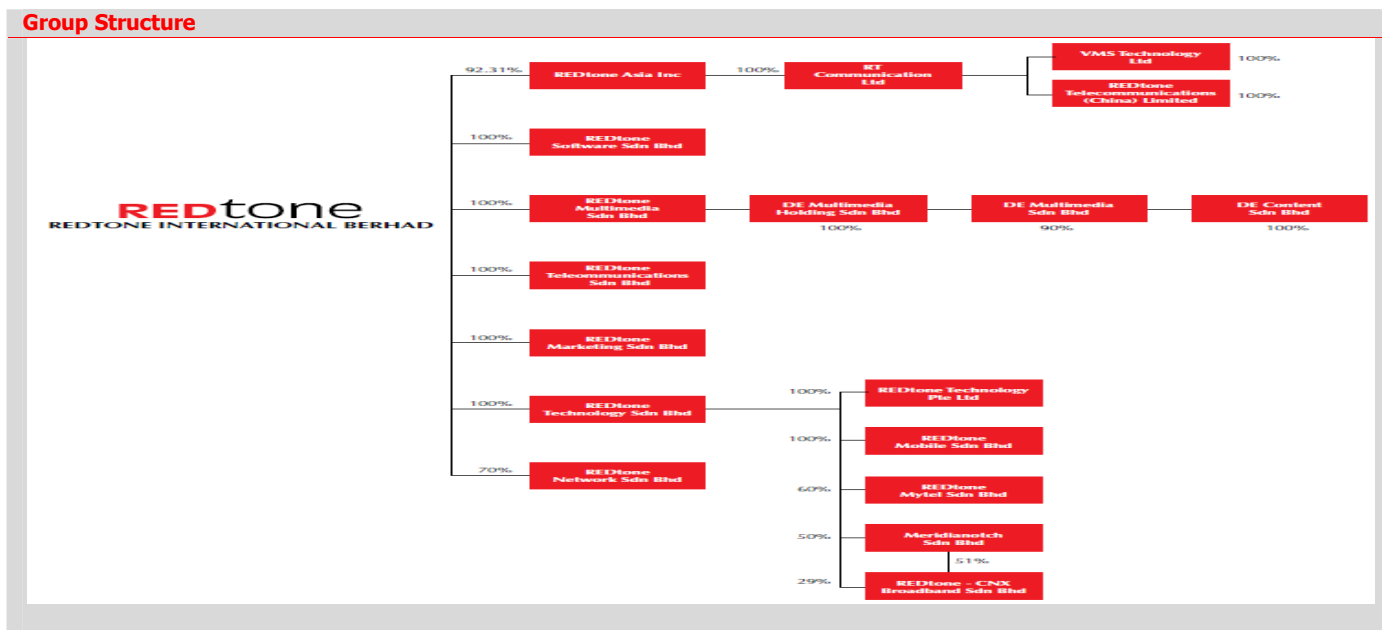
Broadband & Data services. Redtone is known as the #1 Wi-Fi infrastructure builders in Malaysia with vast experience in the design, planning and implementation of Wi-Fi projects on an in-building, community as well as metropolitan scale. The coverage of WiMax services offered in East Malaysia includes area such as Kuching, Kota Kinabalu, Miri, Sandakan and Tawau, operating on a high speed backbone infrastructure to provide internet access for Wi-Fi hotspots. Besides, REDtone is the only company in the industry to offer broadband on demand with speeds of up to 1Gbps for corporate with various last mile technologies e.g. WiMax, WiFi, and 3G. In addition, Redtone data services engaged in the provision of ICT-as-a-Service, Business Continuity Services and Consulting Services to SME and the Government.

Voice. Redtone is number one post-paid discounted call service provider in Malaysia for SME and corporate customers. The group provides integrated network and end-to-end total solution with Voice & Data capability via Optimised Discounted Calls (ODC), a corporate postpaid telephony service which offers savings up to 90% on telecommunication costs by using REDtone SIPhony (VOIP) technology, which allows SME and corporate customers to make calls via DSL or any internet connection. In addition, the group also offers prepaid discounted call services, REDtone PhoneCard, and fixed line services for the enlarge consumer market.

IPTV. The one-time payment eCoder, which is a mini set-top box featuring a range of Chinese-centric programming with internet access, which contents mainly cater for Chinese consumers. The eCoder enables user to pre-record any movies, drama, musics via USB storage and play it offline by using recorder. The eCoder is more than just a multimedia player. It is a virtual entertainment hub that offers access to wide range of interactive applications, internet TV and games with just a simple USB connection.

E-Purse. Flexible and versatile mobile commerce platforms which focus on viral mobile prepaid sales, mobile commerce, and international remittance.

Group Structure



Source: Company

Recent Corporate Activities (2012)

Date of Announcement	Activities	Description
7 June 2012	Divestment	Divestment of the balance of 20% of REDtone Multimedia S/B
20 April 2012	Divestment	Divestment of 80% stakes in REDtone Multimedia S/B
3 Jan 2012	Divestment	Divestment of 65% paid-up capital of REDtone Mobile S/B
10 Feb 2012	Disposal of subsidiary	Disposed REDtone Software S/B for RM3.00
14 Mar 2012	Collaboration	Tie-up with Telekom Malaysia for HSBB services to extend REDtone's data and broadband services to enterprise cloud service and data centre service for SMEs.
20 Apr 2012	Divestment	Disposed REDtone Multimedia S/B for RM1.00, upon completion of the divestment, REDtone Multimedia S/B will be 20% associate company of REDtone.
22 May 2012	MoU	Signed MoU with MIMOS Bhd for collaboration in providing WiFi access solution and also the Intelligent Surveillance Platform (ISP) based in MIMOS WiWi and ISP technology for a period of 3 years.
13 July 2012	Network Sharing Alliance Agreement (NSA)	Network sharing with Maxis in relation to infrastructure sharing and alliance on the 2600Mhz spectrum ("LTE Spectrum") for a period of 5 + 5 years. On the other hand, Maxis will also provide to REDtone certain mobile telecommunication services traffic capacity on a wholesale basis.

Source: Bursa Malaysia

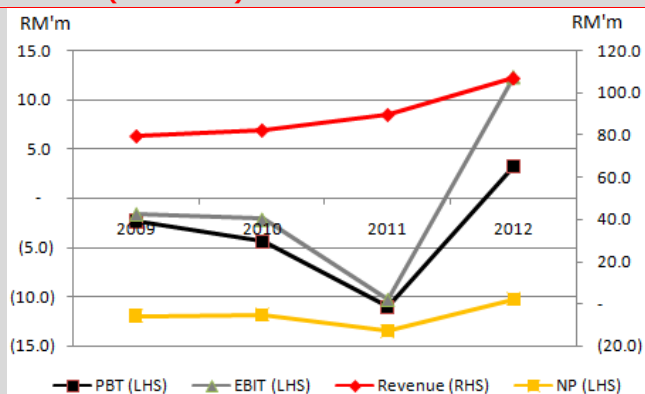
Historical Financials

Redtone's historical financial track record is very lumpy. Despite the group managed to grow its top line since FY09, its margins were always fluctuated due to its oscillate prepaid telecommunications card business segment, which naturally became a cut-throat business over the years, disappointment of its overseas forays as well as persisting high operating costs.

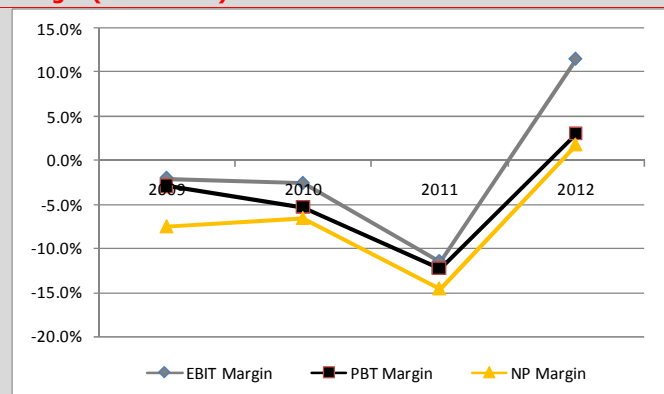
The group's revenue has increased by 6.9% YoY to RM89.5m in FY11 due mainly to the higher revenue contribution from its China venture. Its bottomline was, however, widen to RM11.5m net loss from RM5.0m loss in the preceding year. The losses were mainly due to higher operational costs coupled with impairment of goodwill (RM1.1m) and its past investment in China of RM1.3m.

Moved on to FY12, the group has continued to perform well in its turnover, which up 16.3% YoY, thanks to the higher contribution from its China venture. The group has reported a strong net profit of RM2.1m in FY12 as opposed to a net loss of RM11.7m a year ago. The strong result was mainly boosted by the disposal of three unprofitable subsidiaries, which led the group to record a RM10.9m disposal gain in FY12. Stripping off the exceptional gain of RM10.9m, its core bottomline continued to perform below the bar and record a net loss of RM8.7m, albeit a 25.6% YoY improved as opposed to RM11.7m net loss a year ago.

Revenue (FY09-FY12)



Margin (FY09-FY12)

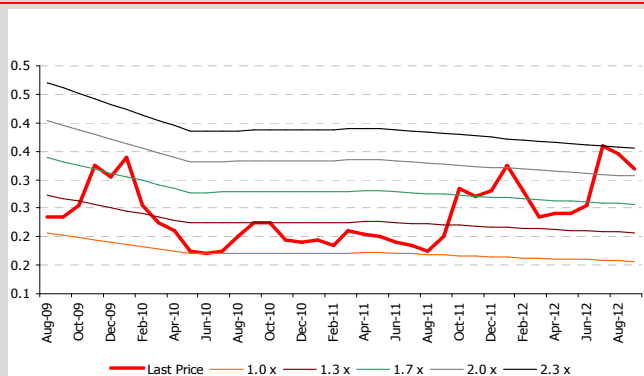


Source: Bursa Malaysia

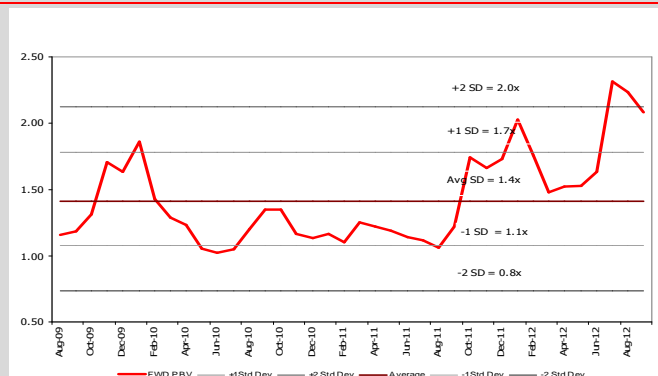
Income Statement						Financial Data & Ratios					
FY May (RM'm)	2010A	2011A	2012A	2013E	2014E	FY May (RM'm)	2010A	2011A	2012A	2013E	2014E
Revenue	82.2	89.6	107.0	111.3	116.3	Growth	3.5	9.0	19.4	4.0	4.5
EBITDA	1.8	(2.3)	12.3	6.5	7.3	Turnover (%)	172.5	-222.5	645.2	-47.6	12.2
Depreciation	5.6	8.0	8.3	8.7	9.0	EBITDA (%)	33.2	-174.1	139.0	-154.6	18.3
Operating Profit	(3.8)	(10.3)	4.0	(2.2)	(1.8)	Operating Profit (%)	-91.0	-149.2	129.4	-186.3	18.4
Other Income	0.0	0.0	0.0	0.0	0.0	PBT (%)	9.5	-116.4	25.5	63.5	20.6
Interest Exp	0.7	0.7	0.8	0.6	0.5	Core Net Profit (%)	3.5	9.0	19.4	4.0	4.5
Associate	0.0	0.0	0.0	0.0	0.0	Profitability (%)					
Exceptional Items	0.0	1.0	2.0	3.0	4.0	EBITDA Margin	2.2	-2.5	11.5	5.8	6.2
PBT	(4.4)	(11.0)	3.2	(2.8)	(2.3)	Operating Margin	-4.6	-11.5	3.8	-2.0	-1.5
Taxation	0.6	1.3	12.3	0.7	0.6	PBT Margin	-5.4	-12.3	3.0	-2.5	-2.0
Minority Interest	(0.4)	0.5	0.3	0.3	0.3	Core Net Margin	-6.6	-13.1	-8.2	-2.9	-2.2
Net Profit	(5.4)	(11.7)	2.1	(3.2)	(2.5)	Effective Tax Rate	-13.3	-11.5	378.9	-25.0	-25.0
Core Net Profit	(5.4)	(11.7)	(8.7)	(3.2)	(2.5)	ROA	-3.4	-8.7	-6.2	-2.3	-1.9
						ROE	-5.8	-14.4	-10.0	-3.8	-3.1
Balance Sheet						DuPont Analysis					
FY May (RM'm)	2010A	2011A	2012A	2013E	2014E	Net Margin (%)	-6.6%	-13.1%	-8.2%	-2.9%	-2.2%
Fixed Assets	33.3	51.8	54.0	50.9	47.7	Assets Turnover (x)	0.5x	0.7x	0.8x	0.8x	0.9x
Intangible Assets	-	-	-	-	-	Leverage Factor (x)	1.7x	1.7x	1.6x	1.6x	1.7x
Other FA	21.6	24.8	18.6	18.6	18.6	ROE (%)	-5.8	-14.4	-10.0	-3.8	-3.1
Inventories	2.0	2.3	0.7	0.7	0.7	Leverage					
Receivables	21.6	17.4	13.3	13.8	14.5	Debt/Asset (x)	0.3	0.1	0.3	0.4	0.4
Other CA	27.9	10.3	32.4	34.4	35.3	Debt/Equity (x)	0.6	0.1	0.7	0.9	1.0
Cash	53.8	27.9	21.6	19.2	19.4	Net Cash/(Debt)	41.3	18.2	13.6	13.7	13.9
Total Assets	160.2	134.6	140.6	137.6	136.2	Net Debt/Equity (x)	-0.4	-0.2	-0.2	-0.2	-0.2
						Valuations					
Payables	17.3	16.5	17.2	18.3	19.1	EPS (sen)	-1.4	-2.7	-1.8	-0.7	-0.5
ST Borrowings	4.9	3.3	2.6	-	-	GDPS (sen)	0.0	0.0	0.0	0.0	0.0
Other ST Liability	34.6	26.1	27.5	29.5	30.2	NTA (RM)	0.23	0.19	0.18	0.18	0.17
LT Borrowings	7.6	6.4	5.5	5.5	5.5	PER (x)	N.M.	N.M.	N.M.	N.M.	N.M.
Other LT Liability	2.5	0.8	0.6	0.5	0.4	Gross Div. Yield (%)	0.0	0.0	0.0	0.0	0.0
Minorities Int.	0.5	7.0	7.8	7.5	7.2	P/NTA (x)	1.4	1.7	1.7	1.8	1.9
Net Assets	92.8	74.4	79.6	76.4	73.9	EV/EBITDA (x)	91.4	-70.4	13.5	25.7	23.0
Share Capital	43.2	44.8	47.6	47.6	47.6						
Reserves	49.6	29.6	32.0	28.8	26.3						
Equity	92.8	74.4	79.6	76.4	73.9						
Cashflow Statement											
FY May (RM'm)	2010A	2011A	2012A	2013E	2014E						
Operating CF	(0.1)	(10.1)	3.0	5.7	6.0						
Investing CF	(20.3)	(11.1)	(8.3)	(5.6)	(5.8)						
Financing CF	43.1	(3.3)	(0.5)	(2.6)	-						
Change In Cash	22.6	(24.6)	(5.9)	(2.4)	0.2						
Free CF	(4.2)	(15.2)	(4.6)	0.1	0.2						

Source: Kenanga Research

Forward P/BV Band



Forward P/BV Standard Deviation



Source: Bloomberg, Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

- OUTPERFORM : A particular stock's Expected Total Return is MORE than 10% (an approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%).
- MARKET PERFORM: A particular stock's Expected Total Return is WITHIN the range of 3% to 10%.
- UNDERPERFORM : A particular stock's Expected Total Return is LESS than 3% (an approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate).

Sector Recommendations***

- OVERWEIGHT : A particular stock's Expected Total Return is MORE than 10% (an approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%).
- NEUTRAL : A particular stock's Expected Total Return is WITHIN the range of 3% to 10%.
- UNDERWEIGHT : A particular stock's Expected Total Return is LESS than 3% (an approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate).

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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