KT (Buy) – NDR feedback

By Chris Hoare | November 25, 2024

What's new: We hosted KT management for an NDR in London and the US last week. The company comes across as highly committed to following the government “Value-up” programme, and seems to be becoming much more profit-focused than the past. Given the history of low returns the scope for upside as this materialises is very significant in our view. KT remains our top pick in Korea and one of our top picks in Global EM. Key takeaways below.

“Value-up programme”: KT’s value up programme contains 4 key steps:

Headcount reduction: KT is taking a proactive approach to reducing headcount cost. 2,800 staff have taken early redundancy and a further 1,700 have been placed in a separate company (on 70% of their original salary), out of a previous headcount of 19,000. This is more aggressive than we would have assumed. The upfront cost is KRW 1trn (Taken in Q4 2024), but annual pre-tax savings are said to be KRW 300bn per year. Given we forecast KRW 1.6trn of underlying pre-tax profit this year, earnings are likely to be accreted significantly going forward.

Disposal of idle assets. KT identified idle (low return) assets with a book value of KRW 7.9trn. Of this, KRW 1.2trn relates to real estate (market value KRW 4-5 trn), KRW 2.2trn to marketable securities (also KRW 2.2trn market value), and KRW 4.4trn to subsidiary holdings (market value “much higher”). The company intends to sell KRW 1trn of the marketable securities and KRW 0.4trn (market value) of real estate by 2028. Thus the company is likely to raise KRW 1.4trn pre-tax (tax likely to be c. 35% on the real estate disposals).

Growing AI revenue: KT has set an ambitious target of KRW 3trn of AI revenue by 2028. Our initial view of this was that it was highly optimistic. However, we much prefer KT’s approach to SKT’s (focused on B2B solutions, through its partnership with Microsoft, rather than trying to build its own B2C revenue streams).

Shareholder remuneration: KT intends to buyback and cancel KRW 1trn of stock over the 4 year period.

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NSR View: KT's value-up strategy is more pro-active than we thought likely. While the disposal of idle real estate could happen faster the pace of headcount reduction is much more rapid than we expected. Shareholder remuneration strategy is proactive and the approach to AI is also sensible. Direction of travel is certainly positive. KT seems to be on a journey to a much more shareholder friendly place than it has been in the past. Given where the multiple is the potential for a re-rating as this plays out is significant.

Mobile Competition: With 5G handset penetration now around 75%, the market is slowing, and will likely only grow 1-2% this year. However, KT remain of the view that competition is benign and will remain so for the foreseeable future.

NSR View: The fact that the slowdown is more a function of maturity rather than regulatory pressure is probably a good thing, but nevertheless we are clearly heading into a period where market MSR is c. 1-2% rather than c. 3% as in the last 2-3 years.

Enterprise and B2B Business: KT seems confident in continued strong growth in the B2B market.

NSR View: We are bullish on the Korean enterprise story. Nothing was said to change our view on this, and KT's greater exposure to Enterprise is part of why they are our preferred Korean Telco.

Capex: KT is clear that mobile capex is likely to be contained, with all operators having largely completed 5G roll out and no talk of 6G until 2029/30 at the earliest. This means that standalone capex should be declining from current levels of around KRW 2.4trn, and group capex also gradually falling until 2029.

NSR View: Long term visibility of falling core capex is obviously supportive of the investment case.

Approach to AI: KT was keen to stress that the focus on AI is sensible and likely to generate a return. In fact, the company said that while it tried to build a Korean language LLM it realised that competing with the hyper-scalers would make generating a return and hence why they stopped this approach.

NSR View: We find KT's approach much more sensible than SKT's in particular.

Shareholder returns: KT has announced the buyback and dividend policy of at least 50% of standalone net

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profit. Dividend for this year is likely to be KRW 2,000, and higher than that next year. Given top line growth and cost cutting earnings should grow and hence the dividend.

Conclusion: Generally, the takeaway was very positive, driven by the continued benign competitive environment, with KT's "Value-up programme" a good deal more bullish than we had assumed. As always in Korea regulatory risk, and the extent to which Telcos remain in the firing line is the negative. However, growth is coming in non-regulated areas which reduces this risk over time, and this is obviously a bigger issue for LG and SKT which are more exposed to this space than KT. Overall, we are happy with KT as our top pick in Korea, and one of our top picks in Global EM.

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