Stable Outlook for Telecommunications Industry

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PEFINDO is of the view that Indonesia's telecommunications industry has a stable outlook, recording double digit growth for more than a decade and at almost two times the level of GDP growth in 2016. We expect the industry to grow at high single digit rate in the near to medium term, with broadband Internet as the key driver. Broadband Internet is dominated by wireless/mobile service providers due to a lack of wireline/fixed broadband networks in suburban and rural areas. The top three listed telecommunications operators — Perusahaan Perseroan (Persero) PT Telekomunikasi Indonesia Tbk (TLKM, $_{id}$AAA/Stable), PT Indosat Tbk (ISAT, $_{id}$AAA/Stable), and PT XL Axiata Tbk (EXCL, not rated) — dominate mobile broadband in Indonesia. For the last three years, mobile broadband has been the source of growth for those operators, compensating for saturated basic services.

Volume growth

We expect higher revenue growth from higher volume plans for data consumption, while data tariff growth will be limited. Data consumption recorded exponential growth to 1.9 million terra bytes (TB) in 2016 from 180,400 TB in 2013, thanks to network and technology evolutions that enable faster Internet access. Increasing data consumption will continue along with the rising middle-income class, mostly using the Internet for browsing and e-commerce. Indonesia's social media usage is among the highest in the world at an average of 2.9 hour/day[1], while e-commerce is predicted to grow strongly in the near to medium term. The middle-income population is also expected to grow with a compound annual growth rate (CAGR) of 6.5% in 2013-2020[2]. The class, which mostly accesses information from mobile telephones and subscriptions, is expected to increase to 92 million in 2019 from 55.4 million in 2015[3], supported by the increasing availability of inexpensive smartphones.

Intense competition, lower data yield

We expect competition to remain intense in terms of customer acquisition, as Indonesia's prepaid subscribers dominate the market. Tariff wars in cellular and data will continue. We anticipate data yield will remain low due to intense data price competition. The top three listed telecommunication operators have experienced a decrease in data yield in the last three years. Mobile broadband pricing in Indonesia, at USD3.4/500 megabytes (MB)[1] or two times lower than Thailand, is much lower compared to other countries. In the medium term, pressures on data yield will limit operators disbursing capital expenditure (capex) and potentially weaken their cash flow generation. The government's plan to regulate data tariffs in the near term will protect the industry at a healthier level. Lower data yield and diminishing basic services will push telecommunications operators to increase their revenue from high value-added services in order to maintain profitable margins in the near to medium term.

Exploring high value-added services is the focus of backbone providers (fiber optics and telecommunications towers). PT Mora Telematika Indonesia (Moratel, $_{id}$A/Stable), a telecommunications infrastructure and service provider, is selling its fiber to the home (FTTH) products using its own brands. Previously, Moratel only provided fiber optic rental in bulk to Internet service providers (ISPs). PT Bali Towerindo Sentra Tbk (BALI, $_{id}$BBB+/Stable), a telecommunications tower company, has also penetrated the FTTH segment to monetize its existing fiber optics. Despite having more players, we see the prospects for the FTTH market as positive due to the current low penetration of fixed broadband services.

Supply gap: Network capacity issue

On the supply side, we are of the view that Indonesia's telecommunications infrastructure lags behind other countries, both for wireless and wireline/fixed broadband. We are also of the view that fixed broadband has a higher level of urgency to be developed, as it offers a more reliable network to serve future technology that requires huge traffic, such as Big Data and the Internet of Things. Fixed broadband penetration at below 10% is among the lowest in the world. Major constraints for penetration are limited broadband infrastructure and geographic challenges, which make Internet services not evenly distributed. One solution is the national Indonesia Palapa Ring project, which aims to build fiber optic connectivity throughout the archipelago, from the west to the east of Indonesia. The Palapa Ring projects are expected to be fully operational in 2019. Moratel, through its subsidiaries PT Palapa Ring Barat and PT Palapa Timur Telematika, has been awarded by the government the contract to construct and manage the West and East Palapa Ring packages.

In the wireless segment, mobile spectrum is also limited, and Indonesia has faced a spectrum crisis since 2013. TLKM, through its subsidiary Telkomsel, won the spectrum tender of 2.3 GHz for 30 MHz, while ISAT and PT Hutchison 3 Indonesia won the tender of 2.1 GHz for 5 MHz each. The new spectrums are expected to increase network quality and efficiency. Internet bandwidth in Indonesia is considered one of the lowest in Southeast Asia[4] and its average Internet connection speed is 7.2 Mbps[5], 2.2x slower than Thailand. Internet penetration is also low at 51%, though slightly higher than the global average of 50%. As mentioned earlier, the current low fixed broadband and Internet penetration should provide new opportunities for telecommunications players, including operators, ISPs, and backbone providers (fiber optics and towers) to grab more revenue from the potential Internet market.

Capex for network investment

Despite significant growth in data usage and subscriber base, we project the capex policy of telecommunications operators will be moderate or underinvested at a minimum of 20% and a maximum of 35% of total revenue, unchanged compared to previous years, which will mostly be internally financed. Projected capex will be allocated more for data coverage and capacity, including 3G/4G base transceiver station (BTS) deployments and additional spectrum. The capex of independent backbone providers (fiber optics and towers) will be highly exposed to operators. We are of the view that the sale and lease-back of towers owned by operators to independent telecommunications towers will occur in the medium term.

Rating outlook

In the next 12 months, we view the ratings of our rated telecommunication players as steady. We rated 10 companies in the sector, including operators, tower providers, fiber optic providers, ISPs, and telecommunications product distributors (mobile phone vouchers, starter packs, and cellular phones). We identified a lower risk in operators compared to other players due to the high barrier to entry and stable revenue growth profile. We evaluated a higher risk profile in backbone providers, ISPs, and distributors due to relatively more players in each segment and increasing financial leverage for capex and working capital needs, as reflected in their credit ratings. Please refer to Table 1. for published ratings.

Table 1. Credit ratings publication of several companies in telecommunication sector

Company	Perusahaan Perseroan (Persero) PT Telekomunikasi Indonesia Tbk	PT Indosat Tbk	PT Mora Telematika Indonesia	PT Tiphone Mobile Indonesia Tbk	PT Inti Bangun Sejahtera Tbk	PT Bali Towerindo Tbk	PT Infrastruktur Bisnis Sejahtera
Ticker name	**TLKM**	**ISAT**	**MORA**	**TELE**	**IBST**	**BALI**	**IFBS**
Period	Sept 30, 2017	Sept 30, 2017	Sept 30, 2017	Sept 30, 2017	Sept 30, 2017	Sept 30, 2017	March 31, 2017
Corporate rating	idAAA/Stable	idAAA/Stable	idA/Stable	idA/Stable	idA-/Stable	idBBB+/Stable	idBBB+/Stable
[IDR Bn] Revenue	97,003.0	22,565.8	1,309.1	20,419.8	558.5	231.8	272.1
[IDR Bn] EBITDA	50,049.0	9,906.3	262.9	628.6	411.9	156.8	56.0
[IDR Bn] FFO	40,301.0	7,700.4	139.8	190.0	311.5	62.9	24.6
[IDR Bn] Adjusted Debt	45,430.0	23,262.0	2,481.0	4,552.0	1,192.6	1,145.2	1,151.2
[IDR Bn] Adjusted Equity	107,112.0	13,184.1	1,543.9	2,849.0	3,608.7	862.1	637.9
[x] Debt to EBITDA	*0.7	*1.8	*7.1	*5.4	*2.2	*5.5	*5.1
[x] Debt to Equity	0.4	1.8	1.6	1.6	0.3	1.3	1.8
[%] FFO to Debt	*118.3	*44.1	*7.5	*5.6	*34.8	*7.3	*8.6
[x] EBITDA to IFCCI	21.2	6.3	2.9	1.8	4.1	1.9	2.6

Source: Companies' Financial Statements, processed by PEFINDO
*Note: *annualized*
FFO = Funds from Operation (calculation of EBITDA – IFCCI + Interest Income – Current Tax Expense)
IFCCI = Gross Interest Expense + Other Financial Charges + Capitalized Interest; (FX Loss not included)

References:

[1]McKinsey & Company "Unlocking Indonesia's digital opportunity", September 2016; [2]Statistics Indonesia; [3]eMarketer; [4]The Global Competitiveness Report 2016-2017; [5]www.statista.com;