Stable Outlook for Telecommunications Industry

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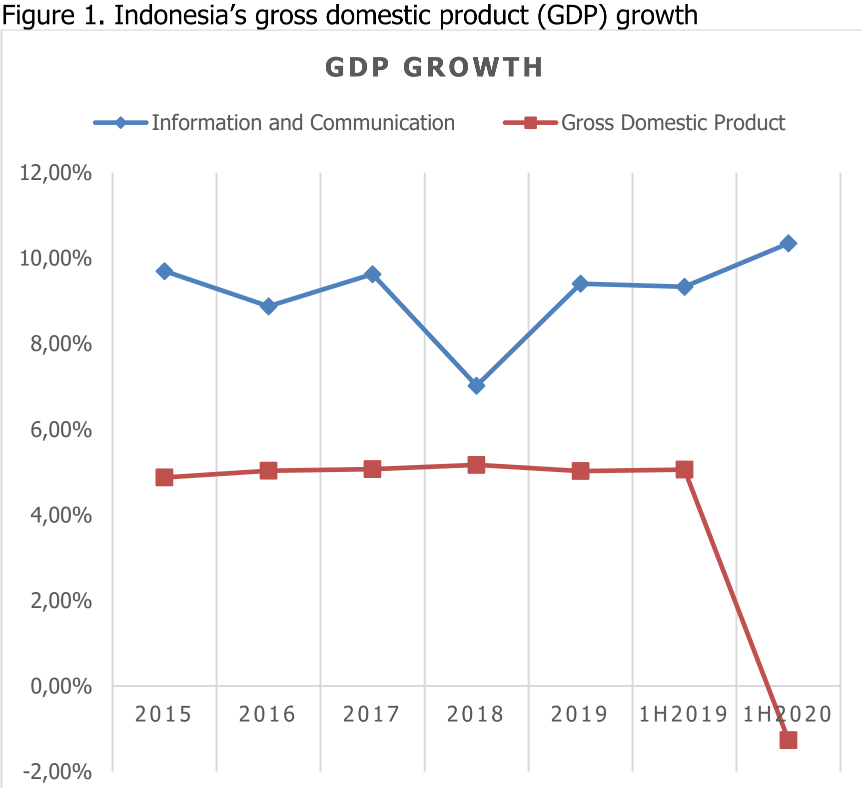
PEFINDO is of the view that the outlook of the telecommunications industry will remain stable in the near to medium term, considering it is one of the drivers of the national economy. This is reflected by how its growth is always above Indonesia's economic growth. In 2019, the information and communication sector grew 9.41% year-on-year (YoY), compared to the national economic growth of 5.02% YoY in the same period. In the first half of 2020 (1H2020), amid unfavorable conditions due to the COVID-19 pandemic, the sector recorded positive growth of 10.35% YoY, while the domestic economy contracted by 1.26% YoY. We view that during COVID-19, the demand for telecommunications services has increased significantly amid the restrictions on mobility and human contact. While a prospect of new work patterns will directly and indirectly support the growth of the telecommunications industry. Based on Association of Internet Service Providers in Indonesia's (APJII) data, the country's internet penetration rate grew to 64.8% of the population in 2018 from 54.7% in 2017, in which the number of Indonesian internet users continued to increase in 2019 and 1H2020. Internet growth and smartphone penetration are supported by the government's plan to develop an information network with broadband services nationwide. The lack of established broadband services in parts of the country provides good growth opportunities for the industry, and an increase in the number of internet and smartphone users will support Indonesia's economy.

The wireless penetration rate of basic telecommunications services, particularly voice and SMS, has reached more than 100% based on the number of subscribers. Although growth of the subscriber base and revenue is expected to slow down due to high penetration and saturated market, this will be partly offset by stable demand for telecommunications services due to the country's large population, and demand for wireless telecommunications and information services. Prices for wireless and wireless services and handsets are more competitive and affordable for the lower income segment.

Figure 1. Indonesia's gross domestic product (GDP) growth



Source: BPS Statistic, processed by PEFINDO

Allocation of significant capital expenditure due to inadequate infrastructure
PEFINDO is of the view that Indonesia's telecommunications infrastructure development lags behind other countries in terms of wireless and fixed broadband. We are also of the view that development of fixed broadband is more urgent, because it offers a more reliable network to serve future technologies requiring large traffic, such as big data and the Internet of Things. The main barriers to penetration are limited broadband infrastructure and geographical challenges, which prevent internet services from being evenly distributed. One solution is the national Palapa Ring project, which aims to build fiber-optic connectivity throughout the archipelago. However, the Palapa Ring only provides a fiber optic backbone, and still needs the cooperation of telecommunications and broadband operators to provide internet access to the public. We are of the view that telecommunications operators are focused on densely populated areas, considering the potential revenue related to the utilization rate of their assets and costs, such as maintenance, can be more efficiently managed in densely populated areas where their assets are already widely installed. As of September 2020, optical fiber utilization for the East Palapa Ring was 14%, and for microwave was 45%.

We are also of the view that the industry requires significant capital expenditure (capex), but translating that capex into income takes a long time. We expect telecommunications operators' capex policies to be moderate at 20-35% of total revenue, which will be funded by a combination of external loans and internal sources. The projected capex will be allocated for data coverage and capacity, including the deployment of 3G/4G base transceiver stations (BTS), optical fiber, and additional spectrum.

Intense competition in near to medium term
PEFINDO is of the view that the telecommunications industry continues to face intense market competition, especially in terms of prices and types of services. Customer growth could further decline in the future due to new regulations, such as the SIM card registration policy limiting the number of SIM cards a subscriber can use, and decreased purchasing power due to COVID-19. As such, we expect competition to remain intense in terms of customer acquisition, with Indonesian prepaid subscribers dominating the market. Mobile and data tariff wars will also continue. In the near to medium term, pressure on tariffs will limit the operators' spending on capex and potentially weaken their cash flows.

We are also of the view that intense competition in the telecommunications tower industry will remain. While the need for new towers will increase in line with the expansion of coverage and capacity by telecommunications operators, there are many big telecommunications tower companies such as PT Sarana Menara Nusantara Tbk and PT Tower Bersama Infrastruktur Tbk, which each has more than 15,000 towers, and small players with less than 3,000 towers in the industry. Due to the large number of players, competition for new tenants is getting tighter, affecting tenancy ratio. We also see a trend of tower acquisitions by tower companies from cellular operators. We expect this to continue in the medium term, as operators focus more on their core business, while carrying out cost efficiency efforts related to tower management and maintenance. Tower companies generate revenues from leasing towers rather than organically building them, because most of the acquisitions are on a leaseback scheme.

Better cellular ARPU post sim card registration policy
We view that although there has been a significant decrease in the number of mobile users after the implementation of the SIM card registration policy, cellular operator average revenue per user (ARPU) has actually improved due to better customer quality. Operators are also making efforts to improve margins by increasing advertising through digital and social media, reducing physical vouchers, and reducing revenue from non-recurring or project-based businesses.

Table 1. Peers' operating management indicators and development of networks

Description	TLKM				ISAT				EXCL			
	1H20	**2019**	**2018**	**2017**	**1H20**	**2019**	**2018**	**2017**	**1H20**	**2019**	**2018**	**2017**
[IDR tn] Revenue	67	136	131	128	13	26	23	30	13	25	23	23
[IDR tn] EBITDA	36	65	59	65	5	10	7	13	6	10	9	8
[IDR tn] EBIT	22	42	38	44	0	0	(2)	4	1	3	(3)	1
[%] EBITDA Margin	54	48	45	50	40	38	28	43	50	40	37	36
[%] GPM	40	38	37	43	10	9	3	21	17	18	(5)	13
[IDR '000] ARPU	45	46	41	43	31	28	19	20	37	35	32	34
[mn] Subscribers	160	171	163	196	57	59	58	110	56	57	55	54
['000] BTS Cellular	228	212	189	161	125	124	75	61	139	130	119	101
4G	178	162	139	110	53	48	17	7	50	40	30	17
3G					45	48	35	30	54	54	51	46
2G	50	50	50	50	27	28	22	24	36	36	37	38

Source: the Company's financial statements and Info Memos
Note: TLKM = PT Telekomunikasi Indonesia Tbk (Persero) , ISAT = PT Indosat Tbk, EXCL = PT XL Axiata Tbk

Low exposure to COVID-19 impact, but maintaining prudent approach

We are of the view that the industry has low exposure to the impact of the COVID-19 pandemic. With current restrictions on mobility and human contact to contain the virus spread, the demand for telecommunications services has increased significantly. S&P Global reported a 30%-70% increase in traffic on mobile broadband and 50%-100% on fixed broadband in Europe, the Middle East, and Africa (EMEA). Other institutions also reported spikes in data traffic in Asia-Pacific countries, prompting companies to increase their spending on additional network capacity. Work-from-home policies may continue to increase the number of customers from the consumer segment, while from the corporate segment we anticipate greater use of server capacity.

Post COVID-19, we see the prospect of forming new work patterns, which will directly and indirectly support the growth of the telecommunications industry. The new work patterns include an increase in remote work and meetings and a rise in the use of technology to monitor employees, such as virtual attendance and detection of computer use. Most companies will also consider accelerating business automation, where technology will replace some of human functions.

However, we still consider that industry players are also exposed to negative indirect impacts, such as longer payment terms for customers experiencing financial difficulties due to the impact of COVID-19 and lower purchasing power, with many companies cutting wages and reducing number of employees. We also expect companies to postpone project completion to next year, either because they are more careful in terms of spending or there are obstacles during construction, such as a delay in permits to open telecommunications access in new areas. This will affect the projection of revenue growth in the near to medium term. In anticipating the indirect impact of COVID-19, industry players focus on projects that are already running and faster to be utilized and translated to revenue. We are of the view that companies will adjust their capex policies to 5-10% below the normal figure, and to better monitor their corporate customers, especially those more likely to experience financial difficulties due to COVID-19.

Stable outlook for most of PEFINDO's rated portfolio

In the next 12 months, we expect the ratings for most of our rated telecommunications players to be stable. We rated five companies in this sector, including operators, tower providers, fiber optic providers, ISPs, and distributors of telecommunications products (mobile phone vouchers, starter packs, and cellular phones). We identified a lower risk for operators compared to other players due to high barriers to entry and stable revenue growth profiles. We observed higher risk profile of backbone providers, ISPs, and distributors due to more intense competition in each segment (high number of players) and increasing financial leverage for capex and working capital needs, as reflected by their credit ratings. We assigned the $_{id}$D rating for PT Tiphone Mobile Indonesia Tbk (TELE) due to its failure to pay its bond interest.

Debt securities that will mature for the five issuers rated by PEFINDO in the fourth quarter of 2020 and full year 2021 are IDR1.8 trillion and IDR2.3 trillion, respectively. We are of the view that the issuance of new debt securities will be limited in the near term as some players are currently in the wait-and-see position. We are also of the view that maturing debt securities in the near term will be repaid by internal cash or bank loans. However, some players are still active in issuing debt securities through the shelf-registered debt securities program. PT Mora Telematika Indonesia (MORA) issued its Shelf Registered Sukuk Ijarah I Phase III Year 2020 in October, of which part of the proceeds will be used for refinancing and capex.

Table 2. Financial highlights of telecommunications players rated by PEFINDO

Description	**Average****	**TLKM Jun-2020**	**ISAT Jun-2020**	**MORA Jun-2020**	**IFBS Jun-2020**	**TELE Sep-2019**
Total Adjusted Assets [IDR Bn]	81,077.7	239,757.0	59,443.6	12,692.8	12,417.5	8,674.9
Total Adjusted Debt [IDR Bn]	33,074.2	77,234.0	37,994.6	8,950.9	8,117.3	4,295.7
Total Adjusted Equity [IDR Bn]	29,920.0	103,691.0	11,750.1	1,725.3	2,513.8	3,733.2
Total Sales [IDR Bn]	21,038.5	66,856.0	13,451.7	1,951.6	1,894.5	19,947.8
EBITDA [IDR Bn]	10,873.7	36,077.0	5,430.0	996.6	991.2	780.0
Net Income after MI [IDR Bn]	2,759.9	10,989.0	(341.1)	114.7	277.0	382.1
EBITDA Margin [%]	49.4	54.0	40.4	51.1	52.3	3.9
Adjusted Debt/EBITDA [X]	*3.3	*1.1	*3.5	*4.5	*4.1	*4.1
Adjusted Debt/Adjusted Equity [X]	3.1	0.7	3.2	5.2	3.2	1.2
FFO/Adjusted Debt [%]	*29.7	*75.4	*21.6	*9.6	*12.0	*11.9
EBITDA/IFCCI [X]	5.8	15.2	3.8	2.0	2.3	2.9
Rating/Outlook		$_{id}$AAA/Stable	$_{id}$AAA/Stable	$_{id}$A/Stable	$_{id}$BBB+/Stable	$_{id}$D

Source: PEFINDO database, 2020
FFO = EBITDA – IFCCI + Interest Income – Current Tax Expense
EBITDA = Operating Profit + Depreciation Expense + Amortization Expense
IFCCI = Gross Interest Expense + Other Financial Charges + Capitalized Interest; (FX Loss not included)
*MI= Minority Interest   *Annualized   **Excluding TELE*
Note: IFBS = PT Infrastruktur Bisnis Sejatera, TELE = PT Tiphone Mobile Indonesia Tbk