INDOPREMIER

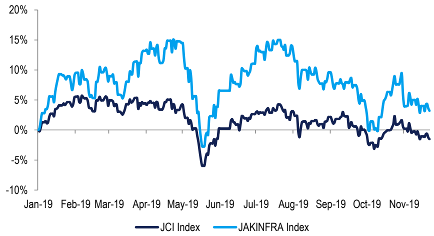
Telecommunications

Overweight

Sector Initiation | 22 November 2019

Sector Index Performance (JAKFIN)

	3M	6M	12M
Absolute	-4.5%	1.1%	0.9%
Relative to JCI	-2.2%	0.0%	-0.9%



Summary Valuation Metrics

EV/EBITDA (x)	Dec-19F	Dec-20F	Dec-21F
TLKM IJ	6.6	6.1	5.7
EXCL IJ	6.1	5.5	4.9
ISAT IJ	4.9	4.6	4.4

P/BV (x)	Dec-19F	Dec-20F	Dec-21F
TLKM IJ	3.6	3.4	3.2
EXCL IJ	2.0	1.9	1.8
ISAT IJ	1.5	1.8	2.2

Div. Yield	Dec-19F	Dec-20F	Dec-21F
TLKM IJ	4.2%	4.1%	4.1%
EXCL IJ	0.0%	0.0%	0.0%
ISAT IJ	0.0%	0.0%	0.0%

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All eyes on monetization

- As penetration matures, the focus of telco operators has shifted to monetising the customer base rather than expanding market share.
- Further data revenue growth shall be driven by smartphone penetration as well as higher data traffic usage instead of increase in yield.
- Overweight telco sector with EXCL as our top pick. Risk is data price war.

Next growth driver will be rise in ARPU

So far data revenue growth in 9M19 has been sparked by growing data consumption. We expect this trend to continue with data traffic growing c.40% CAGR for the industry from 19F-21F. As smartphone penetration matures and reaches a certain threshold, the focus has shifted to monetise the customer base rather than expanding market share. Telco operators can do the following: issue recharge packages with higher pricing point than current ARPU, encourage customers to switch to higher value packages, and increase the minimum recharge to stay on network.

Imperative costs management, especially marketing cost

We expect cost management will come from more controlled marketing cost, which shall translate to lower overall cost of service. We expect EXCL's cost of service dropped the most after the 2G assets kitchen sink which has happened since 4Q18, (depreciation to gross fixed asset dropped by 100bps). Meanwhile, ISAT's will have more controlled personnel cost after the removal of its defined benefit plan (from 10% of total revenue to 8.5%).

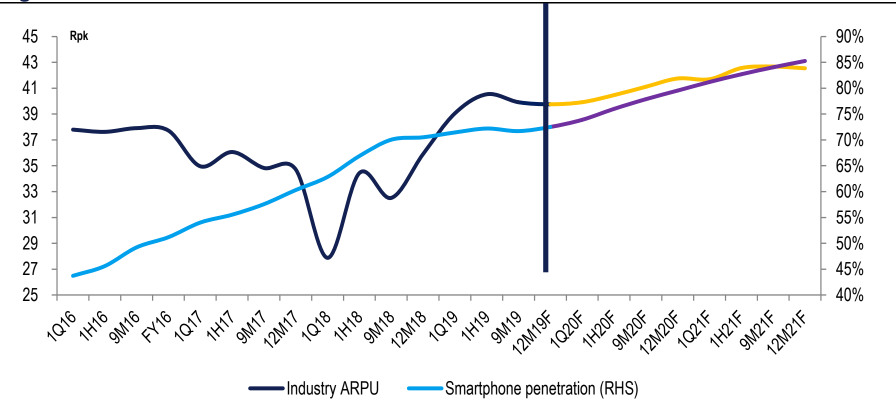
Consolidation of telco operators is needed to spark immediate growth

The new Communication and Informatics Ministry has expressed his support for consolidation during his term. A regulation for spectrum transfer will be the key to create a potential M&A scenario. History suggests consolidation always resulted in positive revenue growth (back in 2010 and 2015).

Initiate Overweight on the sector with EXCL as our top pick

We initiate the telco sector with Overweight rating on the back of higher ARPU and package monetization with EXCL as our top pick, for the following reasons: 1) highest data revenue contribution; 2) lower cost of service from 2G asset depreciation kitchen sink in 2018. Telco sector currently trades at 6.3x EV/EBITDA (in-line with its 10Y avg). Risk is data price war.

Fig. 1: Indonesia ARPU inflection



Sources: Company, IndoPremier *Share Price Closing as of : 22 November 2019*

Next growth driver would be rise in ARPU

So far data revenue growth in 9M19 has been sparked by growing data consumption generated through shift from feature phones to smartphones. We expect the trend to continue with data traffic growing c.40% CAGR for the industry from 2019F-21F. Smartphone penetration will also grow (from c.70% in 2018) to 85% by 2021F.

The main question that comes to mind when investing in telcos would be, when will ARPU recover? Given the sustained competitive intensity and despite consolidation in the industry.

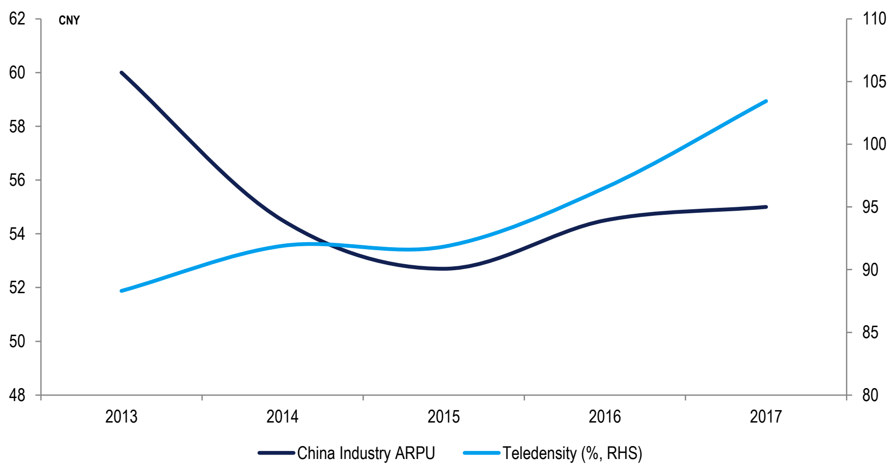
We view that, in large market with high penetration potential, price wars are prone to happen. In those markets, service providers tend to maximize subscriber market share in order to achieve economic of scale for the long run. Hence, the most obvious strategy would be to commit price wars to capture market share. Penetration of service is one of the most vital parameters to determine the extent of price wars; other factors such as number of players do impact at the margin.

Towards the end of the market share grab phase, players who did not gain sufficient market share tend to consolidate with larger players. However, as penetration matures and reaches a certain threshold, the addressable market shirks and players start raising prices as the focus shifts to monetising the customer base rather than expanding market share. The telcos would opt to monetize its existing customer base, as it is more lucrative than incremental market share. We have seen this play out in multiple industries, including Indonesia.

1) China's experience in ARPU increase

In China, ARPU dipped after the 4G launch. The industry's ARPU, was CNY61.5 before the launch in 2013. During the market share grab phase, it tumbled to CNY52.5 by 2015. However, as teledensity has reached 92% in year 2015, ARPU started to rise and improved to CNY55 in 2017. Subscriber consolidation also occurred during the phase.

Fig. 2: China ARPU inflection

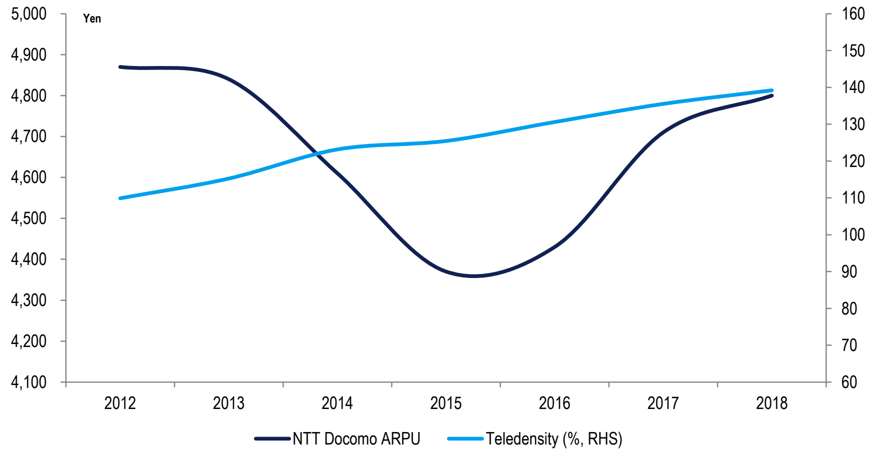


Sources: Company, IndoPremier

2) Japan's experience in ARPU increase

In Japan, we take the biggest operator, NTT Docomo (NTT), as a proxy of the Japan market. Since 4G launced in 2011, NTT's ARPU fell 18% in 2010 to 2015. However, as teledensity rose to 125% in 2015, the trend reversed. Over 2015-2018 ARPU increased by 10%, while teledensity jumped to 139%.

Fig. 3: NTT Docomo ARPU inflection



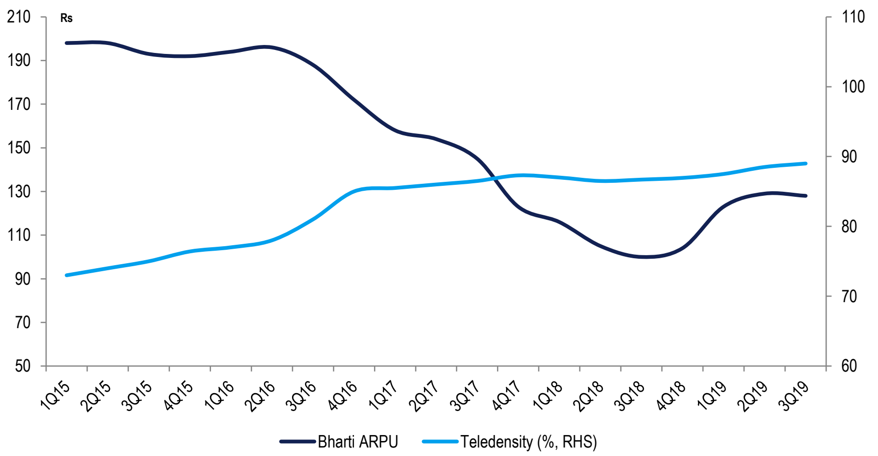
Sources: Company, IndoPremier

3) India's experience in ARPU increase

India experienced a paradigm shift in data usage since Reliance Jio's entry into the market, which led to intense competition and lowered data pricing. Average data consumption per user rose sharply by 10-folds from 2015 to 2018. However, it came at the expense of ARPU decline which has decreased by almost 40% from 2016.

In India, we use Bharti Airtel as a proxy, as revenue share between the top 3 players are quite equal. Bharti's ARPU dropped by half within 3 years as aggressive pricing by Reliance Jio was done for market share grab. However, as teledensity reached 87% by end of 2018, Bharti's ARPU managed to increase by 20%.

Fig. 4: Bharti Airtel's India ARPU increase

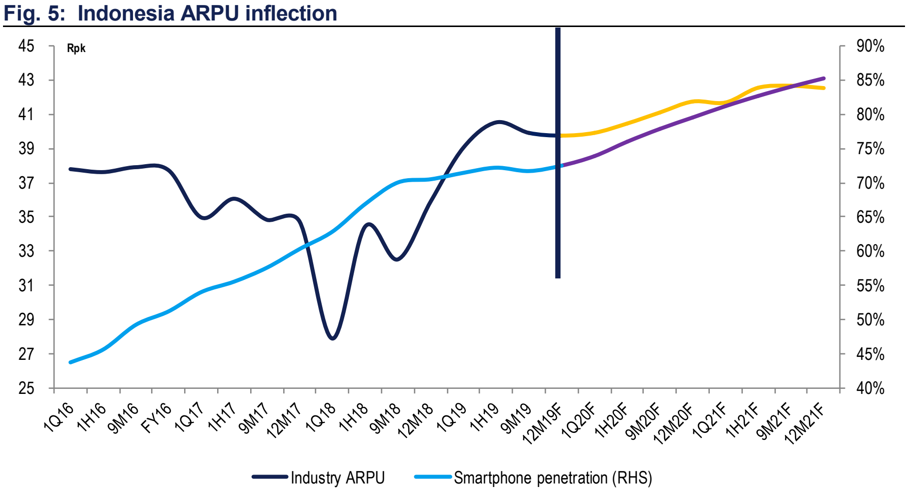


Sources: Company, IndoPremier

4) The trend has arrived in Indonesia

We are now seeing the trend happening in Indonesia. After the SIM-registration, telco operators have been able to eliminate the non-paying subscribers and subscriber consolidation happened. As smartphone penetration reached 67% in 2Q18, industry ARPU has started to inflect in 2Q18 and has rose by about 16% (from its low) by 3Q19. We expect ARPU for the Industry to continue to rise by 7% by 2021 as smartphone penetration continues to rise to 85%. Smartphone penetration is expected to continue to rise with it being fuelled by a combination of falling data prices, better network coverage, improved smartphone affordability, and development of content. Indonesia is similar to India as a sense that it was predominantly a 2G market, but it has changed rapidly. In addition, ARPU remains the most competitive in the world.

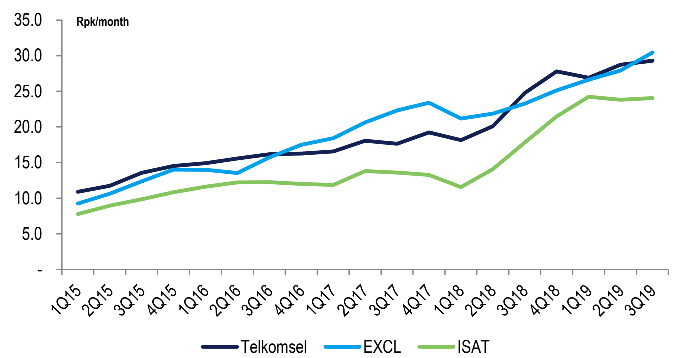
Fig. 5: Indonesia ARPU inflection



Sources: Company, IndoPremier

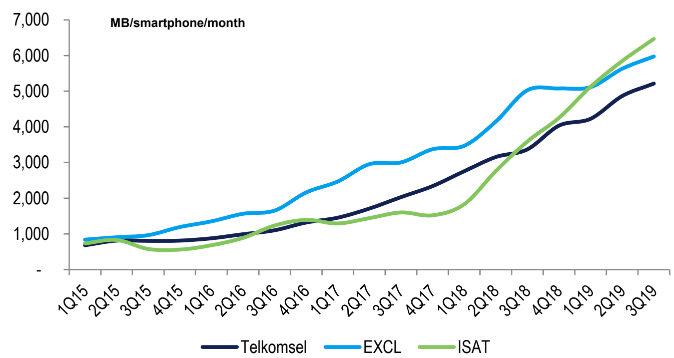
Although smartphone penetration has passed 70%, it seems data consumption has not peaked, as data consumption per month has reached c.6GB from c.1GB in 2016. We also do see consumers willing to spend more on data, as data ARPU continues to rise and telcos continues to be able to upsell their packages shown through the decline in data yield.

Fig. 6: Data ARPU trend



Sources: Company, IndoPremier

Fig. 7: Data traffic per smartphone



Sources: Company, IndoPremier

The latest data traffic growth was driven by 4G launched in late 2015 in parallel with higher smartphone adoption. The launch of 4G increased the average network speed from 1-2 Mbps to 10-20Mbps. Better speed was able to allow users to stream online videos with less buffering interference, which was supported by the infrastructure that caught up with the device and available content.

Rise in ARPU driven by data to offset drop in voice/SMS revenue

As of 3Q19, EXCL has the highest data revenue contribution (78% of cellular), followed by ISAT (75% of cellular) and Telkomsel (65% of cellular). *Monetization will come through upselling of existing plans through targeted ads through SMS or in-house mobile app*. By upselling its products, these telco operators aim to achieve higher growth – even at a glance, data prices may be cheaper per GB but the overall amount of money spent by the customer per month can increase. *Through upselling, ARPU will be able to rise, but the drawback comes from cheaper price/GB, hence the continuous decline in data yield*.

Post SIM registration that happened in 2018, telco industry experienced a clean-up in non-paying subscribers which was responsible in diluting its overall ARPU. As a result, ARPU has been steadily increases over the period, in-line with the current strategy of telcos to continue to upsell its products to customers.

The SIM registration enabled the industry to have lower churn rate (increase customer stickiness). It created a shift in strategy from selling starter packs to more on renewals of data packages. So far, it has been a positive driver for industry growth in 2019.

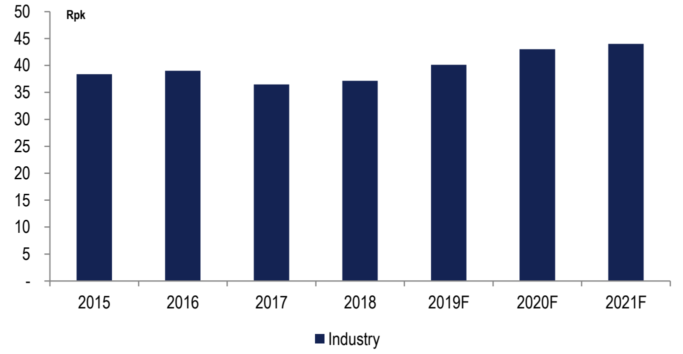
Data revenue will continue to grow driven by rising data consumption as well as rise in smartphone penetration. It's imperative both factors to be readily available and affordable in order to achieve certain traffic growth. If we look back, data growth accelerated in 2013 after devices' prices fell. In addition, 3G data was available in Indonesia from 2008 as prices of Blackberry and Android phones fell. Currently, lower-end smartphone prices have also dropped (by c.30% FY15-9M19 CAGR to as low as Rp599k-1,499k for lower-end 4G smartphones) while availability continues to rise.

Revenue growth was driven by data service revenue through a combination of upselling and data monetization. *However, to some extent rising data revenue was being dragged down by legacy businesses (voice and SMS)*, though it will be diluted overtime. We project overall legacy business to be only c.15% of revenue in FY21F vs. c.48%/c.35% in FY17/18.

Currently, Telkomsel has the highest legacy revenue contribution. Telkomsel's voice and SMS traffic continues to decline due to cannibalization from instant messaging applications amid the rising smartphone penetration. EXCL's data revenue contribution has reached 78% in 3Q19 followed by ISAT at 76% and Telkomsel at 65%.

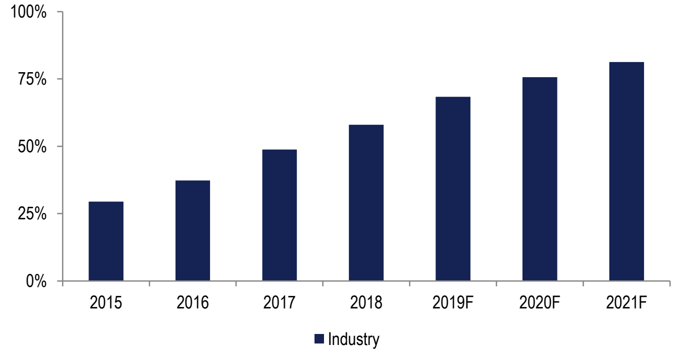
Although we expect industry ARPU to improve, we expect ARPU improvement to come from Telkomsel and EXCL. ISAT's ARPU will experience flat to slight decline in ARPU do to the company releasing monthly packages priced below its current ARPU level. However, data revenue contribution in the industry will continue to grow due to rise in consumption.

Fig. 8: Industry ARPU trend



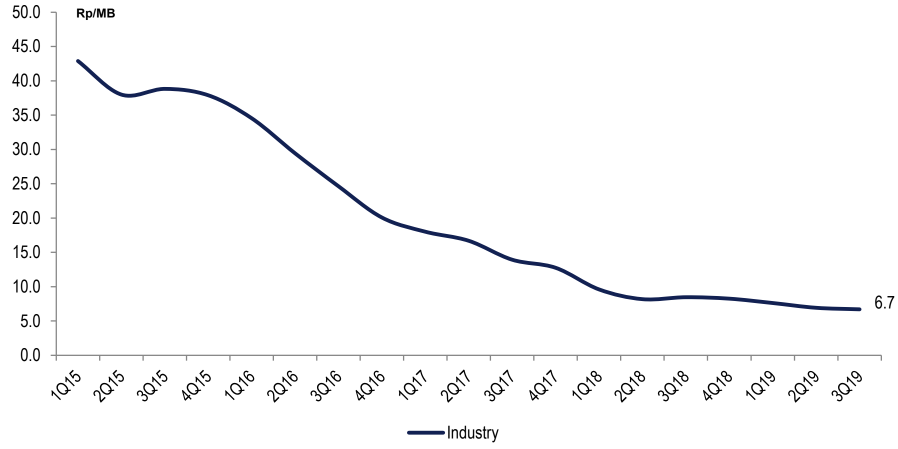
Sources: Company, IndoPremier

Fig. 9: Data revenue contribution



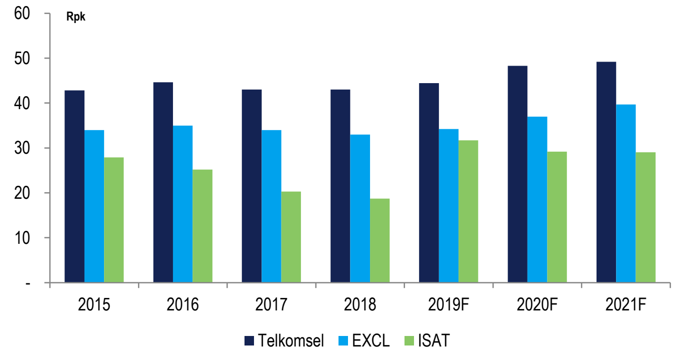
Sources: Company, IndoPremier

Fig. 10: Industry data yield trend



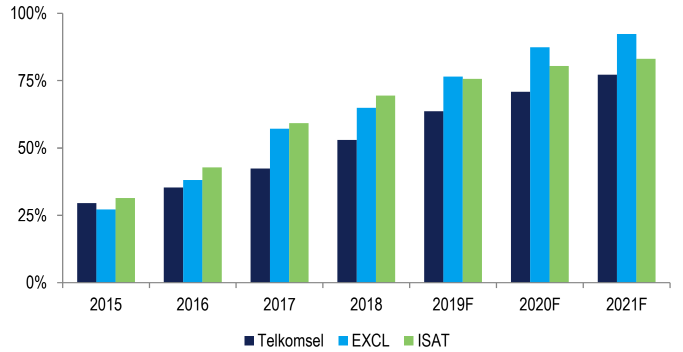
Sources: Company, IndoPremier

Fig. 11: ARPU trend



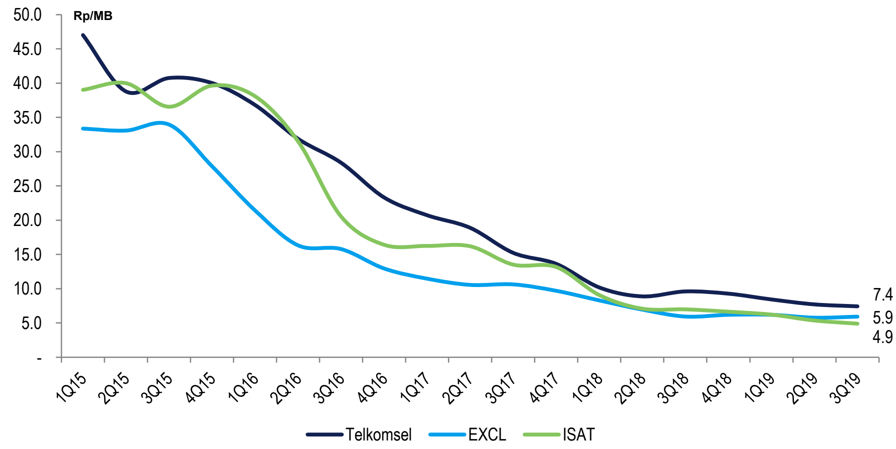
Sources: Company, IndoPremier

Fig. 12: Data revenue contribution



Sources: Company, IndoPremier

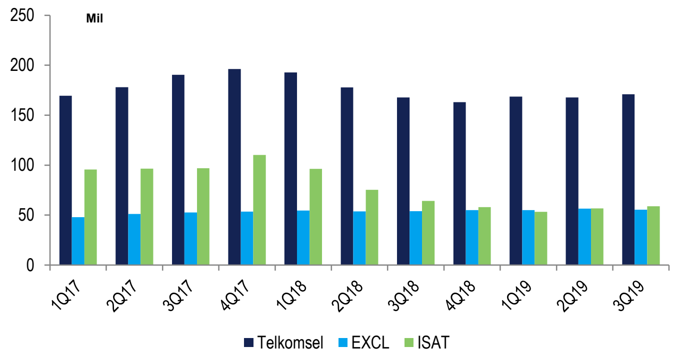
Fig. 13: Data yield trend



Sources: Company, IndoPremier

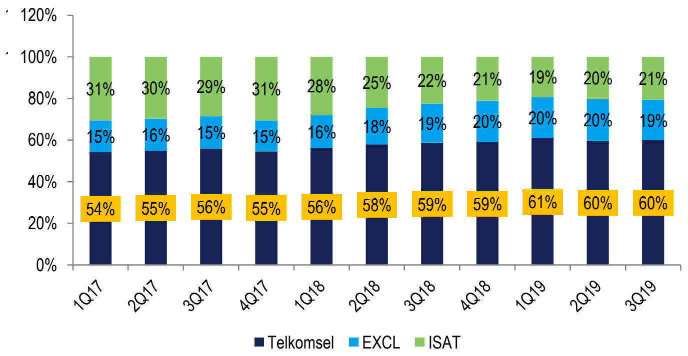
In 3Q19, EXCL lost a bit of subscriber market share as its total subscribers stood at 55.5mn (19% market share) while ISAT gained 2mn subscribers to 59mn subscribers (21% market share) and Telkomsel gained 3mn subscriber to 171mn (60% market share). Aggressive promotion was done by ISAT as its subscriber share has dropped substantially from 30% in 2017 to 20% in 2019. We view that the slight price adjustment in 2H18 and early 1H19 was done to decrease utilization and increase cash flow for network expansion. However, as they are now planning to sell assets to fund rapid expansion, we can expect them to not increase prices substantially in the near-term.

Fig. 14: Subscriber trend



Sources: Company, IndoPremier

Fig. 15: Subscriber market share

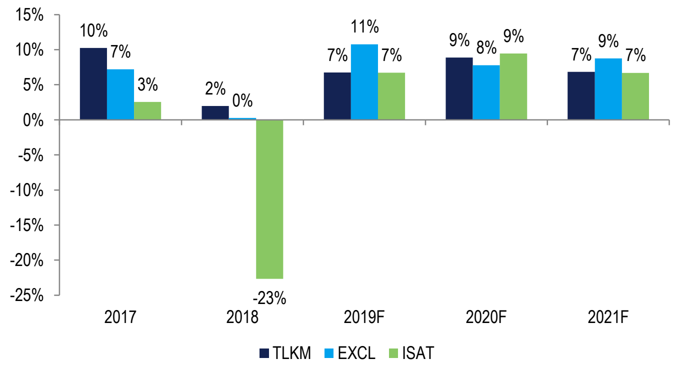


Sources: Company, IndoPremier

In 1H19, the industry experienced a more rational pricing environment compared to 2018 which has enabled the industry to monetize its packages. However, ISAT is still recovering, as a huge EBITDA decline incurred in 2018 with its EBITDA declining 50% YoY amid its strong growth in 2019F.

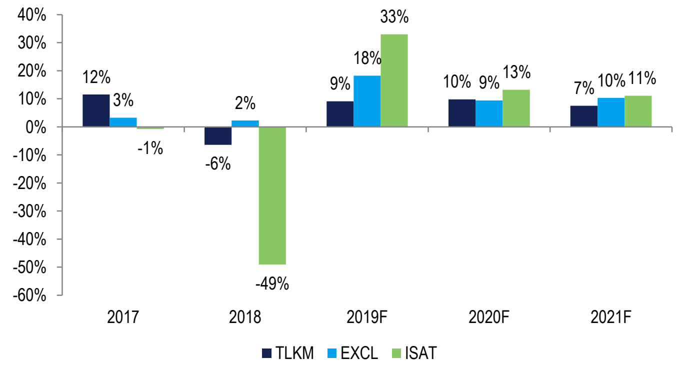
Going forward, revenue growth will be generated through high data traffic growth (c.40% CAGR from 2019F-21F), as well as smartphone penetration reaching 85% by end of 2021. Meanwhile, EBITDA may grow ahead of revenue amid improvement in EBITDA margin. This was due to several costs saving done by the telco operators (i.e. controlled marketing and personnel cost).

Fig. 16: Revenue growth trend



Sources: Company, IndoPremier

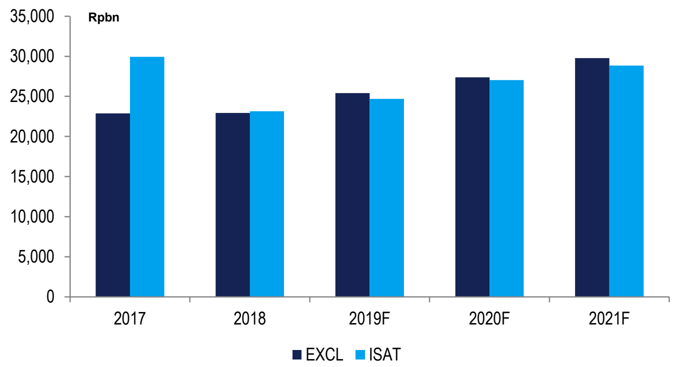
Fig. 17: EBITDA growth trend



Sources: Company, IndoPremier

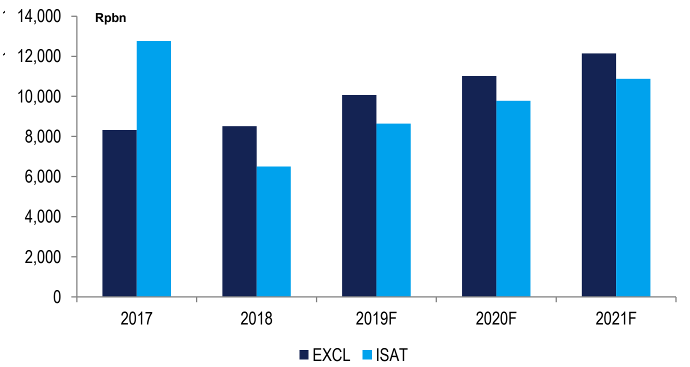
ISAT's strong EBITDA growth was a result of a low base effect from 2018 post SIM-registration. ISAT's absolute EBITDA remain about 10-15% lower than EXCL's from 2019F-21F. This was despite ISAT's lower cost of service in 3Q19 (excluding depreciation - actually came lower than EXCL's, first time since 2017), though we don't think it will be sustainable for every quarter during a capex intensive cycle.

Fig. 18: Revenue comparison



Sources: Company, IndoPremier

Fig. 19: EBITDA comparison



Sources: Company, IndoPremier

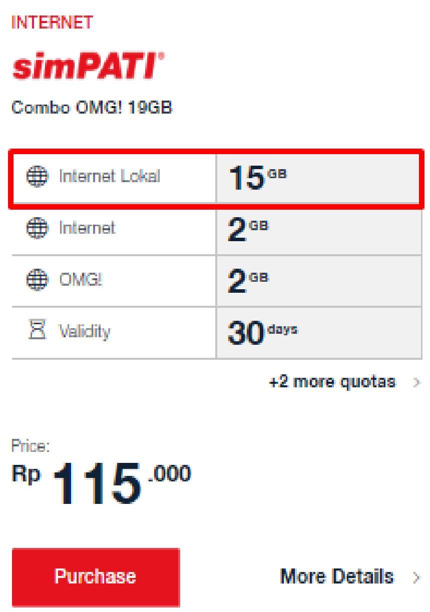
The start of 5G rollout might be a couple years away

What they can do now? In anticipation of 5G, the logical move for telcos would be to strengthen its balance sheet through monetization of assets and subscribers as well as do several cost savings and partnership that drives value. Some strategies below are currently being done by telcos.

1) Lowering costs is imperative

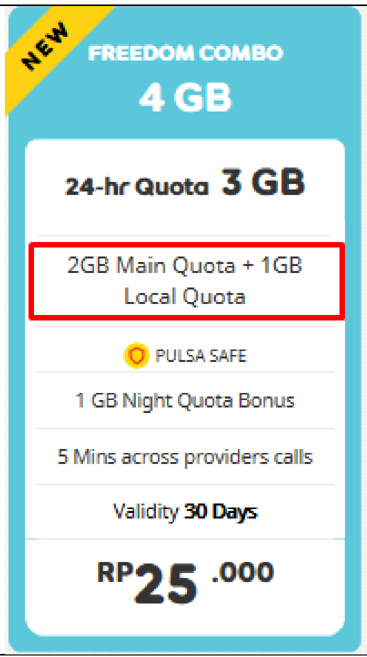
Cost reduction can come through renegotiating down tower renewal leases as well as prioritizing low utilization sites (special data area plans). EXCL started the local data quota approach first through its Xtra Combo Lite used to penetrate the ex-Java market. Given its success in gaining subscribers, ISAT and Telkomsel have followed the approach. The local data quota is a good way to utilize unused BTS capacity in those areas as internet penetration remains low in most ex-Java region.

Fig. 20: Telkomsel's new plan with local data



Sources: Company, IndoPremier

Fig. 21: ISAT's plan with local data

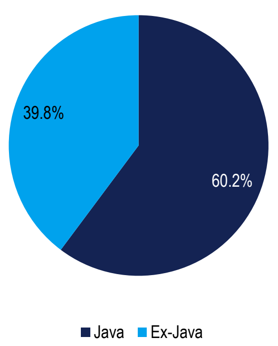


Sources: Company, IndoPremier

2) Prioritizing investments in key profitable areas

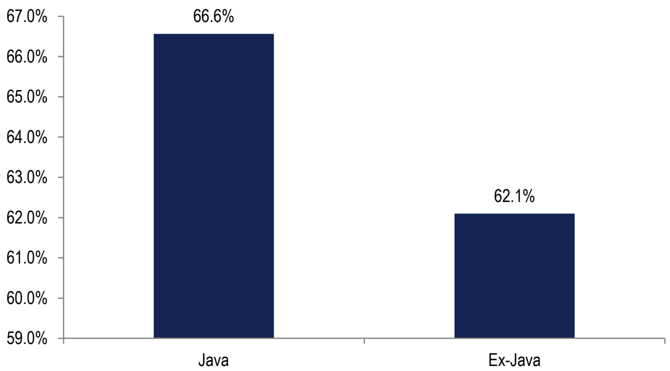
Investments focused in profitable districts would be another approach to penetrate the market. We are currently seeing smaller telcos trying to penetrate ex-Java as internet penetration in some of those areas have gone over 70%. Subscriber acquisition would be easier in those areas as those users would have interacted and are educated with internet and would then seek value plans offered by operators.

Fig. 22: Internet penetration contribution



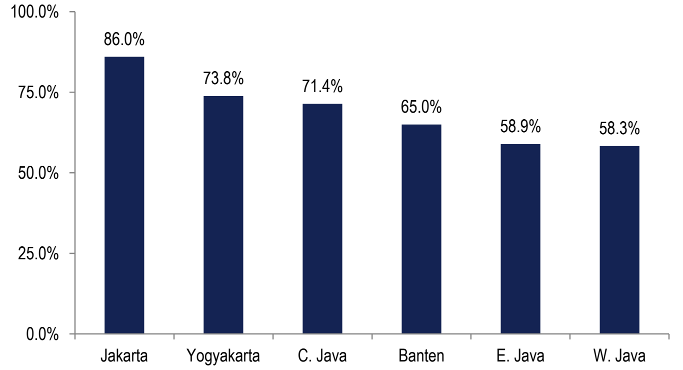
Sources: Company, IndoPremier, APJII

Fig. 23: Internet penetration in Java vs ex-Java



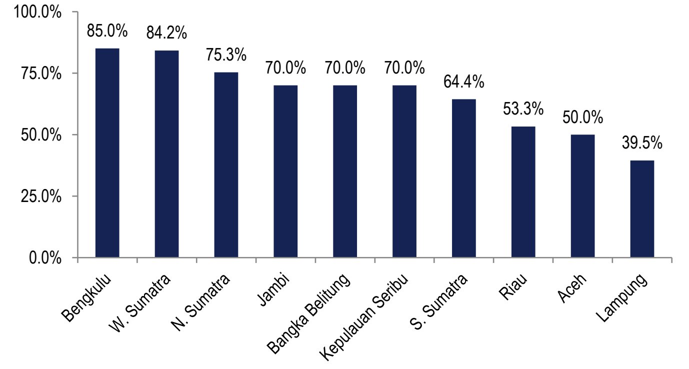
Sources: Company, IndoPremier, APJII

Fig. 24: Internet penetration in Java



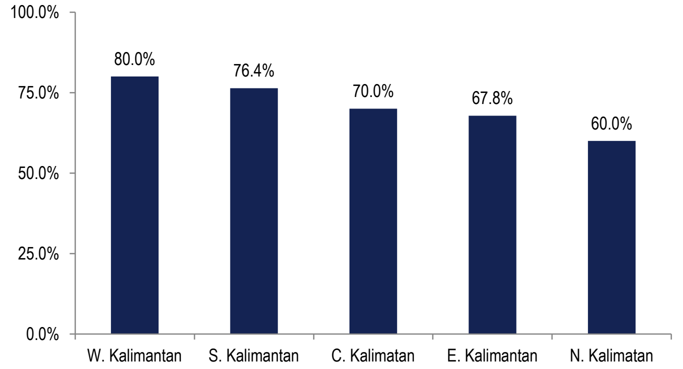
Sources: Company, IndoPremier, APJII

Fig. 25: Internet penetration in Sumatra



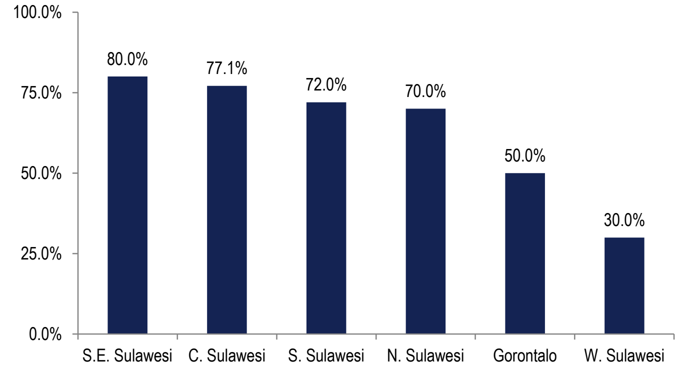
Sources: Company, IndoPremier, APJII

Fig. 26: Internet penetration in Kalimantan



Sources: Company, IndoPremier, APJII

Fig. 27: Internet penetration in Sulawesi

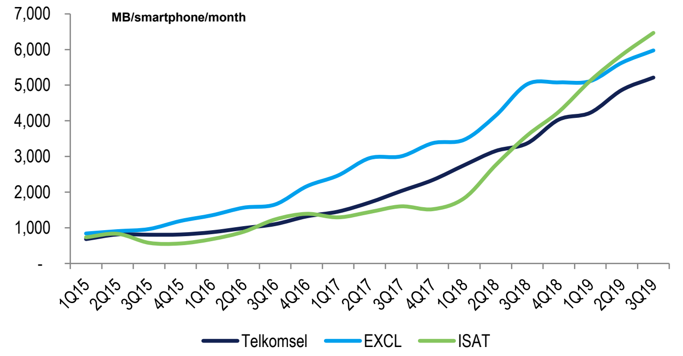


Sources: Company, IndoPremier, APJII

In addition, EXCL and ISAT continue to invest in fiberization in order to handle the rising data traffic. Meanwhile TLKM's latest way of increasing coverage is through purchasing 2,100 towers from ISAT through Mitratel and potentially purchasing EXCL's upcoming 3,200-3,300 tower sale.

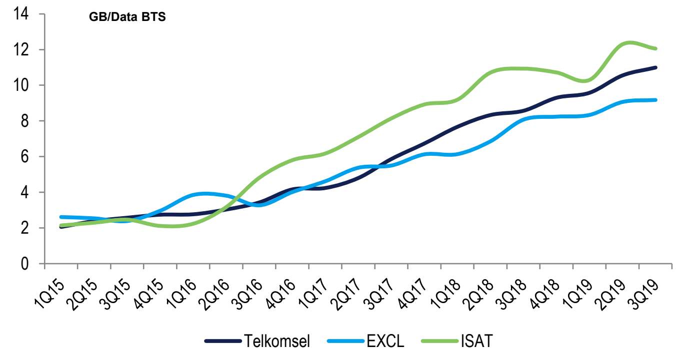
Despite strong data consumption, network expansion has managed to caught-up to the pace of data revenue growth, where utilization per BTS has normalized in 3Q19. ISAT's is leading the data traffic per smartphone which has reached 6.5GB/month while EXCL's data traffic per smartphone has almost reached 6GB/month. Utilization wise, ISAT's towers remains to be most utilized which potentially reduces network speed.

Fig. 28: Data traffic/smartphone trend



Sources: Company, IndoPremier

Fig. 29: Data traffic/BTS

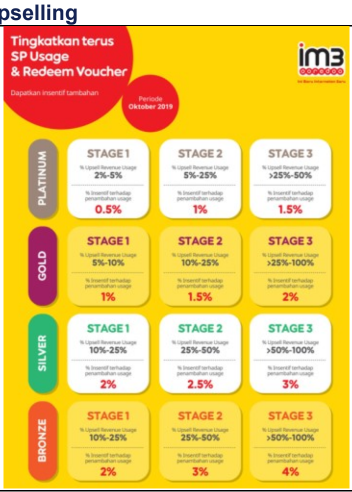


Sources: Company, IndoPremier

3) Higher ARPU via simplification of plans, rationalisation & upselling

Driving ARPU improvement can come through releasing recharge packages with higher pricing point than current ARPU. In addition, shifting and encouraging customers to switch to higher value recharges will also increase ARPU. This can include unlimited packages and also include removal of standalone talk-time recharges and shift to data bundled in every recharge-drive data users. Low ARPU plans are slowly shifted out to encourage lower paying customers to quit, while unlimited data offerings would prompt subscribers to consolidate their usage on a single SIM. *Lastly, increasing the minimum recharge to stay on network would also reduce inactive base customers*.

Fig. 30: ISAT's upselling



Sources: Company, IndoPremier

Fig. 31: EXCL's Xtra Combo VIP upselling

Sources: Company, IndoPremier

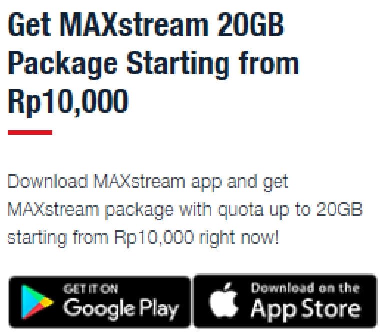
4) Partnership to drive value

The next big trigger in data consumption will come from content that will boost consumption. These contents can come in the form of video streaming platforms and online game. We see telcos increasing focus on coverage and capacity in order to provide speed and volume to support more content. Three key factors that will grow traffic growth for data will come from device (penetration), infrastructure, and content.

In India, more relevant local content, in Hindi started to emerge. Data volume growth in India was driven by video growth. In 2017, video consumption increased almost five times in the country. Higher data consumption is mainly being driven by rise in content. This trend has now arrived in Indonesia as seen by Netflix's strategy on releasing more Indonesia localized content.

Partnership to drive value would also drive ARPU growth through monthly data usage. Telkomsel offers extra quota usable in HOOQ, VIU, and MAXstream to drive more content usage. On the other hand, ISAT and EXCL offer unlimited YouTube and selective application usage for its subscribers.

Fig. 32: Telkomsel's partnership with MAXstream



Sources: Company, IndoPremier

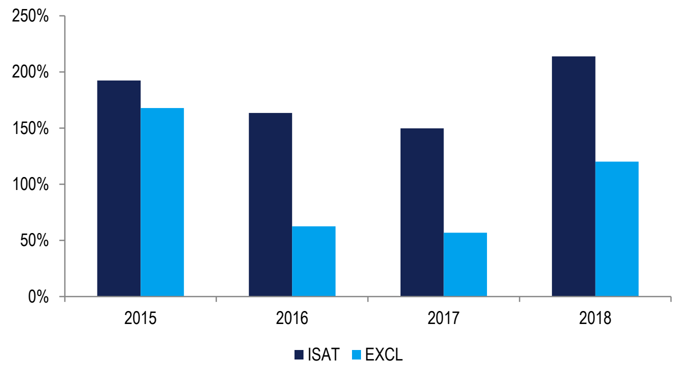
Fig. 33: Indonesian movie by Netflix

Sources: Company, IndoPremier

5) Strengthening the balance sheet becomes more imperative

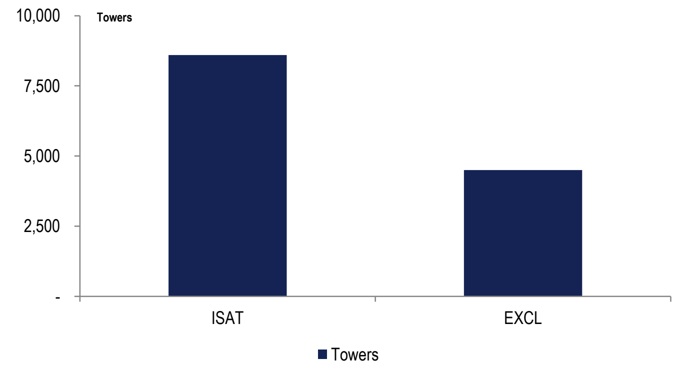
As net gearing of EXCL and ISAT has reached 120% and 214%, respectively, they explored the option to monetise its tower assets to strengthen its balance sheet to boost capex productivity. In a way, sale of assets at higher valuation than the company's own internal valuation triggers a value for them to monetize. Cash received from the sale can potentially be used to further expand coverage, deleverage, or pay special dividend.

Fig. 34: ISAT and EXCL's net gearing



Sources: Company, IndoPremier

Fig. 35: ISAT and EXCL's tower portfolio



Sources: Company, IndoPremier

How's the competition so far?

ISAT managed to gain traction by introducing new packages (Unlimited plan), where it gained subscriber share and high data traffic growth. It's smartphone users now consume the most data per month (c.6.5GB), ahead of EXCL's subscriber starting 2019.

Tighter competition happened in 3Q19 where EXCL was willing to give extra internet quota through Xtra Kuota Zero with 0 cost to subscribe through its Xtra Combo plans. The additional quota can be used for Youtube, Instragram, Netflix, and other apps. The additional quota slashed EXCL's price/MB by 4%-25%.

Meanwhile, ISAT managed to introduce new Freedom Internet package that provides 100% main quota internet, with no time and usage restriction. The new plans offer pure data at the range of Rp4k/GB-Rp8.3k/GB. In October, ISAT raised yellow package plan to Rp3.5k and claim that its unlimited plans are no longer available for new subscribers.

Albeit all these new competitions, we view Telkomsel's move of releasing a family package that can be shared between five users positively. The price per GB falls at Rp4.4k/GB-Rp7.5k/GB. The move allows Telkomsel to cater younger generations where they could previously be using Smartfren or 3.

Fig. 36: EXCL additional data quota free of charge

Sources: Company, IndoPremier

Fig. 37: Telkomsel KuotaKeluarga plan

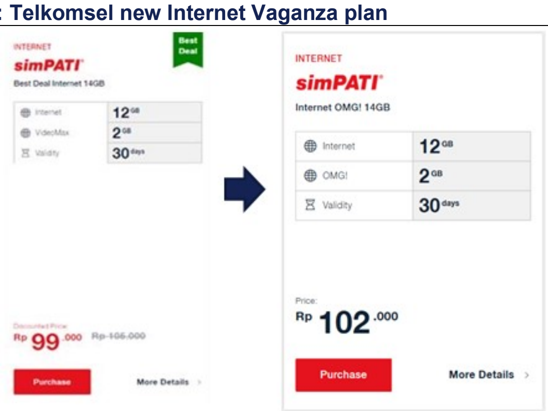
Sources: Company, IndoPremier

Although ISAT and EXCL are recently offering better price per GB quota to customer, we do not expect competition to de-escalate. In the past couple of quarter, the top three telcos have continued to increase their BTS in order to increase capacity. The next logical thing for them to do is to utilize its capacity by offering more attractive plans. The best scenario for the industry is to have the telcos not cut prices, but offer more data for its existing plans. By doing so, the telcos will have the ability to elevate ARPU amid diminishing data yield.

Given that currently, ISAT and EXCL have increased its value offering, we do see limited room for Telkomsel to further increase its data packages going forward given EXCL's lower tower utilization compared to Telkomsel.

Recently, Telkomsel raised its price for Internet Vaganza from Rp99k to Rp102k and rebrand it to Internet OMG! In a glance, it show improvement in the industry, but in reality, Telkomsel introduced a cheaper entry price plan at Rp39k with 4GB data quota and Rp63k with 7GB data quota. The Rp39k plan offers similar data quota with ISAT's Rp25k Freedom Internet plan. Meanwhile, the Rp63k plan is similar to EXCL's Xtra Combo plan entry price and offers the same main quota amount of 5GB, which means bad news.

Fig. 38: Telkomsel new Internet Vaganza plan

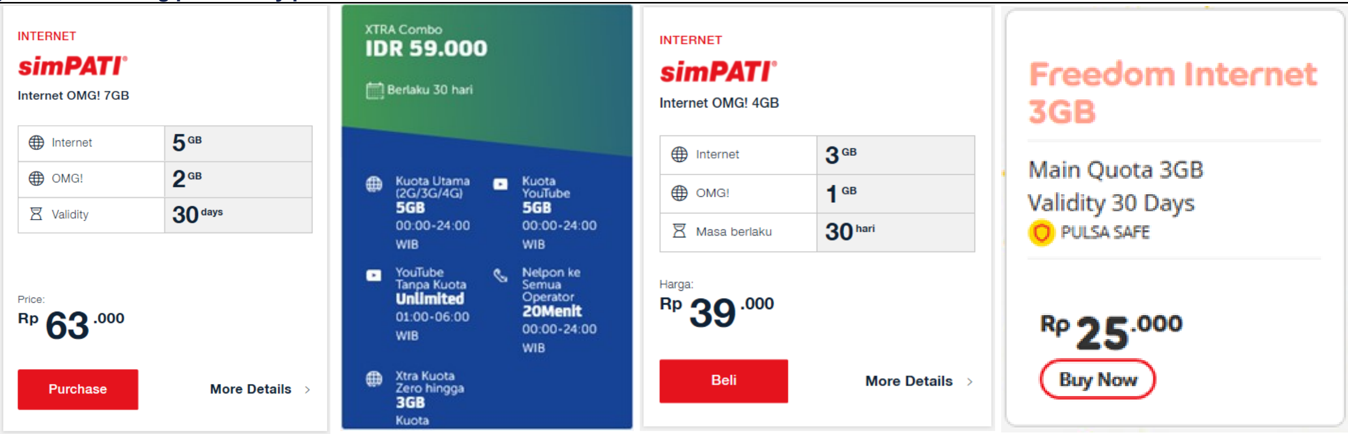


Sources: Company, IndoPremier

Fig. 39: ISAT's yellow package increase

Sources: Company, IndoPremier

Fig. 40: Best-selling plans entry price



Sources: Company, IndoPremier

Price war normally comes when growth targets are not met

History suggest that intensification of price war only happens when telcos don't meet the overall revenue growth target they expect and de-escalates once the goals are met. So far, we saw monetization in 2H18 to 1H19 as these revenue targets were met. However, as revenue growth has started to normalize, we've seen a shift in strategy by offering more data in packages.

In 2008, with little pressure from the CDMA players, the top 3 telcos managed to monetise their position and revenue growth for the industry grew strongly in 2012 (+12%). Hence, strong growth followed intense competition.

Next in 2013, another threat was formed by Hutch and Axis as they tried a new strategy to break the market. This time, they used aggresive data pricing to capitalise on growing smartphone penetration. At the time, smartphone penetration was only around 10% of the population.

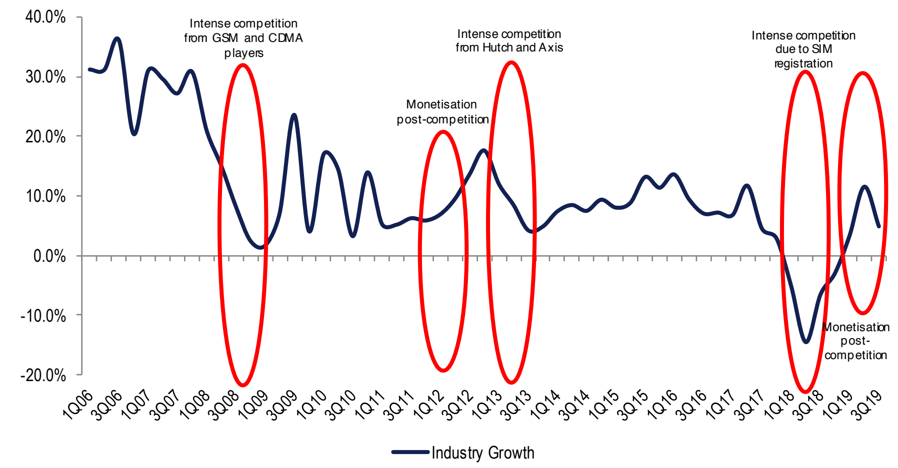
However, both of the telcos' strategy was not sustainable. It happened when EXCL and ISAT retaliated in 2013 by lowering its data prices, the competition crumbled. It was then Saudi Telecom's turn to sell Axis to EXCL in 2014.

Again, after the lack of competition in 2015, the industry managed to capitalised through lower competition. Telkomsel and ISAT managed to benefit further than EXCL in that period because EXCL decided to focus on its newly acquired Axis. Once again, strong growth followed intense competition.

In 2018, competition was quite intensive as telcos were grabbing marketshare before the SIM registration (higher churn post-registration) as well as the recently additional spectrum won that was used to increase capacity.

So far in 2019, growth has been very strong, given low base in 2018 due to SIM-registration and partially driven by data monetization. However, in 3Q19, we are starting to see ISAT introducing new plans to grab market share. As telco operators growth normalized in 3Q19, we are seeing telcos being more aggressive to meet their growth target. The strategy managed to work as ISAT has gained subscriber while EXCL lost a few. For the top 3 telcos, after instensified compeition, stronger growth is followed. Simillar to the event post SIM registration in 2018.

Fig. 41: Top 3 telco revenue growth during and after price war



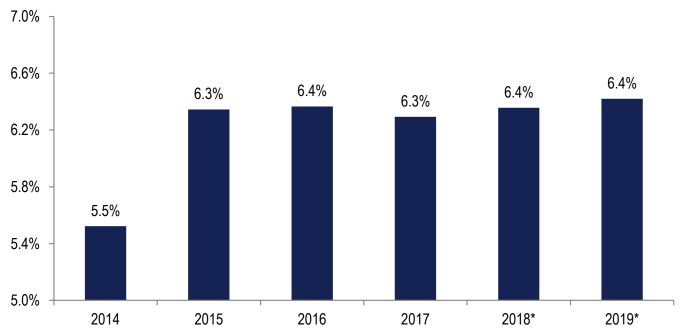
Sources: Company, IndoPremier

Risk for 2020 comes from change in consumer behaviour

Cigarettes and data packages are well known as commonly purchased item for the lower-middle income segment. Uncertainty for 2020 comes from potential change in consumer behaviour due to substantial rise in cigarette prices amid mild increase in minimum wage.

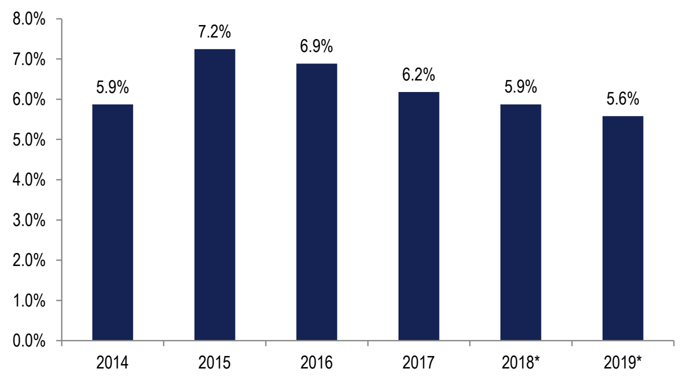
However, we do believe people will continue to spend on data as attachment for content and high penetration have shaped. Historical data shows that consumer spending on telcos go in-hand with overall non-food spending. Risk comes more from uncontrolled food inflation, which would force subscribers to reduce their telco spending in order to meet its daily needs.

Fig. 42: Indonesia yearly telco spending against non-food spending



*Sources: BPS, *IndoPremier estimate*

Fig. 43: Indonesia yearly telco spending against food spending



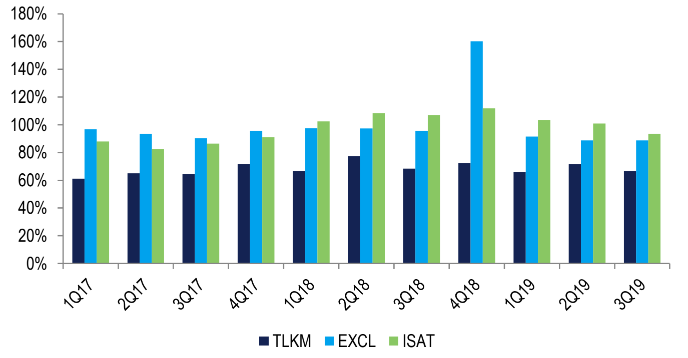
*Sources: BPS, *IndoPremier estimate*

Cost control is imperative; expect a declining trend in marketing expense

<u>In terms of marketing cost, we should expect a declining trend given that 2018 was the year of SIM registration where telco operators were fighting to grab subscriber share due to increase in churn post registration</u>. In addition, the implementation of IFRS 16 (PSAK 73) has managed to shift the companies' financial lease cost to be included in depreciation interest expense and calculated below the EBITDA line. So far ISAT and TLKM have complied with IFRS 16 while EXCL is expected to comply starting 2020.

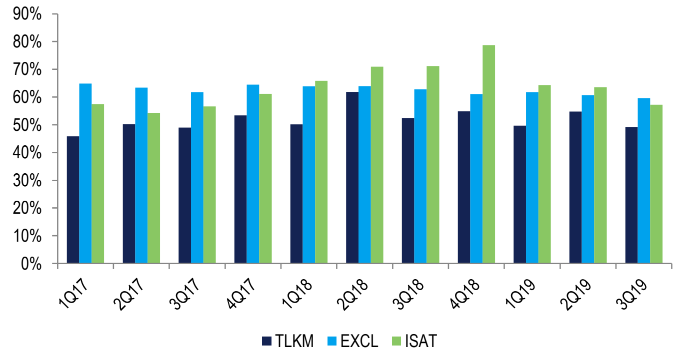
In 3Q19, the main surprise came from ISAT's sudden drop of cost where cost of service excluding depreciation was only 57% of revenue, lower than EXCL of 60% (hasn't happen since 2017). The main driver of the drop was staff benefit reversal (Rp200bn) from cancelation of defined benefit plan. The next question for ISAT comes from the sustainability of cost control. Based on the cost seasonality of the last 3-years, ISAT's cost of service in the last quarter of the year would account for 26-28% of total cost for the year.

Fig. 44: Cost of service as % to revenue



Sources: Company, IndoPremier

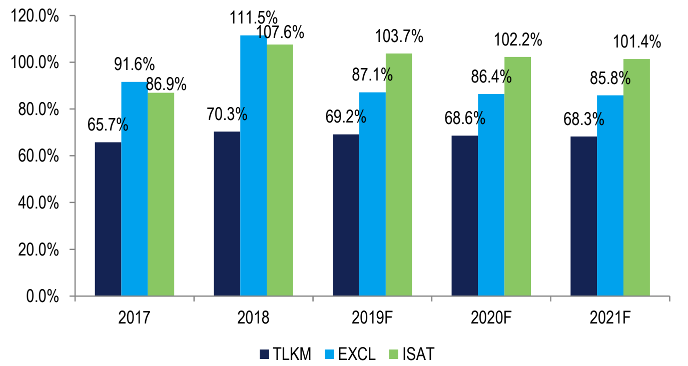
Fig. 45: Cost of services ex-depreciation as % to revenue



Sources: Company, IndoPremier

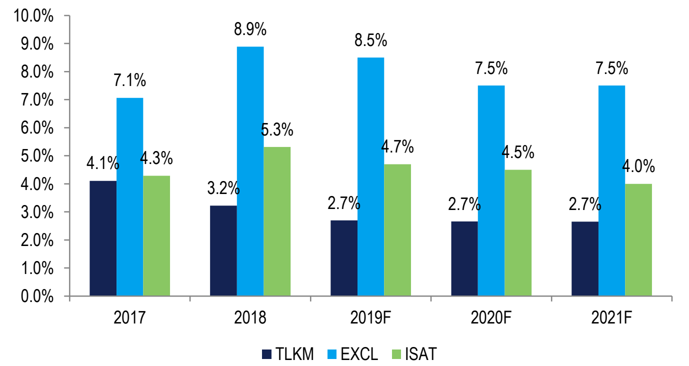
<u>Drop from cost of service going forward will come from savings of marketing and selling expenses and interconnection expenses</u>. However, the drop in interconnection expense comes naturally with the decline in interconnection revenue. More controlled going forward will come from marketing cost is doable because after SIM-registration as telcos are more focused on reloads instead of starter packs.

Fig. 46: Cost of service as % to revenue



Sources: Company, IndoPremier

Fig. 47: Marketing cost as % to revenue



Sources: Company, IndoPremier

Capex for the smaller players remain intensive for the next 3-years

So far, EXCL has managed to stand on its grounds by not increasing its pricing on monthly plans. EXCL was able to do this because it had significant excess capacity. *Being aggressive was doable to leverage this unused capacity in order to boost revenue and grab market share. EXCL used the advantage to exploit the opportunity and provide better value for its subscribers.* Not surprisingly, it had very strong data traffic growth and increased its traffic market share for the period.

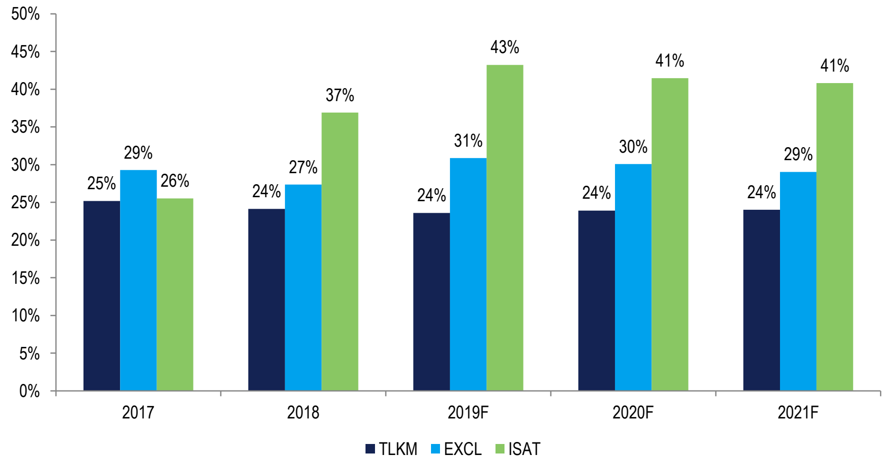
We view that EXCL became aggressive was because it had two years of negative revenue growth since it acquired Axis and four years of negative EBITDA growth from its previous price war against Axis and Hutch. To be aggresive, the company expanded its coverage to ex-Java and launched lower-end packages and paid higher incentives for distribution. Traffic went up while data yield and margin declined.

Meanwhile, ISAT has signed agreements to sell 2,100 towers to Dayamitra Telekomunikasi (Mitratel) and 1,000 towers to Profesional Telekomunikasi Indonesia (Protelindo) for Rp4.44tn and Rp1.95tn. The total cash proceeds of Rp6.39tn will be used to pay down debt and fund future capex. It has also signed into an agreement to leaseback 3,100 towers from the respective buyers for the next 10-years. After the sale, ISAT has c.5,000 remaining towers in its portfolio. The deal completion is expected to be done before end of 2019. To decrease its BTS utilization heavily, we expect ISAT to continue its grounds to roll-out capex heavily and rapidly.

Due to economic of scale in Indihome, TLKM has the ability to switch its capex spending back to its cellular service. We expect TLKM to continue to bid on any upcoming tower sale in the future, incuding. EXCL's 3,200-3,300 towers). Capex intensity for TLKM should remain constant given that it has always invested its network early.

ISAT's capex intensity will remain high in order to roll-out network to offset its high BTS utilization. The quickest way to offset rising cost would be to monetize its packages and increase data yield, but we do not see it happening soon given the huge drop of subscriber share that incurred post SIM-registration.

Fig. 48: Capex Intensity



Sources: Company, IndoPremier

Consolidation is needed to spark immediate growth

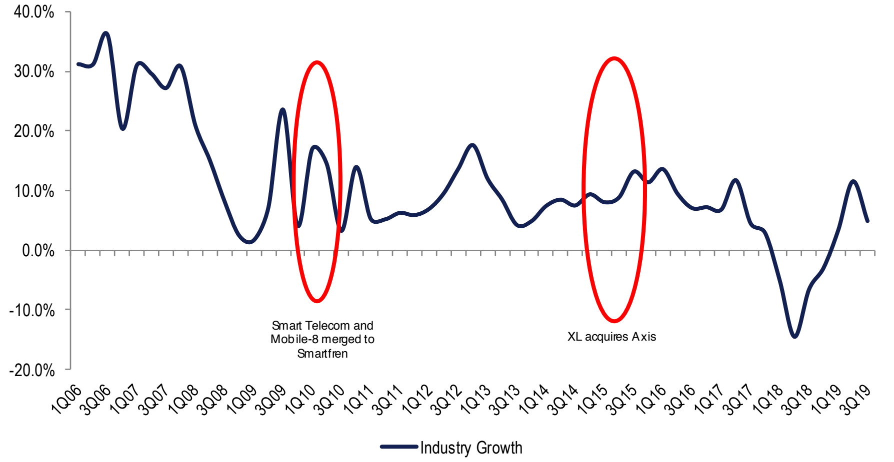
Based on historical data, the year post MnA of telco operators, the consolidated revenue growth of the top 3 in 2010 and 2015 has shown a positive YoY growth of 10-15% for every quarter. The consolidations that happened were merger of Smart Telecom and Mobile-8 to become Smartfren and the acquisition of Axis by EXCL.

Back in 2003 to 2009, many telcos entered the market as the industry growth exceeded 30% annually, while cellular phone penetration was only at 20%. During the aforementioned period, 2 new GSM telcos have started its operation, which were Hutchison Tri Indonesia in 2007 and Axis in 2008. Hutch's entry to the market was through its ownership in Cyber Access Indonesia that owns 3G licence. Axis was owned by Saudi Telecom via its acquisition of Maxis and Lippo Telecom's shares.

On the other hand, there were 5 new CDMA players; Flexi (Telkom-owned), StarOne (Indosat-owned), Bakrie Telecom, Mobile-8 and Smart Telecom also entered the market during the time. Competition was intense on the voice and SMS market. Smaller telcos started selling their towers to fund their operations including capex, which later created the tower industry in Indonesia. The strategy for CDMA was to use low prices to gain subscribers and market share.

In 2010, mobile penetration increased rapidly to 75% and the top 3 telcos continue to pressure the industry, and condition worsen in 2011. By then, Smart Telecom and Mobile-8 had merged to create Smartfren. Meanwhile, the rest of the CDMA players were suffering. CDMA players such as Flexi, StarOne and Bakrie Telecom were no longer in operation.

Fig. 49: Top 3 telco revenue growth post-consolidation



Sources: Company, IndoPremier

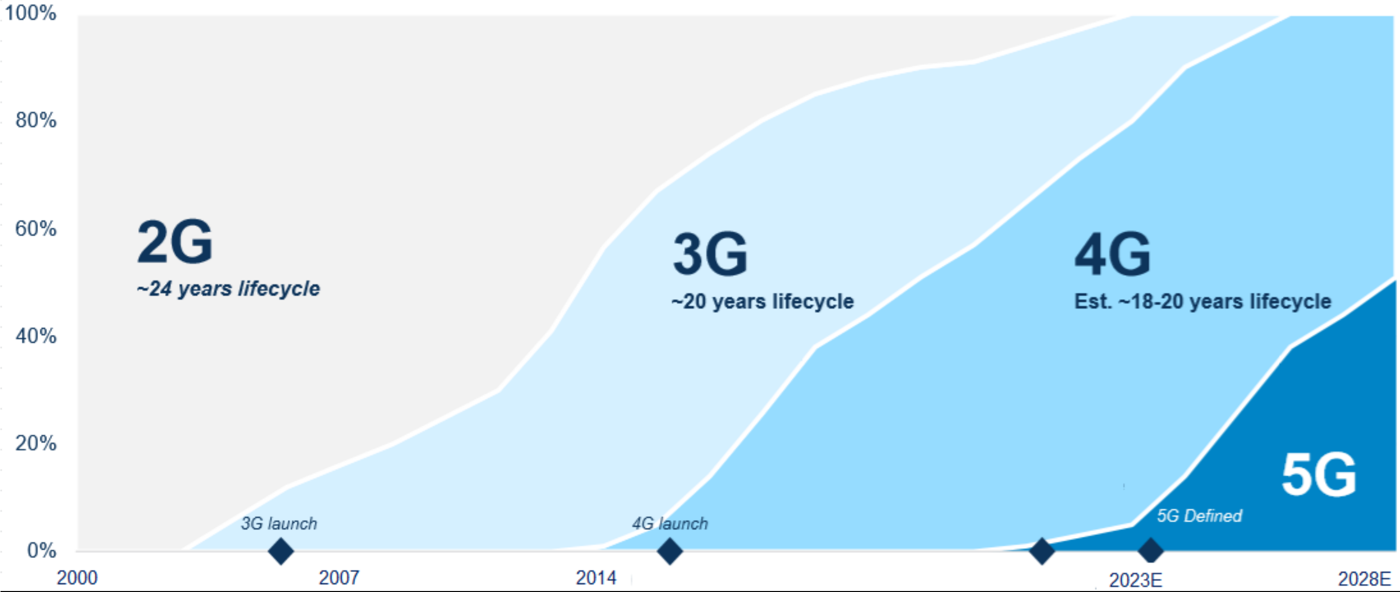
5G rollout will be costly and may take a longer time

Despite 4G market only being in Indo for less than 5-years, initial deployment of 5G are expected to occur within the next 3- years, with completion within 5-7 years. However, adoption may not be as fast as 4G to begin with, as value adds for consumer only comes in a form of speed and latency improvement.

Historically, every generation has taken c.20 years before expire and we see the trend to remain intact even for 4G. 4G should co-exist during the 5G rollout. Lack of 5G handsets will also slowdown rollout. Usage of the new technology will be shaped more for industry use. The capex to rollout alone is expected to be over Rp15tn per annum per telco.

There are ways for the govt to help telcos save cost for expansion, which can be done through allowing network sharing for 5G spectrum to save cost for telcos to expand. Network sharing will help the telcos save on upfront and yearly fees. Instead, the cost saving can be used for the telcos to expand in tower and fiber coverage.

Fig. 50: Lifecycle estimate

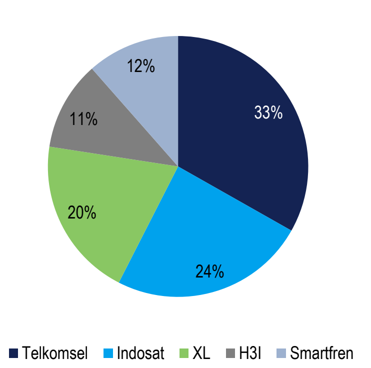


Sources: Company, IndoPremier

If Indonesia telco industry continues to experience price wars, we expect the party that fails to grab market share to consolidate with larger parties. Further consolidation is needed in preparation of 5G to accommodate the rising demand for data and higher investment requirements.

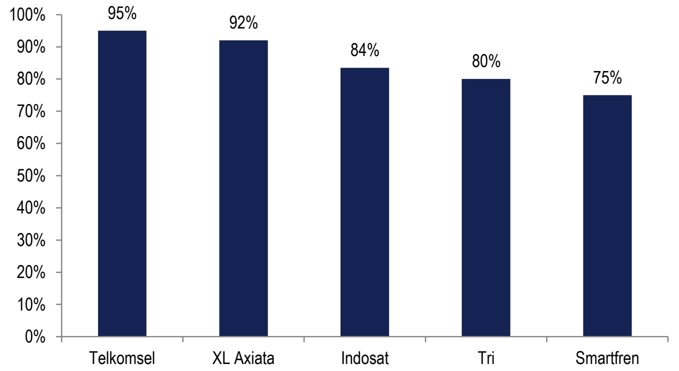
Through consolidation, the merging entity will experience increase in subscribers, coverage, and capacity. The best merging scenario would be telcos who have different customer profile to avoid subscriber cannibalism. Benefits from a merger would be spectrum consolidation which increases capacity, while scale of procurement post-merger should result in better prising and credit terms.

Fig. 51: Spectrum market share



Sources: Company, IndoPremier

Fig. 52: 4G population coverage



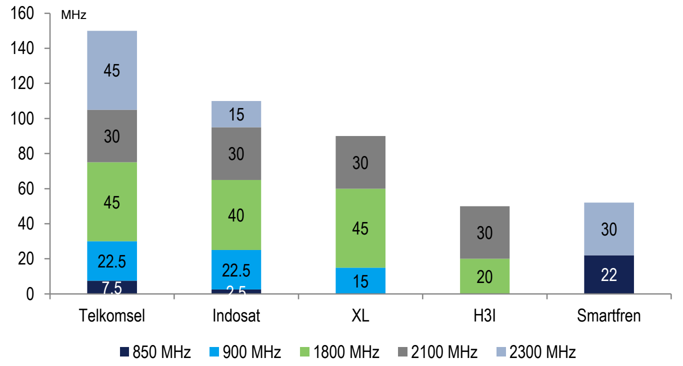
Sources: Company, IndoPremier

The government is giving its support for consolidation

The new Communication and Informatics ministry has expressed his eagerness to solve the spectrum regulation. The current overhang comes from spectrum transfer. Spectrum is categorized as a scarce resource, therefore it must return to the government after use. However, the ministry's latest proposal to solve the problem is through spectrum sharing. If this happens, TLKM would be at a disadvantage do to its big spectrum portfolio.

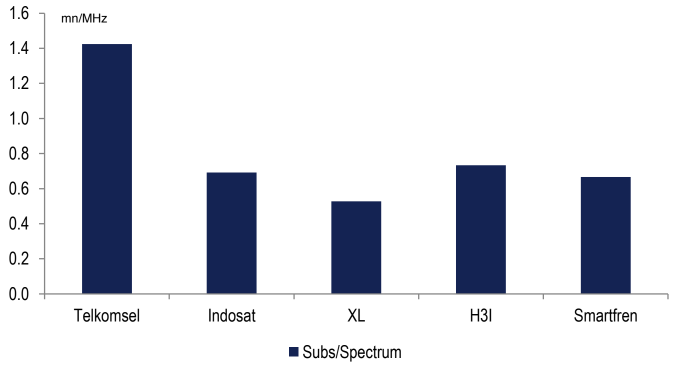
Aside from telco, we have also seen that consolidation is happening within the tower space. In 2018 and 2019, ISAT and EXCL are selling their towers in order to fund its capex for coverage and capacity. Meanwhile, TLKM through its subsidiary Mitratel has started to participate in tower bidding and have purchased 2,100 towers from ISAT.

Fig. 53: Spectrum allocation



Sources: Company, IndoPremier

Fig. 54: Spectrum allocation/subscriber



Sources: Company, IndoPremier

Initiate overweight on the sector with EXCL as our top pick

We initiate the telco sector with EXCL as our top pick, for the following reasons: 1) highest data revenue contribution; 2) lower cost of service from 2G asset depreciation kitchen sink in 2018. Other supporting catalysts for the industry are consolidation of telco operators as well as monetization of packages. However, the risk comes from price war if the telcos do not meet their internal growth target.

We view Indonesia's telco sector as a growing attractive sector, where data revenues continue to grow due to higher consumption and penetration, thus providing EBITDA growth for the industry. The drawback on the sector is the falling legacy revenue as cannibalism from data through messaging apps has taken its toll on previous voice and SMS services. In addition, high smartphone penetration will also halt growth.

Valuation wise, we value TLKM through DCF, with starting year of 2020F. Our key assumptions are 6.5% risk free rate, 7% equity risk premium, 3% terminal growth, and 1 beta due to the stable nature of the business. In addition, the implied WACC is 11.1%. We recommend Hold TLKM with value per share of Rp4,400 and imply 6.3x 2020F EV/EBITDA (+0.5 std average trading multiple) . The risks that TLKM faces are price war between telcos, consolidation of the smaller competitor, and infrastructure sharing.

Fig. 55: Telkomsel DCF valuation

Telkomsel DCF Model	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F
Ebit	35,630	39,683	42,355	46,571	50,883	55,230	59,290	81,613	93,347	105,427	117,912
Less:Cash Tax	-8,824	-9,827	-10,489	-11,533	-12,601	-13,678	-14,683	-20,211	-23,117	-26,109	-17,052
NOPLAT	26,806	29,855	31,866	35,038	38,282	41,553	44,607	61,402	70,230	79,319	100,860
Add: Depreciation	13,438	14,175	14,829	15,747	16,904	18,285	19,885	21,704	23,540	25,421	27,374
Less: Working Capital	249	396	442	-158	597	727	759	-1,958	690	975	1,334
Less: Capex	-14,205	-16,691	-18,361	-20,197	-22,216	-24,438	-26,882	-28,763	-30,777	-32,931	-34,578
Free Cash Flow	26,287	27,735	28,777	30,431	33,567	36,127	38,369	52,385	63,682	72,784	94,990

DCF	Now
Perpetual growth (%)	3.0%
Terminal value	182,961
NPV of DCF	232,071
Net debt	13,294
Equity value	428,326
Singtel's portion	149,914

WACC assumptions	
Cost of equity	13.5
After tax cost of debt	5.6
Risk free rate	6.5
Beta	1.0
Equiy risk premium	7.0
WACC	12.6%

Sources: Company, IndoPremier

Fig. 56: TLKM DCF valuation

TLKM DCF Model	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F
Ebit	43,017	47,756	51,537	56,330	61,666	67,235	72,660	83,004	98,833	116,865	138,586
Less:Cash Tax	-9,958	-10,956	-11,815	-12,818	-14,101	-15,393	-16,759	-19,013	-22,826	-27,246	-32,578
NOPLAT	33,059	36,800	39,722	43,512	47,565	51,841	55,902	63,990	76,007	89,618	106,008
Add: Depreciation	22,718	24,434	26,062	27,955	30,092	32,465	35,071	37,916	40,801	43,760	46,822
Less: Working Capital	-176	58	69	-208	81	144	204	419	-1,120	-520	-321
Less: Capex	-32,920	-36,342	-38,993	-41,861	-44,964	-48,323	-51,961	-55,097	-58,427	-61,964	-65,062
Free Cash Flow	22,681	24,950	26,860	29,397	32,775	36,127	39,215	47,229	57,261	70,894	87,447

DCF	Now
Perpetual growth (%)	3.0%
Terminal value	391,531
NPV of DCF	236,717
Net debt	(38,798)
Equity value	589,451
Less: Singtel's portion	149,914
Telkom's portion	439,537
Target price	4,400

WACC assumptions	
Cost of equity	13.5
After tax cost of debt	5.6
Risk free rate	6.5
Beta	1.0
Equiy risk premium	7.0
WACC	11.1%

Sources: Company, IndoPremier

Meanwhile, we value EXCL through DCF, with starting year of 2020F. Our key assumptions are 6.5% risk free rate, 7% equity risk premium, 3% terminal growth, and 1.2 beta. In addition, the implied WACC is 12.5%. EXCL's value per share comes at Rp4,200/share, implying 4.9x 2020F EV/EBITDA (-1 std average trading multiple) with Buy rating. The risks that EXCL faces are price war between telcos and consolidation of the smaller competitor.

Fig. 57: EXCL DCF valuation

XL Axiata DCF Model	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F
Ebit	2,740	3,146	3,609	4,233	4,930	5,800	6,781	7,848	8,977	10,181	11,444
Less:Cash Tax	-222	-336	-483	-753	-987	-1,280	-1,623	-1,956	-2,304	-2,725	-3,170
NOPLAT	2,518	2,810	3,125	3,480	3,944	4,520	5,159	5,892	6,673	7,457	8,273
Add: Depreciation	7,474	7,970	8,641	9,326	9,926	10,545	11,182	11,840	12,521	13,228	13,962
Less: Working Capital	-96	-89	115	-406	-412	-438	-456	-350	-531	-327	-302
Less: Capex	-7,842	-8,234	-8,646	-8,862	-9,101	-9,365	-9,656	-9,974	-10,323	-10,705	-11,123
Free Cash Flow	2,055	2,457	3,235	3,538	4,356	5,261	6,229	7,407	8,341	9,653	10,811

DCF	Now	WACC assumptions	
Perpetual growth (%)	3.0%	Cost of equity	14.9
Terminal value	36,171	After tax cost of debt	6.8
NPV of DCF	29,335	Risk free rate	6.5
Net debt	(23,278)	Beta	1.2
Equity value	42,228	Equiy risk premium	7.0
Target price	4,200	WACC	12.5%

Sources: Company, IndoPremier

Lastly, we value ISAT through DCF, with starting year of 2020F. Our key assumptions are 6.5% risk free rate, 7% equity risk premium, 3% terminal growth, and x beta due to the stable nature of the business. In addition, the implied WACC is 13%. ISAT's value per share comes at Rp3,300/share, implying 4.8x 2020F (average trading multiple) EV/EBITDA and Hold rating. The risks that ISAT faces are unsustainable cost control during rapid expansion, price war between telcos and consolidation of the smaller competitor.

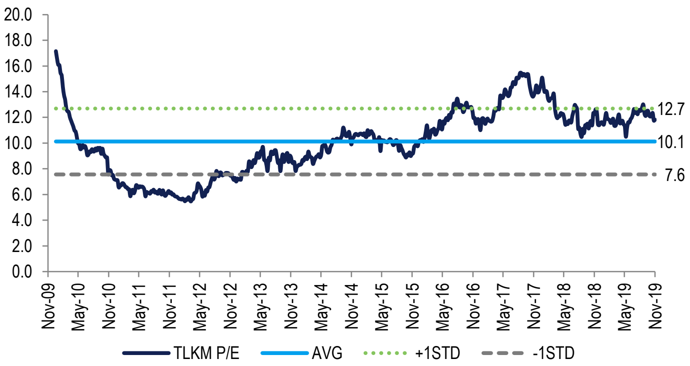
Fig. 58: ISAT DCF valuation

Indosat DCF Model	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F
Ebit	-919	-608	-391	580	2,050	3,677	4,800	6,242	7,429	8,864	10,575
Less:Cash Tax	72	516	474	527	241	-166	-462	-901	-942	-1,328	-1,865
NOPLAT	-848	-92	83	1,107	2,290	3,511	4,337	5,341	6,488	7,535	8,710
Add: Depreciation	9,563	10,393	11,263	12,178	12,782	13,763	14,793	15,874	17,009	18,202	19,453
Less: Working Capital	-206	-226	-181	-303	-362	-462	-481	-480	-511	-580	-657
Less: Capex	-10,672	-11,206	-11,766	-12,355	-12,972	-13,621	-14,302	-15,017	-15,768	-16,556	-17,384
Free Cash Flow	-2,162	-1,131	-601	628	1,739	3,191	4,348	5,719	7,219	8,600	10,122

DCF	Now	WACC assumptions	
Perpetual growth (%)	3.0%	Cost of equity	15.6
Terminal value	31,262	After tax cost of debt	6.8
NPV of DCF	15,035	Risk free rate	6.5
Net debt	(28,617)	Beta	1.3
Equity value	17,679	Equiy risk premium	7.0
Target price	3,300	WACC	13.0%

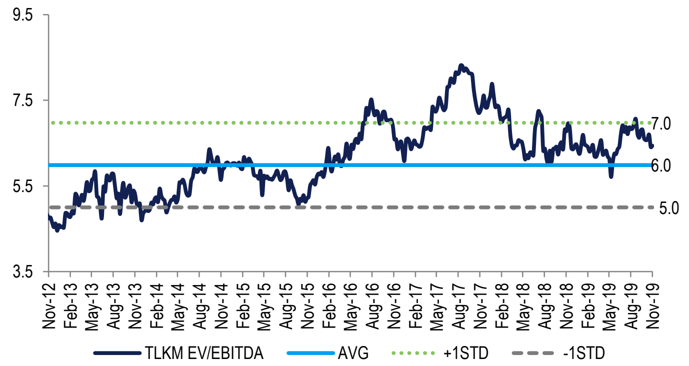
Sources: Company, IndoPremier

Fig. 59: TLKM P/E band



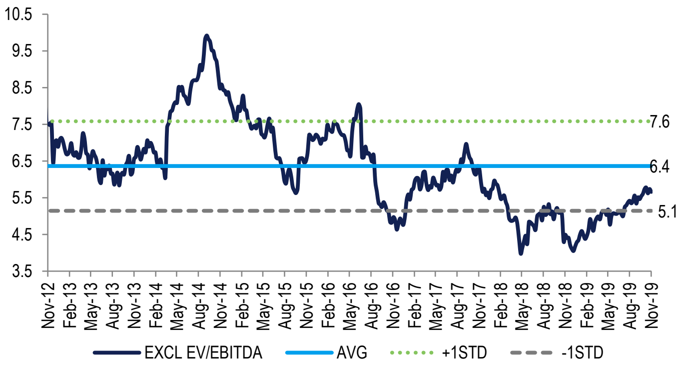
Sources: Company, IndoPremier

Fig. 60: TLKM EV/EBITDA band



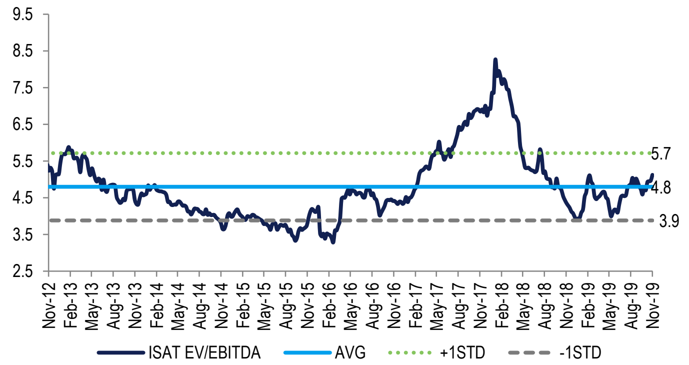
Sources: Company, IndoPremier

Fig. 61: EXCL EV/EBITDA band



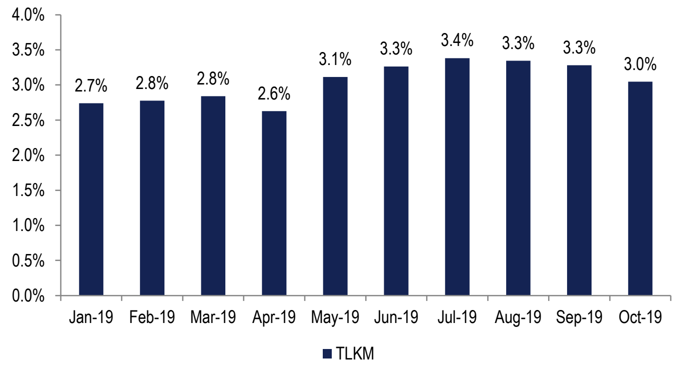
Sources: Company, IndoPremier

Fig. 62: ISAT EV/EBITDA band



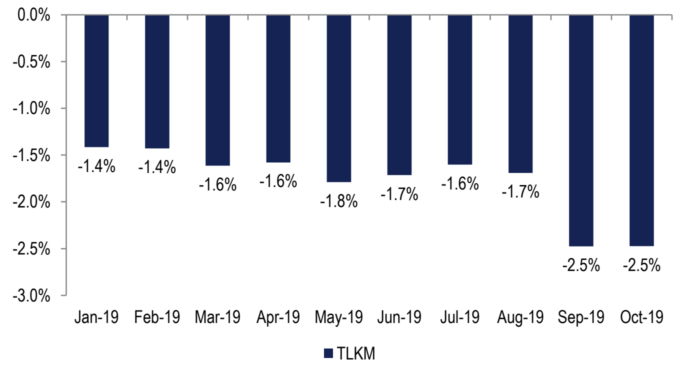
Sources: Company, IndoPremier

Fig. 63: TLKM local funds positioning vs JCI



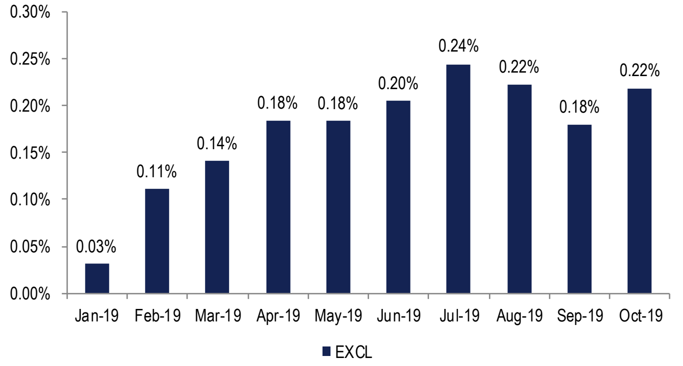
Sources: Company, IndoPremier

Fig. 64: TLKM local funds positioning vs MSCI



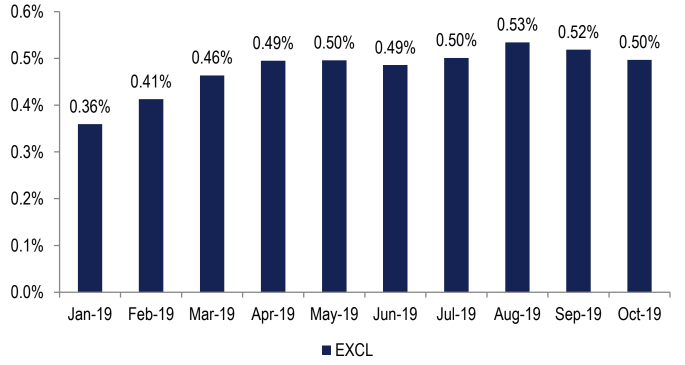
Sources: Company, IndoPremier

Fig. 65: EXCL local funds positioning vs JCI



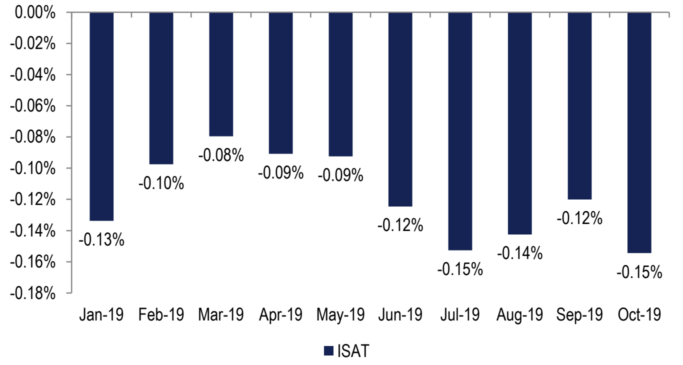
Sources: Company, IndoPremier

Fig. 66: EXCL local funds positioning vs MSCI



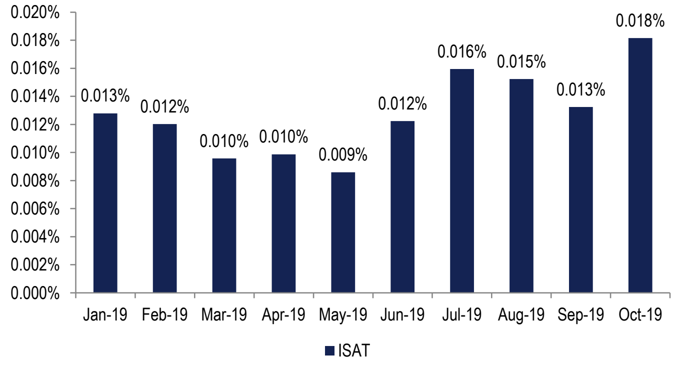
Sources: Company, IndoPremier

Fig. 67: ISAT local funds positioning vs JCI



Sources: Company, IndoPremier

Fig. 68: ISAT local funds positioning vs MSCI



Sources: Company, IndoPremier

INDOPREMIER

Telekomunikasi Indonesia

HOLD

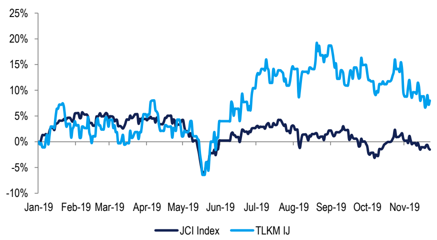
Initiation | Telecommunications | TLKM IJ | 22 November 2019

Stock Data

Target price	**Rp4,400**
Prior TP	*N/A*
Current price	Rp4,050
Upside/downside	*+8.6%*
Shares outstanding (mn)	99,062
Market cap (Rp bn)	401,202
Free float	48%
Avg. 6m daily T/O (Rp bn)	355

Price Performance

	3M	6M	12M
Absolute	-9.0%	10.7%	1.8%
Relative to JCI	-6.8%	9.5%	-0.1%
52w low/high (Rp)		3,510 – 4,470	



Major Shareholders

Republic of Indonesia	52.1%

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Further monetization is needed

- Going forward, smaller contribution of legacy revenue (35% of total revenue) should be less of a drag for Telkomsel's overall revenue.
- We expect capex spending to shift back to its cellular network from Indihome, which can be done through bidding for upcoming tower sale.
- Initiate with Hold due to growth normalization and further progress on monetization is needed.

Normalizing data revenue growth, while further monetization is needed
Mobile service revenue growth slowed to 1.1% QoQ, 1.8% YoY in 3Q19. Driven by data and digital service revenue that was up 3.9% QoQ and 20.6% YoY, and moderate decline in data yields to Rp7.4/MB (-3.7% QoQ, -22.6% YoY). Despite having some growth in subscriber +1.9% QoQ, ARPU declined by -2.1% QoQ, which normalized Telkomsel's revenue growth. Telkomsel needs to further monetize its packages to lead a healthier telco industry.

Legacy revenue contribution getting smaller
The data growth was partially offset by the drop in legacy revenues (-5.1% QoQ, -22.2% YoY). Legacy revenue has always been a drag to Telkomsel's revenue given its previous high revenue contribution, However, data revenue contribution to total revenue have now reached 65% (from 51% in FY18). We expect it to reach 80% contribution by end of 2021F.

Capex can now move back to cellular expansion instead of FTTH
Due to economic of scale in Indihome, TLKM has the ability to switch its capex spending back to its cellular service. We expect TLKM to continue to bid on any upcoming tower sale in the future (incl. EXCL's c.3,250 towers). Monetization of Indihome should come while TLKM awaits the next roll-out.

Shift to more profitable business in ex-Telkomsel segment
EBITDA margin managed to expand to 51% in 3Q19 due to lower O&M cost related to CPE and handset cost, general and marketing costs, mainly driven from the ex-Telkomsel segment. Telkomsel EBITDA margin remains stable at c.54%. We expect TLKM's EBITDA margin to reach 47.5% by 20F.

Initiate with Hold.
Initiate coverage with Hold rating derived through a DCF-based target price (WACC: 12.6%) of Rp4,400, implying 6.3x 2020F EV/EBITDA (vs. its 10Y avg of 6x). We expect going forward margin will expand through the elimination of some non-profitable enterprise business. The key risks are consolidation of its smaller competitors, price war, and infrastructure sharing.

Financial Summary	2017A	2018A	2019F	2020F	2021F
Revenue (Rp bn)	128,256	130,784	139,616	152,004	162,386
EBITDA (Rp bn)	64,379	60,251	65,736	72,190	77,599
EBITDA growth	11.5%	-6.4%	9.1%	9.8%	7.5%
Net profit (Rp bn)	22,145	18,032	20,990	23,710	25,559
EPS (Rp)	224	182	212	239	258
EPS growth	16.5%	-18.6%	16.4%	13.0%	7.8%
ROE	20.3%	15.7%	17.6%	19.1%	19.4%
PER (x)	18.1	22.2	19.1	16.9	15.7
EV/EBITDA (x)	6.4	7.1	6.6	6.1	5.7
Dividend yield	4.1%	4.0%	4.2%	4.1%	4.1%
Forecast change			N/A	N/A	N/A
IPS vs. consensus			98%	98%	97%

Sources: Company, IndoPremier *Share price closing as of: 22 November 2019*

Income Statement (Rp bn)	2017A	2018A	2019F	2020F	2021F
Net Revenue	128,256	130,784	139,616	152,004	162,386
Cost of Sales	0	0	0	0	0
Gross Profit	**128,256**	**130,784**	**139,616**	**152,004**	**162,386**
SG&A Expenses	-84,323	-91,939	-96,598	-104,248	-110,849
Operating Profit	**43,933**	**38,845**	**43,017**	**47,756**	**51,537**
Net Interest	-1,335	-2,493	-2,879	-3,404	-3,862
Forex Gain (Loss)	0	0	0	0	0
Others-Net	61	53	0	0	0
Pre-Tax Income	**42,659**	**36,405**	**40,138**	**44,352**	**47,675**
Income Tax	-9,958	-9,426	-10,035	-11,088	-11,919
Net Income	**22,145**	**18,032**	**20,990**	**23,710**	**25,559**

Balance Sheet (Rp bn)	2017A	2018A	2019F	2020F	2021F
Cash & Equivalent	25,145	17,439	15,447	14,674	14,975
Receivable	9,564	12,141	12,961	14,111	15,075
Other Current Assets	12,852	13,688	13,996	14,328	14,655
Total Current Assets	**47,561**	**43,268**	**42,404**	**43,113**	**44,705**
Fixed Assets - Net	130,171	143,248	153,450	165,357	178,289
Goodwill	3,530	5,032	5,032	5,032	5,032
Non-Current Assets	**17,222**	**14,648**	**15,251**	**16,604**	**17,662**
Total Assets	**198,484**	**206,196**	**216,136**	**230,106**	**245,688**
Payable	15,791	15,214	15,906	17,182	18,272
Other Payables	22,087	20,708	21,761	22,918	24,098
Current Portion of LT Loans	7,498	10,339	11,316	12,540	13,764
Total Current Liab.	**45,376**	**46,261**	**48,982**	**52,639**	**56,134**
Long Term Loans	27,974	33,748	36,937	40,932	44,927
Other LT Liab.	13,004	8,884	8,973	9,063	9,153
Total Liabilities	**86,354**	**88,893**	**94,892**	**102,634**	**110,214**
Equity	7,817	7,915	7,915	7,915	7,915
Retained Earnings	84,896	90,995	95,193	102,306	111,252
Total SHE + Minority Int.	**112,130**	**98,910**	**103,108**	**110,221**	**119,167**
Total Liabilities & Equity	**198,484**	**187,803**	**198,000**	**212,855**	**229,380**

Sources: Company, IndoPremier

Cash Flow Statement (Rp bn)	2017A	2018A	2019F	2020F	2021F
Net Income	22,145	18,032	20,990	23,710	25,559
Depr. & Amortization	20,446	21,406	22,718	24,434	26,062
Changes in Working Capital	-390	3,240	176	-58	-69
Others	7,204	2,993	9,041	9,298	10,278
Cash Flow From Operating	**49,405**	**45,671**	**52,925**	**57,384**	**61,830**
Capital Expenditure	-32,294	-31,562	-32,920	-36,342	-38,993
Others	-713	-3,528	0	0	0
Cash Flow From Investing	**-33,007**	**-35,090**	**-32,920**	**-36,342**	**-38,993**
Loans	2,930	8,285	4,166	5,219	5,219
Equity	0	0	0	0	0
Dividends	-23,982	-26,743	-26,163	-27,035	-27,754
Others	0	0	0	0	0
Cash Flow From Financing	**-21,052**	**-18,458**	**-21,997**	**-21,816**	**-22,535**
Changes in Cash	**-4,654**	**-7,877**	**-1,992**	**-773**	**302**

Key Ratios	2017A	2018A	2019F	2020F	2021F
Gross Margin	N/A	N/A	N/A	N/A	N/A
Operating Margin	34.25%	29.70%	30.81%	31.42%	31.74%
Pre-Tax Margin	33.26%	27.84%	28.75%	29.18%	29.36%
Net Margin	17.27%	13.79%	15.03%	15.60%	15.74%
ROA	11.71%	8.91%	9.94%	10.63%	10.74%
ROE	20.35%	15.72%	17.60%	19.07%	19.44%
ROIC	17.28%	12.61%	13.87%	14.48%	14.37%
Acct. Receivables TO (days)	27	34	34	34	34
Payable TO (days)	78	67	67	67	67
Debt to Equity	31.63%	37.58%	39.80%	41.95%	43.32%
Interest Coverage Ratio (x)	15.9	11.1	11.2	11.2	11.0
Net Gearing	9.21%	22.72%	27.06%	30.44%	32.27%

Sources: Company, IndoPremier

INDOPREMIER

XL Axiata

BUY

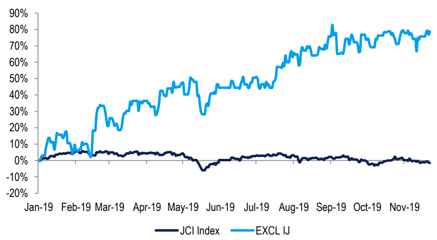
Initiation | Telecommunications | EXCL IJ | 22 November 2019

Stock Data

Target price	**Rp4,200**
Prior TP	*N/A*
Current price	Rp3,540
Upside/downside	*+18.6%*
Shares outstanding (mn)	10,688
Market cap (Rp bn)	37,835
Free float	34%
Avg. 6m daily T/O (Rp bn)	41

Price Performance

	3M	6M	12M
Absolute	5.7%	29.2%	60.2%
Relative to JCI	7.9%	28.1%	58.4%
52w low/high (Rp)			1,880 – 3,620



Major Shareholders

Axiata Investments	66.4%

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Continuous upselling is imperative to increase ARPU

- Higher data revenue exposure (78% of total revenue) minimizes the risk from falling legacy revenue.
- Potential sale of 3,200-3,300 towers can indirectly enhance EXCL's multiple as well as fund network expansion.
- Re-inclusion into MSCI Global Indonesia Index may also boost share price performance in the near-term.

Highest data revenue contribution amongst the top 3 telcos

EXCL strategy to upsell its packages to customers was seen in 3Q19, where overall ARPU managed to increase to Rp36k (+6% QoQ, +13% YoY), despite the drop of about 2mn subscribers (total subscriber of 54m). Data yield managed to stabilize at Rp5.9/MB. Data revenue contribution continues to increase to 78% in 3Q19 (from 63% in 2018). We do expect data traffic to remain strong growing at c.30% CAGR in 2019F-21F.

Lower BTS utilization provides room for lower data yield

Despite having a low data yield, data usage per BTS remains the lowest amongst the top 3 telcos. It allows EXCL to offer more data on its current packages. A move was done by EXCL of giving extra data quota through in-app purchases, in response to ISAT's aggressive package. It was positive in a sense that it did not lower the package price, which would translate to more stable ARPU. We do expect ARPU to rise to Rp40k by end of 2021.

Sale of tower asset to increase valuation and fund expansion

EXCL plans to sell 3,200-3,300 of its tower portfolio to fund its future expansion and monetize its asset. The tower sale may indirectly enhance EXCL's valuation, as the previous tower transaction done by ISAT was done at 9x EV/EBITDA way above EXCL's current valuation (5.7x EV/EBITDA). Assuming ISAT's price of Rp2bn/tower, EXCL can potentially raise Rp6.6tn.

Our top pick within the telco sector, initiate with Buy.

We initiate coverage with Buy rating and Rp4,200 TP derived through DCF (WACC: 12.5%), implying 4.9x 20F EV/EBITDA (vs. 10Y avg of 6.4x). EXCL has the highest contribution of data revenue, which continues to be the growth segment within the telco industry amid the continuous decline in legacy revenue. Cost will also be manageable given 2G asset kitchen sink that happened in 4Q18. A re-inclusion into MSCI Global Indonesia Index may also boost share price performance in the near-term.

Financial Summary	2017A	2018A	2019F	2020F	2021F
Revenue (Rp bn)	22,876	22,939	25,407	27,381	29,778
EBITDA (Rp bn)	8,321	8,512	10,066	11,017	12,149
EBITDA growth	3.26%	2.30%	18.26%	9.44%	10.28%
Net profit (Rp bn)	375	-3,297	665	1,009	1,450
EPS (Rp)	19	-267	102	134	175
EPS growth	-119.01%	-1533.3%	N/A	31.59%	30.85%
ROE	1.75%	-16.50%	3.56%	5.17%	6.99%
PER (x)	189.8	-13.2	34.8	26.5	20.3
EV/EBITDA (x)	6.0	7.0	6.1	5.5	4.9
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%
Forecast change			N/A	N/A	N/A
IPS vs. consensus			120%	96%	87%

Sources: Company, IndoPremier *Share price closing as of: 22 November 2019*

Income Statement (Rp bn)	2017A	2018A	2019F	2020F	2021F
Net Revenue	22,876	22,939	25,407	27,381	29,778
Cost of Sales	0	0	0	0	0
Gross Profit	**22,876**	**22,939**	**25,407**	**27,381**	**29,778**
SG&A Expenses	-21,505	-26,048	-22,667	-24,235	-26,170
Operating Profit	**1,370**	**-3,109**	**2,740**	**3,146**	**3,609**
Net Interest	-1,295	-1,259	-2,276	-2,224	-2,098
Forex Gain (Loss)	-30	-468	0	0	0
Others-Net	176	439	423	423	423
Pre-Tax Income	**221**	**-4,396**	**887**	**1,345**	**1,934**
Income Tax	154	1,099	-222	-336	-483
Net Income	**375**	**-3,297**	**665**	**1,009**	**1,450**

Balance Sheet (Rp bn)	2017A	2018A	2019F	2020F	2021F
Cash & Equivalent	2,455	1,047	2,370	2,603	2,833
Receivable	632	632	635	685	744
Other Current Assets	4,094	5,380	6,242	6,246	6,250
Total Current Assets	**7,181**	**7,059**	**9,247**	**9,534**	**9,828**
Fixed Assets - Net	34,934	36,760	37,375	37,839	38,144
Goodwill	5,915	5,767	5,667	5,567	5,367
Non-Current Assets	**8,292**	**8,029**	**9,378**	**9,378**	**9,378**
Total Assets	**56,321**	**57,614**	**61,668**	**62,318**	**62,718**
Payable	7,476	9,106	9,067	9,209	9,159
Other Payables	3,979	4,050	4,050	4,050	4,050
Current Portion of LT Loans	3,771	2,578	3,805	3,732	3,587
Total Current Liab.	**15,227**	**15,733**	**16,921**	**16,991**	**16,795**
Long Term Loans	10,980	20,493	22,343	21,916	21,061
Other LT Liab.	8,484	3,045	3,395	3,395	3,395
Total Liabilities	**34,691**	**39,271**	**42,659**	**42,301**	**41,251**
Equity	13,226	13,218	13,218	13,218	13,218
Retained Earnings	8,405	5,125	5,790	6,799	8,249
Total SHE + Minority Int.	**21,631**	**18,343**	**19,008**	**20,017**	**21,467**
Total Liabilities & Equity	**56,321**	**57,614**	**61,668**	**62,318**	**62,718**

Sources: Company, IndoPremier

Cash Flow Statement (Rp bn)	2017A	2018A	2019F	2020F	2021F
Net Income	199	-2,858	1,088	1,432	1,873
Depr. & Amortization	6,951	11,621	7,327	7,870	8,541
Changes in Working Capital	1,022	1,584	96	89	-115
Others	1,440	-990	-480	-553	-566
Cash Flow From Operating	**9,612**	**9,358**	**8,030**	**8,838**	**9,733**
Capital Expenditure	-6697	-6274	-7842	-8234	-8646
Others	62	70	-1942	130	143
Cash Flow From Investing	**-6635**	**-6203**	**-9785**	**-8104**	**-8503**
Loans	-1,926	-4,588	3,078	-500	-1,000
Equity	0	0	0	0	0
Dividends	0	0	0	0	0
Others	0	0	0	0	0
Cash Flow From Financing	**-1,926**	**-4,588**	**3,078**	**-500**	**-1,000**
Changes in Cash	**1,051**	**-1,433**	**1,323**	**233**	**230**

Key Ratios	2017A	2018A	2019F	2020F	2021F
Gross Margin	N/A	N/A	N/A	N/A	N/A
Operating Margin	5.99%	-13.55%	10.78%	11.49%	12.12%
Pre-Tax Margin	0.97%	-19.17%	3.49%	4.91%	6.49%
Net Margin	1.64%	-14.37%	2.62%	3.68%	4.87%
ROA	0.67%	-5.72%	1.08%	1.62%	2.31%
ROE	1.75%	-16.50%	3.56%	5.17%	6.99%
ROIC	4.01%	-8.37%	6.59%	7.33%	8.36%
Acct. Receivables TO (days)	10	10	9	9	9
Payable TO (days)	130	130	149	142	131
Debt to Equity	68.19%	125.77%	137.56%	128.13%	114.82%
Interest Coverage Ratio (x)	0.9	-1.8	1.2	1.3	1.6
Net Gearing	56.84%	120.07%	125.10%	115.13%	101.62%

Sources: Company, IndoPremier

INDOPREMIER

Indosat

HOLD

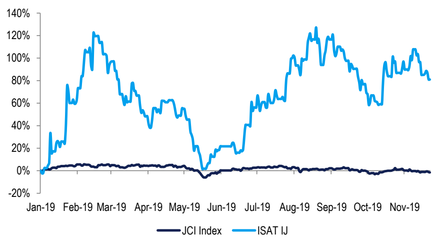
Initiation | Telecommunications | ISAT IJ | 22 November 2019

Stock Data

Target price	**Rp3,300**
Prior TP	*N/A*
Current price	Rp3,050
Upside/downside	*+8.2%*
Shares outstanding (mn)	5,434
Market cap (Rp bn)	16,573
Free float	21%
Avg. 6m daily T/O (Rp bn)	30

Price Performance

	3M	6M	12M
Absolute	-13.6%	58.4%	43.9%
Relative to JCI	-11.4%	57.3%	42.0%
52w low/high (Rp)			1,645 – 3,830



Major Shareholders

Ooredoo Asia	65.0%
Republik Indonesia	14.3%

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Awaiting sustainable costs control

- Despite good performance in 3Q19 coming from cost management, we remain neutral to ISAT given its higher cost seasonality in 4Q.
- Cheaper packages will drive strong data traffic growth. However, ARPU may get hit as it attracts lower segment customer base.
- Initiate with Hold despite lower than industry's valuation as we would want to see a more sustainable costs control.

Good performance recovery in 3Q19

Despite drop in data yield to Rp4.9/MB (-9% QoQ, -30% YoY), data traffic growth of 15% QoQ, 77% YoY managed to offset the decline. Slight gain in subscriber also was also seen as its subscriber share rose to 59mn (+2mn QoQ). The main surprise came from the sudden drop of cost where cost of service excluding depreciation was only 57% of revenue, lower than EXCL of 60% (hasn't happen since 2017). The main driver of the drop was staff benefit reversal (Rp200bn) from cancelation of defined benefit plan.

Tower sales to fund its US$2bn capex target

ISAT has signed agreements to sell 2,100 towers to Mitratel and 1,000 towers to Protelindo for Rp4.44tn and Rp1.95tn. The total cash proceeds of Rp6.39tn will be used to pay down debt and fund future capex. It has also signed into an agreement to leaseback 3,100 towers from the respective buyers for the next 10-years. We expect the company's net gearing to drop to 1.8x from 2.4x after the transaction.

Drop in yield trough cheaper packages to utilize new BTS

Currently, ISAT has the lowest data yield of Rp4.9/MB driven by its aggressive new plan to utilize its new 4G towers as well as to gain some subscriber market share back. We view that network experience remains the key to reduce churn. ISAT's has the highest BTS utilization which translates to slower speed compared to competitors. Customers who are willing to deal with the lower connection speed would most likely generate lower ARPU.

Sustainable improvement is needed to be positive in the long-run

Initiate with Hold with Rp3,300 target price, derived through DCF (WACC: 13%), implying 4.8x 2020F EV/EBITDA (vs. its 10Y avg of 4.8x). Based the seasonality of the last 3-years, ISAT's cost of service in the last quarter would account for 26-28% of total cost for the year. The key potential catalyst will be sustainable slowdown in cost which may lead to operational improvements. Downside will come from price war within the industry and unsustainable cost improvement.

Financial Summary	2017A	2018A	2019F	2020F	2021F
Revenue (Rp bn)	29,926	23,140	24,697	27,030	28,839
EBITDA (Rp bn)	12,763	6,500	8,644	9,785	10,872
EBITDA growth	-0.8%	-49.1%	33.0%	13.2%	11.1%
Net profit (Rp bn)	1,136	-2,522	-388	-1,743	-1,641
EPS (Rp)	209	-464	-71	-321	-302
EPS growth	-184.4%	2.8%	-322.0%	-84.6%	349.7%
ROE	8.3%	-20.0%	-3.5%	-17.6%	-20.0%
PER (x)	14.6	-6.6	-42.8	-9.5	-10.1
EV/EBITDA (x)	2.9	6.2	4.9	4.6	4.4
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%
Forecast change			N/A	N/A	N/A
IPS vs. consensus			N/A	N/A	N/A

Sources: Company, IndoPremier *Share price closing as of: 22 November 2019*

Income Statement (Rp bn)	2017A	2018A	2019F	2020F	2021F
Net Revenue	29,926	23,140	24,697	27,030	28,839
Cost of Sales	0	0	0	0	0
Gross Profit	**29,926**	**23,140**	**24,697**	**27,030**	**28,839**
SG&A Expenses	-26,016	-24,888	-25,617	-27,638	-29,230
Operating Profit	**3,910**	**-1,749**	**-919**	**-608**	**-391**
Net Interest	-2,057	-2,089	-2,308	-2,597	-2,648
Forex Gain (Loss)	24	-150	0	0	0
Others-Net	63	270	338	627	678
Pre-Tax Income	**1,940**	**-2,782**	**-286**	**-2,064**	**-1,898**
Income Tax	-638	578	72	516	474
Net Income	**1,136**	**-2,522**	**-388**	**-1,743**	**-1,641**

Balance Sheet (Rp bn)	2017A	2018A	2019F	2020F	2021F
Cash & Equivalent	1,675	1,045	1,697	2,423	1,841
Receivable	3,989	2,962	3,161	3,460	3,691
Other Current Assets	3,816	3,900	3,941	3,985	4,028
Total Current Assets	**9,479**	**7,907**	**8,800**	**9,868**	**9,560**
Fixed Assets - Net	35,892	36,899	38,008	38,821	39,324
Goodwill	1,597	1,571	1,555	1,540	1,524
Non-Current Assets	**3,693**	**6,763**	**6,805**	**6,848**	**6,892**
Total Assets	**50,661**	**53,140**	**55,169**	**57,078**	**57,301**
Payable	872	803	778	833	865
Other Payables	10,150	13,178	12,915	12,669	12,441
Current Portion of LT Loans	5,178	7,060	1,945	1,750	1,550
Total Current Liab.	**16,200**	**21,040**	**15,638**	**15,253**	**14,856**
Long Term Loans	17,458	17,886	25,490	29,290	31,290
Other LT Liab.	2,187	2,077	2,119	2,161	2,204
Total Liabilities	**35,846**	**41,003**	**43,247**	**46,704**	**48,350**
Equity	2,412	2,677	2,677	2,677	2,677
Retained Earnings	11,585	8,497	8,109	6,366	4,725
Total SHE + Minority Int.	**14,816**	**12,136**	**11,921**	**10,374**	**8,950**
Total Liabilities & Equity	**50,661**	**53,140**	**55,169**	**57,078**	**57,301**

Sources: Company, IndoPremier

Cash Flow Statement (Rp bn)	2017A	2018A	2019F	2020F	2021F
Net Income	1,136	-2,522	-388	-1,743	-1,641
Depr. & Amortization	8,853	8,249	9,563	10,393	11,263
Changes in Working Capital	1,220	-998	228	248	204
Others	-11,208	-4,730	-9,403	-8,897	-9,826
Cash Flow From Operating					
Capital Expenditure	7,637	-8,538	-10,672	-11,206	-11,766
Others	-14,410	3,086	0	0	0
Cash Flow From Investing	**-6,773**	**-5,452**	**-10,672**	**-11,206**	**-11,766**
Loans	-1,729	1,021	2,157	3,288	1,499
Equity	0	0	0	0	0
Dividends	-387	-397	0	0	0
Others	0	0	0	0	0
Cash Flow From Financing	**-2,115**	**625**	**2,157**	**3,288**	**1,499**
Changes in Cash	**-8,888**	**-4,827**	**-8,515**	**-7,918**	**-10,267**

Key Ratios	2017A	2018A	2019F	2020F	2021F
Gross Margin	N/A	N/A	N/A	N/A	N/A
Operating Margin	13.07%	-7.56%	-3.72%	-2.25%	-1.36%
Pre-Tax Margin	6.48%	-12.02%	-1.16%	-7.63%	-6.58%
Net Margin	3.80%	-10.90%	-1.57%	-6.45%	-5.69%
ROA	2.6%	-4.1%	-0.4%	-2.7%	-2.5%
ROE	8.3%	-20.0%	-3.5%	-17.6%	-20.0%
ROIC	11.2%	-5.0%	-2.6%	-1.6%	-1.0%
Acct. Receivables TO (days)	49	47	47	47	47
Payable TO (days)	25	24	24	24	24
Debt to Equity	161.7%	223.2%	254.4%	343.2%	443.7%
Interest Coverage Ratio (x)	1.8	-0.8	-0.4	-0.2	-0.1
Net Gearing	149.8%	213.9%	238.6%	316.5%	418.8%

Sources: Company, IndoPremier

SECTOR RATINGS

OVERWEIGHT	:	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation
NEUTRAL	:	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation
UNDERWEIGHT	:	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation

COMPANY RATINGS

BUY	:	Expected total return of 10% or more within a 12-month period
HOLD	:	Expected total return between -10% and 10% within a 12-month period
SELL	:	Expected total return of -10% or worse within a 12-month period

ANALYSTS CERTIFICATION

The views expressed in this research report accurately reflect the analyst's personal views about any and all of the subject securities or issuers; and no part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in the report.

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