

SECTOR UPDATE REPORT

MNC Sekuritas Research Division
June 20, 2017



TELECOMMUNICATION SECTOR UPDATE

The Digital Revolution Has Arrived

The Strongest Engine of Indonesia Economic Growth 1Q17

Information and communication sector has become the strongest engine of growth with a pace of 9.1% YoY in 1Q17. Total mobile cellular (SIM connections) stood at more than 371 mn, way more than the national population of 259 mn. Going forward, we estimate that the national information and communication sector will continue to grow by 9.7% YoY in FY17E and 10.5% YoY in FY18F, tracking increasing of Indonesian GDP of 5.1%/5.4% in FY17E/FY18F.

Key Growth Catalysts in 2017

We believe that the positive trend in 1Q17 will continue throughout the year. In 2017, we estimate the sector will continue its growth by 9%-10% YoY, mainly due to by : 1) Upside potential from increasing numbers of mobile phone and internet users in FY17E; 2) High growth of data traffic in line with increasing smart phone usage and availability of 4G LTE services; 3) Rapid development infrastructure in a growing 'digital economy'.

Investment Risks: Focus on Interconnection Cut Rate and Network Sharing Issue

In our view, interconnection rate cuts and infrastructure sharing will be the main concerns in the near future. However we believe that the government has a best plan to create a healthier competition to increase efficiency and decrease churn rate for each operators. We expect that the government to review and provide incentives to compensate the operators who have existing infrastructure investment which will be shared to the other providers.

OVERWEIGHT Outlook with Top Picks : TLKM and ISAT

We are being **OVERWEIGHT** for this sector. Our top picks for the Indonesian telecommunication sector are **TLKM (BUY; TP: Rp5,000)**, maintaining its leading position in the industry and **ISAT (BUY; TP: Rp7,450)** with the highest growth of subscribers and good performance during the year.



Research Analyst

Victoria Venny N.S.
victoria.nawang@mncgroup.com
(021) 2980 3111 ext. 52236

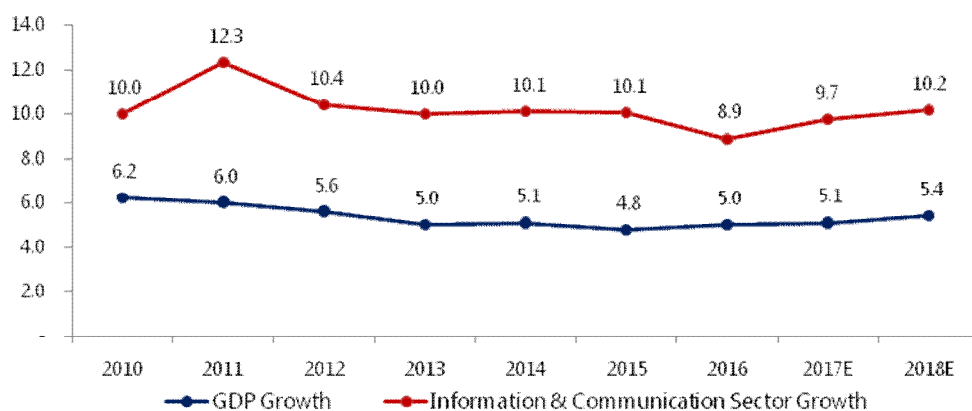
Ticker	Market Cap (Rp tn)	PER (x)		EV/EBITDA (x)		Rec.	Target Price (Rp)
		FY17E	FY18F	FY17E	FY18F		
TLKM	445.53	18.34	17.27	6.89	6.60	BUY	5,000
ISAT	34.23	20.07	13.94	4.61	3.52	BUY	7,450
EXCL	33.98	124.77	40.48	5.54	4.85	HOLD	3,330

Sources: Companies, MNCS Estimate

Attractive Sector with Promising Growth

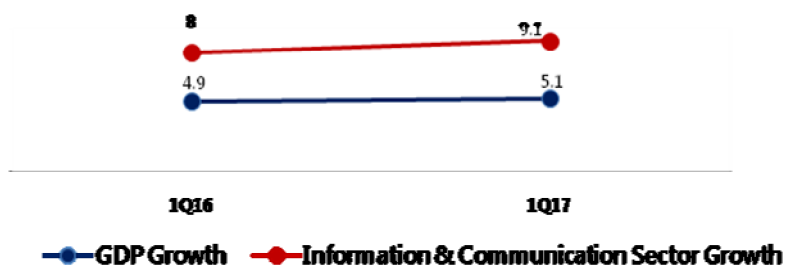
The telecommunication industry has played an important role in the development of Indonesia's economy over the last few years. Despite currently challenging economic conditions, the demand for telecommunication products is increasing. This is evidenced from the communications sector that contributed the most to the growth of the Indonesian economy, at a rate of 8.90% throughout 2016 (BPS). In the last few years, the communication and information sector has regularly been above the commonly-quoted figure of 5% national economic growth. In 1Q17, information and communication sector still enjoys positive growth, reaching 9.1% YoY, higher than national economic growth (5.1% YoY). Exhibit 3 shows that information and communication sector has become the strongest engine of growth with a pace of 9.1% YoY in 1Q17. Going forward, we estimate that the national information and communication sector will continue to grow by 9.7% YoY in FY17E and 10.5% YoY in FY18F, tracking increasing of Indonesian GDP of 5.1%/5.4% in FY17E/FY18F (Exhibit 1).

Exhibit 01. Indonesia GDP vs. Information & Communication Sector Growth (% YoY)



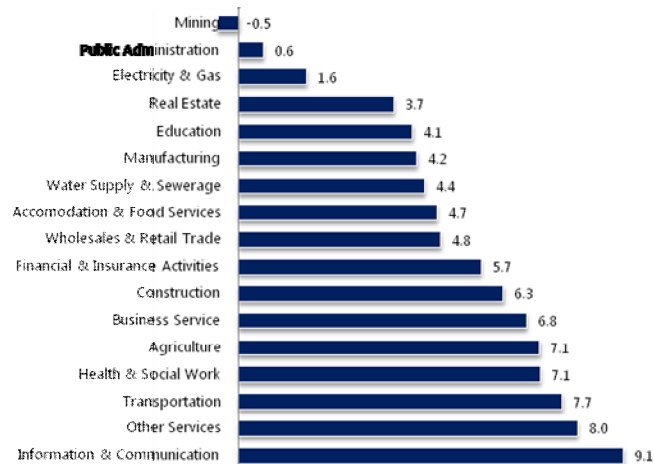
Source : BPS, MNCS Estimate

Exhibit 02. Indonesia GDP vs. Information and Communication Sector Growth in 1Q16 and 1Q17 (% YoY)



Source : BPS

Exhibit 03. GDP Growth by Sector, 1Q 2017 (% YoY)



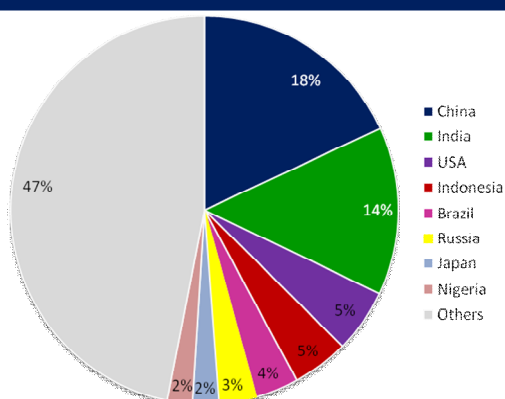
Source : BPS

Upside Potential from Increasing Numbers of Mobile Phone and Internet Users

The telecommunication industry has grown rapidly in Indonesia in recent years, as seen from the number of mobile cellular subscribers, continuing to increase from year to year. As of July 2015, Indonesia was the world's fourth-largest telecommunication market in terms of mobile cellular subscribers (Exhibit 4).

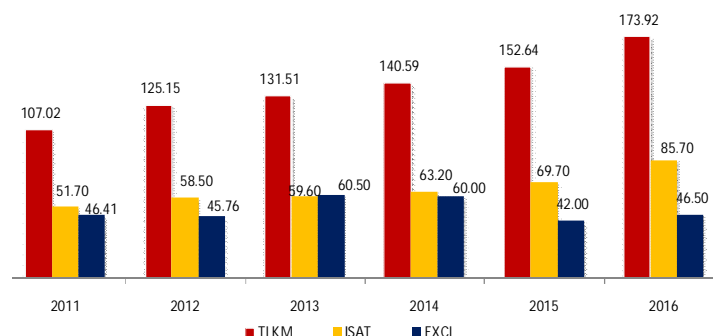
The growth of mobile phone users in Indonesia is quite rapid, and is marked by a rising penetration rate of mobile devices. According to the Ministry of Communications and Informatics and Company of Telecommunications Network Operation, total mobile cellular (SIM connections) stood at 371 mn in 2016, way more than the national population of 259 mn. This means that mobile cellular penetration in Indonesia remains relatively high at 143% of the total population. Total mobile cellular subscriber numbers grew by 8.23% CAGR from 2011 to 2016. Meanwhile, internet users reached 132.7 mn in 2016, growing by 19.26% CAGR from 2011. Still, internet penetration in Indonesia remains relatively low at 51% of the total population. We see that the number of Indonesian internet users has wide room for growth in years ahead. This also implies that Indonesia's telecommunication sector is in a great position to grow sharply.

Exhibit 04. Mobile Cellular Telephone Subscribers around the world



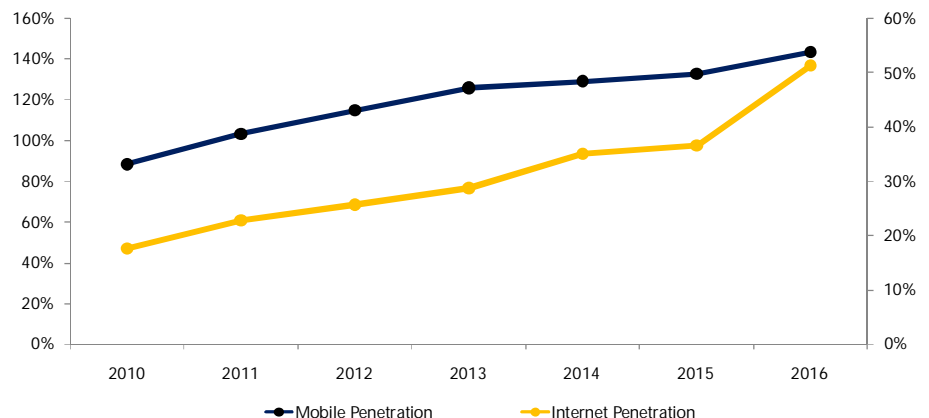
Source : World by Map, July 2015 est.

Exhibit 05. Subscriber base (million subscriber)



Source : Company, Bloomberg

Exhibit 06. Indonesia's Mobile Cellular and Internet Penetration Trend



Source : MCIT, BPS, MNCs

Data Business Will be The Main Catalyst for Future Market Growth

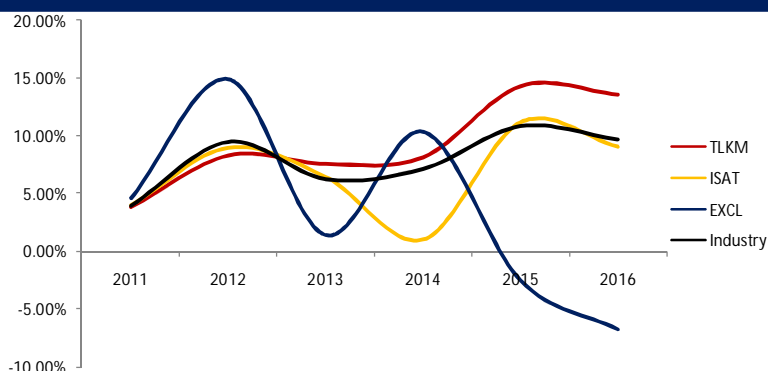
We see that demand for voice and SMS services is shifting toward data service requests. Online services will become a basic need in the future, in line with the growth of Indonesia's young population. High population density and growth of middle-class income have made Indonesia a highly attractive country for telecommunication services, promising the robust development of digital business in the future. An expanding middle class with more digital lifestyle characteristics (such as the use of social media) also supports high demand for data services, which are expected to be the main contributor to telecommunication operators' long-term net profit.

Big Telco Players in Indonesia are Enjoying the Remarkable Enhancement of LTE 4G Service

We see that the growth of data traffic from each operator has increased significantly. The three big telecommunication operators showed a trend of strong traffic growth with CAGR (2014-2016) of 102.04% p.a. for TLKM, 140.03% for ISAT p.a. and 100.02% for EXCL p.a. Going forward, we believe that there will be a higher uptake of mobile data services driven by factors such as increasing economic growth, a growing middle class, increased smart phone usage and the increasing availability of 4G LTE services.

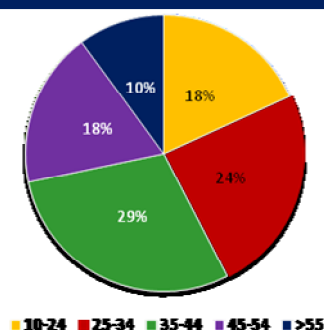
Since its launch at the end of 2014, LTE 4G services in Indonesia have seen the number of users grow significantly. The Ministry of Communication and Information Technology (MCIT) reported 4G users in Indonesia reached 40% of total cellular users in 2016. The achievement grew by nearly 50% when compared to when the fourth generation of mobile technology was first launched. In the early days of its commercialization, the number of users of 4G in the new industry ranged from 20% to 30%. We estimate that 4G users could reach 60% in 2017. Therefore, it will be important for telecommunication operators to invest in their mobile broadband capabilities now, to prepare for future market growth.

Exhibit 07. Industry Revenue Growth (%)



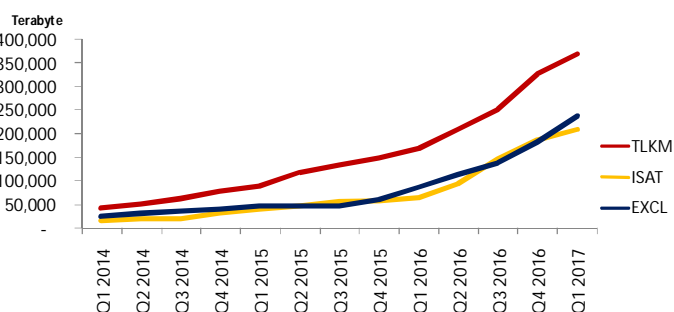
Source : Company, Bloomberg

Exhibit 08. Internet Users in Indonesia, Based on Age FY2016



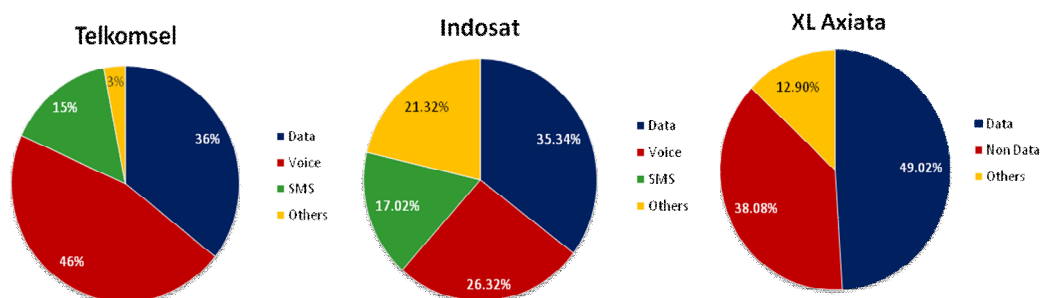
Source : APJII

Figure 09. Traffic Trend of 3 Big Telco Operators 1Q14-1Q17



Source : Company

Figure 10. Revenue Breakdown 3 Big Telco Operators FY2016



Source : Company

Investment Risks: A Price War Led to the Fall of Data Tariff but...

Indonesia's telecommunication sector is a highly competitive. 'Over The Top' (OTT) service and tariff wars have become the main challenge. We also note how OTT service has cannibalized operators' voice and data businesses. OTT is exceeding voice and SMS volumes globally, so telecom operators are facing a decline in average revenue per user (ARPU), since OTTs usually ride on top of operator network infrastructure, with low operational costs and smaller capex.

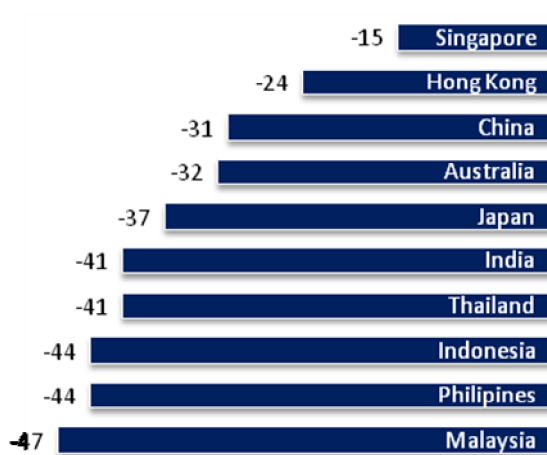
Against this, tariff wars between operators are on the rise. There are operators offering IDR 1 tariffs for voice and SMS among 'same operators' (on-net) while tariffs for 'between operators' (off-net) remain steep. Off-net tariffs could be much higher than on-net ones. Churn rate (customer movement to another operator) will increase and ARPU will fall as a result of tariff wars.

Figure 11. Prepaid handset-based mobile data price for 500 MB in Asia (2015)

Country	Mobile broadband (500 MB/month in USD)
Japan	82.98
Hong Kong	9.80
Malaysia	8.14
Singapore	7.27
Thailand	5.81
China	4.82
Philippines	4.37
Indonesia	4.11
India	4.04
Vietnam	3.46

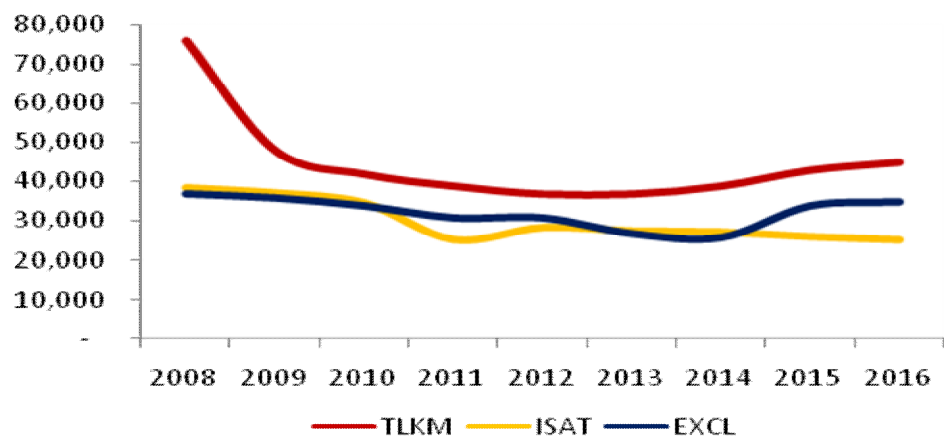
Source : International Telecommunication Union (ITU)

Figure 12. Declining Data Pricing in Asia Pacific, CAGR 2011-2016 (%)



Source : Mc Kinsey

Figure 13. ARPU per subscriber (IDR/month)



Source : Company, MNCS

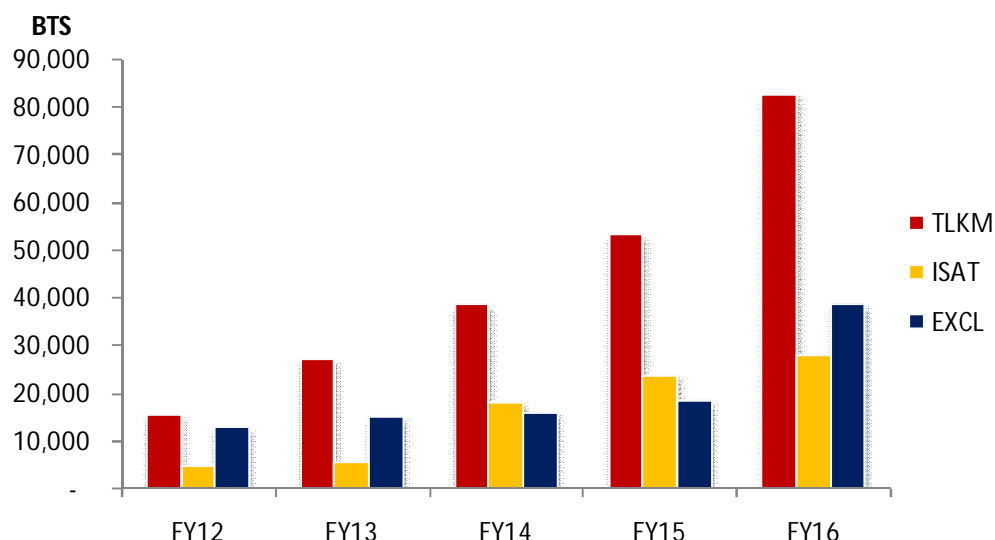
....The Bloody Competition Seemed to Fade Away

The Government of Indonesia has attempted to create fair competition in telecommunication industry, in dealing with this tight competition. Currently, off-net tariffs in Indonesia are higher than on-net ones. In 2017, the Ministry of Communication and Information Technology (MCIT) plans to reduce interconnection tariff by 18% from previous rate, moving from a current IDR250/min to IDR204/min. Hence, the government hopes to increase efficiency and decrease churn rate for each operator. Nevertheless, MCIT has continued to postpone implementation of the regulation which was originally planned to start on 2 February 2017. Many investors think that these regulatory changes will hit TLKM performance. In our view, the planned interconnection rate cut will not exert strong pressure on TLKM, because interconnection segment only contributes around 4% of TLKM's total revenue. Therefore, this policy will only have a minimal impact on operator revenue in the future, because revenue and cost of interconnections decrease in line with data shifting. Although the ARPU slowed down, there is still room for data growth as we mentioned above.

Pros and Cons of Network Sharing Regulation: Is It Fair?

Network sharing is considered by the government to be a correct strategy to ensure telecommunication connections to all corners of the country. The network-sharing proposals could be part of a strategy to support the government's goal of extending connectivity to every Indonesian island by 2019. The revision of Government Regulations 52/2000 and 53/2000 will push operators to share their networks in certain areas (particularly their backbones). There are five models of network sharing, namely, multi-carrier radio access network (MORAN), CME sharing, multi-operator core network (MOCN), roaming and mobile virtual network operator (MVNO).

Figure 14. Total Number of 3G BTS in Indonesia FY12-FY16



Source : Company, Bloomberg

Figure 15. Total Spectrum Holdings in Indonesia FY12-FY16

Spectrum	850MHz	900MHz	1800MHz	2100MHz	2300MHz
Telkomsel	4.5MHz x 2	7.5MHz x 2	22.5MHz x 2	15MHz x 2	15MHz
Indosat	2.5MHz x 2	10MHz x 2	20MHz x 2	10MHz x 2	15MHz
XL Axiata		7.5MHz x 2	22.5MHz x 2	15MHz x 2	
Hutchison			10MHz x 2	10MHz x 2	

Source : Indosat

ISAT and EXCL will Potentially Get a Tail Wind

So far Indosat Ooredoo has established a 'Multi Operator Radio Access' (MORAN) based sharing network with XL Axiata, but recently the operator tried to improve, through a 'Multi Operator Core Network' (MOCN), which allows for frequent use of frequencies for higher efficiency. MCIT is prepared to allow network sharing with the MOCN scheme this year, despite no regulation permitting such a scheme to be issued. Therefore, network sharing will reduce the operator's operating expenses and investment cost.

In our view, this network sharing plans, including the sharing of backbones and spectra will be the main driver for ISAT and EXCL to expand their networks outside Java. On the other hand, we believe that TLKM will not lose its dominance outside Java, considering that TLKM still holds around 80% market share in the outer islands. We expect the government to provide incentives to compensate TLKM for its existing infrastructure investment which will be shared with other providers.

OVERWEIGHT Outlook

Outlook with Top Picks: TLKM and ISAT

In 2017, we estimate the sector will continue its growth by 9%-10% YoY, mainly due to 1) High growth of mobile subscriber numbers, 2) High growth of data traffic and 3) Rapid development infrastructure in a growing 'digital economy'. Going forward, an expanding youthful population, coupled with an increase in smartphone penetration and data speeds, will be the positive catalysts for this sector. Interconnection rate cuts and infrastructure sharing will be the main concerns in the near future and could shape Indonesia's telecom industry in the long run. Therefore, we are being **OVERWEIGHT** for this sector. Our top picks for the Indonesian telecommunication sector are **TLKM (BUY; TP: Rp5,000)**, maintaining its leading position in the industry and **ISAT (BUY; TP: Rp7,450)** with the highest growth of subscribers and good performance during the year.

As a result, we believe TLKM deserves a premium valuation by end-FY17 due to its strong presence, both in Java and outer island markets, which could boost revenue and earnings growth. TLKM currently trades at close to +1STD (average 3-year EV/EBITDA). Our TP of Rp5,000 implies an FY17 EV/EBITDA of 7.77x or +1.5SD of its three-year EV/EBITDA multiple.

We also see that significant growth of subscriber numbers and favorable government regulations will be positive catalysts for ISAT. Our new target price implies FY17E EV/EBITDA of 5.04x, still at a discount relative to TLKM's 7.77x. Going forward, we believe ISAT will have room for growth by end-FY17E.

Figure 16. TLKM EV/EBITDA Ratio Band



Source : Bloomberg

Figure 17. ISAT EV/EBITDA Ratio Band



Source : Bloomberg

MNC SEKURITAS RESEARCH TEAM

Thendra Crisnanda

Head of Institutional Research, Strategy
thendra.crisnanda@mncgroup.com
(021) 2980 3111 ext. 52162

Edwin J. Sebayang

Head of Retail Research, Technical, Auto, Mining
edwin.sebayang@mncgroup.com
(021) 2980 3111 ext. 52233

I Made Adesaputra

Head of Fixed Income Research
imade.saputra@mncgroup.com
(021) 2980 3111 ext. 52117

Victoria Venny

Telco, Infrastructure, Logistics
victoria.nawang@mncgroup.com
(021) 2980 3111 ext. 52236

Yosua Zisokhi

Plantation, Cement, Poultry, Cigarette
yosua.zisokhi@mncgroup.com
(021) 2980 3111 ext. 52234

Rheza Dewangga Nugraha

Junior Analyst of Fixed Income
rheza.nugraha@mncgroup.com
(021) 2980 3111 ext. 52294

Rr. Nurulita Harwaningrum

Banking
roro.harwaningrum@mncgroup.com
(021) 2980 3111 ext. 52237

Krestanti Nugrahane

Research Associate
krestanti.widhi@mncgroup.com
(021) 2980 3111 ext. 52166

Sukisnawati Puspitasari

Research Associate
sukisnawati.sari@mncgroup.com
(021) 2980 3111 ext. 52307

Gilang Anindito

Property, Construction
gilang.dhiroboto@mncgroup.com
(021) 2980 3111 ext. 52235

MNC SEKURITAS EQUITY SALES TEAM

Benny Narendro

Head of Institutional Client
benny.narendro@mncgroup.com
(021) 2980 3111 ext. 52198

Sri Laksamanawati

Head Marketing of Institutional Client
sri.laksamanawati@mncgroup.com
(021) 2980 3111 ext. 52173

Nesya Kharismawati

Equity Sales Manager
nesya.kharismawati@mncgroup.com
(021) 2980 3111 ext. 52182

Harun Nurrosyid

Manager Equity Trader
harun.nurrosyid@mncgroup.com
(021) 2980 3111 ext. 52187

Okhy Ibrahim

Manager Equity Trader
okhy.ibrahim@mncgroup.com
(021) 2980 3111 ext. 52180

Anastasia Pratiwi

Manager Equity Institution
anastasia.pratiwi@mncgroup.com
(021) 2980 3111 ext. 52181

Agus Eko Santoso

Manager Equity Trader
agus.santoso@mncgroup.com
(021) 2980 3111 ext. 52185

Gilang Ramadhan

Manager Equity Trader
gilang.ramadhan@mncgroup.com
(021) 2980 3111 ext. 52178

Iman Hadimulya, ST

Manager Equity Institution
iman.hadimulya@mncgroup.com
(021) 2980 3111 ext. 52174

MNC Research Investment Ratings Guidance

BUY : Share price may exceed 10% over the next 12 months

HOLD : Share price may fall within the range of +/- 10% of the next 12 months

SELL : Share price may fall by more than 10% over the next 12 months

Not Rated : Stock is not within regular research coverage

PT MNC SEKURITAS

MNC Financial Center Lt. 14 – 16
Jl. Kebon Sirih No. 21 - 27, Jakarta Pusat 10340
Telp : (021) 2980 3111
Fax : (021) 3983 6899
Call Center : 1500 899

Disclaimer

This research report has been issued by PT MNC Sekuritas. It may not be reproduced or further distributed or published, in whole or in part, for any purpose. PT MNC Sekuritas has based this document on information obtained from sources it believes to be reliable but which it has not independently verified. PT MNC Sekuritas makes no guarantee, representation or warranty and accepts no responsibility to liability as to its accuracy or completeness. Expression of opinion herein are those of the research department only and are subject to change without notice. This document is not and should not be construed as an offer or the solicitation of an offer to purchase or subscribe or sell any investment. PT MNC Sekuritas and its affiliates and/or their offices, director and employees may own or have positions in any investment mentioned herein or any investment related thereto and may from time to time add to or dispose of any such investment. PT MNC Sekuritas and its affiliates may act as market maker or have assumed an underwriting position in the securities of companies discussed herein (or investment related thereto) and may sell them to or buy them from customers on a principal basis and may also perform or seek to perform investment banking or underwriting services for or relating to those companies.