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Overweight

Telco

Discussion takeaways with Dirjen Kemkominfo

EXCL relative to JCI Index



ISAT relative to JCI Index



Source : Bloomberg



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Dirjen SDPPI Kemkominfo Pak Ismail remarked on telecommunications government policy objectives and delved into theoretical aspects of telco consolidation, spectrum, IMEI implementation and tower fiberization for 5G.

Policy framework to protect telco interests. The torque to more usage of OTT and content continues to be disruptive becoming even more stressing during Covid19. Kemkominfo is working towards creating a level playing field between network operators and OTT/digital players (optimizing spectrum and license fees, taxes, pricing and regulation) to incentivize telco operators to continue investing sufficiently in networks.

Government keen supporter of consolidation if it fulfils key criteria. The government strongly supports market consolidation under certain conditions. Kemkominfo will evaluate the spectrum needs of the resulting merged telco and evaluate their commitments. The evaluation will be based on the business plan with respect to the network to be built and expected subscribers. The evaluation seeks to avoid future monopolistic behavior by the new company. Such a situation can easily arise by controlling scarce frequency resources without actually using them to deny the competition access to spectrum. The government would have to render the optimal spectrum amount for the new company.

Limited spectrum. Pak Ismail also asserted that within 2020 a spectrum of 30MHz will be available for auction in the 2300MHz for 4G. Previously 30MHz was auctioned at a price of Rp1tn in 2017 and this is the minimum cost that operators need to consider if they are willing to get a significant advantage over peers with two holders Telkomsel and Smartfren each with 30MHz on that frequency currently. Pak Ismail said entry of foreign telco players in 700MHz was a non-viable option, mainly due to operational inefficiencies using only one low band spectrum. The largest issue on the digital dividend hinges on when media companies switch off analog signals to be broadcasting over digital channels. In order to auction 5G spectrum Kominfo suggests that all communications between tower masts would have to run through fiber first at an optimal rate of ~90% minimum, or 10% max via microwave transmission for 5G latency and speed to be optimal. Kominfo analyzes calculations to optimally derive the fees for 5G to make them more bearable.

Existing policy on consolidation – no one rule fits all scenarios. Another reason for consolidation/partnerships is that spectrum resources are limited. The govt will consider initiatives only from the highest order, the owners of the operators. Kemkominfo follows the XL Axiata and Axis merger precedent as a policy yardstick for modus operandi to determine the spectrum holding for the next merger scenario and new company. Implicitly, existing telco regulation would suffice for all provisions resulting from telco consolidation. Having said that we think the government will be flexible in facilitating viable and fair solutions as emphasized in the call, and therefore we see that no one rule fits all possible merger scenarios.

Deterring vs. detective method to clamp down on illegal IMEI devices. Kemkominfo adopted the whitelist method to deter the existence of the black market, which a priori assumes that all IMEIs of existing devices are legal by aligning with system databases that lists all IMEIs. This is a less aggressive practice vs. the blacklist method which actively searches for illegal devices in the market. Currently it appears the govt. is in the early stage to make certain that all existing devices are in the system. Pak Ismail reported that all handset sales (both legal & illegal) are down due to Covid19 uncertainties and consumers prefer now to order online, which serves well in their fight against the black market.

Company	Ticker	Rec	Target	Market	P/E (x)		P/BV (x)		ROE (%)
			Price (Rp)	Cap. (RpBn)	2020F	2021F	2020F	2021F	2021F
XL Axiata	EXCL IJ	BUY	2,750	25,651.1	60.6	32.2	1.3	1.3	4.0
Indosat Ooredoo	ISAT IJ	BUY	2,900	10,840.7	n/m	n/m	1.0	1.1	(8.9)
Telkom	TLKM IJ	BUY	4,000	321,952.2	16.3	16.6	3.2	3.2	19.3

Consolidation driven by private initiative

At the weekend, news surfaced that the Malaysian group Axiata was in talks to merge with an Indonesian peer (Indosat, Smarfen, Hutch3 non-listed) via a share swap deal giving a timeframe till the end of this year. The prospects for this are greater this year as Covid19 would expose telco weaknesses in an admittedly more challenging environment.

Motive for consolidation by operators

As in the past, when XL bought Axis, the consolidation brought additional spectrum to the acquirer. Strategically this helped XL to gain network momentum generating the 2nd largest data traffic and very strong ARPU.

The spectrum holding enlargement will be forthcoming with important benefits: --> network improvement --> less price competition --> larger addressable market --> better economies of scale --> ability to reinvest and eventually buy more spectrum. Indonesian telco economics are challenging, and adding more license fees for 5G in their P&L will weigh heavily on the P&L.

Available spectrum at the moment is limited in Indonesia while frequencies for 5G have not yet been found or designated, thus merging spectrum holdings will secure the aforementioned benefits in 4G, whose cycle is expected to be long, and rely less in the non-proven 5G use cases.

Participating in consolidation

We cannot eliminate any player at this point participating in consolidation. ISAT is a good play because it has a lot of spectrum holdings, and ISAT is in turnaround mode improving its leverage position recently.

Hutchison 3 is a good candidate too. Hutch has been cost stringent similar to EXCL's philosophy; thus we see no insurmountable problems in merging. Hutch should have little debt (in 2019 all its debt was converted to equity). The drawback is its spectrum holding is small. Hutch is more pragmatic as the owner has gone through merger/consolidation deals, in their Australia, Italy, and Austria telco holdings previously.

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