July 31, 2015

Telekomunikasi Indonesia

Company Focus

Sebastian Tobing
(sebastian.tobing@trimegah.com

Paula Ruth
(paula@trimegah.com)

The Best In The Industry !

Four reasons to Buy TLKM

We re-initiate Telkom with a Buy on the following reasons: 1) We are more optimistic on competitive environment in Indo telco industry and we expect data tariff to fall at much slower pace going forward (and potentially up on a QoQ basis), 2) Telkom is likely to be the telco that benefits the most from data growth given its best network among all Indo telcos, 3) Telkom's expansion in FTTH (Fiber To The Home) is likely to cement its leadership further in the data business, and 4) Strong balance sheet with decent dividend yield.

A more stable competitive industry environment ahead

After experiencing price war in 2008-12, Indonesian telco industry has enjoyed a relatively more stable pricing environment particularly in voice and sms pricing. Data pricing is still falling but we are optimistic that the downside is small on the back of: 1) Telcos' declining ROIC have resulted in depressed share prices (with the exception of Telkom, which ROIC still expand), 2) The big three Indo telcos have adopted a segregated pricing strategy, allowing it to localize price competitions, and 3) Industry consolidation – there are now five actively competing operators including four GSM operators, down from ten operators in 2009.

Upside in fixed-line data business when it executes FTTH

Telkom has issued Rp7tr bond financing to more aggressively lay out FTTH (Fiber To The Home), which should allow it to monetize its already near monopoly in fixed-line voice business. We expect Telkom to be able to gradually raise its fixed-line data ARPU from Rp128K in 2014 to Rp Rp154K in 2017 on the back of its FTTH expansion.

Valuation: Buy with 15% upside to DCF-based TP Rp3300

Telkom currently trades at 7.9x 2015 EV/EBITDA and 7.2x 2016 EV/EBITDA, higher than its local peers (ISAT and EXCL), which we believe is justified given Telkomsel's leadership in subscribers, revenue, EBITDA market shares, and Telkomsel's best network quality. Telkom trades at a discount to average regional telco excl. Indonesia of 10.2x 2015 EV/EBITDA and 9.7x 2016 EV/EBITDA. Telkom currently trades at 17.6x 2015PE and 15.5x 2016 PE, lower than its local peers and also lower than its regional peers' average of 20.1x 2015PE and 18.8x 2016 PE.

Companies Data

Year end Dec	2013	2014	2015F	2016F	2017F
Sales (Rpbn)	82,967	89,696	98,887	108,146	118,331
Net Profit (Rpbn)	14,205	14,638	16,186	18,126	19,790
EPS (Rp)	147	150	165	185	202
Core Profit (Rpbn)	12,822	14,143	16,048	18,126	19,790
Core EPS (Rpbn)	133	145	163	185	202
Core EPS Growth (%)	1.8%	8.8%	12.9%	13.0%	9.2%
DPS (Rp)	102	89	98	129	141
BVPS (Rp)	628	694	757	812	873
EV/EBITDA (x)	9.4	8.6	7.9	7.2	6.6
Core P/E (x)	21.6	19.8	17.6	15.5	14.2
Div Yield (%)	3.6%	3.1%	3.4%	4.5%	4.9%

Telekomunikasi Indonesia (Telkom) is a state-owned telecommunication company that has a near monopoly in fixed-line telco industry and also has the largest market share in mobile telco industry through its 65% owned subsidiary Telkomsel.

BUY Rp3300

Company Update

Share Price	Rp2,870
Sector	Telecommunication
Price Target	Rp3300 (15.0%)

Stock Data

Reuters Code	TLKM.JK
Bloomberg Code	TLKM.IJ
Issued Shares	100,800
Mkt Cap. (Rpbn)	289,295
Avg. Value Daily 6 Month (Rpbn)	232.6
52-Wk range	3020 / 2590

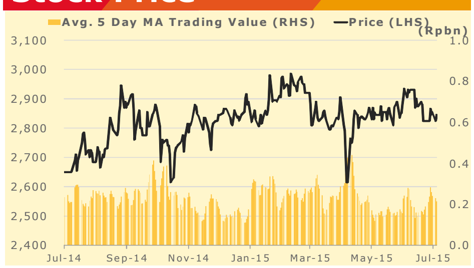
Major Shareholders

Goverment of RI	52.6%
The Bank of New York Mellon Corp	9.0%
Public	38.4%

Consensus

EPS	15F	16F
Consensus (Rp)	168	186
TRIM vs Cons. (%)	-2.3%	-0.8%

Stock Price



Assessment of industry attractiveness

Figure 1. Porter's five competitive forces analysis

Threat of new entrants: Low
BRTI (Indonesian telco regulator) is currently more focused on quality of service rather than affordability. Failure of new entrants in past ten years (i.e. Axis) also deters newcomers.

Bargaining power of suppliers: Low
The aggressiveness of telco equipment suppliers from China i.e. Huawei has resulted in increased competition among suppliers and lower prices.

Competitive rivalry in the industry: Medium
We believe Indo telco industry remains competitive but as pricing has come down significantly, we see healthier competitive environment now. Telco industry is also capex intensive and currently low prices are less attractive to new entrants.

Bargaining power of customers: Medium
High-end customers tend to be sticky but low-end customers are sensitive to price. Customers can choose between four GSM operators and one CDMA operator.

Threat of substitutes: Medium
We see low risk of substitute to telco business but high risk of substitution between telco operators' services (cannibalization) i.e. customers have been using more of the lower margin data products and less of the higher margin SMS product.

Source: TRIM Research

A more stable competitive environment post 2012

After experiencing price war in 2008-12, Indonesian telco industry has enjoyed a relatively more stable pricing environment particularly in voice and sms pricing. Data pricing is still falling but we are optimistic that the down-side is small on the back of: 1) Telcos' declining ROIC have resulted in depressed share prices (with the exception of Telkom, which ROIC still expand), 2) The big three Indo telcos have adopted a segregated pricing strategy, allowing it to localize price competitions, and 3) Industry consolidation – there are now five actively competing operators including four GSM operators, down from ten operators in 2009. We view only Three (owned by Hutchison) to be a price disrupting threat as XL is clearly aiming for higher end customers.

Our view that XL is changing its strategy from price focus to quality focus is supported by XL's recent move to re-activate Axis brand as its fighting brand (management mentioned previously that they would discontinue the Axis brand after acquiring Axis). This leaves Three as the only GSM that maintain only one brand.

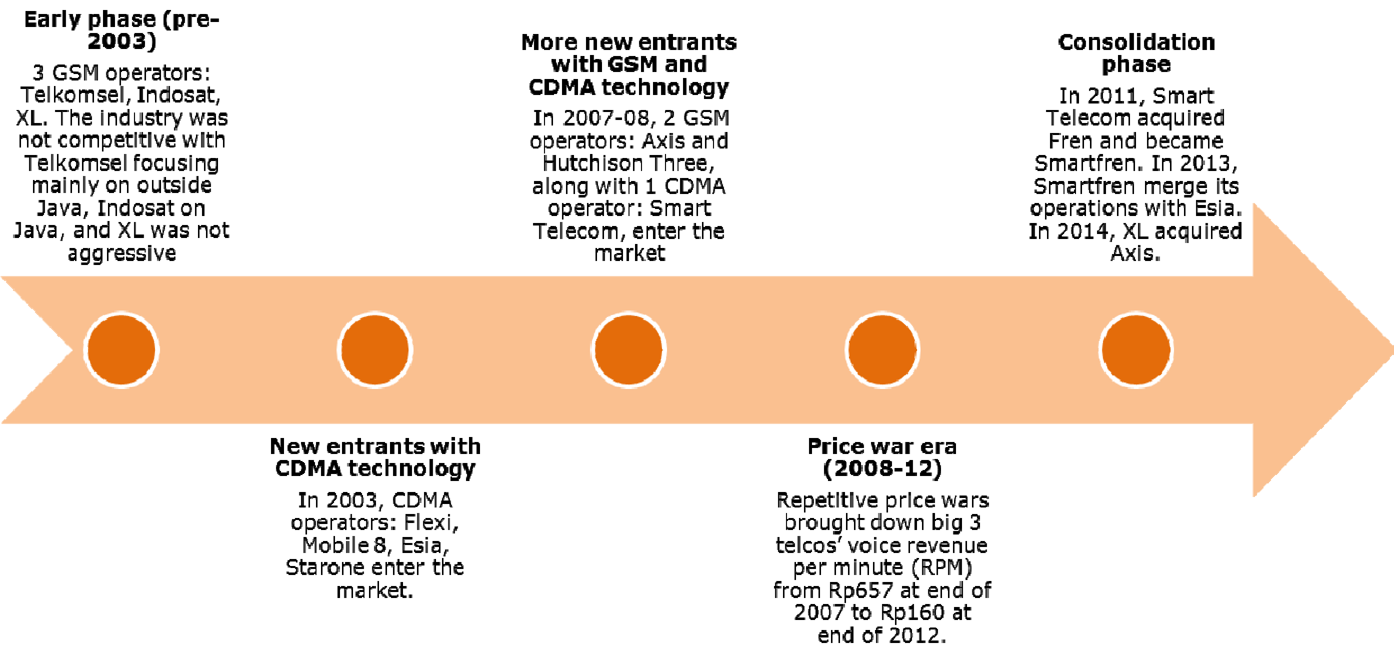
Figure 2. Current marketing positioning of GSM operators

	Telkomsel	Indosat	XL	Three
Postpaid brand (targeting high end customers)	Halo	Matrix	XL	Tri
Quality brand (targeting medium to high end customers)	Simpati	Mentari	XL	Tri
Fighting brand (targeting low to medium end customers)	As	IM3	Axis	Tri

Source: TRIM Research

As can be seen from the timeline below, the era of new entrants and the era of price wars are already behind the industry. It is now in consolidation phase (with Hutchison Three as the only clear potential acquisition target). Going forward, we expect a healthier competitive environment.

Figure 3. Timeline of Indonesia's telco industry's competitive phases



Source: TRIM Research

High-end customers tend to be loyal, but low-mid end customers are not

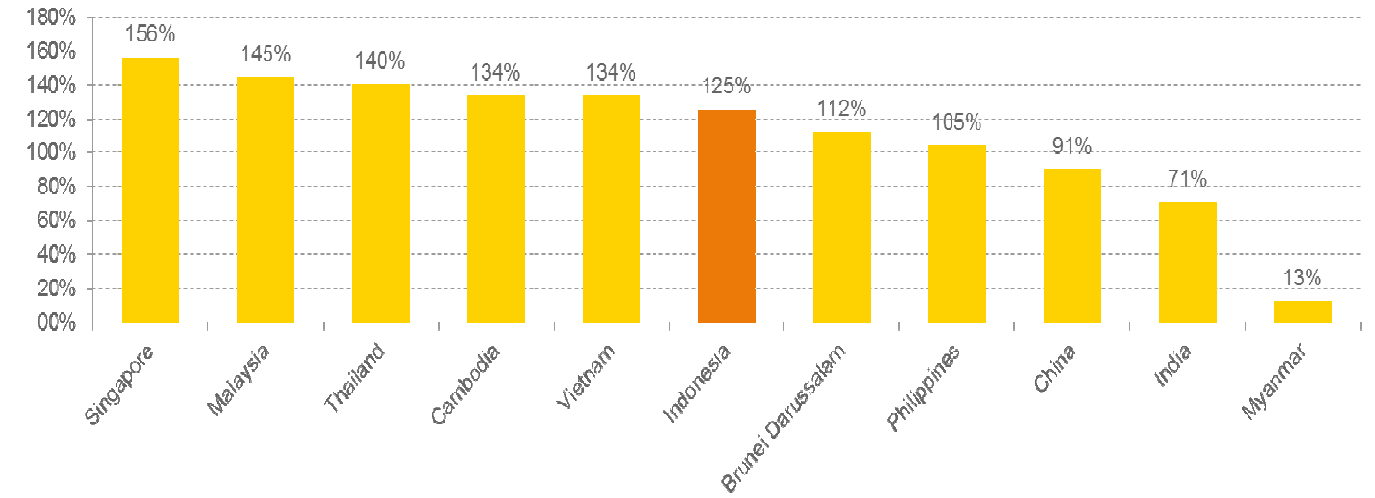
Indonesian mobile subscribers are 99% prepaid, unlike most other countries that are mostly postpaid (whereby price of handset is subsidized by telco operators as an exchange of a 2-3yrs subscription). This is a market structure that we do not expect to change anytime soon, as we observe that there is a high correlation between good individual credit risk track record and higher postpaid. The positive aspect of a prepaid market structure is telco companies in Indonesia do not have to subsidize subscribers' phones. The negative aspect is low to mid-end customers are prone to switch to operators that they view to have similar network quality but cheaper. Note that there is mobile phone number is not transferrable in Indonesia, so high-end customers are typically sticky as they have a much wider network of acquaintances who may not be able to reach them if they switch numbers.

Industry's Growth Potential

Little upside from total subscribers growth…

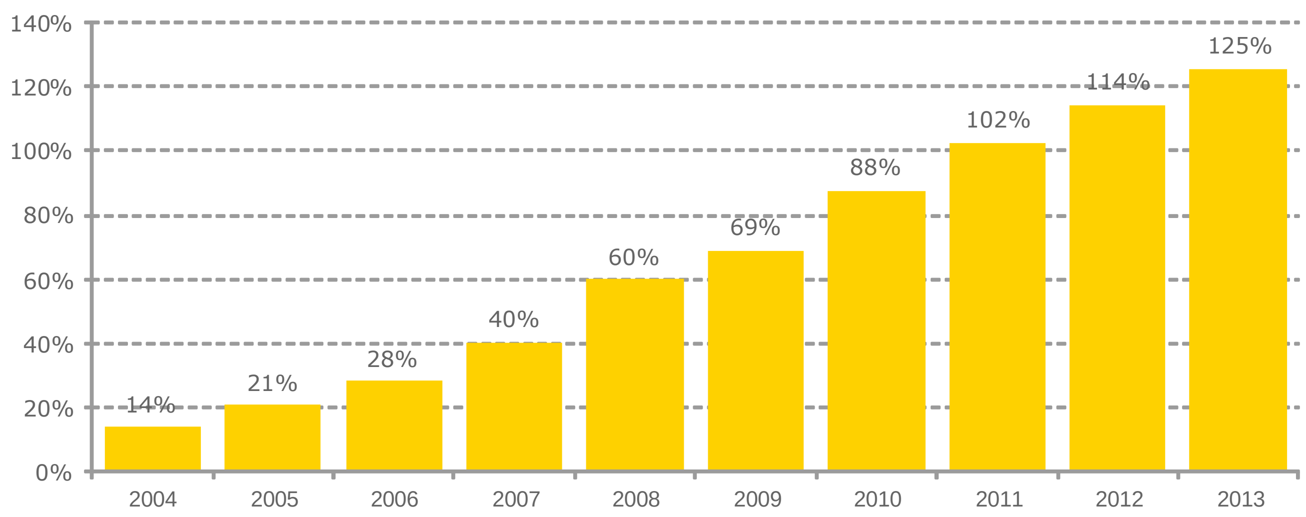
Most Indonesians rely on mobile phones as the primary means for telecommunication. Fixed-line (which is effectively is a monopoly by Telkom) penetration is only 3% while Indonesia's mobile penetration is 125%. Judging by penetration rate in several other countries in Asia, there is still upside to Indonesia's mobile penetration, but limited. Subscriber growth in Malaysia and Singapore slowed down significantly after reaching the 140% mark. Moreover, the additional subscribers from this point on are likely to be of lower income and/or younger population, who are typically lower ARPU (Average Revenue Per User) subscribers.

Figure 4. Mobile Subscribers Penetration in ASEAN, China, and India (2013)



Source: World Bank, ITU, TRIM Research

Figure 5. Indonesia's historical mobile penetration rate



Source: World Bank, Companies, TRIM Research

Figure 6. A snapshot of mobile subscribes and usage in Indonesia

Mobile penetration 125%	3G penetration 45%	Social Media penetration 28%	Mobile users out of total Social Media 86%

Source: Internet live stats, Internet world stats, www.techinasia.com, companies' data, TRIM Research

...but there is still significant upside from higher 3G penetration

3G penetration in Indonesia is still 45% as of 2014, still much lower than total mobile penetration at 125%. Indonesia's relatively young population is also a strong driver of fast adoption of internet. Social media penetration in Indonesia is at 28% (only active users only), and 86% of these active social media users access their social media accounts using their mobile handsets. We are optimistic 3G penetration rate can continue to grow as handset price falls. Currently the cheapest 3G/LTE enabled handset costs Rp1.1mn, equivalent to USD85. From our experience with 2G, penetration would increase dramatically when handset price falls to USD50 level. Note that lower handset price is an important factor in penetration in Indonesia because telco operators do not provide handset subsidy (99% of users are prepaid).

Telkom has the most spectrum, followed by Indosat and XL

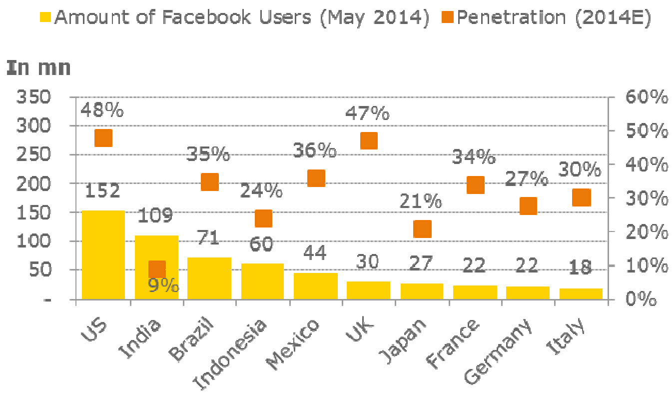
For telco operators, spectrum is the most important resource as there is limited availability in spectrum and it is a resource that is heavily controlled by government. Telkomsel (Telkom's mobile subsidiary, 65% owned by Telkom and 35% owned by Singtel) owns the largest amount of spectrum. Telkomsel owns as much spectrum as XL and more spectrum than Indosat in the 2100 Mhz band, which is currently used for 3G. Telkomsel also owns as much spectrum as XL and slightly more spectrum than Indosat in the 1800Mhz band, which is currently used for 2G but is already allocated for 4G (LTE) spectrum.

Figure 7. Spectrum allocation

	Total	850 Mhz	900 Mhz	1800 Mhz	2100 Mhz	2300 Mhz
Telkomsel	65.0	5.0	7.5	22.5	15.0	15.0
Indosat	57.5	2.5	10.0	20.0	10.0	15.0
XL Axiata	45.0	-	7.5	22.5	15.0	-
Hutchison Three	20.0	-	-	10.0	10.0	-

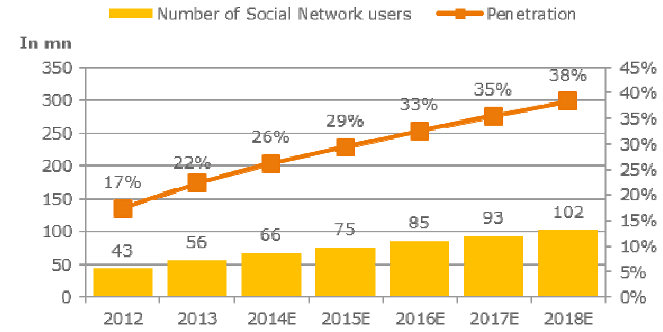
Source: Indosat, Telkom, XL, and TRIM Research

Figure 8. Top 10 Countries in terms of Facebook Accounts (May 2014)



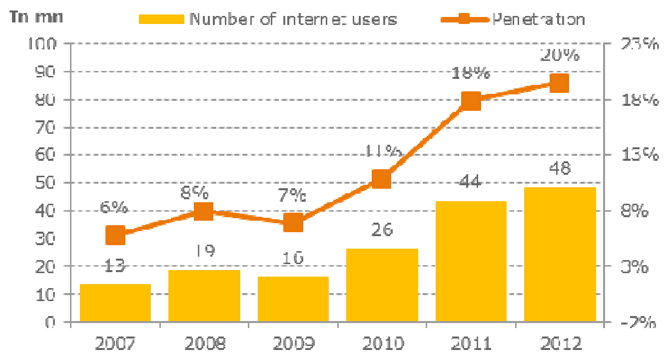
Source: statista.com, World Bank, TRIM Research

Figure 9. Social network users in Indonesia(in millions)



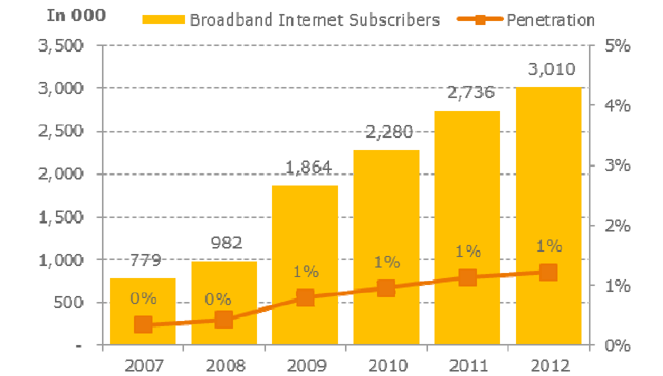
Source: statista.com, World Bank, TRIM Research

Figure 10. Number of Internet Users in Indonesia



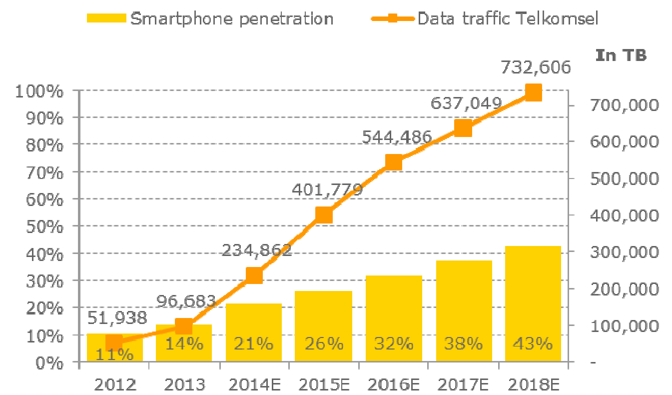
Source: Euromonitor, World Bank, TRIM Research

Figure 11. Broadband Internet Subscribers in Indonesia



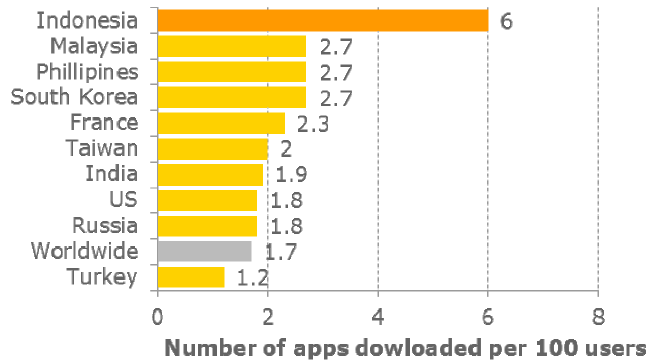
Source: Euromonitor, World Bank, TRIM Research

Figure 12. Indonesia's smartphone penetration vs. Telkomsel's data traffic



Source: Statista.com, Company, TRIM Research

Figure 13. Average mobile app download rate per capita in selected countries as of 3Q14



Source: statista.com

Figure 14. Mobile phone affordability

No.	Cellphone Type	Price (Rp)	Price (USD)	Network Technology	Touch Screen	Price / Monthly GDP per capita	Installment* Monthly Payment (Rp)	Installment* Monthly payment / Monthly GDP per capita
1	iPhone 6 16GB	11,000,000	836	LTE	v	331%	1,833,333	55%
2	Sony Xperia Z3	7,300,000	555	LTE	v	220%	1,216,667	37%
3	Samsung Galaxy S5	6,250,000	475	3G	v	188%	1,041,667	31%
4	LG G3	5,775,000	439	LTE	v	174%	962,500	29%
5	Samsung Galaxy E7	4,100,000	312	LTE	v	123%	683,333	21%
6	Asus Padfone S	2,950,000	224	LTE	v	89%	491,667	15%
7	Asus Zenphone 6	2,700,000	205	3G	v	81%	450,000	14%
8	Lenovo Vibe X	2,700,000	205	3G	v	81%	450,000	14%
9	BlackBerry Z10	2,550,000	194	LTE	v	77%	425,000	13%
10	Acer Liquid Jade	2,400,000	182	3G	v	72%	400,000	12%
11	Samsung Galaxy Prime SM-G530H	2,300,000	175	LTE	v	69%	383,333	12%
12	BlackBerry Z3	2,150,000	163	3G	v	65%	358,333	11%
13	Evercoss Elevate Y2	2,100,000	160	3G	v	63%	350,000	11%
14	Xiaomi Redmi Note 4G	2,100,000	160	LTE	v	63%	350,000	11%
15	Asus Zenphone 5	2,000,000	152	3G	v	60%	333,333	10%
16	Sony Xperia E3	1,900,000	144	LTE	v	57%	316,667	10%
17	Acer Liquid Z5	1,800,000	137	3G	v	54%	300,000	9%
18	ZTE V9820 (4G locked for specific operator)	1,650,000	125	LTE	v	50%	275,000	8%
19	Lenovo A6000	1,625,000	124	LTE	v	49%	270,833	8%
20	Xiaomi Redmi 2	1,625,000	124	LTE	v	49%	270,833	8%
21	Xiaomi Redmi 1S	1,550,000	118	3G	v	47%	258,333	8%
22	Blackberry 9320	1,400,000	106	3G	-	42%	233,333	7%
23	Android One	1,250,000	95	3G	v	38%	208,333	6%
24	IVO V5	1,200,000	91	LTE	v	36%	200,000	6%
25	Polytron Zap 5	1,099,000	84	LTE	v	33%	183,167	6%
26	Nokia 225	650,000	49	2G	-	20%	108,333	3%
27	Nokia 220	525,000	40	2G	-	16%	87,500	3%

*Assuming installment period of 6 months

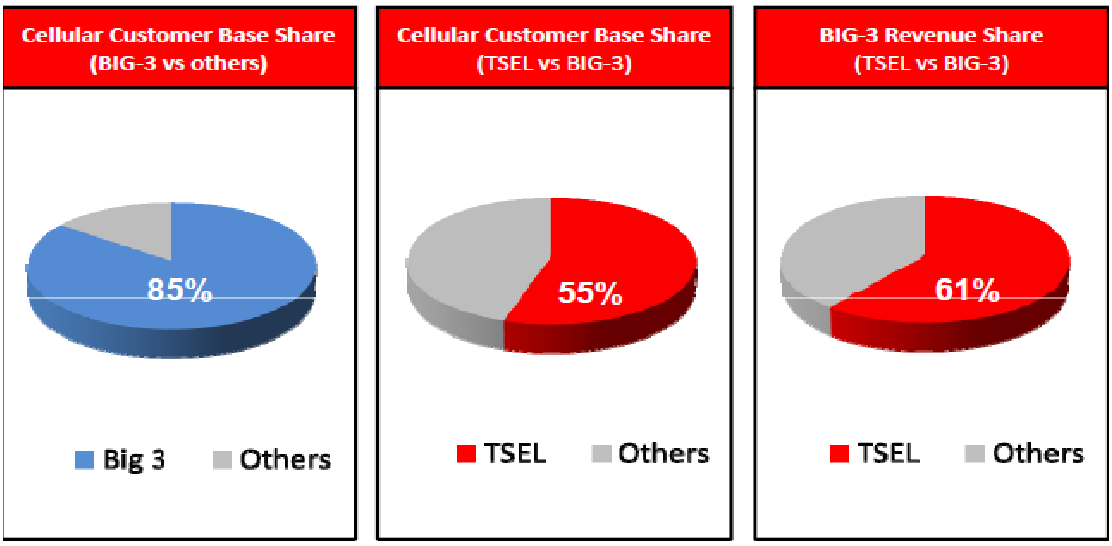
Source: Sinyal Tabloid, CEIC, TRIM Research

Management's Strategy

Telkom is the leader in almost every segment

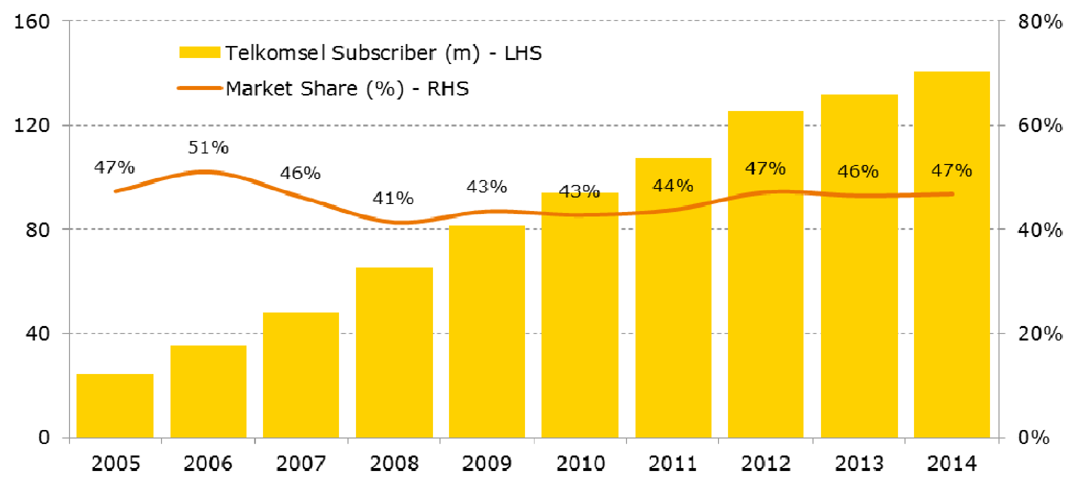
Telkom's mobile service subsidiary Telkomsel (65% owned by Telkomsel and 35% owned by Singtel) is the leader in mobile business whether it is judged by subscribers or revenue market share. We expect Telkomsel to continue to retain its number one position as it continues to invest to remain the leader in network quality. Telkom also effectively has a monopoly in fixed-line business.

Figure 15. Telkomsel is the clear leader in mobile (figures are company estimates)



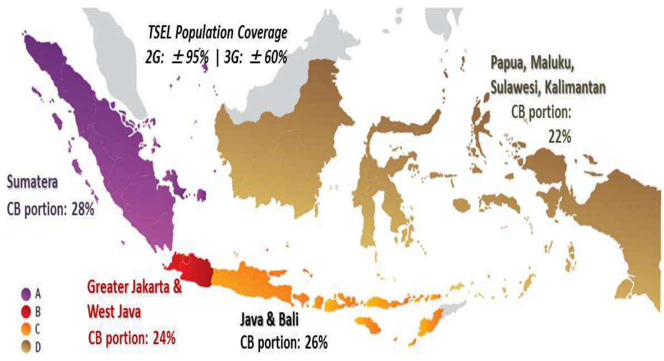
Source: Company estimates

Figure 16. Telkomsel's Subscriber & Market Share (as% of total subscribers)



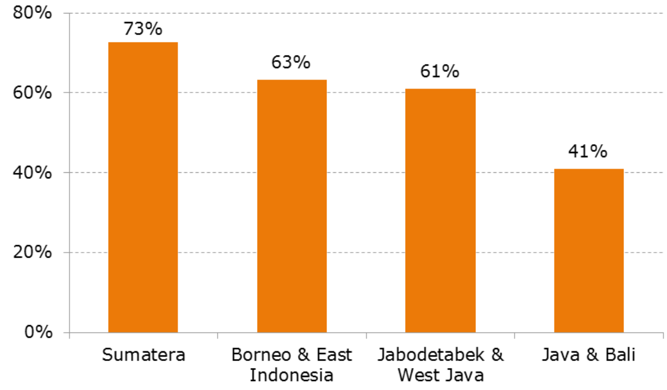
Source: Company

Figure 17. Telkomsel's customer base per region



Source: Company, TRIM Research

Figure 18. Telkomsel's penetration per region

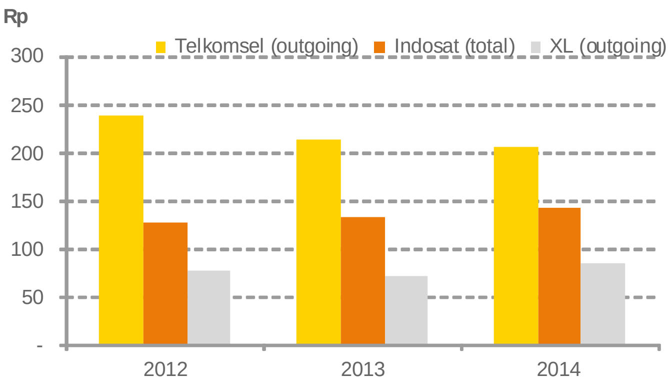


Source: Company, TRIM Research

Telkomsel has a well diversified customer base

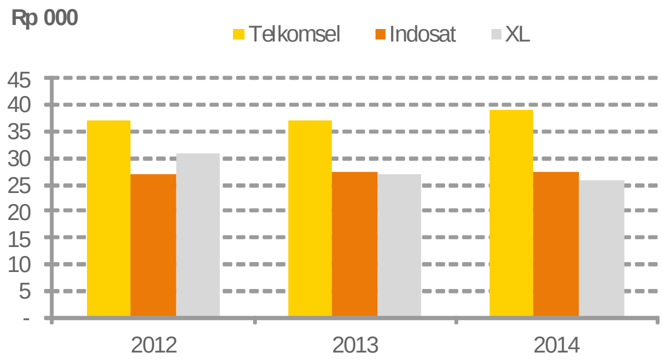
Only 50% of Telkomsel's customer base is in Java and Bali (including greater Jakarta), while 28% in Sumatra and 22% in East Indonesia. This is much more diversified than its two nearest competitors XL and Indosat, which we estimate to have ~70% of its customers in Java and Bali (including greater Jakarta). Telkomsel's entrenched position in outside Java and Bali area (strong brand awareness and clearly ahead in network quality) is one of the main reasons that allows Telkomsel to charge higher tariffs in these areas in which it has significant market share (i.e. in North Sumatra Telkomsel has ~80% market share). Telkomsel has the highest total ARPU among the big three operators and also the highest voice ARPM (Average Revenue Per Minute).

Figure 19. ARPM of Top 3 Operators in Indonesia



Source: Companies, TRIM Research

Figure 20. ARPU of Top 3 Operators in Indonesia



Source: Companies, TRIM Research

Future growth will be driven by ARPU, not subscribers

During price war era, telco operators' revenue growth was driven by subscribers while ARPU declined. ARPU grew for the first time in 2014 (we only kept 10 years record of Telkom's growth drivers) and we expect this new trend to continue in the foreseeable future. The main drivers of ARPU growth is voice tariff growth and data volume growth. We expect telco operators to leverage lower voice demand elasticity into higher tariff growth. We still expect SMS revenue to decline but data revenue will still grow driven by volume.

Figure 21. Telkom's forecast drivers

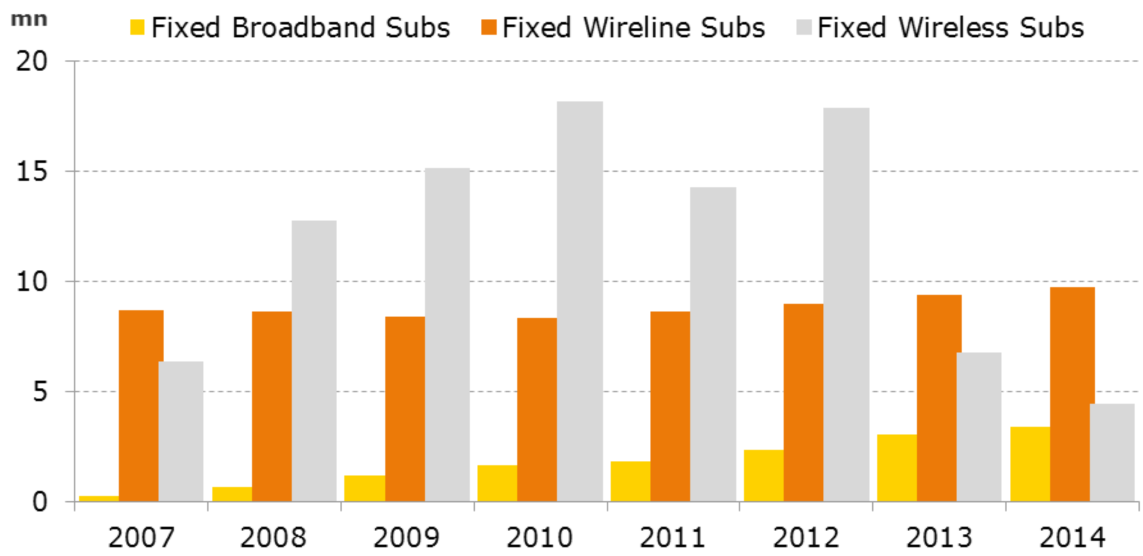
31 December	2013A	2014A	2015E	2016E	2017E	2018E	2019E
Telkomsel							
Industry mobile subs (m)	283.4	313.2	318.5	323.3	328.1	333.0	338.0
Telkomsel mobile subs (m)	131.5	140.6	143.6	146.5	149.4	152.3	155.2
Subscriber market share	46.4%	44.9%	45.1%	45.3%	45.5%	45.7%	45.9%
Implied ARPU (Rp 000)	39.0	40.6	43.1	45.9	48.6	51.3	53.7
% change	-0.4%	4.1%	6.2%	6.4%	5.9%	5.7%	4.7%
Chargeable MOU (min/sub/month)	91	99	102	103	107	110	112
Incoming MOU (min/sub/month)	75	81	83	84	87	90	92
Free MOU (min/sub/month)	-	-	-	-	-	-	-
Blended MOU (min/sub/month)	166	180	185	187	194	200	204
% change	-10.0%	8.5%	3.2%	1.0%	3.5%	3.0%	2.0%
Total minutes carried (b min)	255.1	293.5	316.2	326.0	344.1	361.4	375.7
% change	-0.5%	15.0%	7.7%	3.1%	5.6%	5.0%	4.0%
Free minutes (%)	0%	0%	0%	0%	0%	0%	0%
Incoming minutes (%)	55%	55%	55%	55%	55%	55%	55%
Voice revenue/ minute (Rp)	117	113	107	105	107	108	109
% change	-10.5%	-3.6%	-5.0%	-1.8%	1.0%	1.0%	1.0%
Elasticity factor	(0.0)	4.1	1.6	1.7	(5.6)	(5.0)	(4.0)
Data traffic (terabyte)	96,683	234,862	410,532	559,752	654,910	753,146	851,055
% change	86.2%	142.9%	74.8%	36.3%	17.0%	15.0%	13.0%
Data Rate (Rp/kb)	0.11	0.06	0.05	0.05	0.05	0.04	0.04
% change	-27.2%	-44.8%	-19.1%	-6.1%	-1.0%	-1.0%	-1.0%
Chargeable SMS (bn)	146	133	120	116	115	114	113
% change	25.4%	-9.2%	-9.8%	-3.0%	-1.0%	-1.0%	-1.0%
Revenue / chargeable SMS (Rp)	**86**	**98**	**112**	**118**	**118**	**119**	**119**
% change	NA	14.0%	14.3%	4.7%	0.5%	0.5%	0.5%
Gross revenue (Rp t)	66.9	73.9	82.0	89.1	96.2	103.6	110.6
Net revenue (Rp t)	60.0	66.3	73.5	79.9	86.2	92.9	99.1
Net EBITDA margin	56.4%	56.2%	55.7%	55.5%	55.1%	54.8%	54.4%
Capex/sales	19.3%	21.9%	20.9%	16.0%	15.0%	15.0%	14.0%
Telkom (ex-Telkomsel)							
Fixed line subs (m)	9.3	9.7	9.9	10.2	10.2	10.2	10.2
Fixed line ARPU (Rp 000)	77.0	70.2	67.8	68.4	68.4	68.4	68.4
Telkom Flexi subs (m)	6.8	4.4	4.2	2.2	2.3	2.3	2.4
Telkom Flexi ARPU (Rp 000)	8.1	14.4	8.3	7.6	7.5	7.4	7.4
Telkom Speedy subs (m)	3.0	3.4	3.7	4.2	4.7	4.9	5.0
Telkom Speedy ARPU (Rp)	138.6	127.7	120.6	136.3	154.1	174.1	194.5
Revenues (Rp t)	22.9	23.4	25.4	28.3	32.1	35.9	39.7
EBITDA margin	34.5%	36.6%	36.4%	36.6%	36.9%	37.3%	37.6%
Capex/sales	58.0%	43.3%	37.0%	50.0%	50.0%	35.0%	35.0%

Source: Company and TRIM Research

Plenty of upside in fixed broadband

We believe there is plenty of potential in Telkom's fixed-line business, which we expect to contribute 14% of Telkom's revenue in 2015. We are particularly upbeat on Telkom's fixed broadband business, which currently is marketed under the brand "Speedy". Most of Telkom's fixed broadband existing and potential customers are now connected through copper wires. Telkom will use the proceed from its bond issuance to invest in fiber optic infrastructure to homes, which should increase bandwith capacity by approximately 20x. Other competitors (First Media, MNC group) are also investing in fiber optic connectivity to homes (FTTH) but Telkom should be able to outspend its competitors and become the clear leader in fiber optic connectivity to homes.

Figure 22. Fixed line business' subscribers



Source: Company

Figure 23. Comparison between copper and fiber optic wires

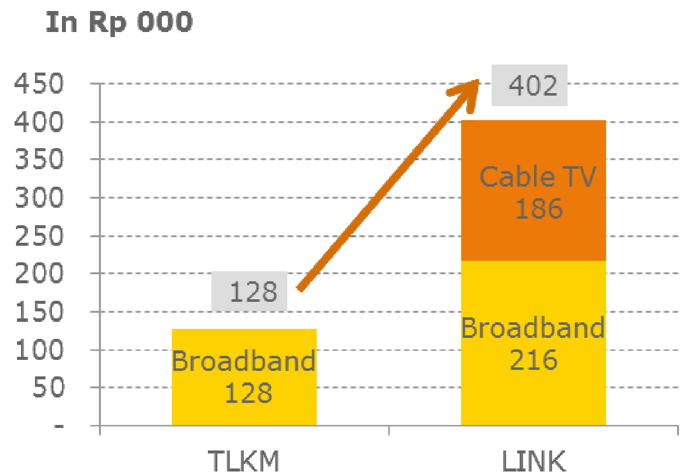
	Copper wire	Fiber Optic
Bandwidth	Up to 5 Mbps	Up to 100 Mbps
Stability	Stable enough	Very stable
Maintenance	Need regular maintenance	No regular maintenance needed
Durability	Affected by electromagnetic interference	Not affected by electromagnetic interference
Security	Not safe from lightning	Safe from lightning

Source: Company

Significant ARPU upside in broadband

Telkom currently only has Rp128k of fixed broadband ARPU, significantly lower than First Media's Rp216k ARPU in broadband service and much lower than the full potential Rp402k ARPU including cable TV. Clearly there is plenty of ARPU upside if Telkom can lay out its fiber optic network and can execute in the double play business of selling both broadband and cable TV services.

Figure 24. LINK and TLKM Fixed Service ARPU (2014)



Source: Companies, TRIM Research

Strong operating cash flow

Despite growing in high capex business, company's strong operating cash flow could be utilized as the main source of funding. As of Dec 2014, operating cash flow accounted for Rp 37.7tn with capex around Rp 24tn and loan refinancing Rp 10tn. Fast cash cycle from Telkomsel prepaid voucher (72% from total revenue) supported the company's cash flow. In terms of Free Cash flow, company recorded Rp 18.8tn as of Dec 2014 and we expect it will continue strengthen noting its solid business model.

Figure 25. Cashflow

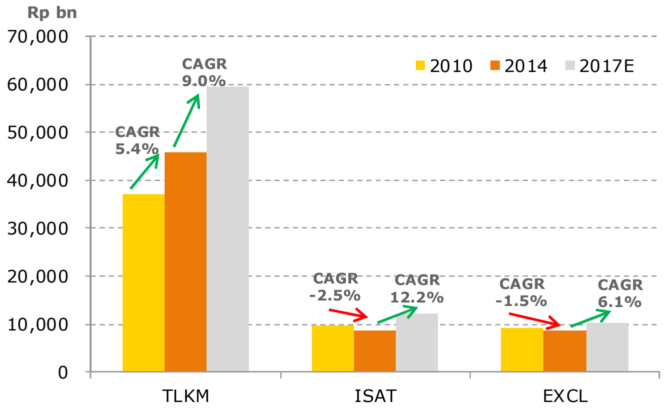
Cashflow Statement (Rp bn)	**2013A**	**2014A**	**2015F**	**2022F**	**2025F**
Cashflow from Operation	**36,574**	**37,736**	**41,681**	**39,376**	**41,079**
Cashflow from Investment	**(22,702)**	**(24,748)**	**(28,433)**	**(30,732)**	**(33,088)**
Cashflow from Financing	**(9,760)**	**(14,087)**	**(10,167)**	**(6,011)**	**(6,230)**
Net changes in cash	4,112	(1,099)	3,081	2,633	1,762
Cash & Temporary Inv - BOY	17,456	21,568	20,469	23,550	26,183
Cash & Temporary Inv - EOY	**21,568**	**20,469**	**23,550**	**26,183**	**27,944**

Source: Company, TRIM Research

Highest EBITDA as the most integrated telco company

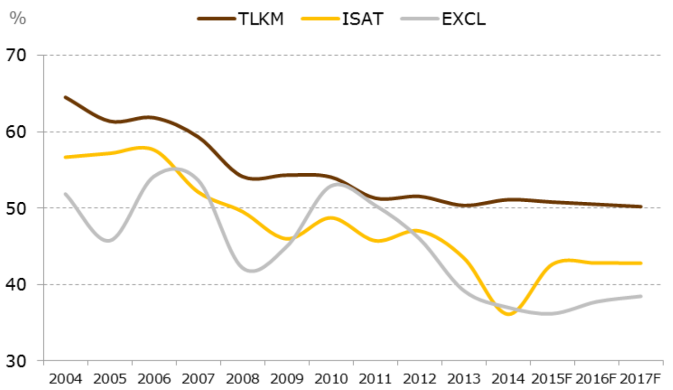
High profitability with controlled efficiency has supported the company's cashflow. The company recorded highest EBITDA among other telco company, Rp 45.8tn, growing 5.4% CAGR 2010-2014. This was relatively outstanding given that other two big telco companies posted negative EBITDA growth. EBITDA margin as of Dec 2014 recorded at 51.1%, far above its competitor which gathered 36-37% EBITDA margin. The company has more integrated business model including fixed line business (voice) which offered highest gross margin (~60%). However, the company has to suffer its margin in the next two years as they need to allocate more capex investment for future business development adjusting the rapid technology. However, we think margins should be at safe level.

Figure 26. EBITDA



Source: Company, TRIM Research

Figure 27. EBITDA Margin (%)

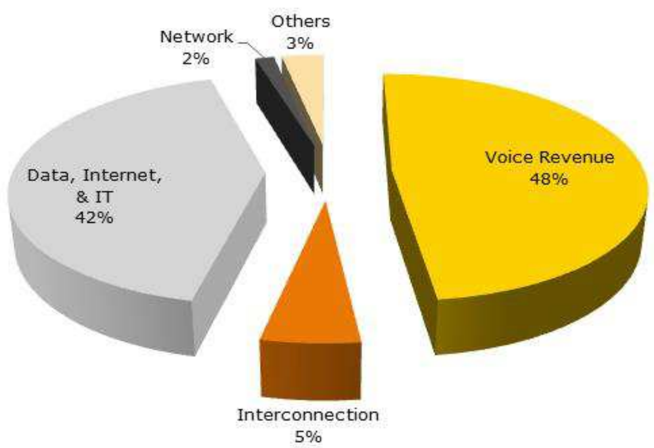


Source: Company, TRIM Research

Efficiency

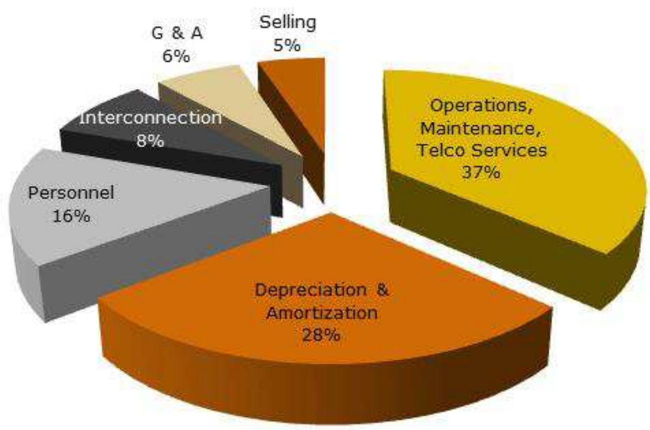
To maintain its margin at healthy level, the company also controlled its cost tightly. Biggest portion was operating and maintenance expense accounting for 37%, followed by depreciation and amortization (28%), and personnel expense (16%). Selling expense been squeezed to 3.4% of revenue in 2014 from it's highest level, 4.6% in 2011. General and administration expense also been squeezed to 4.4% of revenue in 2014 from 5.0% in 2013.

Figure 28. Revenue Breakdown



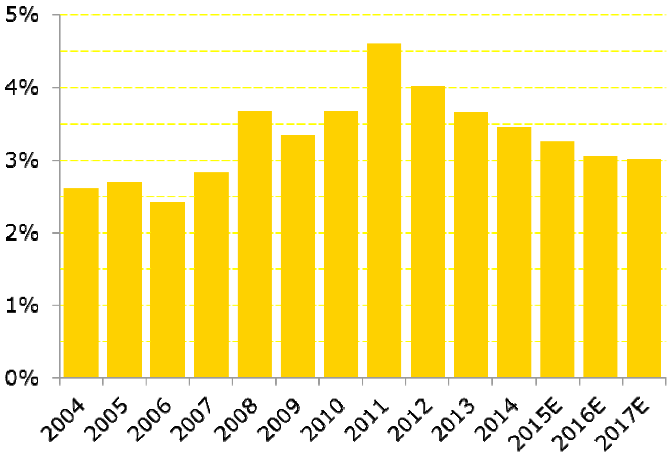
Source: Company, TRIM Research

Figure 29. Cost Breakdown



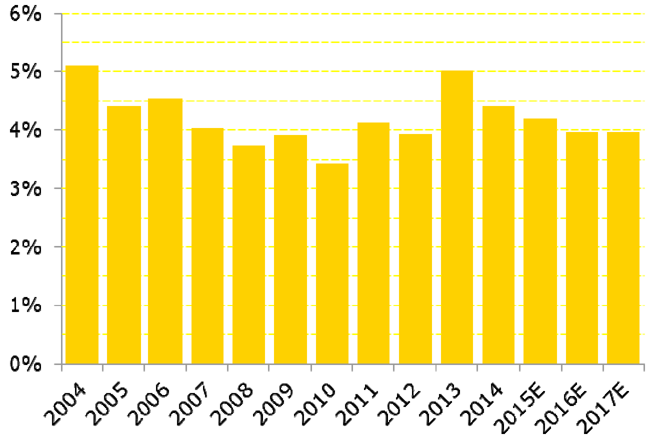
Source: Company, TRIM Research

Figure 30. % Selling Expense to Revenue



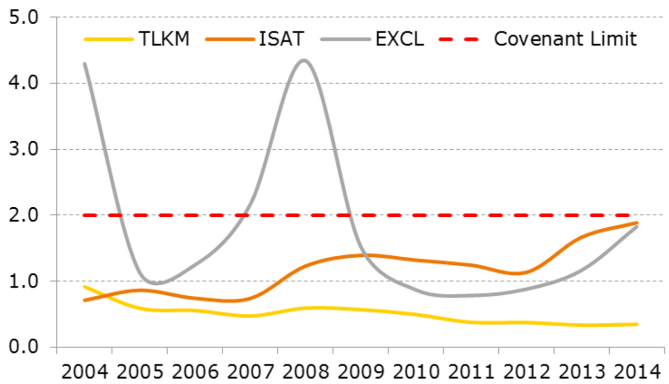
Source: Company, TRIM Research

Figure 31. % G & A Expense to Revenue



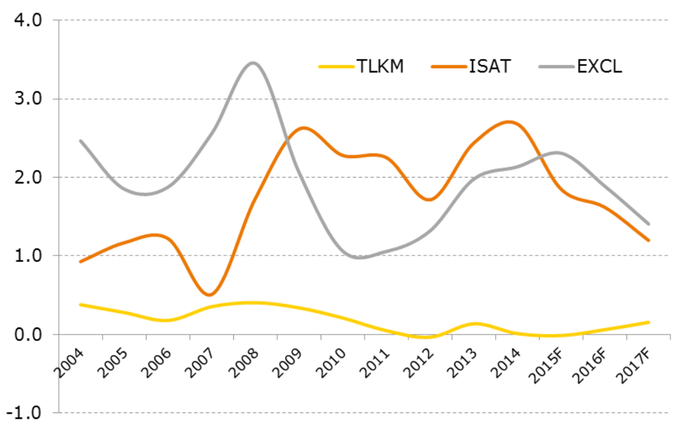
Source: Company, TRIM Research

Figure 32. Debt to Equity (x)



Source: Company, TRIM Research

Figure 33. Net Debt to EBITDA (x)



Source: Company, TRIM Research

Manageable foreign currency risk

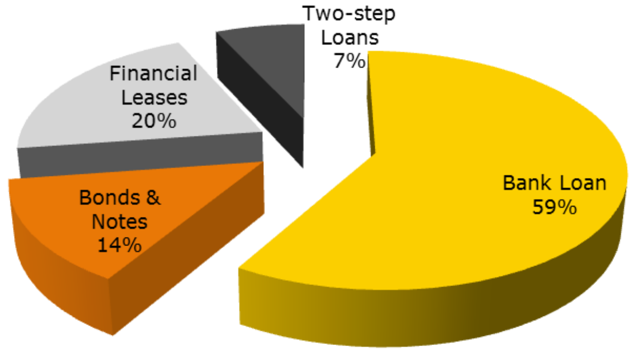
The company has exposure to currency fluctuations since their revenue stream in rupiah (Dollar revenue only from international coverage) while capex is in foreign currency. Thus the company has some debt and liabilities in foreign currency. Forex debt itself is around Rp 3.4tn or 14% from total debt, consist of USD denominated (10.6%) and YEN (3.2%). The remaining 86% of debt is rupiah denominated. To minimize its exposure to the currency risk, the company place some of their liquid asset in valas deposit thus net forex exposure is only USD 40mn & ¥ 7.72bn or equivalent to Rp 520bn.

Figure 34. FY14 Funding Composition (Rp bn)

(Rp bn)	ST	Current Maturities	LT Portion	Total
Bank Loan	1,810	4,052	7,878	13,740
Bonds & Notes		1,069	2,239	3,308
Financial Leases		571	4,218	4,789
Two-step Loans		207	1,408	1,615
Total Debt				**23,452**

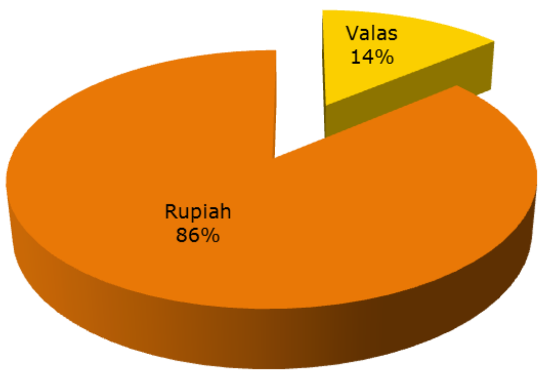
Source: Company, TRIM Research

Figure 35. Funding Portion as of FY14 (%)



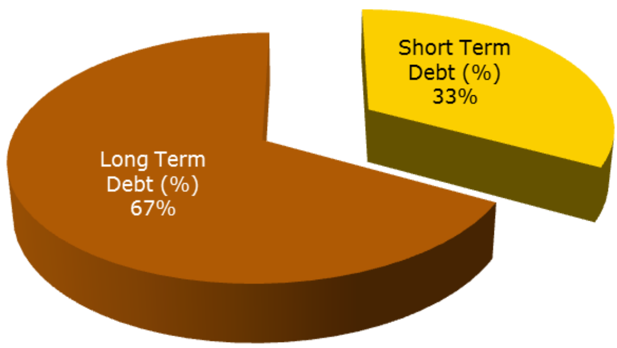
Source: Company, TRIM Research

Figure 36. FY14 Funding Based on Currency



Source: Company, TRIM Research

Figure 37. FY14 Funding Based on Maturity

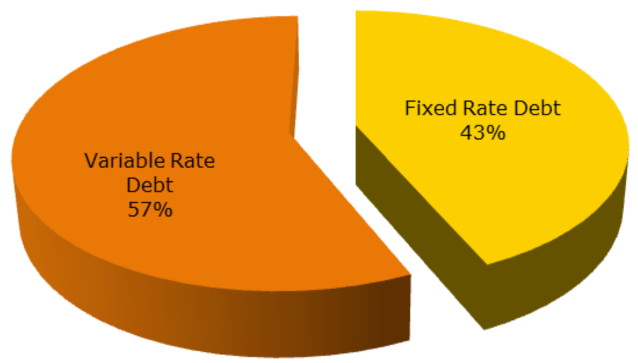


Source: Company, TRIM Research

Exposure to interest rate movement

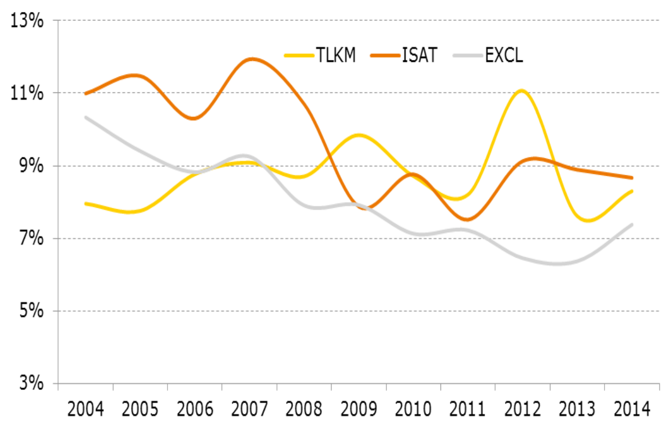
From the cost of fund side, the company has fixed and floating rate debt with the blended cost is 8.3%. Floating rate debt has bigger portion than the fixed rate one, 57% vs 43%. The company signed interest rate swap contract to secure some of its floating rate into fixed rate to minimize the interest rate fluctuation risk. Sensivity analysis showed that every 25bps changes in the benchmark interest rate (LIBOR/JIBOR) could affect the company's loss/gain by Rp 33bn, assuming other variables, such as foreign currency, is constant.

Figure 38. FY14 Variable vs Fixed Rate Debt



Source: Company, TRIM Research

Figure 39. Blended Cost of Debt (%)

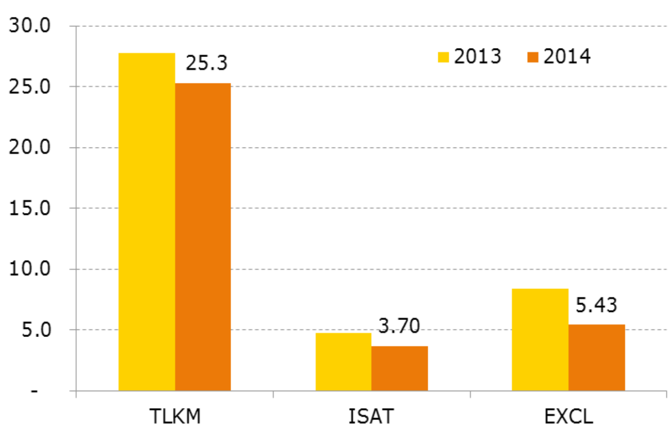


Source: Company, TRIM Research

Solid interest & debt coverage

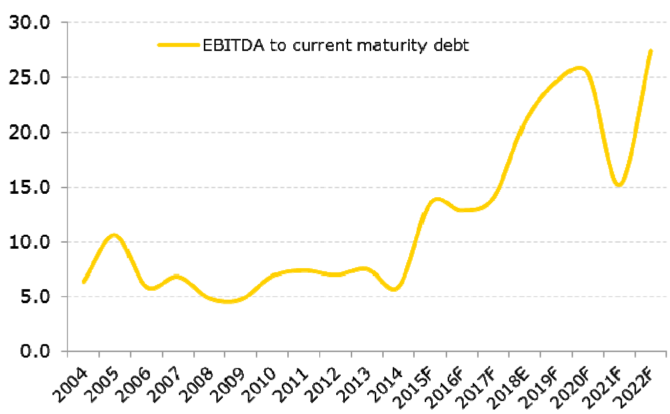
EBITDA to interest coverage ratio reached 25x in 2014, it could well cover the company's liability over interest and principal payment. It also far above other big three players which only 4.5x (average). We expect the company to have no problem in fulfilling its principal debt payment when they are due as EBITDA/current maturity debt will be in the 13.6-27.5x level in 2015E-22E.

Figure 40. EBITDA Interest Coverage (x) - Telco



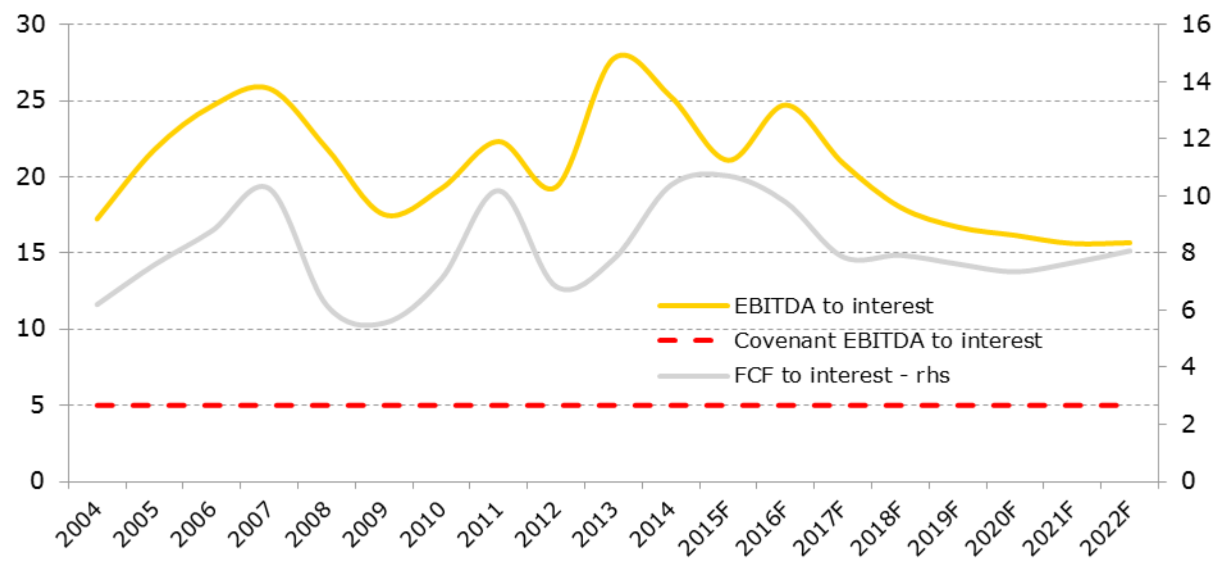
Source: Company, TRIM Research

Figure 41. EBITDA to current maturity debt (x)



Source: Company, TRIM Research

Figure 42. Telkom's Interest Coverage (x)

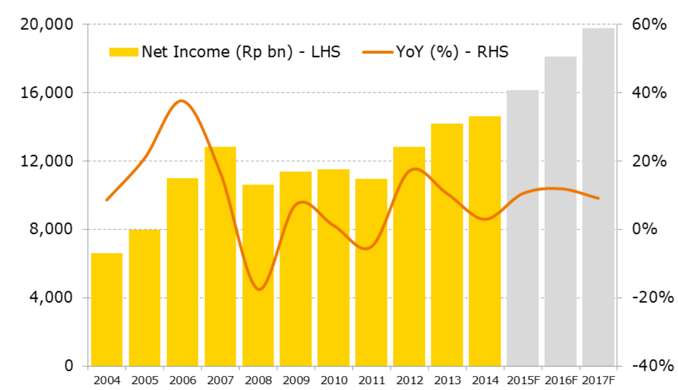


Source: Company, TRIM Research

Bottom line always positive

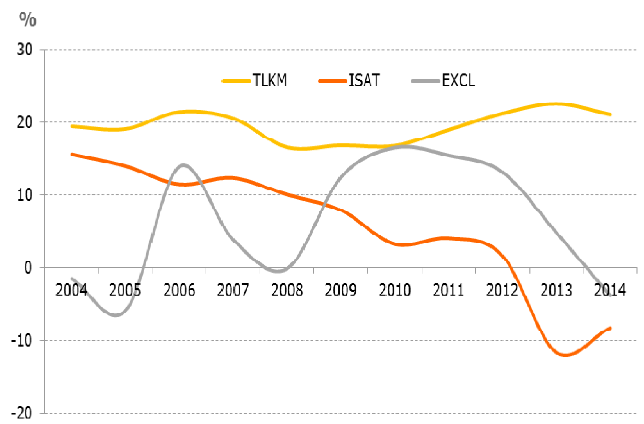
The company has more stable net income margins and higher profitability compared to its competitors. As of Dec 2014, it recorded Rp 14.6tn net income (3% YoY) along with 21% net income margin while its competitor booked negative earnings. 2014 Return on Equity (ROE) declined to 21.6% from 23.5% in 2013 given 2013's high base due to one-off gain from Telkom Vision 80% divestment.

Figure 43. Net Income



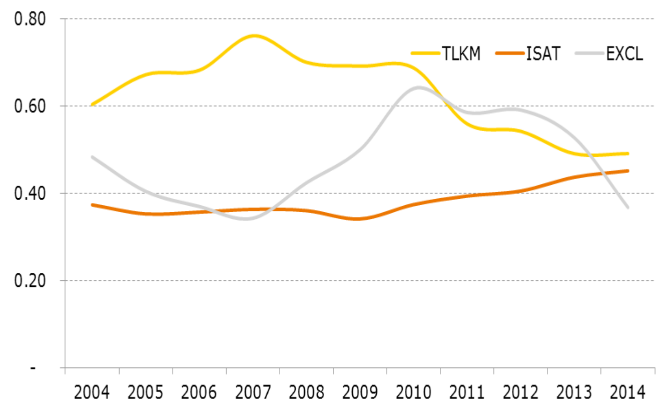
Source: Company, TRIM Research

Figure 44. Net Margin (%)



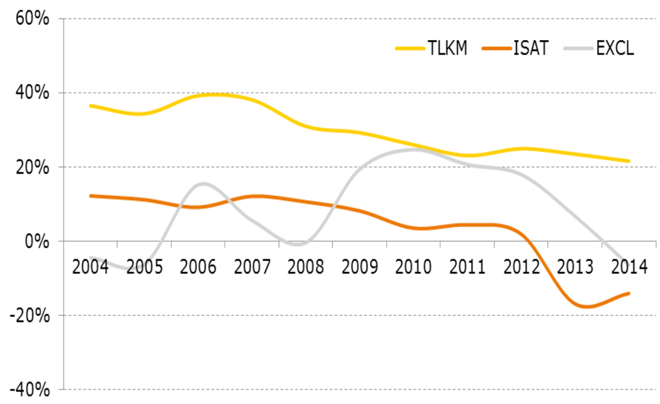
Source: Company, TRIM Research

Figure 45. Assets Turnover (x)



Source: Company, TRIM Research

Figure 46. Return on Equity (%)



Source: Company, TRIM Research

Valuation: Buy with 15% upside to TP Rp 3300

We initiate Telkom with a Buy on the following reasons: 1) We are more optimistic on competitive environment in Indo telco industry and we expect data tariff to fall at much slower pace going forward (and potentially up on a QoQ basis), 2) Telkom is likely to be the telco that benefits the most from data growth given its best network among all Indo telcos, 3) Telkom's expansion in FTTH (Fiber To The Home) is likely to cement its leadership further in the data business, and 4) Strong balance sheet with decent dividend yield.

We derive our valuation using 10-year DCF followed by a terminal value based on 9x EV/EBITDA for Telkomsel and 6x EV/EBITDA for Telkom. We assume higher EV/EBITDA for Telkomsel as it is the clear leader in Indo mobile industry with ~50% subscriber market share, highest brand equity with best network. We think there is upside to our 6x EV/EBITDA valuation for Telkom, particularly if the company can execute well on its FTTH expansion and monetize its towers and property businesses.

Our target price of Rp3,300 is a round-up from Rp3,277 NAV/share, which consists of Rp2,715/share (83% of total) for Telkom's 65% ownership in Telkomsel and Rp562 for remainder of Telkom's business (mostly its fixed-line).

Telkom currently trades at 7.9x 2015 EV/EBITDA and 7.2x 2016 EV/EBITDA, higher than its local peers (ISAT and EXCL), which we believe is justified given Telkomsel's leadership in subscribers, revenue, EBITDA market shares, and Telkomsel's best network quality. Telkom trades at a discount to average regional telco excl. Indonesia of 10.2x 2015 EV/EBITDA and 9.7x 2016 EV/EBITDA.

Telkom also looks attractive on PE basis relative to both local and regional peers. Telkom currently trades at 17.6x 2015PE and 15.5x 2016 PE, lower than its local peers and also lower than its regional peers' average of 20.1x 2015PE and 18.8x 2016 PE

Figure 47. Regional comparison

Ticker	Name	EV/EBITDA 2015E	EV/EBITDA 2016E	P/E 2015E	P/E 2016E
Indonesia					
TLKM	**Telkom (Telekomunikasi Indonesia)**	**7.9**	**7.2**	**17.6**	**15.5**
EXCL	XL Axiata	5.1	4.6	142.6	27.6
ISAT	Indosat	4.4	4.1	43.0	19.1
Singapore					
ST	Singtel (Singapore Telecommunications)	14.7	14.1	16.8	15.8
STH	Starhub	9.7	9.6	18.2	18.1
M1	M1	9.6	9.3	16.3	15.7
Malaysia					
Axiata	Axiata	8.9	8.3	21.8	19.6
Digi	Digi.com	13.1	12.5	20.7	20.0
Maxis	Maxis	13.3	12.8	25.4	23.6
T	Telekom Malaysia	7.4	7.1	25.4	23.1
Philippines					
TEL	Philippine Long Distance	9.4	9.0	18.1	17.9
GLO	Globe Telecom	8.8	8.1	20.9	19.6
Thailand					
ADVANC	AIS (Advance Info Services)	10.4	9.8	18.5	16.4
DTAC	Total Access Communication	6.4	5.7	18.9	16.9
Average All		**9.2**	**8.7**	**30.3**	**19.2**
Average Excl. Indonesia		**10.2**	**9.7**	**20.1**	**18.8**

Source: TRIM Research

Figure 48. DCF calculations (Telkomsel + Telkom ex–Telkomsel)

TELKOMSEL	1	2	3	4	5	6	7	8	9	10
YE Dec 31 (in Rp b)	**2016F**	**2017F**	**2018F**	**2019F**	**2020F**	**2021F**	**2022F**	**2023F**	**2024F**	**2025F**
EBIT	32,973	35,760	38,710	41,654	44,364	46,723	49,132	51,584	53,895	56,173
Tax Rate	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
EBIT*(1-t)	24,730	26,820	29,033	31,240	33,273	35,042	36,849	38,688	40,421	42,130
+ D & A	11,324	11,771	12,167	12,295	12,495	13,025	13,438	13,699	13,950	14,040
- Capex	-12,777	-12,934	-13,934	-13,878	-13,670	-13,346	-14,068	-14,775	-15,457	-16,104
+ Change in working capital	2,102	1,375	1,064	1,603	1,271	1,282	1,408	1,305	1,253	1,211
FCFF	25,379	27,032	28,330	31,259	33,368	36,003	37,626	38,917	40,167	41,277
FCFF - Discounted	22,795	21,807	20,528	20,344	19,506	18,903	17,744	16,484	15,281	14,105

Value of cash-flows thro 2025	187,498		
Terminal value - 9x EV/EBITDA	222,410	Risk-Free rate	8%
		Equity market risk premium	5%
Enterprise value	409,907	Beta	105%
Net Debt / (Cash)	-120	Cost of equity	13%
Equity value	410,027	Post-tax cost of debt	8%
Telkom stake	1	Debt/Capital ratio (Avg 2016-25)	31%
Value per share	**2,715**	WACC	11%

TELKOM (ex-Telkomsel)	1	2	3	4	5	6	7	8	9	10
YE Dec 31 (in Rp b)	**2016F**	**2017F**	**2018F**	**2019F**	**2020F**	**2021F**	**2022F**	**2023F**	**2024F**	**2025F**
EBIT	3,421	4,297	5,334	6,358	7,526	9,308	11,226	13,146	15,140	17,042
Tax Rate	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
EBIT*(1-t)	2,575	3,234	4,015	4,785	5,665	7,006	8,450	9,895	11,396	12,827
+ D & A	6,923	7,553	8,036	8,567	8,914	8,737	8,438	8,121	7,679	7,246
- Capex	-14,145	-16,051	-12,557	-13,887	-15,156	-14,128	-12,714	-13,082	-13,333	-13,454
+ Change in working capital	901	589	456	687	545	550	603	559	537	519
FCFF	-3,746	-4,674	-50	152	-33	2,164	4,777	5,493	6,279	7,138
FCFF - Discounted	-3,364	-3,770	-37	99	-19	1,136	2,253	2,327	2,389	2,439

Value of cash-flows thro 2025	3,458	Risk-Free rate	8%
Terminal value - 6x EV/EBITDA	51,291	Equity market risk premium	5%
		Beta	105%
Enterprise value	54,749	Cost of equity	13%
Net Debt / (Cash)	-481	Post-tax cost of debt	8%
Equity value	55,230	Debt/Capital ratio (Avg 2016-25)	31%
Value per share	**563**	WACC	11%

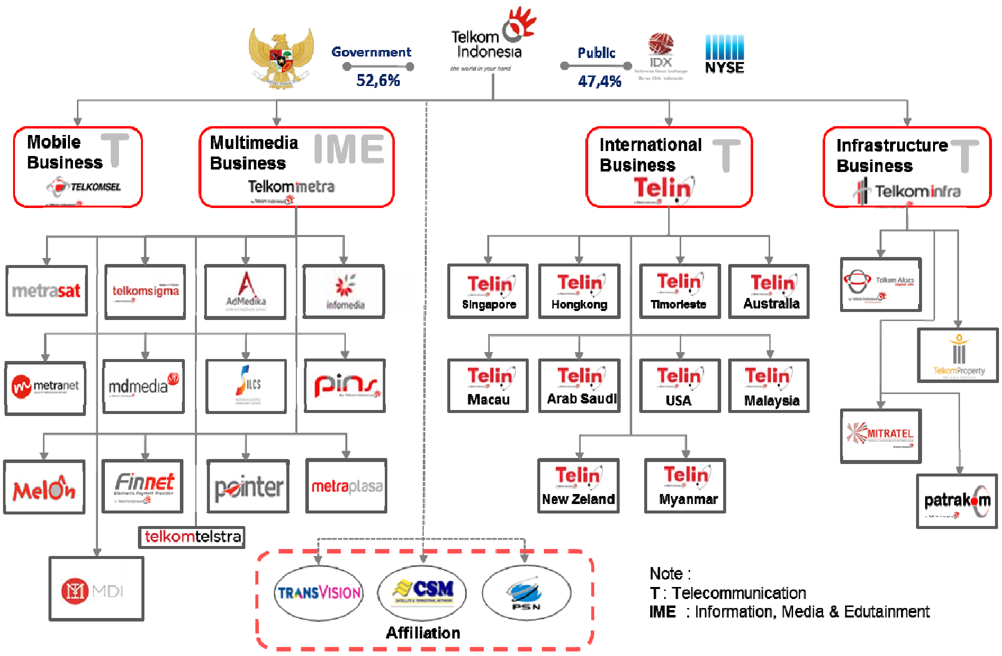
Source: TRIM Research

Company Background

PT Telekomunikasi Indonesia (Persero) Tbk, or called “Telkom”, was founded by Dutch Government in 1884. Then in 1991, Company status been changed to Persero and went public in Jakarta & Surabaya stock exchange in 1995.

Year of 1999 became a strategic year for Indonesia telecommunication industry where the government cancelled all monopoly rights in the industry, ushering in a new era in Indonesia telecommunication that is more competitive but also more vibrant. Telkom changed its official business article in 2002. Under the new article, the company aims to become a leading *Full Network and Service Provider (FNSP)* in InfoCom which deliver best services and latest technology at reasonable price.

Figure 49. Telkom Group & Subsidaries



Source: Company (excluding treasury shares held by Telkom)

Income Statement (Rpbn)

Year end Dec	2013	2014	2015F	2016F	2017F
Revenue	82,967	89,696	98,887	108,146	118,331
Rev. Growth (%)	7.5%	8.1%	10.2%	9.4%	9.4%
Gross Profit	NA	NA	NA	NA	NA
Opr. Profit	25,996	28,713	32,945	36,395	40,057
EBITDA	41,776	45,844	50,221	54,642	59,381
EBITDA Growth (%)	5.1%	9.7%	9.5%	8.8%	8.7%
Net Int Inc/(Exp)	(668)	(576)	(1,206)	(858)	(1,337)
Gain/(loss) Forex	(249)	(14)	(12)	0	0
Other Inc/(Exp)	2,070	661	195	0	0
Pre-tax Profit	27,149	28,784	31,922	35,537	38,720
Tax	(6,859)	(7,338)	(7,895)	(8,790)	(9,577)
Minority Int.	6,085	6,808	7,840	8,621	9,353
Extra. Items	0	0	0	0	0
Reported Net Profit	14,205	14,638	16,186	18,126	19,790
Core Net Profit	12,822	14,143	16,047	18,126	19,790
growth (%)	2.2%	10.3%	13.5%	13.0%	9.2%
Dividend per share	102	89	98	129	141
growth (%)	17.4%	-12.6%	10.0%	31.3%	9.2%
Dividend payout ratio	69.5%	59.7%	59.7%	70.0%	70.0%

Balance Sheet (Rpbn)

Year end Dec	2013	2014	2015F	2016F	2017F
Cash and equivalents	21,568	20,469	23,550	26,183	27,944
Other curr asset	11,507	13,293	13,941	15,422	17,028
Net fixed asset	86,761	94,809	103,578	112,872	123,152
Other asset	8,115	12,324	14,324	18,528	24,294
Total asset	127,951	140,895	155,392	173,005	192,418
ST debt	5,525	7,709	3,694	4,232	4,228
Other curr liab	22,912	24,077	31,103	35,215	38,428
LT debt	14,731	15,743	19,255	25,394	33,021
Other LT Liab	7,359	7,241	6,816	6,312	6,872
Minority interest	16,882	18,318	20,195	22,086	24,166
Total Liabilities	50,527	54,770	60,868	71,152	82,548
Shareholders Equity	60,542	67,807	74,329	79,767	85,704
Net (debt) / cash	(1,312)	2,983	(601)	3,443	9,305
Total cap employed	99,514	109,109	120,595	133,559	149,762
Net Working capital	4,638	1,976	2,693	2,158	2,316
Debt	20,256	23,452	22,949	29,626	37,249

Cash Flow (Rpbn)

Year end Dec	2013	2014	2015F	2016F	2017F
Core Net Profit	12,822	14,143	16,048	18,126	19,790
Depr / Amort	15,780	17,131	17,277	18,247	19,324
Chg in Working Cap	1,334	4,832	8,218	3,003	1,965
Others	6,638	1,630	138	0	0
CF's from oprs	36,574	37,736	41,681	39,376	41,079
Capex	(19,953)	(26,105)	(24,722)	(26,922)	(28,985)
Others	(2,749)	1,357	(3,711)	(3,810)	(4,102)
CF's from investing	(22,702)	(24,748)	(28,433)	(30,732)	(33,088)
Net change in debt	1,404	981	3,196	(503)	6,677
Others	(11,164)	(15,068)	(13,363)	(5,508)	(12,907)
CF's from financing	(9,760)	(14,087)	(10,167)	(6,011)	(6,230)
Net cash flow	4,112	(1,099)	3,081	2,633	1,762
Cash at BoY	17,456	21,568	20,469	23,550	26,183
Cash at EoY	21,568	20,469	23,550	26,183	27,944
Free cashflow	11,713	18,837	25,482	21,624	22,346

Key Ratio Analysis

Year end Dec	2013	2014	2015F	2016F	2017F
Profitability					
Gross Margin (%)	NA	NA	NA	NA	NA
Opr Margin (%)	31.3%	32.0%	33.3%	33.7%	33.9%
EBITDA Margin (%)	50.4%	51.1%	50.8%	50.5%	50.2%
Core Net Margin (%)	15.5%	15.8%	16.2%	16.8%	16.7%
ROAE (%)	22.9%	22.0%	22.6%	23.5%	23.9%
ROAA (%)	10.7%	10.5%	10.8%	11.0%	10.8%
Stability					
Current ratio (x)	1.2	1.1	1.1	1.1	1.1
Net Debt to Equity (x)	(0.0)	0.0	(0.0)	0.0	0.1
Net Debt to EBITDA (x)	(0.0)	0.1	(0.0)	0.1	0.2
Interest Coverage (x)	17.3	15.8	13.8	16.5	14.1
Efficiency					
A/P (days)	NA	NA	NA	NA	NA
A/R (days)	28	28	27	28	28
Inventory (days)	NA	NA	NA	NA	NA

Interim Result (Rpbn)

	1Q14	2Q14	3Q14	4Q14	1Q15
Sales	21,250	22,292	22,299	23,855	23,616
Gross Profit	NA	NA	NA	NA	NA
Opr. Profit	6,902	7,264	7,434	7,113	7,264
Net profit	3,585	3,826	4,035	3,192	3,814
Core Profit	3,573	3,818	3,656	3,096	3,676
Gross Margins (%)	NA	NA	NA	NA	NA
Opr Margins (%)	32.5%	32.6%	33.3%	29.8%	30.8%
Net Margins (%)	16.9%	17.2%	18.1%	13.4%	16.2%
Core Margins (%)	16.8%	17.1%	16.4%	13.0%	15.6%

Capital History

Date	
14-Nov-95	IPO @ 2,050

PT Trimegah Securities Tbk
Gedung Artha Graha 18th Floor
Jl. Jend. Sudirman Kav. 52-53
Jakarta 12190, Indonesia
t. +62-21 2924 9088
f. +62-21 2924 9150
www.trimegah.com