

PT. Telekomunikasi Indonesia Tbk (“Telkom Indonesia”) (TLK) Memo

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Year: 3rd

Important Company Financial Data

Price: 38.04	Cash: \$1.27 B
Market Cap: \$18.22 B	Total Debt: \$1.75 B
P/E: 13.99	Beta: 0.41
EPS: 2.72	Volume: 270,756
Dividend and Yield: 1.10 (2.9%)	Net Profit Margin: 16.53%
Price: 38.04	ROE: 29.56%



Thesis / Key Points

- The Indonesian economy is growing and is demographically suited towards a growth in the mobile communications industry. GDP grew at 6.2% in 2010 and 6.5% in 2011.
 - Year-over-year GDP growth in Q3 2012 was 6.2%. This line was in line with forecasted growth for the Indonesian economy.
 - Domestic consumption and investment remained strong, despite a struggling world economy
 - There was a slowdown in trade, which led to a slight drop in year-over-year GDP from the 6.4% growth rate in Q2 2012.
 - A manufacturing index rose to its highest level in nineteen months in October 2012, due to increasing export orders.
 - Q3 results and low inflation rates led to Bank Indonesia (the nation’s central bank) maintaining its benchmark interest rate at 5.75% for the ninth consecutive month.
 - Bank Indonesia forecasts strong growth in 2013
 - The governor of Bank Indonesia, Darmin Nasution, recently stated that Indonesia’s economy would grow at a rate close to 6.7% next year, primarily due to strong domestic demand (which accounts for about 60% of GDP).
 - Bank Indonesia had previously project a growth rate of 6.3% - 6.7% for 2013.
 - The forecast is based on the fact that Indonesia has a stable economy and strong domestic demand that is driven by a growing middle class.
 - This economic growth will increase disposable income for this growing middle class, leading to increased consumption.
 - The forecast also predicts that investment will rise by 11.6% in 2013, which will help increase consumers’ purchasing power.
 - Indonesia is the world’s fourth most populous nation with a population of more than 242 million.
 - Most of this population resides in one of the major islands. Indonesia’s most populous island, Java, is the most populous island in the world, with a population of about 141 million. Java contains 2 of Indonesia’s largest cities, Jakarta and Surabaya.
 - The median age of the Indonesian population was 27.8 (as of 2010), and 61% of the population was below 35 years of age (as of 2011). A large majority of these individuals are highly educated, and Indonesia has an adult literacy rate of more than 92% (as of 2008).
 - Indonesia is beginning to experience the impact of the “demographic dividend”, which results from a declining birth rate and small elderly population relative to the total population.
 - In addition, Indonesia is fairly highly urbanized, which facilitates the delivery of digital services and content.
- Telkomsel is Indonesia’s leading wireless carrier and will experience substantial growth as mobile data usage increases.
 - Telkomsel, which is 65% owned by Telkom Indonesia, is Indonesia’s leading carrier with almost 110 million subscribers, as of Q1 2012. Telkomsel currently has an approximately 43% market share.
 - Telkomsel still has room to grow, because while the mobile penetration rate is 92% in Indonesia, only 20% of these mobile users currently use smartphones.
 - The growth of the smartphone market in Indonesia is a great catalyst (longer-term) for the growth of TLK.
 - In addition, despite the young and highly-educated population, there is very limited penetration of fixed Internet services (DSL or cable) in the country. Indonesia does not have the wire-line infrastructure to support major growth in fixed internet services.
 - Instead, there is a large growth opportunity in the wireless broadband internet market. About 4% of Telkomsel’s subscribers currently have mobile broadband service, and this user base has been roughly doubling over the past few years.
 - It is likely that such growth will continue, as smartphones become more popular and as tablets begin to gain market share in Indonesia.
 - In Q3 2012, Telkom Indonesia’s number of broadband subscribers increased 42.5% to 15.9 million, giving TLK the largest broadband subscription base in Indonesia.

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- In Indonesia, only about 31% percent of households own a desktop computer, compared with 80% of households that own an internet capable mobile phone or tablet. Currently, many Indonesians use internet cafes, but as mobile devices continue to gain market share, wireless service providers such as Telkomsel will see tremendous growth.
 - According to a Nielsen survey from 2011, 51% of Indonesian online consumers who did not own a smartphone indicated that they “definitely or probably” would purchase a smartphone within the next 12 months, while only 20% indicated that they “definitely or probably” would not purchase a smartphone.
- Telkom Indonesia’s other business segments are also growing and the growing appeal of bundled services will further enhance the company’s market position.
- In Q3 2012, TLK grew revenue by 7.6% and net profit by 19.3%
 - While a large portion of these increases were due to growth in TLK’s mobile subscriber base, the company’s IT services division produced very strong results. IT services grew by 6.5% from Q2 2012, suggesting there is greatly increasing demand for the company’s services.
 - To prepare for this increasing demand, Telkom Indonesia is making investments in its infrastructure, such as with the acquisition of a data center in West Java.
 - In addition, the Customer Premises Equipment, Universal Service Obligation, and Tower Rent division experienced 23.1% growth in Q3.

Misperception

- Telkomsel was declared bankrupt in September 2012. However, this ruling did not result from financial insolvency, but rather a technicality of Indonesian law.
- According to Indonesian law, creditors can petition for a company to be declared bankrupt if the company has two outstanding debts, one of which is unpaid. This law was brought into effect during the Asian financial crisis in the late 1990s. In this situation, Telkomsel and Prima Jaya Informatika, a distributor, disagreed about a potentially void contract worth about \$555,000.
 - On November 22, the Supreme Court of Indonesia rejected the bankruptcy ruling, clearing Telkomsel of all liability.
 - Investors may have been concerned about other potential strange legal rules in Indonesia, but this ruling indicates that the Supreme Court will not allow technicalities in the legal system to affect strong companies.
- TLK tends to pay most of its dividends in one lump-sum payment during the middle of the year, as opposed to the standard quarterly payments. This policy could be seen as a result of uncertain cash flows.
- However, the company has strong operating cash flows and has used cash to better its infrastructure network.

VAR

- Please see exhibit

How It Plays Out

- In Indonesia, there is an upcoming wireless spectrum “auction.” However, this auction will be conducted using the “beauty contest” mechanism, meaning that the spectrum will be allocated based on the strength of each company, as opposed to its financial bid. In this “beauty contest”, one of the key criteria will be the number of subscribers, meaning that Telkomsel will likely be granted the spectrum.
- In addition, I believe that continued growth in the Indonesian economy will lead to greatly increases smartphone and tablet penetration in the future, leading to high revenues from data subscription packages.
- Both of these factors will contribute to both near- and long-term gains in the stock price of TLK.

Risks / What Signs Would Indicate We Are Wrong?

- The spectrum auction has been delayed numerous times, the last delay being due to Telkomsel’s bankruptcy proceedings. Further delays or Telkomsel not winning the auction would be a setback for TLK, as it both expects to win the auction and needs the additional spectrum to continue to expand its data service products.
- While the economy in Indonesia is currently growing, it must continue to do so at rates near 6% in order to keep unemployment low. If economic growth slows, Indonesia could be subject to many of the same issues that have impacted economies around the world over the past few years.
- One potential reason for a slowdown in Indonesian growth would be a decline in the economic growth of China. Indonesia currently sends a large proportion of its commodity exports to China and decreased demand would negatively impact the economy.
- TLK is a majority state-owned corporation. While this could be beneficial for the company, changes in the country’s political structure could prove harmful.

Signposts / Follow-Up

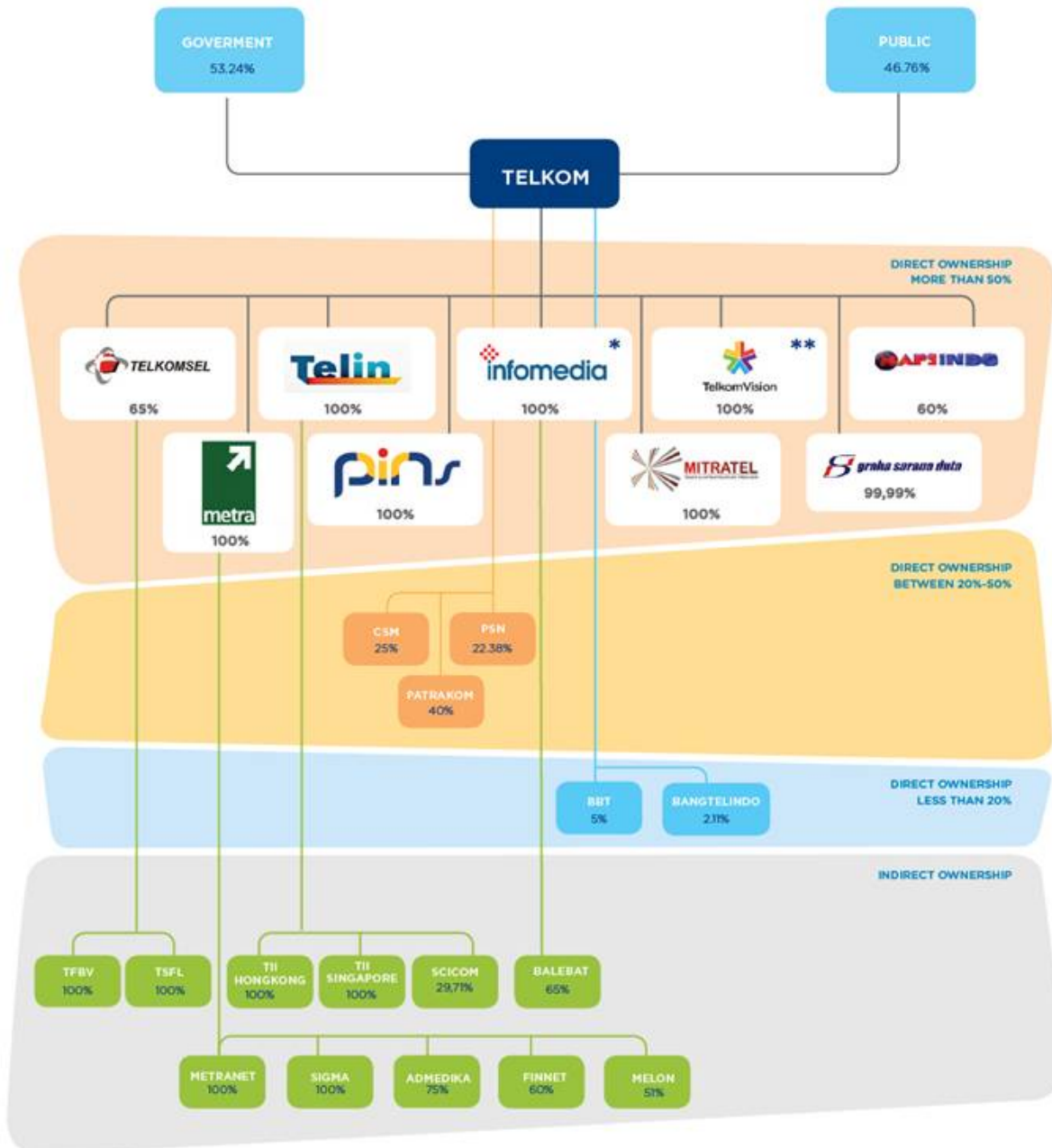
- Growth rates in smartphone adoption, particularly for iPhones and Android devices
- Results of the spectrum auction
- Success of tablets in Indonesia
- Overall economic growth in the country

Company Description

TLK is a majority state-owned, semi-privatized, Indonesian operator of telecommunication, information, multimedia, and entertainment services. One of TLK’s largest subsidiaries, Telkomsel, is the largest wireless service provider in Indonesia.

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Exhibit 1: Telkom Indonesia’s structure



- This chart shows the multiple subsidiaries of TLK and how its own ownership structure is split between the government and public.
 - o Telkomsel is 65%-owned by TLK and 35% owned by SingTel
 - Decisions are made by the Board of Directors, where TLK holds 5 of 8 seats
 - o Most other subsidiaries of TLK are wholly-owned

Exhibit 2: VAR

1. Tom Elliot, Strategy Analytics

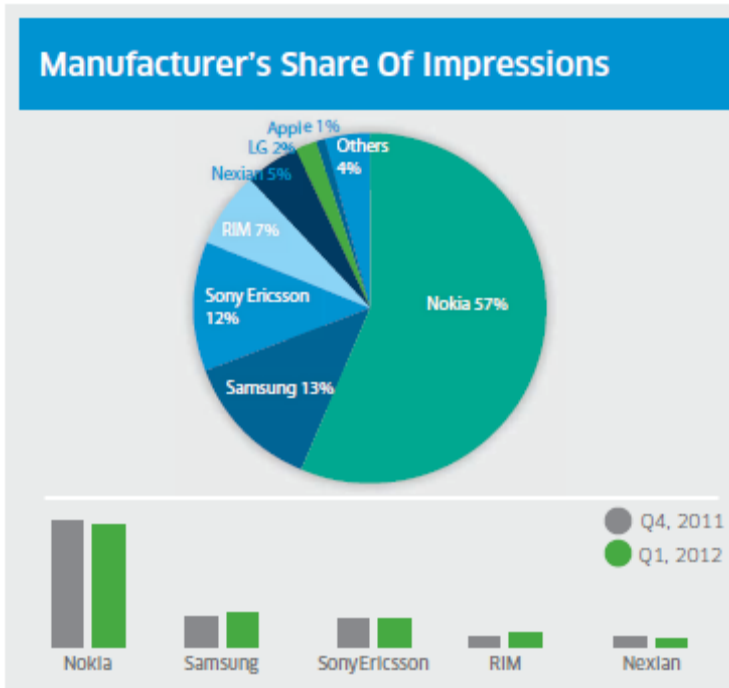
- a. Mr. Elliot recently wrote a report about Indonesia and its prospects for mobile growth
- b. Questions and Answers
 - i. From what I’ve read, it seems as if Indonesia is an area where the general public may skip a generation of technology and transition directly into mobile without the intermediary desktop setup – do you agree?

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1. Yes, the home computer is not common in Indonesia, and currently people generally use internet cafes or their phones to access the internet. Historically, the lack of wired setups has been due to problems with the electric grid and costs.
 - ii. Telkomsel recently had its bankruptcy declaration overturned – how do you think that will impact the landscape?
 1. Not much – was seen as more a legal technicality.
 2. However, it should be noted that things “can come out of left field” and that companies and investors should remain aware
 - iii. You mentioned that Blackberry has been very popular in Indonesia – do you see the economy as able to sustain higher-level smartphones, given rising income and education levels and a growing middle class?
 1. Hard to tell; RIMM needs to continue its success in the area, so it will work hard to do so. However, lots of people could be persuaded to switch if a messaging service similar to BBM is developed. The iPhone is still currently too expensive for most people.
 - iv. One risk you mentioned in your report is the lack of power infrastructure – how do you see this affecting the future growth of mobile providers in terms of subscribers?
 1. Mobile operators are now looking for alternative energy solutions
 2. However, the lack of a strong electricity infrastructure will slow down growth in the future.
 - v. Wireless broadband service adoption rates have been doubling over the past few years? Do you see that trend continuing?
 1. Yes, because it solves a real problem with a practical solution. Indonesia does not have a strong commitment to wireline technology.
2. Indonesian professionals contacted through the UVA Club of Indonesia
- a. In Indonesia, what company do you use for cell phone service? Why did you choose that company?
 - i. Telkomsel for my primary phone. Indosat for my blackberry service (office corporate contract). Neither give me exceptional service(both suffers from difficulty connecting, spotty coverage, and dropped calls), but Telkomsel has better reach and reliability than Indosat.
 - ii. Telkom – reputation of reliability
 - b. What kind of cell phone do you use, and are you subscribed to a data service? What are the details of your service plan - how many minutes, how much data?
 - i. Primary phone; Iphone - no minutes plan, I believe 2 GB a month data (i choose it for the download speed)
Blackberry : Standard bb exchange service (the one around Rp. 300k a month), I forgot the data plan.
Ipad : Telkomsel data service - unlimited data (the one around Rp. 450k/mo)
 - ii. MEMBER SINCE TELKOMSEL FIRST CAME OUT; HAVE USED SAME NUMBER SINCE THE START; MONTHLY SUBSCRIPTION, UNLIMITED. USE FOR TEXTING, LOCAL AND INTERNATIONAL CALLS, EMAILING AND OCCASIONAL BROWSING
 - c. At your home, do you have a computer with broadband internet or do you rely on wireless internet?
 - i. Wireless
 - ii. WIRELESS

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Exhibit 3: Market share by phone manufacturer:



- This chart shows significant room for growth for many smartphone manufacturers, such as Motorola or Apple, in the Indonesian market.