



Indonesia's telecom operators hit by new regulation

by [Anthony Prayugo](#)

In October 2017, Indonesia's Ministry of Communication and Information Technology [issued a ministerial decree](#) stating that all prepaid SIM card owners in Indonesia must register their prepaid phone numbers with their valid national ID and family register if they had not already done so. The registration period was from October 31, 2017 to February 28, 2018. Failing to adhere to this policy within the deadline will result in suspension of services available to the phone numbers. The suspension, which is illustrated in Figure 1, was conducted in several phases from March 1 to April 30, 2018.

During this period, Indonesia's three [largest publicly listed telecom operators](#) — Telekomunikasi Indonesia Persero Tbk PT (TLKM), Indosat Tbk PT (ISAT), and XL Axiata Tbk PT (EXCL) — [engaged in a price war](#) in a bid to retain consumers. Last year, TLKM itself boasted a market share of 45.3% phone subscribers while ISAT and EXCL had a total of 34% phone subscribers in Indonesia. Profit margins for ISAT, TLKM, and EXCL dropped in the second quarter of 2018 (see Figure 2) amidst declining number of prepaid subscribers and intensifying pricing competition. Correspondingly, the RMI-CRI 1-Year Probability of Default (PD) for all three telecom operators rose during the blocking period.

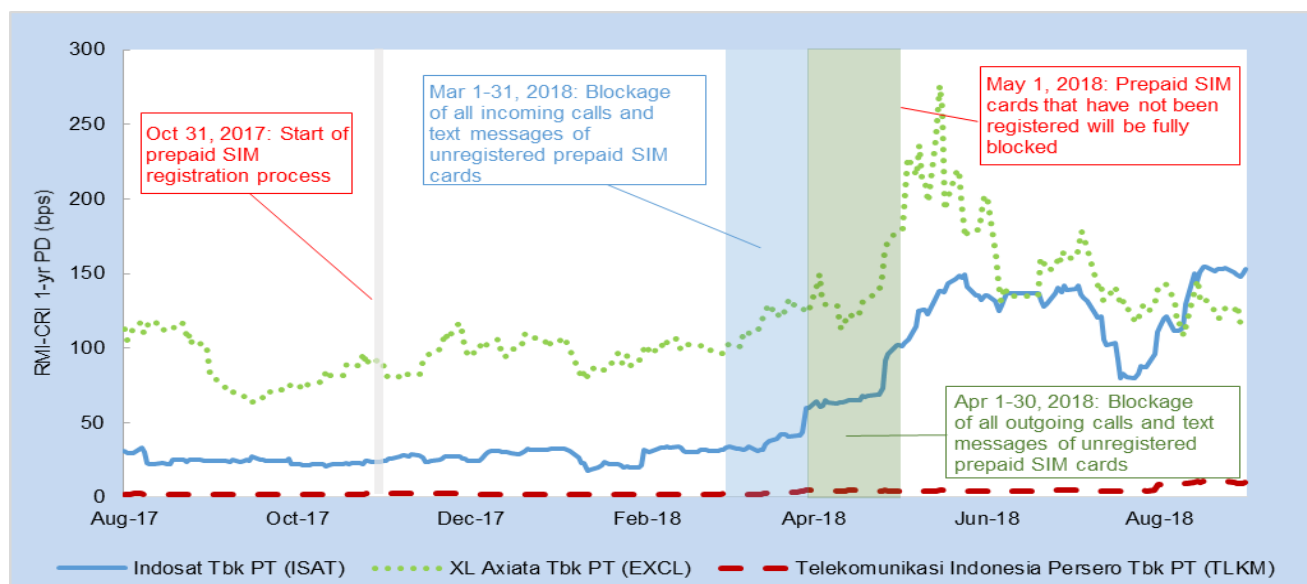


Figure 1: RMI-CRI 1-year PD for TLKM, ISAT, and EXCL. Source: RMI-CRI

The drop in the number of prepaid subscribers was significant for the three operators as prepaid subscribers currently made up the bulk of the total number of subscribers (see Table 1 below). As of 1 April 2018, the [Indonesian government](#) had already blocked over 100.9mn out of around 376mn prepaid SIM cards. Although the average revenue per user (ARPU) of prepaid subscribers was lower than their postpaid counterparts — about 6x lesser in the case of ISAT — prepaid users overwhelmingly outnumbered postpaid users and therefore contributed more to the revenue of the companies, where around 88% of subscriber's revenue came from prepaid subscribers in the case of ISAT. This problem was further exacerbated by the continuing decline of the three operators' legacy businesses in voice call and SMS. In Q2 2018, TLKM recorded a 21.4% decrease QoQ in its cellular voice & SMS revenue while ISAT saw its voice and SMS's revenue decline 7.9% and 20.4% QoQ respectively.

Comparing across the three operators, TLKM had the lowest PD and was least affected by the new regulation due to its comparatively lower leverage and higher profit margin compared to the other big three operators. ISAT

was hit hardest by the new regulation, as it saw its profit margin and prepaid subscribers drop the most among the big three and experienced the highest increase of PD from Oct 31, 2017 to Aug 31, 2018. Mainly driven by its prepaid customer exodus, ISAT's cellular customer base decreased by 21.7% QoQ. Unlike TLKM and EXCL which still saw an increase in their data revenue, ISAT's [data revenue](#) also dropped 5% QoQ in the second quarter. In addition, it was the most leveraged among the three operators with a 155% net debt to equity ratio as compared to 78.5% for EXCL. The disappointing results in 1H18 coincide with the increase of ISAT's 1-year PD from 31.5bps on February 28 to 153bps on August 31, 2018, rising above EXCL's PD during this period.

		Q3 2017	Q4 2017	Q1 2018	Q2 2018
Prepaid Subscribers ('000)	TLKM	185,866	191,583	187,678	172,580
	ISAT	95,800	109,000	94,800	73,800
	EXCL	51,900	52,800	53,700	52,000
Postpaid Subscribers ('000)	TLKM	4,496	4,739	5,074	5,307
	ISAT	1,200	1,200	1,400	1,500
	EXCL	631	703	804	891

Table 1. TLKM, ISAT, and EXCL's prepaid and postpaid subscribers as of Q2 2018. Source: Bloomberg.

EXCL's PD saw a spike in June 2018 and then decreased to lower level than that of ISAT. While EXCL posted a negative profit margin in the second quarter of this year, its data segment [now accounts](#) 79% for the majority of its service revenue. This is essential as operators have recently started to monetize data. With the ongoing decline of structural legacy businesses, the data segment will become more important for telecom companies in the future. Moreover, this will make EXCL's revenue less sensitive to the decline in the legacy businesses which is currently occurring across the industry. EXCL's prepaid subscribers are also relatively stable compared to TLKM and ISAT. It experienced around 3% loss of prepaid subscribers QoQ compared to the 8% and 22% loss for TLKM and ISAT respectively.

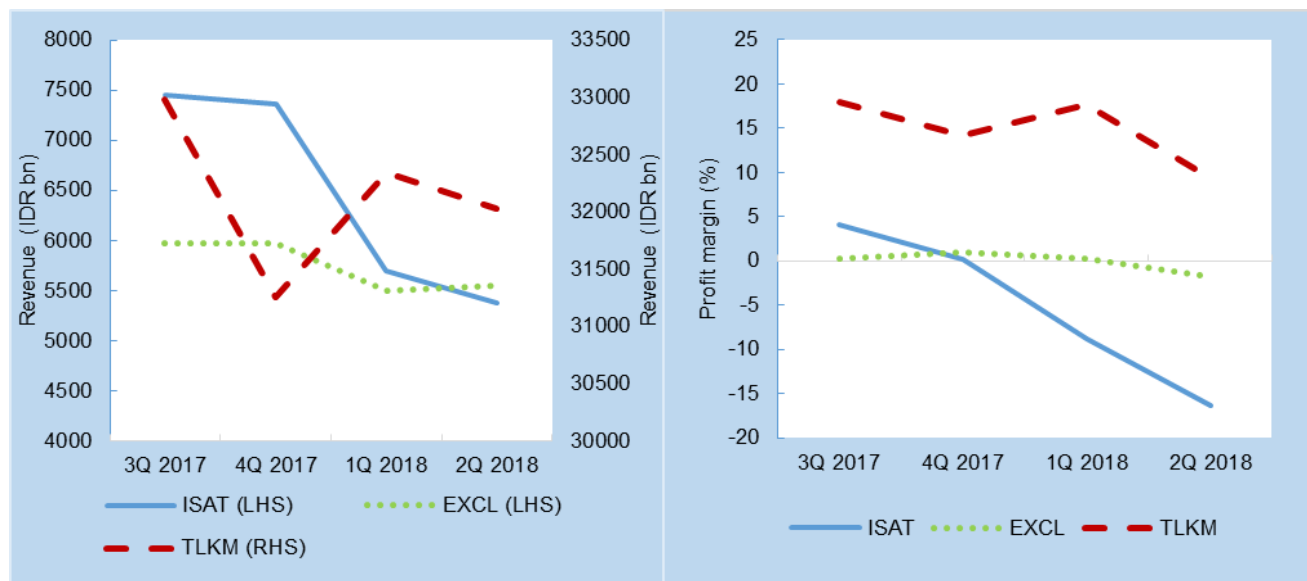


Figure 2: Financial metrics for TLKM, ISAT, and EXCL. Source: Bloomberg

Figure 3 below illustrates the term structure of the RMI-CRI Forward 1-year PD for the three operators on 31 Aug 2018. The Forward PD works similarly to a forward interest rate. For instance, the 3-month Forward 1-year PD is the probability that the firm defaults during the period from 3 months onwards to 1 year plus 3 months, conditional on the firm surviving the next 3 months. For ISAT and EXCL, the figure reflects a worsening credit quality among the three operators after the enactment of the new policy and the credit risk of these two companies will reach its peak in about 2 years.

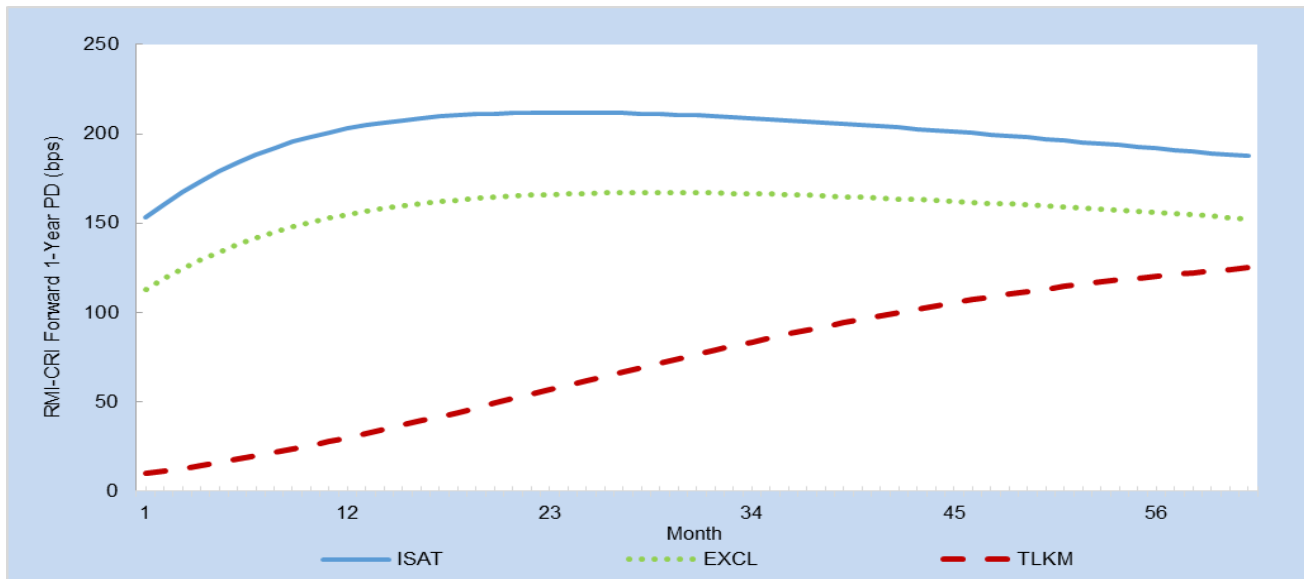


Figure 3: RMI-CRI Forward 1-year PD term structures for TLKM, ISAT, and EXCL on August 31, 2018. Source: RMI-CRI

Although the new policy seemed to contribute negatively to the companies’ credit profile, there are signals that the telecom industries are currently in their inflection point. In July 2018, Indonesia telecom operators raised data price for the first time since 2016. Nationwide, [data price increased](#) by around 4% to 11%. The new regulation will eventually lead to rational pricing which will increase profitability as it will make it harder for consumers to switch their accounts while chasing for cheaper options.

Data usage is also currently [on the rise](#) in Indonesia. There were 76.1mn mobile phone internet users in Indonesia in 2017 and the number was expected to steadily increase to 113.4mn in 2022. Furthermore, Indonesia was a leader in the Asia-Pacific region in terms of mobile web usage. In 2016, Indonesians spent 66 minutes on average daily on mobile web. This trend was followed by the aggressive and continued network investment from Indonesia’s telecom operators to build base transceiver stations (BTS).

In short, although the three companies were negatively affected by the regulation in the short run, they believed that the new regulation will be beneficial for them in the long-term. With a growing business dependency on their data segment, the new regulation will provide the telecom market a platform for a more rational data pricing, leading to a more profitable business in the long run.

Credit News

Bond market faces Italian debt supply test

Sep 02. Italy’s sovereign bond yields have been rising in response to the new populist government’s expensive election promise to include tax cuts and universal income for the poor that could leave a negative impact on the country’s fiscal health. Sovereign yields have climbed significantly after a series of sharp bond market sell-offs since late May, as the central bank has yet to raise the bulk of its remaining financing needs for 2018. Italy has less than three months to secure EUR 63bn in funds, placing the country’s debt issuance record behind those of other Eurozone nations. [\(FT\)](#)

Ford bonds slide after Moody’s downgrade

Aug 31. Ford Motor Company’s bond are falling after Moody’s downgraded its debt rating from Baa2 to Baa3. The yields for bonds maturing in 2025 and 2026 had risen by 5 basis points and 10 basis points, to 4.84% and 5.03%, respectively. Moody’s move to cut Ford’s rating corresponded to Ford’s weakening global business position, the challenges Ford will face when implementing its fitness redesign program and Ford’s ambitious plan to restructure its business, which may carry a USD 11bn restructuring charge. [\(FT\)](#)

Government to infuse Rs 980 crore as equity in Air India to service debt

Aug 30. According to the Economic Times, the Indian government is expected to provide Rs 980 crore of equity to Air India to help the beleaguered airline service a portion of its outstanding debt. Most of the money will be used to make interest payments on nonconvertible debentures that are due in September. Air India's turnaround plan, which was approved by the government in 2013, included a total cash infusion of Rs 30,231 crore spread out over a period of nine years. The move to back Air India's liabilities is part of the government's larger plan to divest its stake in the national carrier. ([Economic Times](#))

Singapore debt market deepens with Asian Bond Grant Scheme

Aug 29. Since its launch by the Monetary Authority of Singapore in January 2017, the Asian Bond Grant Scheme has enlarged Singapore's debt market as first time issuance nearly tripled to USD 27.4bn in 2017, from USD 10.2bn in 2016. The scheme will support up to half of typical issuance-related expenses capped at SGD 0.4mn for rated issuances. The scheme has helped to position Singapore as a financial centre with structural capabilities, a robust regulatory environment and a deep swap market which allows investors to hedge against risks associated with bond issues. Total debt issuance in Singapore has risen 39% to USD 259bn in 2017 due to strong investor sentiment and more issuers seeking longer-term funding ahead of expected rate increases. ([Business Times](#))

In China, less than 20% defaulted bonds have been paid back

Aug 28. A Bloomberg News analysis on 84 publicly-sold notes that have defaulted since 2014 found that the local market saw only a 17% repayment rate on USD 12bn of missed principal or coupon payments as of Aug. 27. According to analysts, the key factors that impact recovery rates are local government's willingness to assist, physical assets that the borrowers own and whether it is a publicly traded company. This result demonstrates China's needs to develop a special market dedicated to trading bonds in default and mechanisms to price credit risk throughout the life cycle of a bond. In light of this problem, the government is exploring setting up a platform for anonymous trading of distressed debt to boost investor participation. ([Bloomberg](#))

China's private equity industry faces turbulence after debt clampdown ([Business Times](#))

Pacific Drilling seeks court approval of USD 500mn deal to exit bankruptcy ([Reuters](#))

INR 3.6tn of India loans under scrutiny on bankruptcy deadline ([Business Times](#))

Regulatory Updates**HKMA to exempt overseas incorporated banks from IRRBB framework**

Sep 03. HKMA will exempt institutions incorporated overseas from local IRRBB framework in cases where the parent group is not additionally represented in Hong Kong through a locally incorporated institution. The policy was updated after a feedback from industry associations which suggested that the new local IRRBB framework may lead to disproportional costs for some institutions incorporated overseas, especially those with small-scale local operations in Hong Kong. Details regarding the exemption would be provided in the finalized version of the IRRBB policy documents, set to be issued this year. ([Regulation Asia](#))

Major UK restructuring and insolvency reforms announced

Aug 29. The UK government announced that it will legislate to update the restructuring and insolvency systems in response to international developments in the insolvency systems and domestic corporate collapses. Some of the changes include the introduction of a new standalone restructuring procedure which resembles the existing scheme of arrangement with the addition of a cross-class cramdown, a new

moratorium procedure to give companies time to consider options for rescue and prohibitions against suppliers from terminating contracts on the basis of insolvency. There will also be greater accountability for directors of distressed companies. ([Lexology](#))

China will promote reform, opening of bond market ([Business Times](#))

RBI says banks to see rise in bad loans in FY 2019 ([Business Standard](#))

Published weekly by [Risk Management Institute](#), NUS | [Disclaimer](#)

Contributing Editor: [Liu Hanlei](#)