Fitch Ratings 2021 Outlook: Asia-Pacific Telecoms

5G Capex Risk to Drive Prudent Capital Management

Fitch's Sector Outlook: Stable

Fitch Ratings expects a gradual EBITDA recovery, stable leverage and for data monetisation to take centre stage post the coronavirus pandemic in 2021. Telcos are likely to bolster cash generation ahead of the 5G investment upcycle, supporting stable competition in most markets. We have three countries on worsening outlook – Singapore, Thailand and Indonesia – from four in 2019, reflecting tough market conditions and capex pressure, particularly 5G capex in the former two markets. Asset sales and dividend cuts provide some financial flexibility to fund near-term capex expansion.

Rating Outlook: Stable

Fitch expects limited rating changes, with 14 of our 16 public Foreign-Currency Issuer Default Ratings on Stable Outlook. The Negative Outlooks on Telekom Malaysia Berhad (TM, A-) and Bharti Airtel Limited (BBB-) are sovereign-driven. We revised the Outlooks on SK Telecom Co., Ltd (SKT, A-), its subsidiary, SK Broadband Co., Ltd. (SKB, A-), PT Indosat Tbk (BBB/AAA(idn) and Total Access Communication Public Company Limited (DTAC, AA(tha)), to Stable, from Negative, in 2020 amid better operating metrics.

Fitch upgraded two and downgraded two issuers since January 2020. The upgrades relate to Indonesian tower operators, PT Profesional Telekomunikasi Indonesia (Protelindo, BBB/AAA(idn)/Stable) and PT Tower Bersama Infrastructure Tbk (TBI, BB/AA-(idn)/Stable). Meanwhile, the downgrades relating to Singapore Telecommunications Limited (Singtel, A/Stable) and its fully owned Australian subsidiary, Singtel Optus Pty Limited (A-/Stable), were due to weakening organic deleveraging as a result of intense competition and higher 5G capex.

Rating Distribution Weighting: Investment Grade

The portfolio is largely investment grade, supported by underlying strength and, in some cases, influence from higher-rated parents.

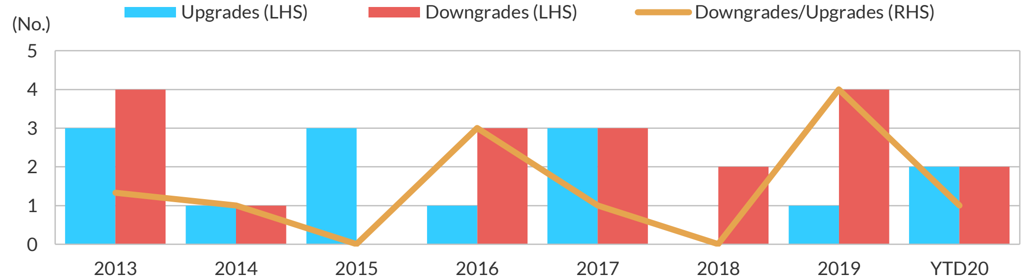
What to Watch

- Resumption of data revenue growth, following pandemic relief measures and restrictions, which will drive telcos' organic deleveraging capacity.
- Sustainability of tariff hikes in India's wireless services and lower capex could turn around free cash flow (FCF) for the first time in years.
- Expensive airwaves in pending spectrum auctions in India, Malaysia, Indonesia and Thailand may squeeze telcos, leaving them with less flexibility to weather the 5G capex upcycle.
- Singapore's 5G investment may be indicative of the cost of a standalone network.
- New entrants in the Philippines may influence price competition.

Janice Chong, Director

"Rating headroom is narrowing, despite a stable rating trajectory for most of our Asia-Pacific telecom portfolio, underlining the importance of staggered investments, dividend cuts and non-core asset sales in preserving balance-sheet strength."

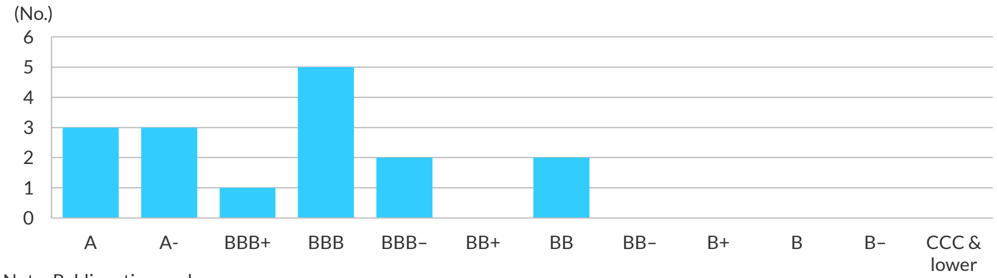
Upgrades vs. Downgrades



Note: Public ratings only
Source: Fitch Ratings

Distribution of IDRs - International Scale

(As of 23 October 2020)



Note: Public ratings only
Source: Fitch Ratings

Sector Forecast

Leverage Trend – Steady

Fitch expects stable average gross and net FFO leverage for the sector, at around 2.8x and 2.4x, respectively. Our forecast includes staggered 5G capex and spectrum costs as they become certain, with low visibility on returns for at least the next two years. Higher-than-expected 5G and spectrum investments and lower return on investments could weigh on leverage metrics. Spectrum auction outcomes in India, Malaysia, Indonesia and Thailand could influence the leverage trajectory.

Cash Flow Generation – FCF Negative

A majority of the telcos in our Asia-Pacific portfolio have negative FCF, underscoring the rapid capex investment phase and lagging operating cash flow. We expect mid-single-digit growth in 2021 as the economy improves (2020F: 1%-2%) and prudent capital management through staggered 5G investment, dividend cuts and non-core asset sales to preserve balance-sheet strength. Emerging markets, such as India, Indonesia, the Philippines, Thailand and Sri Lanka, are likely to pace 5G investments from 2021-2022 to mitigate cash burn while they are still expanding 4G networks.

Liquidity Position – Manageable

Liquidity for the portfolio as a whole remains robust. We forecast average cash cover of short-term debt at around 1.7x (2020F: 1.1x) and cash plus cash flow from operation (CFFO) cover of short-term debt at around 5.9x (2020F: 3.8x).

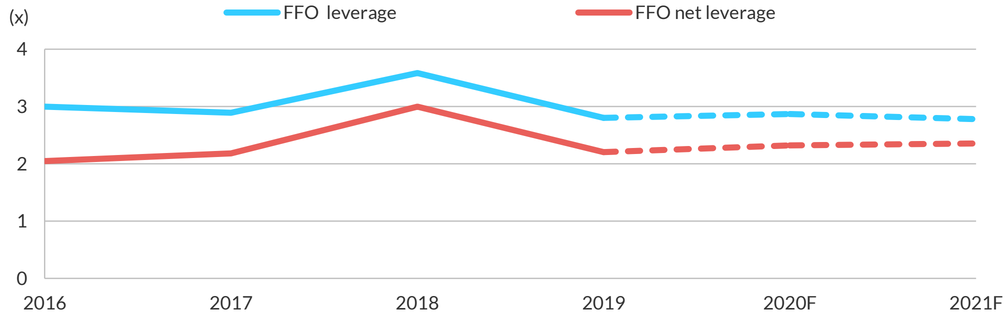
Potential Disrupting Factor – Uncertainty to Fuel 5G Risk

Higher-than-expected 5G investments and low visibility of investment returns will constrain FCF, reducing rating headroom over the next three years. Our forecasts include staggered 5G capex and spectrum costs as these become certain, with low visibility on returns in the medium term. The impact will, however, be uneven across the portfolio, given the asymmetrical development.

Restrictions on Chinese equipment could delay 5G rollouts and pressure telcos to keep prices affordable, particularly in emerging markets. Our base-case assumptions do not consider further policy restrictions.

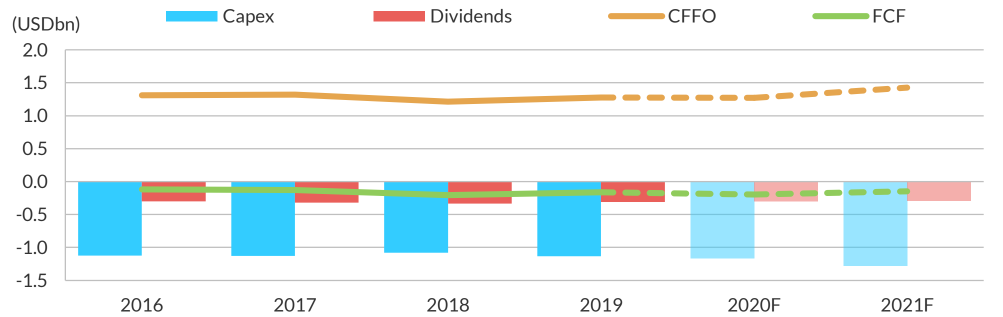
There has been limited 5G success in consumer segments due to a lack of differentiation from existing 4G services and, therefore, the ability to charge premium pricing. The spectrum's potential lies in enterprise applications that can be fully realised through a costlier deployment of a 5G standalone network.

Mean Leverage: Actual and Forecast



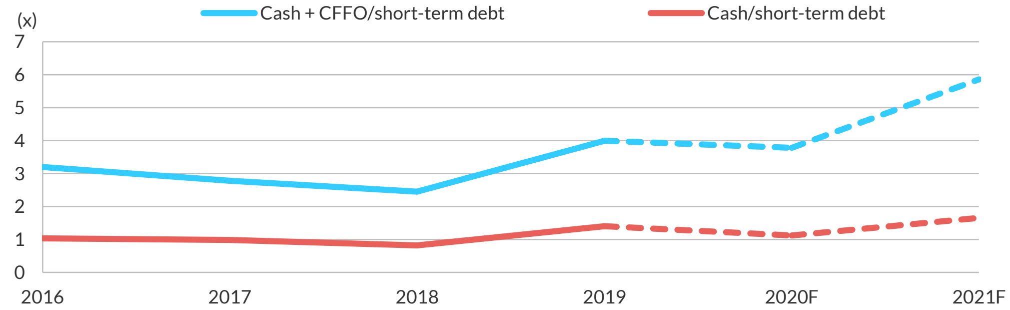
Source: Fitch Ratings, Fitch Solutions, companies

Mean Cash Flow Performance and Forecast



Source: Fitch Ratings, Fitch Solutions, companies

Mean Cash Liquidity Measures



Source: Fitch Ratings, Fitch Solutions, companies

India Telecoms – Sector Outlook Stable

Forecast

Leverage Trend – Steady

Fitch forecasts mean net leverage of the top-three telcos to remain stable, at 4.2x-4.3x (2020F: 4.2x) in light of stronger cash flow generation and lower capex. We expect Bharti's FFO net leverage to be around 2.2x-2.4x, below our downgrade trigger of 2.5x, supported by sustained higher wireless tariffs amid easing price competition. Our leverage calculation factors in outstanding regulatory dues of USD4.0 billion. Bharti paid USD2.4 billion on adjusted gross revenue dues in 2020.

We expect the parent of Reliance Jio, Reliance Industries Ltd (BBB-/Stable), to be close to a net cash position towards end-2021, following the sale of a 33% stake in Jio Platforms for about USD20 billion. Net leverage at Vodafone Idea Limited is likely to deteriorate substantially as a result of the Supreme Court's verdict that the company should pay average gross revenue dues of USD8.9 billion. Its cash balance at end-June 2020 of USD470 million already falls below its short-term debt maturities and guarantees of USD3.6 billion.

Cash Flow Generation – FCF Neutral

Average CFFO is likely to rise thanks to higher tariffs from increasing data usage amid user migration to 4G networks. Barring spectrum payments, negative average FCF could turn neutral, as we expect capex/revenue to decline to around 28% in 2021 (2020F: around 30%).

Sector Fundamentals

Further Consolidation

We expect Jio and Bharti to gain revenue share at the expense of Vodafone Idea to dominate 75%-80% of the market, from around 70% currently. This would see Vodafone Idea lose 50 million-70 million subscribers in the next 12 months, after losing about 155 million subscribers in the last nine quarters. Jio could pick-up over half of Vodafone Idea's subscriber losses, with the balance going to Bharti.

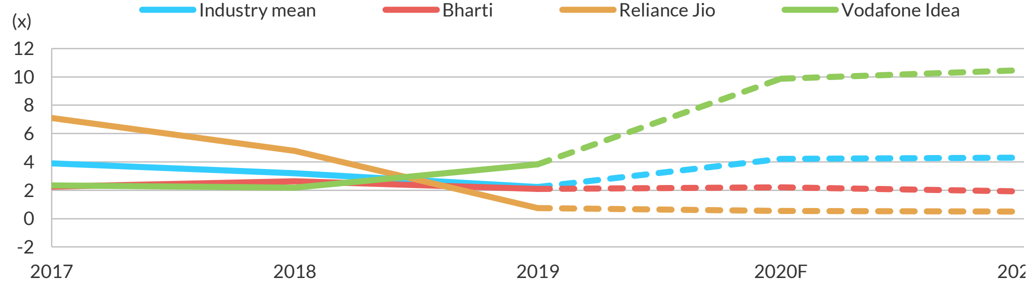
Delay in 5G Spectrum Auctions

5G spectrum auctions could be delayed if the government prioritises 4G auctions in 2021 to allow telcos to renew spectrum in 800MHz/900MHz bands in certain states. We expect limited participation by Bharti and Vodafone Idea in the 5G auctions given high reserve prices and limited use cases. Both companies may raise equity by monetising stakes in soon-to-be-merged tower companies; Bharti Infratel and Indus Towers.

Strong Revenue and EBITDA Growth

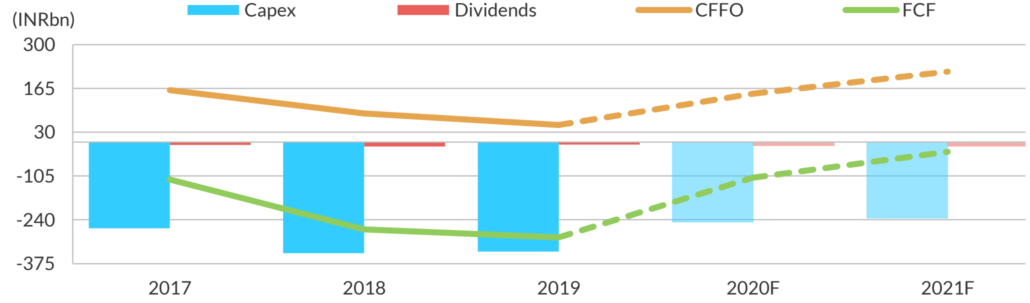
We expect Bharti and Jio's revenue to rise by around 10%-15% (2020F: 15%-20%), following strong growth expectation in 2020 of over 30%. EBITDA margins may widen by 100bp-200bp to 37% and 44% for Bharti and Jio, respectively, on higher wireless tariffs and fixed-broadband expansion. Vodafone Idea may continue to lose subscribers, although EBITDA could slightly recover amid cost savings.

FFO Net Leverage: Actual and Forecast[a]



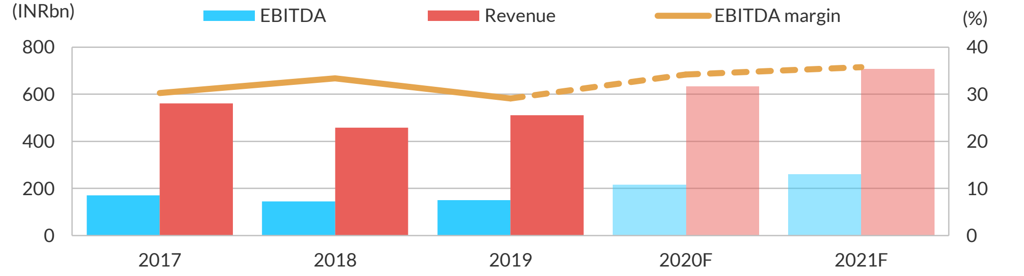
[a] Bharti,Jio and Vodafone Idea's debt does not include deferred spectrum liabilities
Source: Fitch Ratings, Fitch Solutions, companies

Average Cash Flow Performance and Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

Average Revenue, Profitability and Forecast



[a] Bharti's numbers exclude African operation
Source: Fitch Ratings, Fitch Solutions, companies

Indonesia Telecoms – Sector Outlook Worsening

Forecast

Leverage Trend – Rising

We believe sector leverage may increase towards 2.0x in 2021 (2020F: 1.7x) amid rising network investment to meet demand in mobile data and fibre broadband services. However, we expect that PT Telekomunikasi Indonesia Tbk (Telkom, BBB/Stable), PT XL Axiata Tbk (BBB/Stable) and Indosat will have sufficient leverage headroom to absorb the capex burden. Telcos may also raise funds through the sale of non-core assets and tower rentals may be reduced on contract renewal, strengthening deleveraging capacity.

Cash Flow Generation – FCF Negative

We forecast negative FCF to persist into 2022 due to large capex investments. Average capex/revenue (excluding spectrum) in 2021 is likely to remain high at around 27%-28% (2019: 31%), driven by capacity expansion and fixed-line fibre infrastructure. Strong demand for 2.3GHz spectrum in the upcoming auction may further heighten investments. XL and Indosat are funding network expansion and fiberisation efforts through other means, such as finance leases.

Sector Fundamentals

Strategic Execution to Bolster Growth

Fitch believes strategy execution will be paramount amid a slowing economy, as operators strive to boost revenue, which we forecast to rise by mid-single-digits in 2021, from low-single-digits in 2020 (2019: 6%). The effects of the pandemic were subdued for Indonesia's mobile market in 1H20 relative to the Philippines and Thailand, although a prolonged economic slowdown could temper prospects.

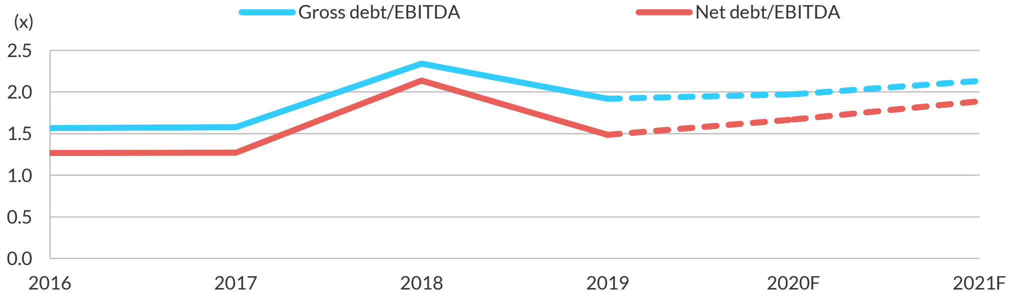
Sustained Competitive Intensity

We think competition will persist, as mobile operators continue to adopt tactical pricing strategies in certain clusters, depending on operators' available network capacity and subscribers' ability to pay. However, larger data bundle offerings at incremental prices should also raise blended average revenue per user (ARPU). Indonesia's three largest telcos all intend to pursue profitable growth.

Industry Reforms Underway

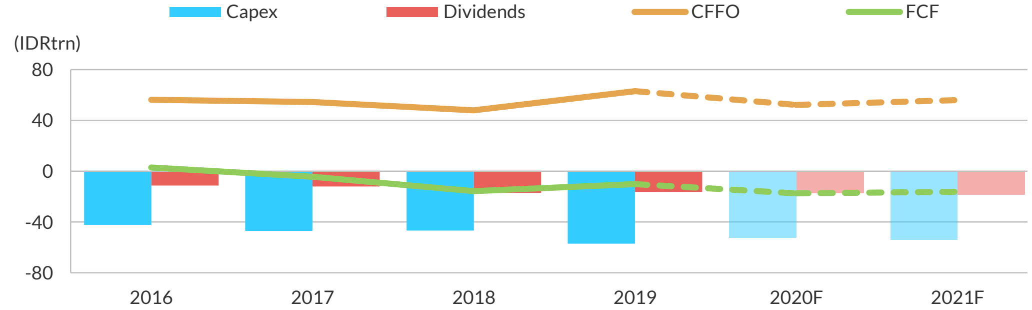
Fitch believes 5G rollout by smaller rivals will prove difficult without scale efficiencies to drive investment feasibility. Indonesia's new omnibus law – whose final draft is still underway – permits spectrum-sharing of new technology, which should benefit smaller telcos. However, we expect Telkom to retain its market dominance and strong network leadership, as extensive fibre infrastructure becomes an important element of the country's eventual 5G rollout.

Mean Leverage: Actual and Forecast[a]



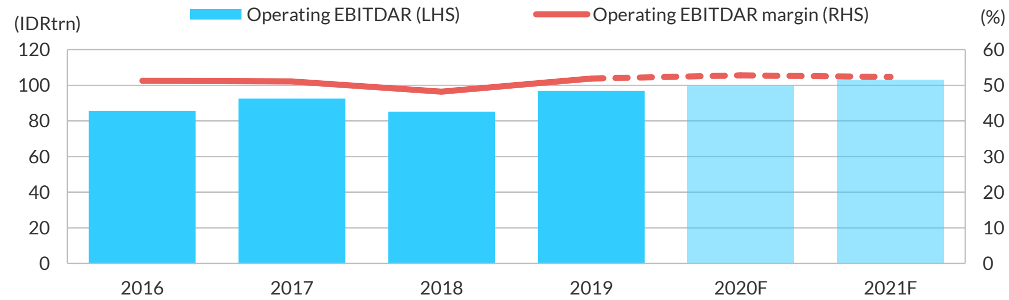
[a] Refers to the average of the three largest telcos - Telkom, XL and Indosat
Source: Fitch Ratings, Fitch Solutions, companies

Aggregate Cash Flow Performance and Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

Aggregate Profitability and Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

Indonesia Telecom Towers – Sector Outlook Stable

Forecast

Leverage Trend – Slightly Declining

We forecast stable average FFO net leverage, at 4.0x–4.2x in 2021 (2020F: around 4.2x), for Indonesia's top-two tower companies – TBI and Protelindo. TBI's FFO net leverage could improve towards Fitch's positive guidance of 4.75x in the absence of new tower deals and lower shareholder returns in 2020. We also expect Protelindo's net leverage to improve to 2.8x-2.9x (2020F: 2.9x-3.0x).

Shareholder returns and M&A continue to drive leverage profiles, as capex is largely demand-driven and backed by long-term non-cancellable tenancy contracts. Our forecast assumes a progressive increase in dividends and share buybacks at TBI but steadier dividends at Protelindo given its conservative shareholder return policy.

Cash Flow Generation – FCF Positive

Mean FCF is likely to remain stable in 2021, at 7%-10% (2020F: 10%), benefiting from strong CFFO but moderated by slightly higher capex as tower companies renew ground leases and expand tower and fibre infrastructure. We think CFFO growth will be backed by high capex intensity at the top-three telcos at 27%-28% (2019: 31%), driven by capacity expansion and fixed-line fibre infrastructure.

Sector Fundamentals

Rising Demand for Mobile Data

We forecast industry revenue to rise by 6%-8% in 2021 (2020F: 10%-15%, including acquisitions). A surge in data demand amid the pandemic, which only had a modest impact on tower companies, and a shift towards larger data bundles and unlimited offerings will drive telcos' demand for tower and fibre infrastructure. A faster 5G rollout is likely to accelerate tower company expansion; however, we expect 5G roll out to be delayed to 2022.

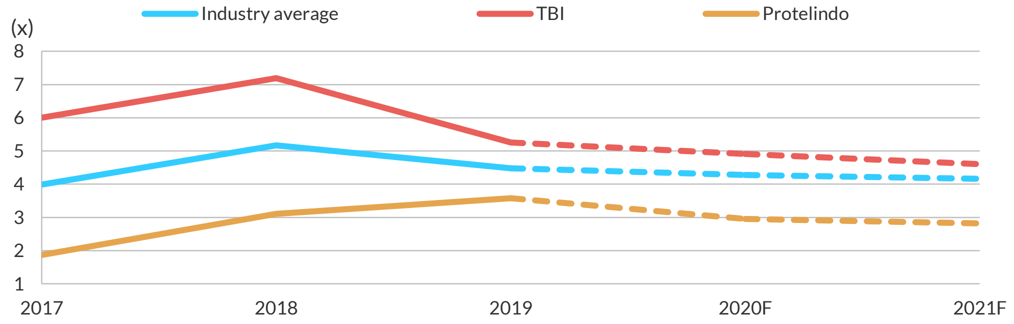
Slight Dilution in Profitability

Average 2021 EBITDA margin may decline by 100bp-150bp (2020F: 84%-86%) due to lower tower rentals for new contracts. However, improving tenancy ratios may partially offset tower rental pressure and keep profitability high.

Industry Consolidation

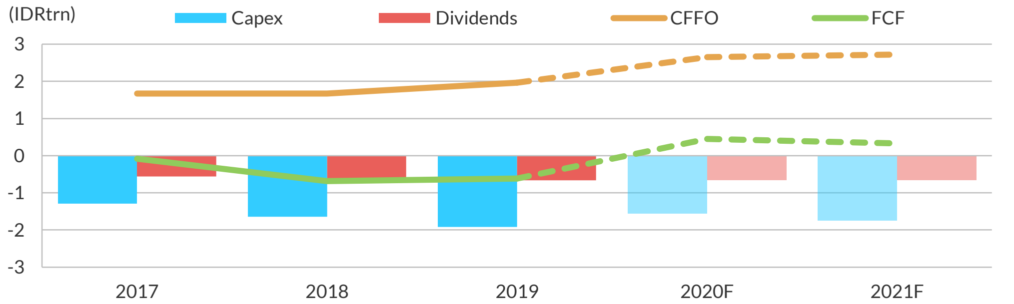
The tower industry will continue to consolidate around TBI and Protelindo, as telcos may monetise their tower assets to fund capex, while smaller tower companies could exit the industry as they lack financial flexibility and execution capability.

FFO Net Leverage: Actual and Forecast



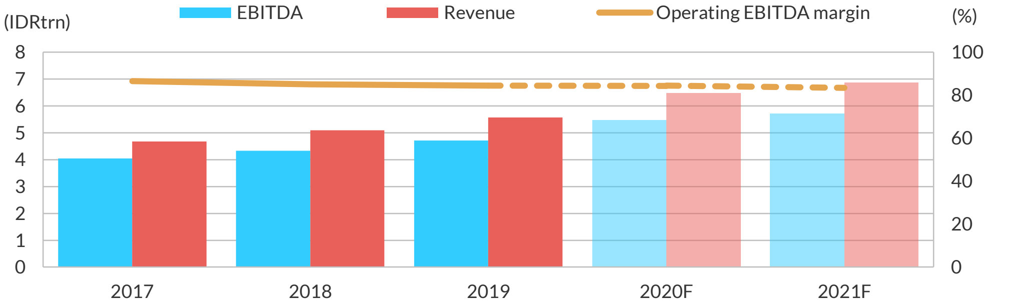
Source: Fitch Ratings, Fitch Solutions, companies

Mean Cash Flow Performance and Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

Average Revenue, Profitability and Forecasts[a]



[a] Refers to mean of TBI and Portelindo
Source: Fitch Ratings, Fitch Solutions, companies

Korea Telecoms – Sector Outlook Stable

Forecast

Leverage Trend – Steady

Fitch expects net leverage to remain flat at about 1.5x in 2021 (2020F: 1.5x) amid the progressive pace of 5G network upgrades and our view of stable competition. Our October 2020 revision of the Outlook on SKT to Stable from Negative underscores improving operating cash generation due to continuous 5G adoption. The second-largest wireless operator, KT Corporation (A/Stable), also has a sufficient financial buffer to fund 5G capex.

Cash Flow Generation – FCF Neutral to Positive

FCF is likely to turn positive, thanks to improving operating cash generation and tightly controlled capex. 5G monetisation from the upselling of higher ARPU plans and expansion into non-telecom businesses, such as media, security services and e-commerce, should boost operating cash flow. We also expect capex to continue dropping following a peak in 2019.

Sector Fundamentals

5G Conversion to Accelerate

We expect telcos to achieve robust growth in 5G subscribers, helping to lift wireless ARPU and expand revenue. This is supported by better availability of 5G handsets, generous subsidies and the popularity of unlimited data plans bundled with peripheral services, such as music streaming and media content. Korea's 5G user base reached 8.7 million in August 2020, representing around 12% of total mobile connections. SKT leads with a 46% 5G subscriber base, followed by KT (30%) and LG Uplus Corp. (24%).

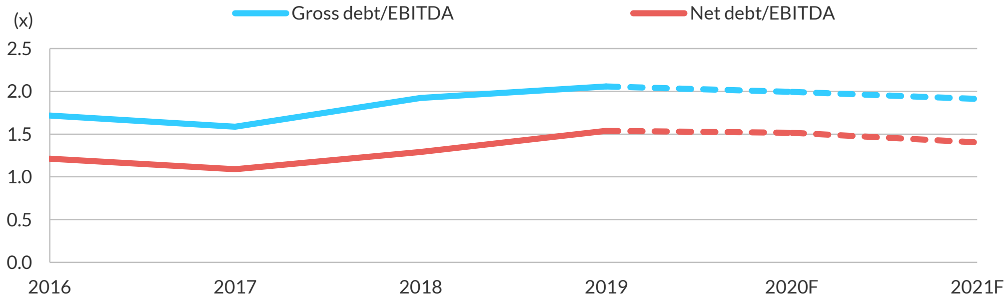
Expanding Non-Telecom Businesses

Expansion into non-core segments, such as SKT's security services under its subsidiary, ADT Caps Co., Ltd, and e-commerce business, should contribute to cash flow generation and diversification. KT and SKT's internet-protocol television segments will benefit from subscribers switching from cable-TV operators amid bundling and better content. Revenue from pay per view, home shopping and advertising should also rise in line with an increasing segment market share.

Rising Presence of Telcos in Pay-TV

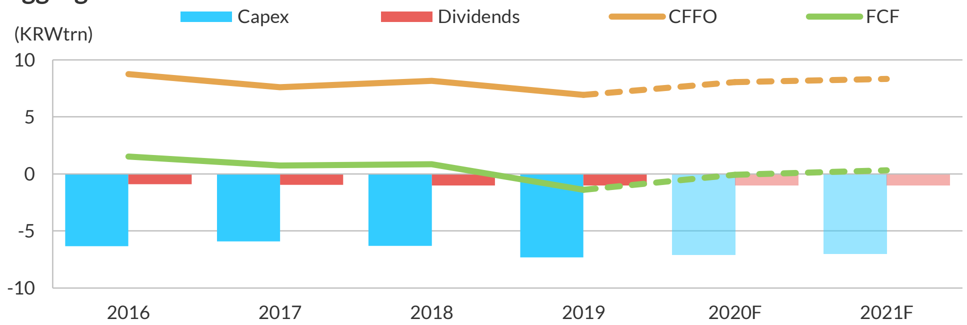
The flurry of M&A is likely to continue following the easing of rules that enabled local operators to strengthen their positions against foreign-based streaming companies, such as Netflix. KT Skylife Co., Ltd, KT's satellite-TV subsidiary, was named as a preferred bidder in July 2020 to acquire Hyundai HCN Co., Ltd, Korea's fifth-largest cable operator. This is after two major deals by SKT and LG Uplus, which acquired the country's first and the second largest cable-TV operators, respectively. We expect more deals to come as other cable-TV operators are up for sale.

Mean Leverage: Actual and Forecast



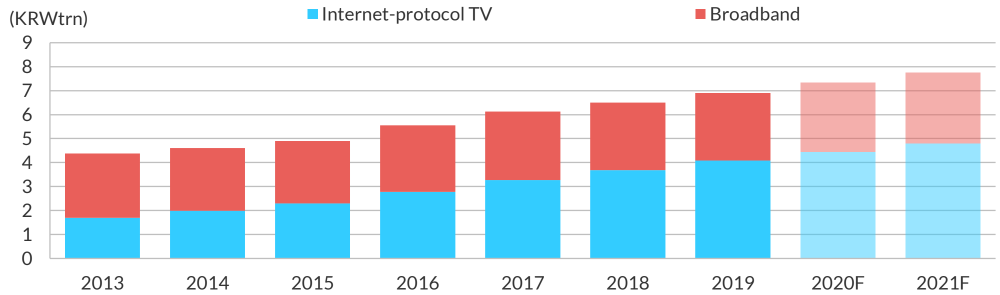
Note: Average refers to KT and SKT
Source: Fitch Ratings, Fitch Solutions, companies

Aggregate Cash Flow Performance and Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

IPTV and Broadband Revenue



Source: Fitch Ratings, companies

Malaysia Telecoms – Sector Outlook Stable

Forecast

Leverage Trend: Steady

Larger 5G spectrum payments and the proliferation of unlimited data plans may hamper an EBITDA recovery, representing downside risk to our steady sector leverage forecast. Malaysia revoked its 5G spectrum allocation, which had been awarded to five companies, following a public backlash against the lack of a transparent, open-tender process. Meanwhile, TM's narrowing returns and capex resumption are likely to see leverage revert to above the industry average.

Cash Flow Generation – FCF Neutral

Our neutral 2021 forecast for the sector's FCF reflects our expectation for cash preservation ahead of the 5G capex upcycle to maintain balance-sheet strength. Major telcos have cut dividends in the past to manage their leverage profiles. Operational cash flow may improve through cost-cutting measures, which should help offset higher capex. Our capex projections exclude potential 5G spectrum fees, so any significant debt-funded capex would delay deleveraging.

Sector Fundamentals

Competition Extends to Converged Services

Competitive pressure is a key headwind for the sector, potentially capping an EBITDA recovery. However, we believe telcos are unlikely to engage in long-term price competition, as they turn to convergence strategies to reduce customer churn and meet the rising demand for online connectivity during the pandemic. Maxis Berhad, Celcom Axiata Berhad and DiGi.Com Berhad are also scaling up their converged offerings through wholesale arrangements with TM and TIME dotCom Bhd.

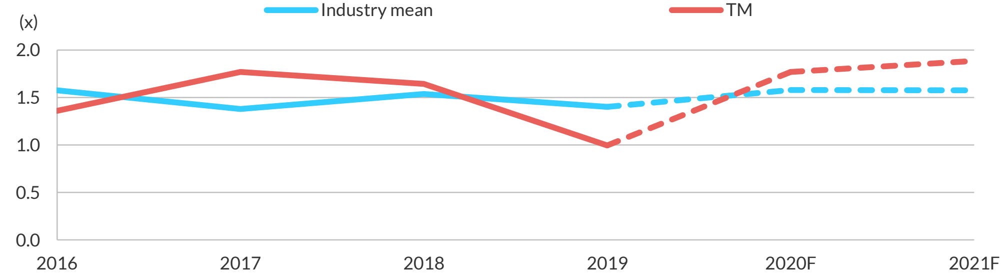
TM Best-Placed for Converged Services

We expect TM to retain its dominant position in Malaysia's fixed-broadband market. Its ability to deploy converged services through quadruple-play offerings should enable it to compete more effectively against domestic fixed-line providers and mobile operators. However, we believe TM will continue to rely on domestic roaming to support its wireless coverage in the absence of a clear spectrum roadmap.

Unclear 5G Spectrum, Policy Roadmap

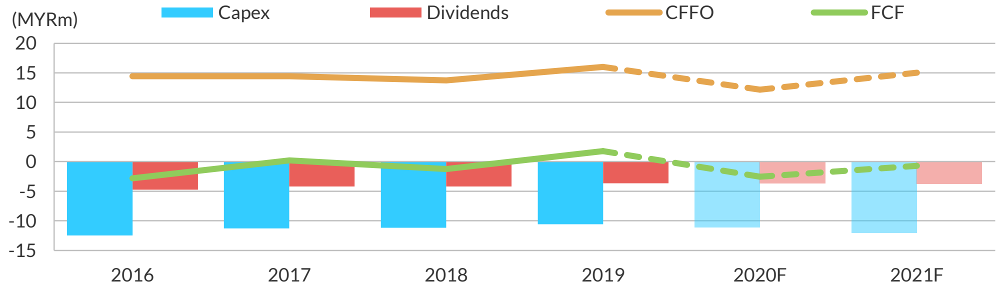
The lack of clarity on the country's 5G policy framework and spectrum timeline could delay network commercialisation until 2022. The government's original consortium model could help to defray costs amid tough market conditions. Meanwhile, a single national wholesale 5G network will strengthen TM's competitiveness and converged network strategy, but this would hinge on TM's ability to obtain sufficient spectrum. The extensive fibre infrastructure needs to support higher data speeds and capacity puts TM in a strong position.

Mean Net Debt/EBITDA: Actual and Forecast



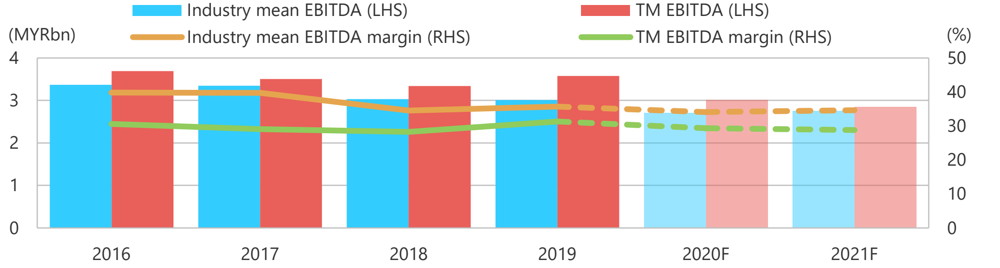
Industry average includes TM, Axiata, Maxis and DiGi
Source: Fitch Ratings, Fitch Solutions, companies, Bloomberg

Aggregate Cash Flow Performance and Forecasts



CFFO comprise that of TM, Axiata and Bloomberg estimates for Maxis and DiGi
Source: Fitch Ratings, Fitch Solutions, companies

Mean Profitability and Forecast



Industry average comprises TM, Celcom and Bloomberg estimates for Maxis and DiGi
Source: Fitch Ratings, Fitch Solutions, companies

Philippines Telecoms – Sector Outlook Stable

Forecast

Leverage Trend – Steady

Net leverage for the sector is likely to be steady at around 2.5x-2.6x in 2021 (2020F: 2.5x), as the resumption in EBITDA growth and normalisation of the cash-conversion cycle (from pandemic-related relief measures in 2020), offset capex expansion. We expect sector revenue growth of 6%-7% (2020F: 1%), driven by fast-expanding home broadband services and stable competition in mobile. Deleveraging prospects hinge on a resurgence in mobile revenue and limited capex aggression.

Cash Flow Generation – FCF Negative

Regulatory pressure and looming competition are likely to drive capex higher in 2021, following a deferral in 2020 due to the pandemic restrictions. FCF is likely to stay negative, albeit steady. The Philippines has among the highest capex/revenue ratios in Asia Pacific, at around 40%. The country's new common-tower policy is also likely to hasten tower builds and access to cell-sites, which are being held up by the lengthy regulatory approval process for permits.

Sector Fundamentals

Limited Interim Threat from New Entrants

We forecast stable competition for the next 12 months, despite the impending entry of Dito Telecommunity Corporation by March 2021 and the emergence of fixed-broadband provider, NOW Telecom, Inc., as the fourth mobile operator. However, we expect competition to intensify in the medium-term as new entrants expand coverage. Dito aims to cover at least 37% of the national population over the next six months, while NOW Telecom's limited spectrum, at 20MHz of 3.5GHz, may imply a niche target market.

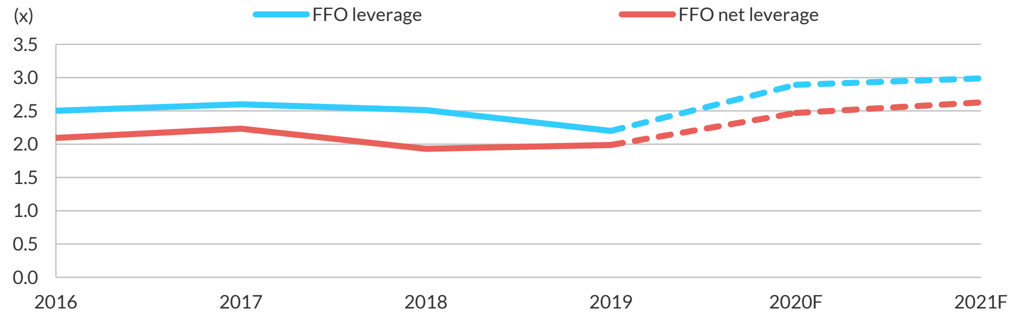
Focus on Strategic Execution, Network Improvements

Fitch expects strategic execution to take centre stage amid the challenges posed by the pandemic, as incumbent operators, PLDT Inc. (BBB/Stable) and Globe Telecom, Inc. (BBB-/Stable), strive to boost revenue. PLDT's heavy capex investments over the past few years and the reallocation of 2G spectrum to 4G have improved network quality and coverage, contributing to increased revenue share since 4Q19 at the expense of Globe.

4G Focus; Limited 5G Coverage

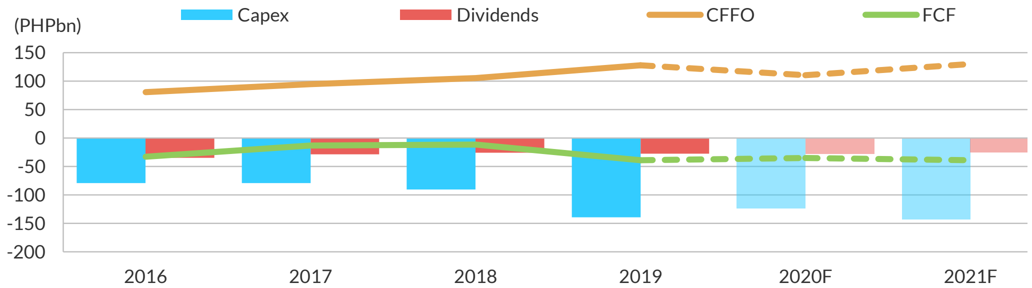
Telcos will continue to depend on the existing 4G network to meet data demand while pacing 5G investment over the next few years to support cash flow. The extent of 5G rollouts will depend on the affordability of 5G devices, particularly in a prepaid market that yields a monthly ARPU of USD2 for mobile and USD20 for home broadband. Globe and PLDT are likely to restrict 5G fixed-wireless access to selected metropolitan areas.

Mean FFO Net Leverage: Actual and Forecast



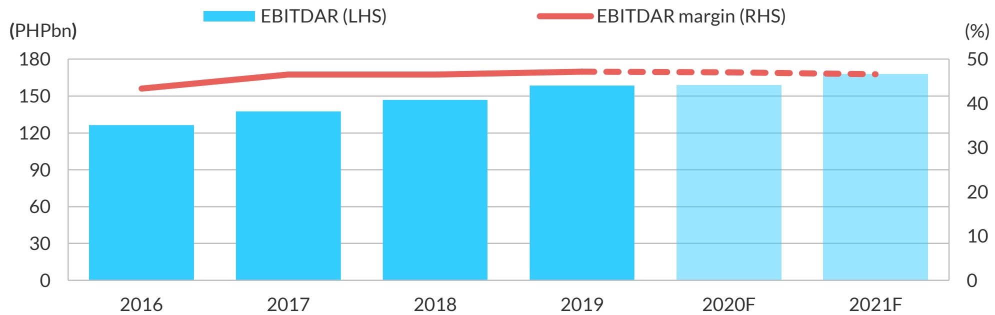
Source: Fitch Ratings, Fitch Solutions, companies

Aggregate Cash Flow Performance and Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

Aggregate Profitability and Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

Singapore Telecoms – Sector Outlook Worsening

Forecast

Leverage Trend – Rising

Net leverage for the sector is likely to deteriorate to around 2.5x in 2021 (2020F: 2.0-2.1x) due to continuing tough market conditions and a step up in 5G capex. Capex could increase by 30%-35% as telcos roll out 5G standalone networks. Any delay in assigning the 700MHz spectrum would reduce net leverage by around 0.2x. The timing of the SGD846 million spectrum payment will depend on when the frequency band is made available to telcos.

Cash Flow Generation – FCF Negative

Free cash flow visibility will hinge on the increase in 5G capex, while the lack of compelling use cases is likely to delay the return on investment in the initial years. We expect incumbent telcos, Singtel, StarHub Ltd and M1, to manage capital prudently, including shareholder returns, to ease their capex burdens. Potential monetisation of non-core assets, such as Singtel's towers in Australia, could also provide financial flexibility.

Sector Fundamentals

Modest Recovery

We expect cost-saving initiatives and the resumption of enterprise spending and information and communications technology projects to drive an EBITDA recovery. However, it is likely to remain below pre-pandemic levels until 2022 in view of weak roaming revenue and continuing data price competition. We believe telcos will maintain 5G tariffs at 4G prices to drive subscriber migration at its infancy, given the lack of compelling applications that sufficiently differentiate 5G value from 4G services.

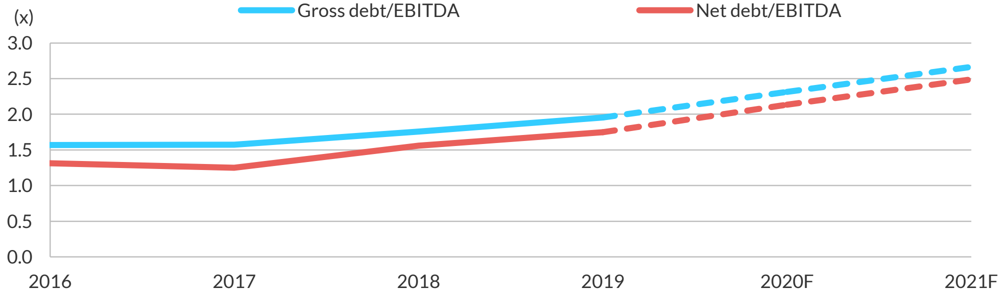
5G Investment Upcycle Begins

Singapore's ambition to leapfrog 5G rivals to pursue a standalone network will drive telecoms' capex, with the 3.5GHz spectrum-band freed up for commercial use in 2021. StarHub announced its 5G capex guidance of around SGD200 million over a five-year period, and expects to front-load investment in 2021, while staggering the rest across 2022-2025. We think the capex burden would be greater for Singtel, although it has not provided guidance. StarHub and M1, through their 50:50 joint venture, were awarded the country's second nationwide 5G licence.

Industry Due for Consolidation

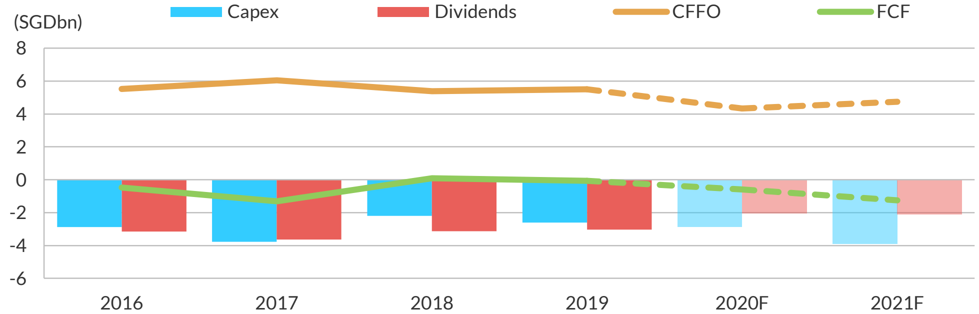
We believe 5G investment is critical for strengthening the competitiveness of incumbent telcos through product differentiation and network quality, potentially weeding out smaller operators and easing competition in the medium term. TPG Telecom Pte Ltd and mobile virtual network operators are less likely to engage in price competition for 5G, as they depend on incumbent telcos for 5G wholesale services. TPG Telecom, which ended its free trials in March 2020, will need to substantially improve its network and service quality to compete with rivals.

Mean Leverage: Actual and Forecast



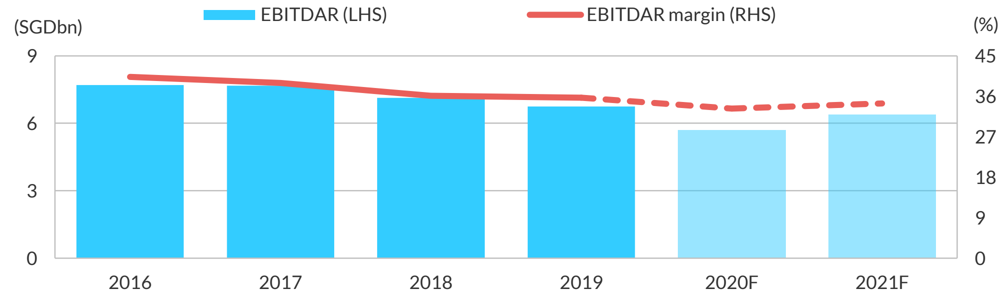
Singtel's EBITDA includes overseas contributions, while StarHub's is based on Bloomberg estimates. Average excludes M1
Source: Fitch Ratings, Fitch Solutions, companies, Bloomberg

Aggregate Cash Flow Performance and Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

Aggregate Profitability and Forecasts



Singtel's EBITDAR include overseas contributions, while StarHub's is based on Bloomberg estimates. Average excludes M1
Source: Fitch Ratings, Fitch Solutions, companies

Sri Lanka Telecoms – Sector Outlook Stable

Forecast

Leverage Trend – Steady

Fitch expects mean FFO net leverage for fixed-line market-leader, Sri Lanka Telecom PLC (SLT, AA+(lka)/Negative), and mobile leader, Dialog Axiata PLC (AAA(lka)/Stable), to remain stable at around 1.6x in 2021 (2020F: 1.6x). However, we think leverage for the two companies will diverge, as we expect Dialog to improve its net leverage and to generate a positive FCF margin of 5%-6%, while SLT's net leverage is likely to deteriorate by 0.1x-0.3x annually due to negative FCF.

Cash Flow Generation: FCF Positive

We forecast mean CFFO for SLT and Dialog to rise to around LKR32 billion (2020F: LKR28 billion - 30 billion). Average industry FCF should be neutral, with Dialog generating about LKR5 billion-7 billion and SLT generating negative FCF of LKR4 billion-7 billion. SLT's CFFO will be insufficient to fund its large capex requirements and dividend commitments.

We expect average capex/revenue to increase to 26%-27% (2020F: 23%-25%) as telcos return to normal capex levels to expand 4G network coverage and fibre connectivity, following lower capex in 2020 due to the pandemic. We expect SLT and Dialog's home-broadband segments to expand by a high-teen percentage from a small base and for SLT's lead over Dialog on fibre coverage to persist.

Sector Fundamentals

Data and Home Broadband to Drive Revenue

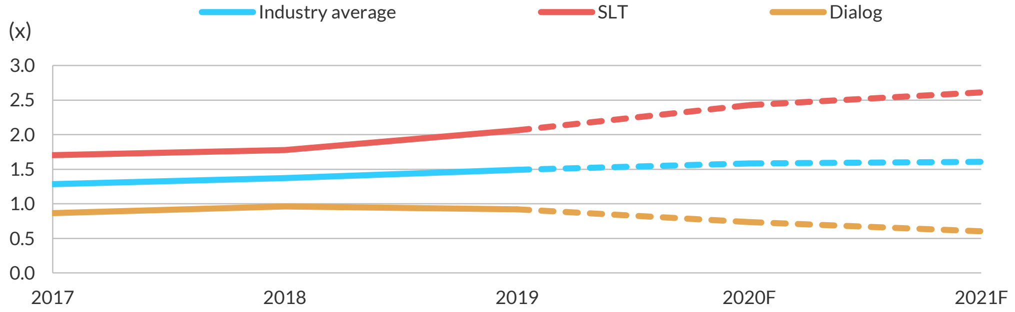
We expect 2021 industry revenue to rise by 5%-7%, driven by a surge in data and fixed broadband, following lower growth of around 2%-3% in 2020. Mobile data services are likely to expand by 15%-20% (2020F: 25%-30%) on higher smartphone penetration and rising data consumption. Bundled ARPU should rebound to pre-pandemic levels, following a drop of 6%-8% in 1H20.

We forecast stable average operating EBITDA margins of around 34%-35% (2020F: 35%) on better economies of scale in the data and home-broadband segments. This should offset the negative effect of a changing revenue mix.

Further Consolidation Probable

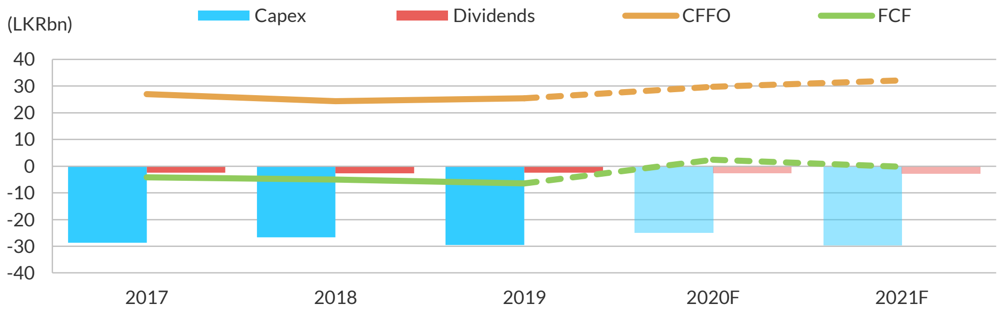
We expect further sector consolidation and believe Bharti Airtel Lanka (Private) Limited (Airtel Lanka), a subsidiary of Bharti, may seek M&A due to mobile competition and higher taxes amid elevated capex requirements. Airtel Lanka acquired the 900MHz spectrum, which was surrendered when Etisalat Lanka and Hutch Lanka merged in 2018. We expect telcos to focus on profitability rather than price-based competition.

FFO Net Leverage: Actual and Forecast



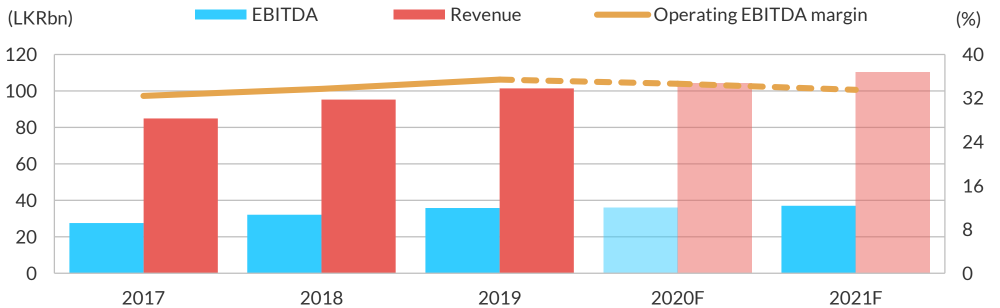
Source: Fitch Ratings, Fitch Solutions, companies

Average Cash Flow Performance and Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

Average Revenue, Profitability and Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

Thailand Telecoms – Sector Outlook Worsening

Forecast

Leverage Trend – Rising

We expect mean net debt/EBITDA to increase to 3.1x in 2021 (2020F: 2.8x) for Thailand's three largest mobile operators – Advanced Info Service Public Company Limited (AIS; AA+(tha)/Stable), DTAC and the mobile business unit of True Corporation Public Company Limited. FCF is likely to remain negative on elevated capex and spectrum payments.

Cash Flow Generation: FCF Negative

We assume aggregate CFFO will increase to around THB111 billion (2020F: THB108 billion). However, this is insufficient to cover THB122 billion in capex (2020F: THB137 billion) and THB22 billion in dividends (2020F: THB26 billion). We forecast industry service revenue to expand by 2%-3%, supported by a rebound in the domestic economy and continued growth in data usage. The sector's median EBITDA margin should improve to 35%-36% (2020F: 34%), led by continued cost control measures and lower marketing expenses.

Sector Fundamentals

Rational Competition

Fitch expects price competition in the Thai telecom sector to remain rational. Operators are likely to shift their focus to profitability from market-share gains by reducing handset subsidies and have started to phase out generous unlimited prepaid data plans that were launched in early-2020. These measures should support gradual data monetisation and more sustainable data-centric business models.

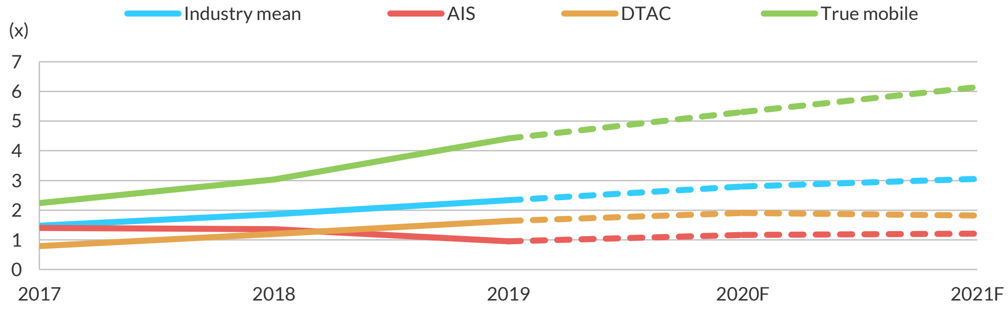
DTAC Still Under Pressure

DTAC could struggle to regain market share into 2021, as rivals undertake aggressive capex and spectrum investments to extend their leads in network quality. DTAC's 2.3GHz network rollout over the past year has improved its network and increased net subscriber additions, but this may be short-lived as the two largest domestic mobile operators, AIS and True, step up their 2.6GHz network and 5G rollout investments.

5G Capex Upcycle

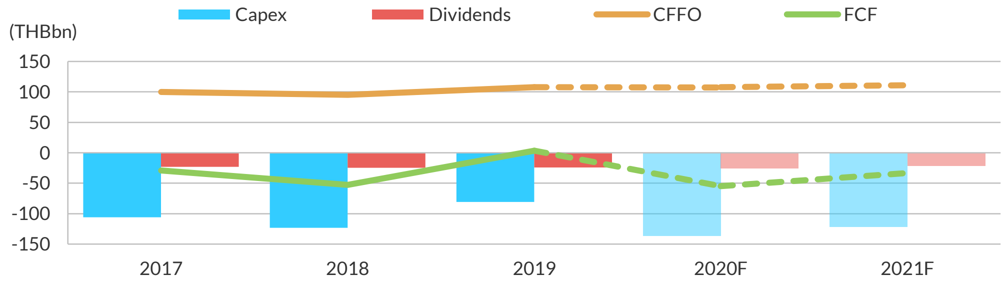
Fitch expects sector investment, excluding spectrum payments, to remain high, at around THB75 billion (2020F: THB70 billion), as AIS and True increase capex to support their 5G rollouts. AIS is rolling out a non-standalone 5G network and plans to launch the service on a commercial basis in 4Q20. Meanwhile, DTAC is likely to pace 5G investment over the next few years to preserve balance-sheet strength.

Net Debt/EBITDA Actual and Forecast



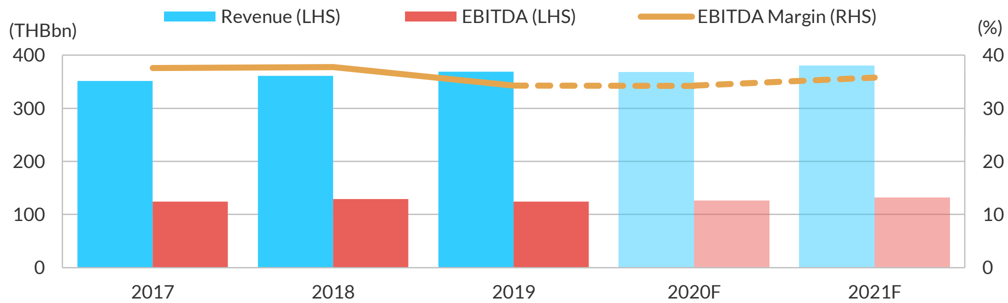
Source: Fitch Ratings, Fitch Solution, Company reports

Aggregate Cash Flow Performance and Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

Average Revenue, Profitability Forecasts



Source: Fitch Ratings, Fitch Solutions, companies

Key Rating Triggers for Select Issuers on Rating Watch or Positive or Negative Outlook

Issuer	IDR	Outlook	Liquidity ratio[a] 2021F(x)	Leverage[b] 2021F(x)	Key downgrade trigger	Key upgrade trigger
Telekom Malaysia Berhad	A-	Negative	2.4	1.9	FFO net leverage above 2.3x Downgrade in the sovereign's IDRs Weakening of linkages with the sovereign	A revision of the Outlook on Malaysia's soveriegn IDRs to Stable would lead to a corresponding revision of our Outlook on TM
Bharti Airtel Limited	BBB-	Negative	1.6	1.9	A downward revision of the Country Ceiling or higher-than-expected regulatory dues, slower recovery in the Indian operations or debt-funded M&A resulting in FFO net leverage remaining above 2.5x for a sustained period	A revision of the Outlook on the Indian sovereign to Stable would indicate that the Country Ceiling is likely to remain at 'BBB-'. This would lead us to revise the Outlook on Bharti to Stable, provided FFO net leverage remains below 2.5x on a sustained basis

[a] Estimated cash and unused facilities at end-2020 adjusted for forecast FCF/debt maturing in 2021
[b] FFO net leverage
Source: Fitch Ratings

Outlooks and Related Research

2021 Outlooks
Global Economic Outlook - September 2020 (September 2020)
5G Investment Upcycle in Global Telecoms (September 2020)
What Investors Want to Know: Coronavirus Impact on Asia-Pacific Telecoms (June 2020)
Spotlight: Indonesian Tower Sector (June 2020)
Spotlight: Globe Versus PLDT (June 2020)
Spotlight: Indonesia Mobile Sector (May 2020)
What Investors Want to Know: Asia-Pacific Telecoms (January 2020)

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