What Investors Want to Know: Asia-Pacific Telecoms

Competition, 5G Capex May Sway Sector Outlook

Stable Sector Outlook

Fitch Ratings expects a steady rating trajectory for most of our Asia-Pacific telecom portfolio amid stable competition in most markets, leading to gradual EBITDA recovery. However, rating headroom is narrowing. Capex and spectrum payments that are higher than our expectations and lower returns on 5G investments could weigh on leverage metrics.

We believe telcos will undertake prudent capital preservation, including reducing shareholder returns and selling non-core assets, to manage their balance sheet strength.

Growth, 5G Outlook Key Investor Issues

The resumption of data revenue growth following pandemic relief measures, intense competition and 5G capex risk were among the issues raised during our sector outlook roundtable webinar and follow-up investor calls in December 2020. Investors were also keen to understand the rating trajectory of the major issuers.

What Do the Coronavirus Surge and Vaccines Mean for the Sector?

What are Fitch's Views on 5G Capex and Spectrum Investments?

What is the Impact of 5G and a Digital Banking Licence on Singtel?

Is the Worst Over for Bharti?

Will CKHT's Tower Sale be Credit Positive? How Will Hutch Indonesia Benefit from the Proposed Merger with Indosat?

What Led to TBI's Multi-Notch Rating Upgrade?

Will Fitch's Rating Approach on NBN Change to Bottom Up If the State Cuts Its Stake?

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Fitch Ratings 2021 Outlook: Asia-Pacific Telecoms (November 2020)

5G Investment Upcycle in Global Telecoms (September 2020)

What Investors Want to Know: Coronavirus Impact on Asia-Pacific Telecoms (June 2020)

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What Do the Coronavirus Surge and Vaccines Mean for the Sector?

The coronavirus pandemic's impact will vary across the region, depending on the risk of further lockdowns or restrictions, although we expect the availability of vaccines to limit the risks to our forecasts. Our rating case envisages a gradual revenue recovery in 2H20, from a trough in 2Q20.

Indian telecoms and Indonesian towers were the least affected among the companies in our portfolio, defying the effects of the coronavirus. On the other hand, Singapore telcos were the most affected by weak roaming revenue, deferred enterprise spending and continuing price competition, which may delay a full recovery to 2022. The revival of roaming revenue will take time amid the continued overseas travel restrictions in place, particularly for economies reliant on tourism.

Fitch expects limited rating changes over the next 12-18 months, underscoring our stable sector outlook. All of our public Foreign-Currency Issuer Default Ratings (IDR) were on a Stable Outlook, except for one, as of end-December 2020. The Negative Outlook on India's Bharti Airtel Limited (BBB-) is, however, sovereign-driven. Rating headroom is narrowing for most of our APAC telecom portfolio, underlining the emphasis on capital preservation through staggered investment, dividend cuts and non-core asset sales.

We have three countries on a worsening outlook – Singapore, Thailand and Indonesia – from four in 2019, reflecting tough market conditions and capex pressure, particularly 5G capex in the first two markets.

Issuers on Watch, Positive or Negative Outlook

	At end-2020	At end-2019
Singapore Telecommunications Limited	A/Stable	A+/Negative
Singtel Optus Pty Limited	A-/Stable	A/Negative
SK Telecom Co., Ltd	A-/Stable	A-/Negative
SK Broadband Co., Ltd.	A-/Stable	A-/Negative
Telekom Malaysia Berhad	BBB+/Stable	A-/Negative
PT Indosat Tbk	BBB/Stable	BBB/Negative
Total Access Communication Public Company Limited	AA(tha)/Stable	AA(tha)/ Negative
Bharti Airtel Limited	BBB-/Negative	BBB-/Rating Watch Negative
PT Profesional Telekomunikasi Indonesia	BBB/Stable	BBB-/Positive

Source: Fitch Ratings

What are Fitch's Views on 5G Capex and Spectrum Investments?

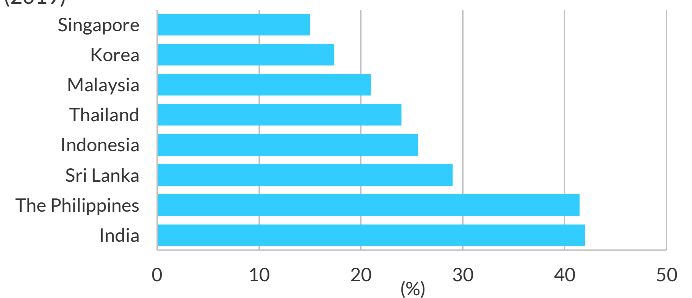
We expect operating cash flow to lag behind 5G investments significantly, keeping free cash flow (FCF) constrained over the next three years. A lack of compelling applications that sufficiently differentiate 5G value from 4G services suggests any near-term uplift from 5G revenue is unlikely to be significant.

Our forecasts assume staggered 5G capex and spectrum costs as these become certain, with low visibility on returns over the next three years. The impact will, however, be uneven across the portfolio in light of the asymmetrical developments.

Emerging markets like India, Indonesia, Sri Lanka, Thailand and the Philippines are likely to pace 5G investments over the next few years to support cash flow, and enable investments to meet proven demand. Capex intensity in these markets typically hover around 25%-40%, above the region's average in the low 20s. Spectrum auction outcomes in India, Malaysia and Thailand could squeeze telecom operators, leaving them with less flexibility to weather the 5G capex upturn.

APAC Telecoms Capex/Revenue

(2019)



Source: Fitch Ratings

Meanwhile, incumbent telcos in advanced 5G markets such as South Korea, China, Taiwan, Singapore and Australia are likely to position 5G as a network differentiator to strengthen their competitiveness. Singapore's 5G investment will provide an indication of the standalone network costs.

Fitch expects 5G capex to decline gradually for Korean telcos, SK Telecom Co., Ltd (SKT, A-/Stable) and KT Corporation (A/Stable), after peaking in 2019. Expansion in 5G after 2020 is likely to be demand-driven, suggesting the likelihood of capex moderating without a meaningful increase in average revenue per user. Fitch revised the Outlook on SKT's rating to Stable, from Negative, in October 2020, as incremental cash flow from 5G conversion and well-controlled capex are likely to drive deleveraging. SKT led the country's 5G market with 4.3 million users in 3Q20, followed by KT's 2.8 million 5G subscribers.

We also expect a gradual deleveraging for Taiwan's second-largest telco, Taiwan Mobile Co., Ltd. (TWM, AA(twn)/Negative), in 2021-2022 through disciplined capex and EBITDA recovery. However, the large upfront 5G spectrum payments in 2020 could drive FFO net leverage to 2.6x, above the 2.1x threshold at which we may take negative rating action. TWM's telecom capex after 2020 is likely to normalise to 16%-17% of service revenue (Fitch's 2020 estimate: 104%, including spectrum payments). We forecast 5G rollout will lift revenue growth by low-single-digits in 2021, and EBITDA by 6%-7% due to lower marketing costs and mobile subsidies.

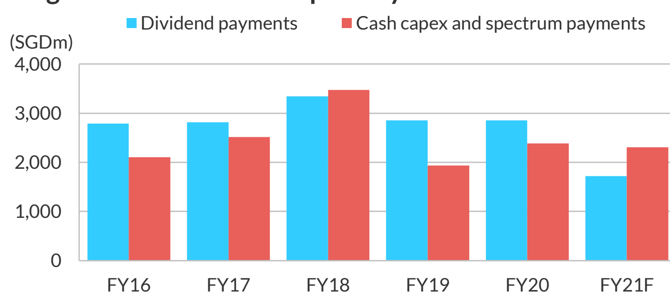
What is the Impact of 5G and a Digital Banking Licence on Singtel?

Initial capex guidance by mobile network operators StarHub and Singapore Telecommunications Limited (Singtel, A/Stable) suggests that staggered investments for a 5G standalone network may reduce the burden on FCF. StarHub – which is pursuing network-sharing through a 50:50 joint venture with rival mobile network operator M1 – is planning 5G capex of SGD200 million over a five-year period, with investments front-loaded in 2H20-2021. This includes its own standalone core network and 50% share of investments in a radio access network, 3.5GHz base stations, transmission and 5G spectrum costs.

Singtel provided group capex guidance for the financial year ending March 2021 (FY21) of SGD2.2 billion (excluding spectrum costs and intangibles), below our original assumption of SGD2.5 billion-2.6 billion. The FY21 capex budget comprises AUD1.5 billion for Singtel Optus Pty Limited (A-/Stable) and SGD700 million for the rest of the group. Telecom capex would be higher in 2022 if the 700MHz frequency band becomes available for commercial use in Singapore.

Singtel has demonstrated commitment to manage capital prudently, including shareholder returns, to ease its capex burden, moving away from its aggressive dividend policy. The group has adopted a scrip dividend scheme since 3Q20, allowing its shareholders the option of receiving new shares in the company in lieu of cash dividends. It also reduced FY20 final dividends by 49% in May 2020, and FY21 interim dividends declared by 25% in November. Singtel was paying substantial yearly dividends of SGD2.8 billion-3.3 billon in FY16-FY20, close to the amount of its annual cash capex.

Singtel's Dividend and Capex Payments



Note: FY18 comprised SGD2.9bn ordinary and SGD490m special dividends
Source: Fitch Ratings, Singtel

The full digital banking licence (DFB) recently awarded to Singtel and ride-hailing company, Grab, through a 40:60 joint venture, is not likely to contribute meaningfully to Singtel's cash flows over the next few years. The consortium aims to formally launch the digital bank in early 2022, with investments progressively increasing to SGD1.5 billion over five years, out of which the proportionate share of Singtel's 40% equity stake will be SGD600 million.

The Monetary Authority of Singapore guidelines require the licence holders to commence operations as a restricted DFB with a minimum paid-up capital of SGD15 million, before progressively increasing to SGD1.5 billion to become a full functioning DFB over three to five years, provided certain regulatory conditions are met.

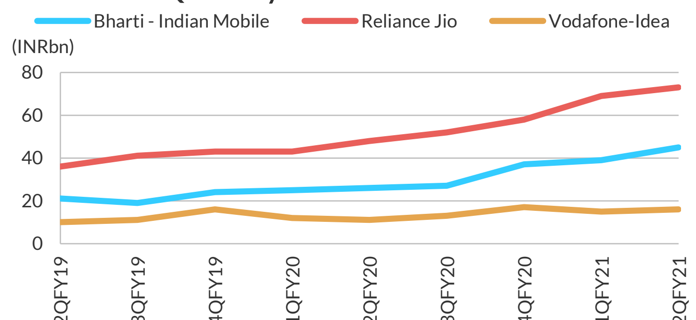
Is the Worst Over for Bharti?

The Negative Outlook on Bharti does not reflect our view of Bharti's underlying credit profile - which has been improving due to strong growth in the Indian and African wireless operations - but rather the heightened probability of a lowering of India's (BBB-/Negative) Country Ceiling to 'BB+' from 'BBB-'.

We believe our assessment of Bharti's underlying credit profile has factored in regulatory costs and a likely increase in capex on upcoming spectrum auctions. We forecast Bharti's FFO net leverage will be 2.2x-2.4x, below the threshold of 2.5x above which we will take negative rating action. Bharti's FY21 revenue and EBITDA will likely rise by 17%-25%, led by growth in the Indian wireless market and steady expansion in African markets, despite the economic slowdown caused by the coronavirus pandemic.

Its Indian wireless segment's EBITDA will widen by 40%-50% in FY21, led by at least 15 million in subscriber additions and a tariff improvement of 10%-12%, which will probably keep the operating EBITDA margin stable at 35%-36% in FY21. Bharti and Reliance Jio, a subsidiary of Reliance Industries Ltd (BBB-/Stable), will consolidate revenue market share at the expense of struggling telco Vodafone Idea Ltd.

Indian Telcos Quarterly EBITDA



Source: Fitch Ratings, companies

Our assessment factors in an additional USD4 billion for adjusted gross revenue dues in our FY21 leverage forecast. We also take into account USD750 million in debt in our leverage calculation related to a potential payment to India's Department of Telecommunications for one-time spectrum charges.

Bharti is likely to generate low positive free cash flow in FY21 on flat core capex, a decline in interest costs and the government's two-year moratorium on the payment of existing spectrum dues, which will defer about USD840 million per year in FY21 and FY22. We believe the company may spend USD500 million in FY21 and USD1 billion in FY22 to fund the upfront spectrum investments.

Will CKHT's Tower Sale be Credit Positive? How Will Hutch Indonesia Benefit from the Proposed Merger with Indosat?

CK Hutchison Group Telecom Holdings Limited's (CKHT, BBB+/Stable) EUR10 billion planned tower sale to Spanish-based tower company, Cellnex Telecom S.A. (BBB-/Stable), will provide financial flexibility to the company and its parent, CK Hutchison

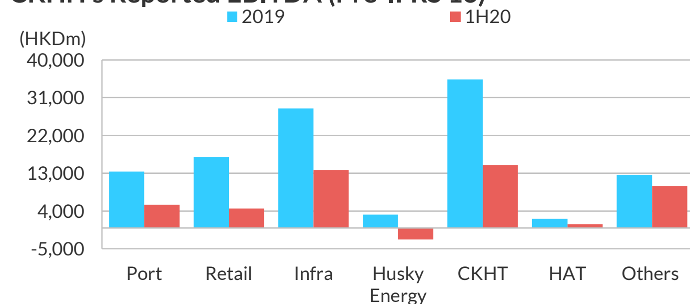
Holdings Limited (CKHH, A-/Stable), amid the tough operating environment.

We expect the proceeds to be reinvested into the business, and used for deleveraging and shareholder returns within the CKHH group. Fitch rates CKHT using a top-down approach by notching its IDR one level below the ratings of CKHH due to their close linkages, as assessed under Fitch's Parent and Subsidiary Linkage (PSL) Rating Criteria. A downgrade of CKHH's ratings would therefore lead to a corresponding negative rating action on CKHT, which is fully owned and tightly managed by CKHH.

The extent of deleveraging at CKHT and CKHH as a result of the transaction is unclear, but management remains committed to maintaining the credit metrics of the two companies. Capital allocation is likely to be determined when the transaction closes, which will be staggered over the next 12 months. Fitch has not factored the deal into our forecasts.

Rising fixed-mobile convergence and the need for spectrum assets may spur M&A activity. CKHT assumes a mobile-centric operating profile in most markets in Europe, with the exception of a fixed-line presence in Austria and Italy. The telecoms business under CKHT and Hutchison Asia Telecommunications (HAT) accounted for 35% of CKHH's reported EBITDA, making it the largest contributor to the group. HAT directly owns CKHH's telecom operations in Indonesia, Vietnam and Sri Lanka.

CKHH's Reported EBITDA (Pre-IFRS 16)



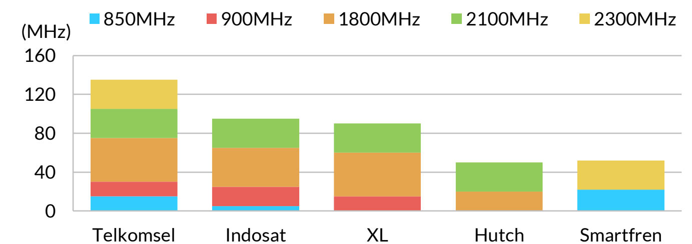
Source: Fitch Ratings, CKHH

CKHH's memorandum of understanding with Qatar-based Ooredoo Q.P.S.C. (A-/Stable) to combine their Indonesian telecom subsidiaries, PT Hutchison 3 Indonesia and PT Indosat Tbk (BBB/AAA(idn)/Stable; Standalone Credit Profile (SCP): bb) underscores the significance of scale and spectrum assets. Terms of the potential transaction and shareholding structure are pending negotiations until end-April 2021.

We believe the ministerial decree of Indonesia's new omnibus law, which will likely be finalised in 1Q21, will spur industry consolidation and M&A activity in the telecoms sector. We expect regulatory reforms to benefit smaller telcos with spectrum-sharing for new technologies and spectrum retention after M&A. However, PT Telekomunikasi Indonesia Tbk (Telkom, BBB/Stable) will continue to maintain its market dominance and strong network leadership in both fixed and mobile services. Telkom's 65%-owned subsidiary, PT Telekomunikasi Selular (Telkomsel), is the incumbent mobile operator, capturing 55% of mobile revenue share in 1H20.

Indosat's IDRs include a three-notch uplift from its SCP of 'bb' due to the legal and strategic linkages with Ooredoo, which owns a 65% stake. Fitch is likely to assess Indosat based on its SCP if linkages with Ooredoo weaken.

Spectrum Holdings in Indonesia[a]
At end-December 2020



[a] Excludes the 30MHz of 2.3GHz, which Telkomsel, Hutch and Smartfren have been selected for the spectrum tender
Source: Fitch Ratings, companies

What Led to TBI's Multi-Notch Rating Upgrade?

Fitch's upgrade of PT Tower Bersama Infrastructure Tbk's (TBI) rating to 'BBB-' from 'BB' reflects the Indonesian company's resilient business risk profile, supported by strong cash flow visibility backed by non-cancellable long-term telecom contracts with built-in escalation clauses.

The tower business is characterised by low technological risk, customer churn and maintenance capex requirements as well as reasonable pricing power on limited tower overlap with peers. The business has high operating leverage leading to strong cash generation, which allows for a higher leverage threshold for tower companies compared with other corporates.

TBI's business profile has steadily improved, with organic tower and tenancy additions driven by Indonesian telcos' large capex to strengthen 4G networks and expand fibre infrastructure. TBI's ratings benefit from long-term lease agreements that provide visibility and stability to its cash flow. Total revenue locked in was around IDR26 trillion (USD1.7 billion) at end-September 2020, and the average remaining contract life was 5.3 years.

We forecast 2020 FFO net leverage will improve to around 4.8x-5.0x (2019: 5.3x) and stay below 5.5x, the threshold above which we would consider negative rating action. We estimate revenue and EBITDA increased by around 13%-15% in 2020 (2019: 9%) and will rise by 15%-20% in 2021 on strong tower and fibre network demand from telcos along with the acquisition of 3,000 towers from PT Inti Bangun Sejahtera.

We also expect TBI's market share to rise to 20% (2020: 17%) in 2021 as it expands faster than the industry average. We forecast a stable 2020-2021 EBITDA margin of 85% (2019: 85%), with pressure on tower rentals offset by strong profitability from the addition of co-locations.

However, high cash flow visibility means that management has fair control over the leverage at which the company operates. We expect TBI to prudently distribute shareholder returns, keeping net debt/last-quarter annualised EBITDA below 5.0x (9M20: 4.6x) or FFO net leverage below 5.5x.

Will Fitch's Rating Approach on NBN Change to Bottom Up If the State Cuts Its Stake?

Fitch rates NBN Co Limited (AA/Negative) two notches below the Australian sovereign rating (AAA/Negative) using a top-down approach under our Government-Related Entities (GRE) Rating Criteria. We assess NBN Co's GRE score at 30 out of the maximum of 60 because of the strong ties with the sovereign and the incentive for the government to provide support. The 'Very Strong' status, ownership and control factor is based on the high degree of government oversight of its operations, investments and financing strategies, as well as full state ownership.

We expect the government to maintain control in the near-to-medium term, but firm plans for full or partial privatisation would lead Fitch to reassess the GRE factors. Privatisation plans are uncertain at this stage and the process, if initiated, would be lengthy. A series of regulatory processes, outlined in the NBN Co Act 2011, need to be completed before a formal privatisation process can be started.

Under our GRE criteria, a weakening of linkages with the sovereign, leading to a GRE score of less than 17.5, would result in a bottom-up approach from NBN Co's SCP of 'bb'. This would require a marked change in the assessment of more than one of the four GRE factors - a reduction in state shareholding or control, a weaker support track record, and greater socio-political and financial implications of a default.

In addition, the government has guaranteed some of NBN Co's lease obligations, but the guarantee will be dropped once it achieves an acceptable investment-grade credit risk. Fitch is likely to place NBN Co on Rating Watch in the event the state announces its intention to sell its stake. We expect the formal privatisation process to take at least 12 months from the initial announcement. A change of ownership would lead to a reassessment of its linkages with any potential new corporate parent, based on Fitch's PSL rating criteria in terms of legal, operational and strategic importance.

Fitch's GRE Notching Guidelines

SCP of state-owned enterprise vs rating of government/overall support score	Equal or more than	Between		Between		Between		Between		Equal to	Equal to or less than
	45	35	42.5	27.5	33	20	25	15	17.5	12.5	10
Same or above	Standalone or capped	Standalone or capped		Standalone or capped		Standalone or capped		Standalone or capped		Standalone or capped	Standalone or capped
Up to three notches away from government	Equalised	Equalised		Equalised		Top down minus 1[a]		Bottom up + 1 capped at government minus 1		Bottom up + 1 capped at government minus 1	Standalone
Four notches away from government	Equalised	Top down minus 1		Top down minus 1		Top down minus 2		Bottom up + 1		Bottom up + 1	Standalone
More than four notches away from government or standalone not assigned/not meaningful	Equalised	Top down minus 1		**Top down minus 2**		Top down minus 3		Bottom up + 2 or +3 capped at government minus 3b		Bottom up + 1b	Standalone[b]

[a] If the SCP of the GRE is one notch below the government and the credit drivers of the GRE are largely independent from those of the government, a one-notch uplift to the same rating as the government can also be considered
[b] When the standalone is not assigned or not meaningful, entities for which the notching approach is bottom up or standalone would not be rated
Source: Fitch Ratings

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