

Telekomunikasi

23 October 2014

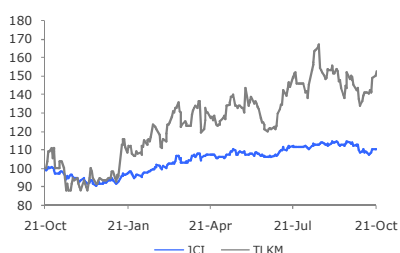
Company Update

BUY (Unchanged)**StockData**

| | |
|---------------------------|----------|
| Target price (Rp) | Rp3,000 |
| Prior TP (Rp) | 3,000 |
| Shareprice (Rp) | Rp2,850 |
| Upside/downside (%) | +5 |
| Sharesoutstanding (m) | 97,101 |
| Marketcap. (US\$ m) | 23,059.5 |
| Free float (%) | 48.8 |
| Avg. 6m dailyT/O (US\$ m) | 21.3 |

Price Performance

| | 3M | 6M | 12M |
|---------------------|-------------|------|------|
| Absolute (%) | 7.5 | 23.2 | 27.9 |
| Relative to JCI (%) | 7.7 | 19.6 | 15.4 |
| 52whigh/low (Rp) | 3,010/1,961 | | |

**Major Shareholders**

| | |
|-----------------------|-------|
| Republic of Indonesia | 51.2% |
|-----------------------|-------|

Estimate Change; Vs. Consensus

| | 2014F | 2015F |
|-------------------|-------|-------|
| Latest EPS (Rp) | 156.1 | 170.7 |
| Vs. Prior EPS (%) | 0.0 | 0.0 |
| Vs. Consensus (%) | 0.2 | 0.0 |

Source: Bloomberg

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Investing for the future

- **Developing fiber optic networks**
- **Enhancing revenue from corporate and SME**
- **Deepening the retail segment**
- **Divest non-core assets**

Backbone and broad band investment. Telkom has decided to take over the development of Palapa Ring and started the development in broadband network of East Indonesia with the SMPCS (Sulawesi-Maluku-Papua Cable System). Telkom has also entered a consortium of seven other telco operators to develop broadband connection SEA-US (South East Asia-United States). These two projects are part of the Indonesia Digital Network Indonesia Global Network, a strategy of Telkom in network infrastructure. We think this strategy will fit with fast development internet adoption and over-the-top (OTT) applications, which will net high speed infrastructure. Telkom is aiming to connect the last mile through wifi hotspots to increase connectivity at the retail end.

Aiming at corporate and SME. Telkom has entered several strategic alliances to tap into the corporate and SME segments. Telkom has formed a new JV with JasaMarga (JSMR IJ, Rp6,125 , Buy) to develop fiber optic network along toll road network of JSMR, and also formed an alliance to develop MIS and e-toll for JSMR. The company is also investing in a data center by transforming old office building in data center supporting cloud computing. This is all a part of the strategy to diversify revenue from corporate and the SME segment by offering a more value added service.

...and retail as well. PINS, a subsidiary of Telkom has recently acquired 25% of Tiphone (TELE IJ, Rp935, not rated) worth Rp1.4tn. Through this acquisition, TLKM is aiming to have further reach on consumer-end especially on device distribution. PINS has been appointed to handle the migration of 4-5mn subs of Telkom Flexi to Telkomsel by providing replacement handsets. Telkom have also been appointed to provide ICT service to re-open HalimPerdanakusuma airport and Ciputra World.

Unlocking values. Telkom explores the possibility to unlock value of its non-core assets. Last year, Telkom has divested 80% of Telkomvision to Transcorp. Recently, by using share swaps with Tower Bersama (TBIG IJ, Rp8,575 , Buy), Telkom unlocked value of its passive tower assets. We expect further divestment on Telkomsel's 14,000 towers in the future. Telkom has been reported to explore the possibility to divest Telkom Sigma, a subsidiary engaging in data center and ICT solution.

| Year To 31 Dec | 2012A | 2013A | 2014F | 2015F | 2016F |
|--------------------|--------|--------|--------|--------|---------|
| Revenue(RpBn) | 77,143 | 82,967 | 89,765 | 96,363 | 106,073 |
| EBITDA(RpBn) | 40,154 | 43,626 | 45,473 | 49,333 | 54,140 |
| EBITDA Growth (%) | 7.9 | 8.6 | 4.2 | 8.5 | 9.7 |
| Net Profit(RpBn) | 12,850 | 14,205 | 15,732 | 17,203 | 19,528 |
| EPS (Rp) | 127 | 141 | 156 | 171 | 194 |
| EPS Growth (%) | 17.1 | 10.5 | 10.8 | 9.3 | 13.5 |
| Net Gearing (%) | 6.5 | 1.6 | 1.7 | (2.9) | (6.7) |
| PER (x) | 22.4 | 20.2 | 18.3 | 16.7 | 14.7 |
| PBV (x) | 4.0 | 3.5 | 3.2 | 2.9 | 2.7 |
| Dividend Yield (%) | 2.9 | 3.2 | 3.6 | 3.9 | 4.4 |
| EV/EBITDA (x) | 6.6 | 6.1 | 5.9 | 5.5 | 5.1 |

Source : TLKM,IndoPremier

Share Price Closing as of : 21-October-2014

Refer to Important disclosures on the last of this report

Backbone and fiber optic

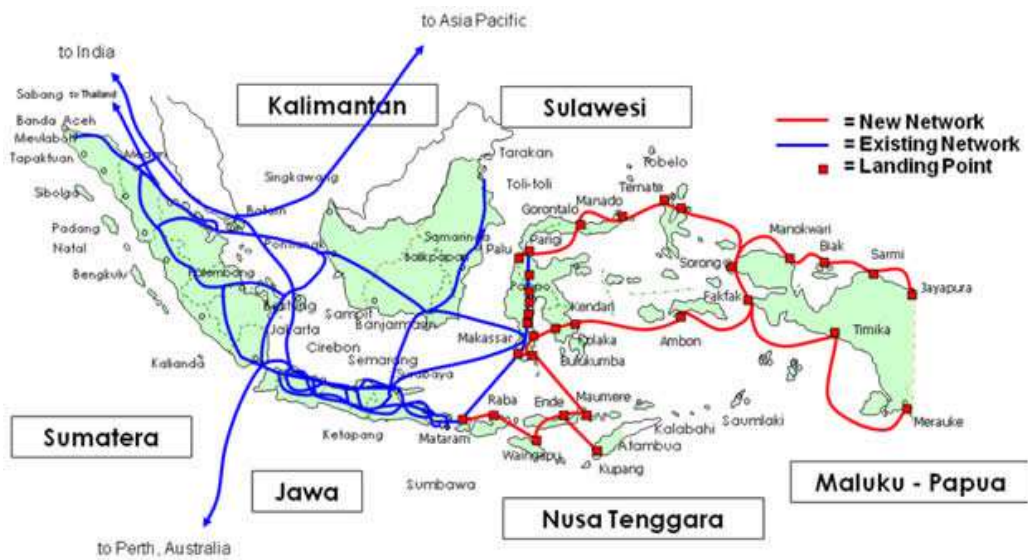
Telkom has engaged in two fiber optics projects: 1) Indonesia Digital Network which is also known as Palaparing as fiber optic network and 2) Indonesia Global Network, providing access to global network through global exchange gates.

Indonesia digital Network

The Government has rolled a nationwide fiber optic project namely, Indonesia Digital Network 2015, which aims to develop a fiber optic network across Indonesia part of the IT infrastructure development. The Palapa Ring should be developed by a consortium of domestic telecommunication operators. However due to lack of commitment, only Telkom was able to develop parts of the Eastern Ring.

Back in Sep13, Telkom started its initiative to invest in fiber optic cable network of Sulawesi-Maluku-Papua Cable System (SMPCS) which consists of 5,444km of marine cable and 655km inland cable. Telkom has teamed up with Alcatel and NEC to develop this network, expected to be completed in early 2015. Earlier in Aug13, Telkom developed a fiber optic network of 400km in Central Aceh to North Sumatera. All these investments are parts to develop the Palapa Ring. Total investment for this project is estimated to reach Rp1.7tn

Fig. 1: Palapa Ring planned and existing network



Source: TLKM

Global exchange gateways

Completion of the Palapa Ring is just half of the story. Getting data traffic into the global network is another step. Telkom has teamed up with a consortium to develop 1) South East Asia – Middle East – Western Europe 5 (SEA-ME-WE 5) and 2) South East Asia – US (SEA-US). The two global networks will be integrated with the current infrastructure in Indonesia.

Telkom, using its subsidiary Telin, has entered a consortium of 12 Asian telco operator and 2 European telco companies to develop a submarine network to connect Asia and Europe. The SEA-ME-WE5 network is 20,000km long passing 17 countries and will connect to Indonesia in Medan and Dumai. This new network will be integrated with existing gateways of Telkom such as America gateway (AAG), South East Asia Japan Cable System (SJC), Batam Singapore Cable System (BSCS), and DumaiMalaka Cable System (DMCS).

The SEA-US submarine cable system is 15,000km long starting from Manado (Indonesia), Davao (Philippines), Piti (Guam), Oahu (Hawaii), and Los Angeles (US). Capex of this project is estimated to reach US\$250mn and is expected to be completed in 2016. The consortium consist of seven global telco operators namely, Telkom, Globe Telecom, RAM Telecom, HawaiiTelcom, Teleguam Holdings, GTI Corporation and Telkom USA.

Acquiring business domestically

Telkom using its subsidiary PINS has acquired 25% of Tiphone worth Rp1.4tn. About 15% was bought from existing shareholders and 10% purchased through non-preemptive rights. This is a straight forward vertical integration as Telkom wants to tap more into the handset and voucher distribution business. It has been reported that TELE is aiming to acquire Simpatindo (non listed), a distributor and operators of Telkomsel's voucher and outlets. The acquisition is estimated of Rp500bn. In the future, TELE might be acting as a holding company for handphone and voucher distribution for Telkom's products.

As Telkom Flexi's operation has been stopped, about 4-5mn subscribers will be transferred to Telkomsel. PINS will be responsible to the handset replacement. We believe this will involve TELE as handset provider since the company has wide range of handsets. Telkom Flexi subs will be liable to handset discount if ARPU usage is more than Rp10,000 per month. So far, Telkom has yet to determine the discount on handsets. The largest Flexi customer base is in East Java, about 1mn subs, followed by Jakarta/Greater Jakarta of 750k with the remaining spread out in other areas.

Investing in IT startup companies

Telkom has developed business incubator centers in Bandung and Jogjakarta to cater start-up IT companies. Telkom has committed an investment of US\$200mn in capital venture companies. In order to increase success rate, Telkom has teamed up with Fenox Venture Capital from Silicon Valley US. This company is a specialist in IT start-up companies and has investment in Bukalapak.com and Urbanindo.com in Indonesia. The development of OTT applications led Telkom to support and develop start-up IT companies, as Telkom has a huge subscriber base of 150mn customers.

Other value added services

Telkom is currently investing in data centers due to increasing demand from corporate and SME. The company is leveraging its property asset from old switching and exchange stations. Capex committed to this data center is about Rp1.0tn and expected to be completed in 2015. Telkom has about 30 sites to be converted into data centers, of which 18 sites will start this year with the remaining in the following year.

Wireless network connection using 3G technology has limitation on connection speed and quality. Telkom has launched 10,000 wifi access points program to divert traffic from wireless network to better quality fiber optic. This will require cross-selling from Telkomsel subscriber with Speedy internet service. Up to now, Telkom has already operated 1,140 access points. This business strategy will leverage the investment in fiber optic network and OTT applications.

Another potential area to explore for Telkom will be mobile money, offered using its brand T-cash. Telkomsel has about 134mn subscriber as of Jun14, this provide highest banking penetration based on mobile money. However, mobile money is still quite restricted from the Central Bank causing adoption of mobile money to remain low.

Unlocking value

Telkom has entered a share swap agreement with Tower Bersama (TBIG IJ) to exchange with ownership in Mitratel. 49% shares of Mitratel have been exchanged with 290mn shares in TBIG through issuance of preemptive rights. There is a 2-year option attached to exchange 51% of the remaining shares of Mitratel with 473mn shares of TBIG. Telkom would also be entitled to receive earn out payment of Rp1.74tn depending on performance of Mitratel post share-swap (with key performance index such as colocation). Based on 21 Oct closing price of TBIG @ Rp8,575, this transaction value equals an additional Rp83 per share to Telkom's shareholder. According to our tower analyst, William Simadiputra, the share swap deal is valued at EV/EBITDA ranging from 10.4-13.5x. This is much higher than TLKM's EV/EBITDA FY14 of 6.4x, unlocking value of its subsidiaries.

TLKM Company Update

Fig. 3: Mitratel deal structure share swap with TBIG



Source : TLKM

Fig. 4: Deal value including options

| | No of shares (mn) | Share price (Rp) | Value (Rpbn) |
|--------------------------|----------------------|---------------------|-----------------|
| Share swap 1 | 290 | 8575 | 2,487 |
| Share swap 2 | 473 | 8750 | 4,139 |
| Earn out | | | 1,740 |
| Total cash value | | | 8,366 |
| Cash value per share, Rp | | | 83.0 |

Source : TLKM, IndoPremier

Impact beyond 2016

Telkom is investing to develop new areas of revenue align with its core corporate strategy of TIMES (Telecommunication, Information, Media, Edutainment and Service). Telkom will face challenges in conventional telecommunication service. Therefore, new wave revenue is important to sustain revenue growth. Telkom management believes that infrastructure of fiber optics will be the key driver to growth to induce further growth from higher value added service from OTT apps. We also believe that the new Government will support efforts to improve e-government, while on the private side, IT solution will be further introduce to increase productivity and efficiency. We think that Telkom is on the right track to invest in its future. However, monetization of these investments will likely have impact beyond 2016.

TLKM Company Update

| Year To 31 Dec (RpBn) | 2012A | 2013A | 2014F | 2015F | 2016F |
|-----------------------------|----------|----------|----------|----------|----------|
| Income Statement | | | | | |
| Net Revenue | 77,143 | 82,967 | 89,765 | 96,363 | 106,073 |
| Cost of Sales | 0 | 0 | 0 | 0 | 0 |
| Gross Profit | 77,143 | 82,967 | 89,765 | 96,363 | 106,073 |
| SG&A Expenses | (51,445) | (55,121) | (60,016) | (63,779) | (69,574) |
| Operating Profit | 25,698 | 27,846 | 29,749 | 32,584 | 36,499 |
| Net Interest | (1,459) | (668) | (5) | (235) | (88) |
| Forex Gain (Loss) | 0 | 0 | 0 | 0 | 0 |
| Others-Net | (11) | (29) | 10 | 11 | 0 |
| Pre-Tax Income | 24,228 | 27,149 | 29,754 | 32,360 | 36,411 |
| Income Tax | (5,866) | (6,859) | (7,439) | (8,090) | (9,103) |
| Minorities | (5,512) | (6,085) | (6,584) | (7,067) | (7,780) |
| Net Income | 12,850 | 14,205 | 15,732 | 17,203 | 19,528 |
| Balance Sheet | | | | | |
| Cash & Equivalent | 17,456 | 21,568 | 9,666 | 12,355 | 16,042 |
| Receivable | 5,409 | 6,421 | 5,898 | 6,332 | 6,970 |
| Inventory | 579 | 509 | 504 | 499 | 494 |
| Other Current Assets | 4,529 | 4,577 | 4,577 | 4,577 | 4,577 |
| Total Current Assets | 27,973 | 33,075 | 20,645 | 23,763 | 28,083 |
| Fixed Assets - Net | 77,047 | 86,761 | 90,812 | 95,170 | 100,415 |
| Goodwill | 1,443 | 1,508 | 930 | 352 | 0 |
| Non Current Assets | 83,396 | 94,876 | 98,349 | 102,129 | 107,022 |
| Total Assets | 111,369 | 127,951 | 118,994 | 125,892 | 135,106 |
| ST Loans | 37 | 432 | 0 | 0 | 0 |
| Payable | 7,280 | 11,600 | 0 | 8,733 | 9,527 |
| Other Payables | 11,169 | 11,312 | 11,199 | 11,216 | 11,243 |
| Current Portion of LT Loans | 5,621 | 5,093 | 1,339 | 338 | 0 |
| Total Current Liab. | 24,107 | 28,437 | 20,756 | 20,287 | 20,769 |
| Long Term Loans | 11,803 | 10,410 | 2,910 | 2,490 | 2,441 |
| Other LT Liab. | 8,481 | 11,680 | 11,680 | 11,680 | 11,680 |
| Total Liabilities | 44,391 | 50,527 | 35,346 | 34,457 | 34,890 |
| Equity | (1,236) | 1,914 | 1,914 | 1,914 | 1,914 |
| Retained Earnings | 52,777 | 58,628 | 64,134 | 70,155 | 76,990 |
| Minority Interest | 15,437 | 16,882 | 17,600 | 19,366 | 21,311 |
| Total SHE + Minority Int. | 66,978 | 77,424 | 83,648 | 91,436 | 100,215 |
| Total Liabilities & Equity | 111,369 | 127,951 | 118,994 | 125,892 | 135,106 |

Source : TLKM,IndoPremier

TLKM Company Update

| Year to 31 Dec | 2012A | 2013A | 2014F | 2015F | 2016F |
|-------------------------------------|---------|---------|----------|----------|----------|
| Cash Flow | | | | | |
| Net Profit | 18,362 | 20,290 | 22,316 | 24,270 | 27,308 |
| Depr. & Amortization | 3,409 | (4,398) | 11,049 | 1,026 | 1,127 |
| Changes in Working Capital | (24) | 3,236 | (2,967) | 104 | 187 |
| Others | (4,162) | (4,692) | (6,097) | (6,833) | (7,691) |
| Cash Flow From Operating | 17,585 | 14,436 | 24,301 | 18,567 | 20,931 |
| Capital Expenditure | (4,969) | (7,053) | (14,522) | (4,807) | (6,020) |
| Others | (3,421) | (1,727) | 441 | 84 | 164 |
| Cash Flow From Investing | (8,390) | (8,780) | (14,081) | (4,723) | (5,855) |
| Loans | (96) | (1,526) | (11,686) | (1,422) | (387) |
| Equity | (1,692) | 3,150 | 0 | 0 | 0 |
| Dividends | (7,127) | (9,233) | (10,226) | (11,182) | (12,693) |
| Others | 1,503 | 2,586 | 272 | 1,449 | 1,692 |
| Cash Flow From Financing | (7,412) | (5,023) | (21,640) | (11,155) | (11,388) |
| Changes in Cash | 1,783 | 633 | (11,420) | 2,689 | 3,687 |
| Financial Ratios | | | | | |
| Gross Margin (%) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Operating Margin (%) | 33.3 | 33.6 | 33.1 | 33.8 | 34.4 |
| Pre-Tax Margin (%) | 31.4 | 32.7 | 33.1 | 33.6 | 34.3 |
| Net Margin (%) | 16.7 | 17.1 | 17.5 | 17.9 | 18.4 |
| ROA (%) | 12.0 | 11.9 | 12.7 | 14.0 | 15.0 |
| ROE (%) | 20.1 | 19.7 | 19.5 | 19.7 | 20.4 |
| ROIC (%) | 20.1 | 20.7 | 22.0 | 23.8 | 25.2 |
| Acct. Receivables TO (days) | 24.0 | 24.7 | 23.5 | 21.7 | 21.5 |
| Acct. Receivables - Other TO (days) | 1.2 | 1.3 | 1.5 | 1.4 | 1.4 |
| Inventory TO (days) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Payable TO (days) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Acct. Payables - Other TO (days) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Debt to Equity (%) | 26.1 | 20.6 | 5.1 | 3.1 | 2.4 |
| Interest Coverage Ratio (%) | 8.0 | 5.4 | 1.5 | 1.0 | 0.7 |
| Net Gearing (%) | 6.5 | 1.6 | 1.7 | (2.9) | (6.7) |

Source : TLKM,IndoPremier

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INVESTMENT RATINGS

BUY : Expected total return of 10% or more within a 12-month period
HOLD : Expected total return between -10% and 10% within a 12-month period
SELL : Expected total return of -10% or worse within a 12-month period

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