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Research Update:

PT Profesional Telekomunikasi Indonesia Upgraded To 'BB+' On Sustainability Of Financial Position; Outlook Stable

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Table Of Contents

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Overview

- We expect Indonesia-based independent tower company Protelindo's moderate revenue growth and positive free operating cash flows in the next few years to allow it to absorb a large tower portfolio acquisition and maintain its current financial position.
- We are raising our long-term corporate credit rating on Protelindo to 'BB+' from 'BB' and the long-term issue rating on the company's senior unsecured bank loan to 'BB+' from 'BB'.
- The stable outlook reflects our expectation that Protelindo will be able to maintain its operating efficiency and cash flows, even if the company makes a large tower portfolio acquisition.

Rating Action

On May 12, 2014, Standard & Poor's Ratings Services raised its long-term corporate credit rating on PT Profesional Telekomunikasi Indonesia (Protelindo) to 'BB+' from 'BB'. The outlook is stable. At the same time, we raised the long-term issue rating on the existing senior unsecured bank loan that the Indonesia-based independent tower company guarantees to 'BB+' from 'BB'. We also raised the long-term ASEAN regional scale rating on Protelindo to 'axBBB+' from 'axBBB-'.

Rationale

We raised the rating as we believe Protelindo's scale, cash flows, and financial position have significantly improved over the past two years--sufficient to even allow the company to absorb a large tower portfolio acquisition. We have factored in acquisition of 4,500 mobile phone transmission towers as part of our base-case scenario. We believe the company's current financial position could even accommodate acquisition of about 7,500 towers, although this quantum is highly unlikely, in our view.

Protelindo's financial position is supported by moderate revenue growth from new towers and increase in co-locations, positive free operating cash flow, and conservative dividend policy. We expect funds from operations (FFO) to debt at 25%-30% in 2014. We expect the ratio to remain in the same range in 2016 even if the company pays Indonesian rupiah (IDR) 7 trillion for acquiring 4,500 towers in 2015. As per our calculation, Protelindo can acquire up to

7,500 towers without the FFO to debt falling below 20%. The company has not declared dividends in the past to preserve cash for potential tower acquisitions.

Protelindo's business risk profile reflects stable cash flow generation from long-term tower leases of about 10 years, strong operating efficiency, and good market position. It is Indonesia's largest independent tower company, with PT Tower Bersama Infrastructure Tbk. being a close second. Protelindo's more than 9,500 towers have a tenancy ratio (the number of operators sharing a tower) of about 1.88x. We also recognize that large telecom operators still control about two-thirds of telecom towers in Indonesia. Nevertheless, we believe that the demand for towers from independent tower companies will increase as local regulations encourage tower sharing.

Tower portfolio acquisitions could help accelerate a reduction in Protelindo's customer concentration from PT Hutchison CP Telecommunications (HCPT). HCPT contributes about 35% of Protelindo's revenue and has a weak market position, in our view. Protelindo's concentration risk is mitigated by (1) the essential nature of the telecom infrastructure to the industry; (2) the support of HCPT's parent Hutchison Whampoa Ltd. (A-/Stable/--; cnAA/--) through consistent investments in the company; and (3) non-cancelable lease contracts, even if ownership of the telecom operator changes.

Our base case assumes:

- New construction of 1,750 towers in 2014, gradually declining to 1,250 in 2016. In addition, we have factored in a 4,500 tower acquisitions in 2015.
- Increase in co-locations by about 1,000 in 2014 and 2015 and about 1,700 in 2016.
- Percentage increase in average rent per tenant in the low single digits
- Revenue increases by 25%-30% annually and EBITDA margin declining slightly to about 75% from about 76% over the next three years.
- Annual capital expenditure of about IDR1.9 trillion in 2014, declining to about IDR1.5 trillion in 2016.
- IDR7 trillion acquisition cost for 4,500 towers in 2015.
- No dividend payment for at least the next two years.

Based on these assumptions, we arrive at the following credit measures:

- FFO to debt of 25%-30% in 2014 and 2016.
- FFO to cash interest coverage of 4.5x-5.5x over the next three years.

Liquidity

We assess Protelindo to have "strong" liquidity, as defined in our criteria. The company's sources of liquidity are likely to cover its uses of liquidity by more than 1.5x in the next 12 months.

Principal liquidity sources include:

- Cash and cash equivalents of IDR1.5 trillion and undrawn credit facilities of about IDR575 billion as of Dec. 31, 2013.
- Projected FFO of about IDR2.5 trillion in 2014 and about IDR3 trillion in 2015.

- IDR1 trillion of rupiah bonds issued in the first quarter of 2014.

Principal liquidity uses include:
- Debt maturity of about IDR300 billion annually over the next two years.
- Annual capital expenditure of about IDR1.5 trillion to IDR2 trillion over the next two years.

Outlook

The stable outlook reflects our expectation that Protelindo will be able to maintain its operating efficiency, cash flows, and "significant" financial risk profile even if the company makes a large tower portfolio acquisition. We also expect any material tower acquisition to improve Protelindo's customer diversity but not weaken the ratio of FFO to debt materially below 20%.

Downside scenario

We could lower the rating if the company undertakes large debt-financed tower acquisitions, such that we expect the FFO to debt to remain below 20% for a prolonged period. We could also downgrade Protelindo if the company's market position deteriorates because HCPT winds up its operations or sells them to a weak telecom operator.

Upside scenario

We could raise the rating if Protelindo's scale, market position, and diversity materially improve. We could also upgrade the company if we expect it to strengthen and then maintain its financial performance, including FFO to debt of close to 30% or more, supported by a robust financial policy framework. In either case, the company would need to meet our sovereign stress test to be rated above the sovereign rating of Indonesia.

Ratings Score Snapshot

Corporate Credit Rating: BB+/Stable/--
Business risk: Satisfactory
- Country risk: High risk
- Industry risk: Intermediate risk
- Competitive position: Strong

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bb+

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)

- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bb+

Related Criteria And Research

Related Criteria

- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Key Credit Factors For The Telecommunications And Cable Industry, Dec. 12, 2013
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Upgraded

	To	From
PT Profesional Telekomunikasi Indonesia		
Corporate Credit Rating	BB+/Stable/--	BB/Stable/--
ASEAN Regional Scale	axBBB+/--/--	axBBB-/--/--
Protelindo Finance B.V.		
Senior Unsecured	BB+	BB

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