

TOTAL ACCESS COMMUNICATION PLC

No. 57/2018
4 May 2018

CORPORATES

Company Rating: AA+
Outlook: Negative

Company Rating History:

Date	Rating	Outlook/Alert
29/03/17	AA+	Negative
05/06/15	AA+	Stable
03/04/14	AA	Stable
15/10/10	AA-	Stable
30/09/08	A+	Stable
07/07/06	A	Stable
03/12/04	A-	Positive
12/07/04	A-	Stable
01/02/02	A-	

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RATIONALE

TRIS Rating affirms the company rating of Total Access Communication PLC (DTAC) at “AA+” with a “negative” outlook. The rating reflects DTAC’s market position as a major mobile phone service provider in Thailand, easing concerns over spectrum constraint after DTAC signed an agreement with TOT PLC (TOT) on the 2.3 gigahertz (GHz) spectrum. The rating also reflects DTAC’s financial strength, backed by strong cash flow generation and sufficient liquidity. The rating is partly enhanced by the support DTAC receives from Telenor ASA (Telenor).

The rating also takes into consideration DTAC’s challenging business position from intense competition in the industry and the potential deterioration of its financial profile due to the hefty capital expenditures required to ensure bandwidth capacity and network quality.

KEY RATING CONSIDERATIONS

Easing pressure on spectrum constraint

dtacTriNet Co., Ltd. (DTN), a wholly-owned subsidiary of DTAC, has signed a partnership agreement with TOT, a state-owned telecommunications company, to provide 4G LTE-TDD (Long Term Evolution-Time Division Duplex) services on TOT’s 2.3-GHz spectrum of 60-megahertz (MHz) bandwidth. DTN will pay Bt4.51 billion annually to use up to 60% of the total network capacity.

The deal materially eases concerns on DTAC’s spectrum constraint, as a total of 35 MHz of its spectrum in use under the concession agreements for the 850-MHz and 1.8-GHz frequency bands will expire in September 2018. DTAC’s spectrum portfolio is now strengthened with sufficient bandwidth to cater to fast-growing data and bandwidth demands.

The telecom regulator has pledged to conduct an auction for the 1.8-GHz spectrum prior to DTAC’s concession expiry; however, carrying out is still in question. TRIS Rating expects that DTAC will participate in the forthcoming 1.8-GHz bandwidth auctions to remain competitive with its spectrum holdings. However, holding the coveted 2.3-GHz spectrum helps slash DTAC’s pressure to outbid its rivals in the next auctions.

Challenge on business position

DTAC has been facing challenging business position in recent years due to intense competition in the industry plus concerns over its spectrum constraint. DTAC’s number of subscribers declined from 25.3 million in 2015 to 21.8 million at the end of March 2018. During 2015-2017, while the industry grew at an average annual rate of 5% in terms of service revenue (excluding interconnection charges or IC), DTAC successively reported downshift by 2% per annum. DTAC’s service revenue market share has declined for the past four years and slid to the third place in 2017, suggesting a weakened market position.

The lingering falloff in revenue is due to its depleting subscriber base, especially in the prepaid segment, and saturating voice service revenue. The number of prepaid subscribers is expected to tail off as its 2G (second generation) concession is expiring. DTAC is vowing to place greater emphasis on profit-making postpaid customers, as opposed to the less-fruitful prepaid subscribers. With additional bandwidth acquired, DTAC’s strategy is to improve its data

service and user experience in an effort to entice postpaid subscribers, edge up average revenue per user (ARPU), and, to a certain extent, steer the company out of revenue meltdown.

However, all mobile operators are taking the same path. Thus, the market competition, either to poach or safeguard customers from rivals, will remain intense. TRIS Rating expects DTAC to revive its market position and regain service revenue market share in the wake of its strengthened spectrum portfolio.

Strong cash flow generation

Despite weaker market share in terms of service revenue, DTAC's cash flow generation is strong. At the end of 2017, DTAC reported Bt64.8 billion in service revenue, excluding the IC, the same level as the prior year. However, operating cash flow improved markedly from whopping cost-cutting measures. DTAC has made a concerted effort to wring significant costs out of its operation. The company revisited and pared down its marketing expenses, including a handset subsidy and promotional campaigns. Funds from operations (FFO) rose by 18% from Bt23.5 billion in 2016 to Bt28.6 billion in 2017.

For the first quarter of 2018, DTAC reported a slight drop in service revenue, excluding the IC, by 1.1% year-on-year (y-o-y) to Bt16 billion. FFO rose by 19% y-o-y to Bt7.7 billion (including one-off adjusted provisions with respect to a dispute with CAT Telecom PLC (CAT) of approximately Bt0.3 billion). Operating cash flow remained on a solid course, due in large part to softened regulatory costs arising from a reduction in universal service obligation (USO) fees, the adoption of progressive rates of license fee, an ongoing downshift in handset subsidies, and rationalized marketing outlays.

Looking ahead, TRIS Rating expects DTAC to remain under pressure, as the stiff competition persistently stands to undercut its earnings. Although DTAC could substantially rein in operating costs in the past years to arrive at strong cash flow, the downside risks include subdued market position and high subscriber reacquisition costs.

TRIS Rating is of the view that the cost-cutting measures are untenable and DTAC will be more aggressive in its marketing campaigns to restore its market position. Besides, a merit from lower regulatory costs will be largely offset by higher network operating expenses. Network operating expenses are on the rise, following its network densification, annual fees to be paid to TOT, as well as rental expenses for CAT's telecom infrastructure and equipment which are currently under discussion. During 2018-2020, TRIS Rating's base case assumes DTAC's FFO will be at Bt21-Bt26 billion per annum.

Weakening financial profile

DTAC's financial profile is prone to weaken, taking into account looming higher network operating costs and the tremendous capital expenditures required for spectrum acquisition and network expansion. Under the 2.3-GHz bandwidth agreement with TOT, DTAC has to ensure 80% of network coverage on the 2.3-GHz spectrum. TRIS Rating's base case assumes DTAC to pull in capital investments, excluding the cost of new licenses, to the tune of approximately Bt57-Bt60 billion during 2018-2020

During 2018-2020, the FFO to total debt ratio is expected to range from 30%-56%. The debt to capitalization ratio is expected to stay over 60%. The ratio of net debt to EBITDA (earnings before interest, tax, depreciation, and amortization) is expected to surge from 0.6 times (annualized with trailing 12 months) in the first quarter of 2018 to stay at 2-2.5 times. However, the actual investment cost for the new spectrum is uncertain, subject to several factors including the amount of spectrum to offer to the market, degree of bidding competition, and regulatory spectrum allocation plans.

Ample liquidity

During the next 12-24 months, DTAC's sources of funds should be sufficient to meet its commitments. Sources of funds are primarily from the FFO of approximately Bt21-Bt26 billion per annum plus cash and cash equivalents of Bt29.5 billion at the end of March 2018. Uses of funds are planned capital expenditures of Bt17-Bt20 billion per annum and debt repayments totaling Bt11.4 billion. The excess cash flow is expected to be reserved for the 1.8-GHz spectrum acquisition. TRIS Rating expects DTAC to ensure a liquidity cushion partly by optimizing its dividend payout in a bid to grapple with the large investment in the network rollout and license costs.

Support from Telenor

DTAC's credit rating is enhanced by the support from its major shareholder, Telenor, in the areas of managerial assistance and technological know-how. DTAC is considered significant to Telenor in light of its earnings contribution. DTAC is recognized as a top earner in the Telenor Group outside Norway. In recognition of this, TRIS Rating expects that Telenor will support DTAC financially in time of need.

RATING OUTLOOK

The "negative" outlook reflects declining market position and the expectation that DTAC will continue to face challenges in restoring its competitive strengths amid the intense competitive landscape. DTAC's financial profile is likely to weaken

from the hefty investment needed to ensure spectrum bandwidth capacity and expand network coverage.

RATING SENSITIVITIES

DTAC’s rating could be downgraded if its operating performance falls short of expectations and/or the company fails to revive its market position, despite obtaining the additional spectrum. A downward rating pressure would also emerge if DTAC’s financial profile deteriorates, with leverage staying elevated for a sustained period.

The outlook could be revised back to “stable” if DTAC could entrench its market position and deliver improved operating performance while maintaining a strong financial profile. Any change in the degree of support DTAC receives from Telenor will also affect DTAC's credit rating.

COMPANY OVERVIEW

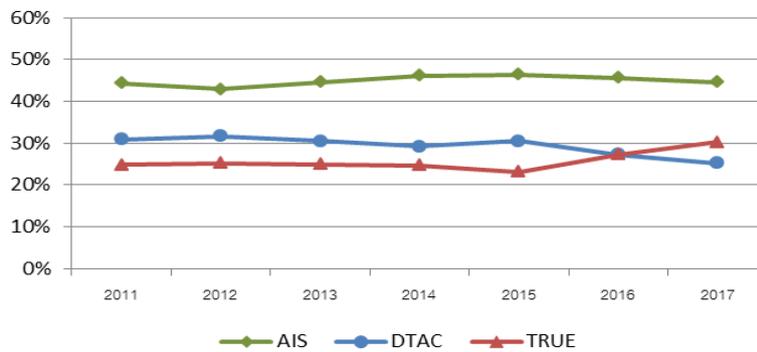
DTAC was incorporated in 1989 and was listed on the Stock Exchange of Thailand (SET) in 2007. Telenor, a leading Norwegian telecommunications company, directly held 42.6% of DTAC's shares as of February 2018.

DTAC operates on three frequency bands: 850-MHz, 1.8-GHz, and 2.1-GHz. Across the three frequency bands, the company holds a total of 50 MHz of spectrum bandwidth. This amount of spectrum bandwidth is adequate to serve its subscribers. A portion of the total (35 MHz) is covered under the concession agreements for the 850-GHz and 1.8-GHz frequency bands which will expire in September 2018. The balance of 15 MHz is covered by the license for the 2.1-GHz band valid until 2027. In addition, DTAC recently entered into an agreement with TOT to provide wireless broadband 4G LTE-TDD services on TOT’s 2.3-GHz spectrum. Under the agreement, DTAC will use up to 60% of the total network capacity of 60-MHz bandwidth.

At the end of March 2018, DTAC had 21.8 million subscribers. DTAC’s service revenue market share was around 25% at the end of 2017.

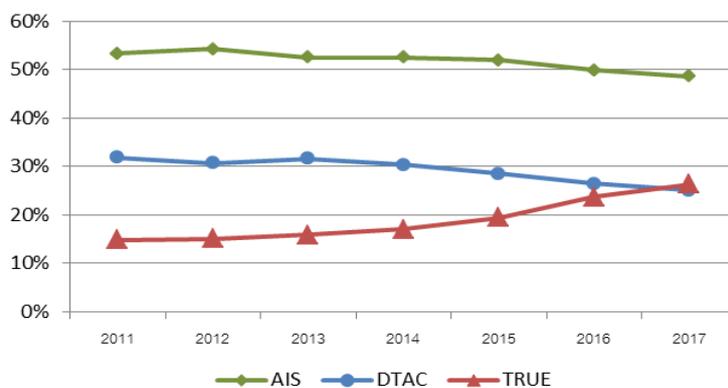
KEY OPERING PERFORMANCE

Chart 1: Market Share by Subscribers



Sources: 1) DTAC
2) Advanced Info Service PLC (AIS)
3) True Corporation PLC (TRUE)

Chart 2: Service Revenue Market Share



Note: Excluding IC
Sources: DTAC, AIS, TRUE

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Mar 2018	----- Year Ended 31 December -----			
		2017	2016	2015	2014
Sales and service revenues	19,060	78,275	82,478	87,753	90,493
Gross interest expense	(173) ***	1,557	1,567	1,384	1,337
Net income from operations	1,371	2,115	2,002	6,188	10,735
Funds from operations (FFO)	7,684	28,646	23,543	24,790	26,328
Total capital expenditures	3,014	19,335	18,301	19,903	15,581
Total assets	113,877	114,501	115,379	110,965	106,426
Total debt	49,000	49,015	49,165	48,000	33,664
Shareholders' equity	30,549	29,235	27,146	27,224	32,598
Operating income before depreciation, and amortization as % of sales	42.5	38.6	32.8	31.5	34.1
Pretax return on permanent capital (%)**	5.9	5.0	5.4	12.9	22.4
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	(48.4) ***	19.7	17.4	20.2	23.4
FFO/total debt (%)**	61.0	58.4	47.9	51.6	78.2
Total debt/capitalization (%)	61.6	62.6	64.4	63.8	50.8

* Consolidated financial statements

** Annualized from the trailing 12 months

*** Including one-off extra items of adjustment of provisions related to dispute with CAT resulting in negative interest expenses

Total Access Communication PLC (DTAC)**Company Rating:**

AA+

Rating Outlook:Negative

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