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TM – when the grass is really greener

By HARI RAJ

THE twilight years of the Roman Empire saw a seemingly relentless push towards expanding its borders contrasted with the gradual decline of its base of power. Could Telekom Malaysia Bhd (TM) be facing a similar situation?

On an annualised basis, the telco's just-released first quarter numbers were around 30% below market expectations, dragged down by the uninspiring performance of the fixed line operations and subsidiary Celcom (M) Bhd.

Mitigating the downturn was a marked increase in earnings from overseas operations and foreign exchange, led by the contribution of TM's Indonesian unit PT Excelcomindo Pratama (XL).

For the first quarter of its 2006 financial year (FY06), TM recorded a net profit of RM519mil on the back of RM3.8bil in revenue, up 39% and 11% respectively over the previous corresponding period.

As for Celcom, despite a 29% quarter-on-quarter (qoq) increase in net profit to RM180.3mil and subscriber expansion of 5%, both fixed line and cellular services recorded a decline in revenue.

Datuk Abdul Wahid Omar

The fact that Celcom's revenue registered a 6% drop both qoq and year-on-year (yoy) gave analysts grounds for concern.

"The fact of the matter is that the drop in Celcom's revenue is disappointing, especially when compared with the likes of DiGi, which posted revenue growth of 4% qoq and 38% yoy," says a market observer.

In addition, Celcom's average revenue per unit (ARPU) continued its downtrend, with the prepaid sector registering a drop of 14% compared with a 4% decline in the postpaid sector.

Earlier this week, TM chief executive officer Datuk Abdul Wahid Omar explained that the decline in Celcom's revenue was mainly due to the significant churn that the company experienced among its postpaid customers, one that had a "financial sting" on first quarter results.

Wahid was referring to the large churn in the postpaid sector that was evident in the fourth quarter of last year. Reports estimate the churn's impact to be a net decline of some 76,000 subscribers in that quarter, though Wahid points out Celcom

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added 20,000 new customers in the year's first quarter as well as 35,000 new postpaid customers in April.

He also highlighted TM's Minutes plan, introduced in the second quarter of last year, as a reason for the churn. TM launched three new postpaid plans this week, including a simplified Minutes plan, in an effort to address the decline in its domestic market.

However, there has been market chatter that Celcom has relaunched its plans so many times that consumers may well be confused.

One local outfit believes that Celcom's erosion has reached a critical point, a level that needs to be addressed lest TM experience a significant loss in investor confidence. The house believes that Celcom has yet to launch any services or plans that are likely to reverse its ARPU decline.

A foreign research house has a more sanguine outlook, keeping its eye on Celcom to show improvements in quarters hence as new products and services are launched. The house expects Celcom's contribution to pick up after a weak first quarter as the full impact of its new initiatives are translated into earnings, in line with increased subscriber growth in April and reduced churn.

TM's fixed line revenue softened by 12% yoy to RM1.64bil, with the decline attributed to lower ARPU for the business and residential sectors by 18% and 24% yoy respectively.

Wahid's take was that the decline represented a global trend whereby calls are migrating from fixed lines to mobile networks, adding that TM planned to slow the decline by managing credit and offering attractive packages.

While analysts were mixed as to TM's first quarter results, some remain optimistic that earnings would pick up while others laid out the warning signs, all emphasised the importance of TM's international operations.

These operations were the star performers for TM, largely due to the performances of XL and Sri Lanka-based Dialog.

Reports place overseas contributions at 19.6% to group profits and 24.3% to group revenue, up from 15.2% and 9.9% during the previous financial year.

TM's first quarter net profit of RM519mil was boosted by RM213mil in foreign exchange gains, of which RM161mil or 75% was contributed by XL. Equity income from Singaporean subsidiary M1 Mobile was offset by foreign exchange losses from the stronger Singaporean dollar.

According to a foreign research house, foreign mobile revenues rose 177% yoy, making up 137% of revenue growth and more than helping to offset TM's poor home market. XL, which became TM's subsidiary in the fourth quarter of last year, reported a 34.5% increase in operating profit to some RM96mil for the first quarter ended March 31, 2006, compared with the same period last year. The company's net profit came in at

RM145mil compared with a net loss of RM1.3mil during the first quarter last year, while sales picked up 39% to RM398mil.

This improved performance was largely attributed to subscriber growth. During the same period, XL registered a 151% increase in the number of subscribers to a total of 8.2 million, meaning that it has exceeded the 6.8 million subscribers signed to Celcom as at the end of last year.

TM may have more up its sleeve when it comes to its overseas operations, following Wahid’s confirmation that it is considering selling shares in Spice Telecom Ltd, the company’s 49%-owned Indian mobile phone company. Reports in India speculate that TM is planning to float Spice by November, a date that Wahid did not confirm.

However, the spectre of competition may haunt TM here as well, as reports indicate that TM does not plan to expand Spice’s coverage nationwide in India. This approach contrasts with Maxis’ 74%-owned Aircel, which has applied to expand across India.

The danger here is that TM risks missing the boat, especially given the pace of developments in India’s telecommunications sector.

Having said that, reports from the Indian media link national investment arm Khazanah Nasional Bhd with India’s Idea Cellular, giving rise to speculation that Idea and Spice could be merged, thereby expanding Spice’s access.

Going forward, continued strength in TM’s foreign operations is widely expected to drive the group’s earnings, with rising overseas contributions expected to offset the erosion of TM’s domestic operations. Expansion into the Philippines-based mobile operator Sun Cellular has also been mooted, while TM may also acquire a stake in Saudi Telecom Co.

Wahid has gone on record to say that TM is still interested in strengthening the company’s presence in Asean and Asia. He expects TM’s overseas operations to contribute a third of its earnings for FY06.

Capital expenditure has picked up considerably, however, rising 44.6% yoy domestically and shooting up 287% internationally (due to XL’s consolidation - otherwise international capital expenditure reduced).

TM is spending RM6.2bil in capital expenditure this year, up 51% from FY05.

RM3.2bil will be spent domestically and RM3bil will be spent abroad, including RM1.5bil pumped into XL.

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