

Telecommunications

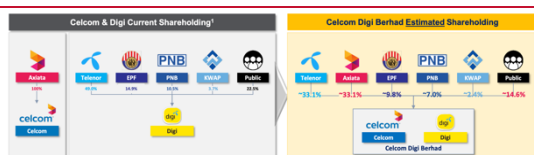
Neutral

Celcom and Digi Merger, Take Two



By **Lim Khai Xiang** | limkx@kenanga.com.my

Maintain NEUTRAL on the sector. We are positive but were not surprised with the proposed merger between Celcom and Digi which keeps national interests intact with >51% local ownership. We see potential synergies mainly coming from minimizing asset duplication, and not from forced layoffs and believe this deal is more likely to go through vs. a failed attempt in 2019. Overall, maintain NEUTRAL pending a deal completion and given that information at the moment is too sparse for us to pencil in a realistic scenario. We maintain our MP call on DIGI, OCK and MAXIS, and OP calls on AXIATA (TP: RM4.40) for its continued growth in its OpCos, merger or not, and on TM (TP: RM6.85) banking on its long-term growth prospects in the cloud/data segments.



What we know so far. Axiata and Telenor (parents) are in advanced discussions to merge Celcom and Digi into Celcom Digi Berhad (MergeCo). Axiata and Telenor would each own 33.1% of MergeCo with the rest to be owned by Digi's existing shareholders. National interests are intact as Axiata and Malaysian institutional shareholders will own more than 51% of MergeCo. On top of the 33.1% stake in MergeCo, Axiata will receive c.RM2b

in cash, with Digi raising RM1.7b in debt and Telenor to pay the remaining RM0.3b. MergeCo would become the largest Malaysian MNO with pro forma revenue of RM12.4b vs. Maxis of RM9b. The structure of MergeCo is yet to be determined, with the possibility of injection of Celcom assets into Digi, vice versa, or the use of an SPV to acquire both entities.

Why now? And implications for the telecom sector. According to Telenor, it is their natural next step to expand their Asian footprint. According to Axiata, consolidation among MNOs in Malaysia is necessary. In our view, we believe that the merger is motivated by (i) stiffening competition in the Malaysian mobile space and (ii) strategic knowledge-sharing and cost-savings to pave their way for a more sustainable future (i.e. arrest the years-long decline in profits). Should the merger go through, we believe that having one less competitor allows operators to better compete in more sustainable ways via evolving cost efficiencies and therefore, we are **positive** on the eventuality of a successful deal.

Anti-competitive? Impacts on other players? While MergeCo would have c.40% of the market share among the mobile players, we believe that by considering the additional competitive threats that OTT, such as WhatsApp, pose to MNO's traditional call and SMS revenue streams, MergeCo is not in a position with an excessive amount of market share. Thus, we do not believe that there will be any antitrust hurdles to the deal. For Maxis, MergeCo's leaner cost structure and thus "better" product pricing could spell potential downward pressure on product prices, potentially posing a threat to Maxis'. But we do not see this as an immediate threat yet as executing on a leaner cost structure, is likely to be realized over a longer term, mindful that right-sizing of workforce would need to be managed carefully.

Potential synergies. While both parents have claimed that there will be synergies in forming MergeCo, there has not been any due diligence as of yet (to prevent leakage of news). Axiata has pointed out that the potential synergies of RM15-20b guided in the failed Axiata and Telenor merger does not apply to this deal as those figures would have included: (i) their operations in other regions, and (ii) cost savings from spectrum and network, both of which will no longer be a drag in 5G rollout thanks to the government SPV. In our view, any cost savings would come from reducing the duplication of assets, by optimizing the usage of their existing infrastructure to support both of their networks. We estimate capex to fall from 15-16% of revenue to possibly 12-13% of revenue. Both parents have emphasized that they will protect existing employees and that there will be no forced layoffs, which we view as a necessary assurance to the authorities.

A future together? With no clear guidelines on spectrum ownership in the event of a merger, we believe that both entities would prefer to keep their own spectrums with the aim of jointly improving, rather than competing against both, their 4G networks. (Refer overleaf)

Déjà vu? Possibly not. In our view, compared to the 2019 attempt, there is greater incentive for both entities to merge this time, as we view the SPV ownership of the 5G spectrum to allow more space to compete in 5G offerings. We also see a higher (relative to 2019) likelihood of this deal going through as: (i) there are no cross-border complications, and (ii) they have agreed on a shareholder structure vs. 2019 when deal fell apart partially due to disagreement in equity stake. That said, we believe that a potential deal breaker could be the lack of synergies, as had initially expected.

Maintain NEUTRAL pending the deal completion and information at this moment is too sparse for us to pencil in a realistic scenario. We maintain our MP calls on DIGI, OCK and MAXIS and OP calls on AXIATA (TP: RM4.40) for its continued growth in its OpCos, merger or not, and on TM (TP: RM6.85) banking on its long-term growth prospects in the cloud/data segments.



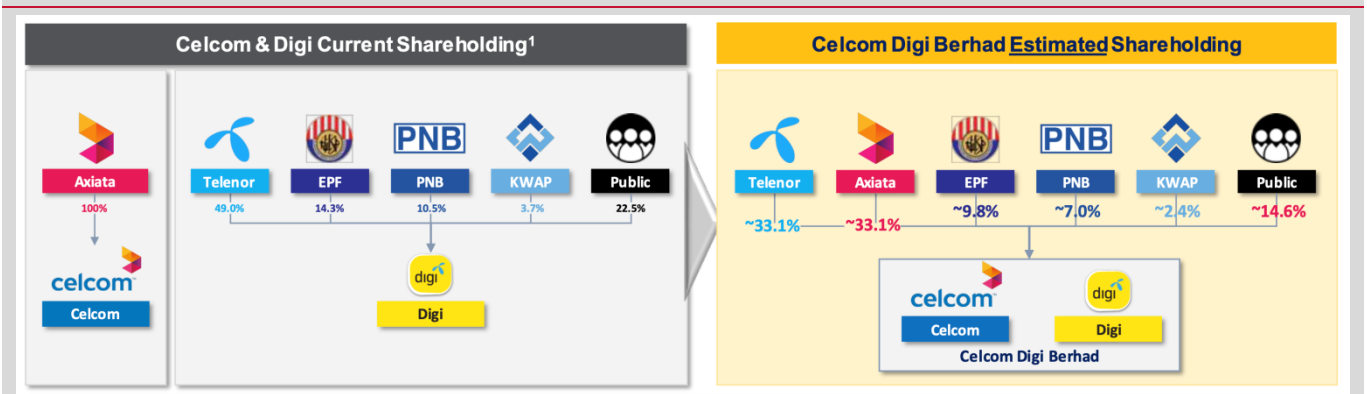
A future together? With no clear guidelines on spectrum ownership in the event of a merger, we believe that both entities would prefer to keep their own spectrums with the aim of jointly improving, rather than competing against, both their 4G networks. Considering that 4G coverage and quality has ample room for improvement, coupled with the JENDELA objectives to achieve nationwide connectivity, we opine that neither of the entities will have to return their spectrum. That said, an MCMC article that referred to the 2019 failed Axiata Telenor merger hinted that they had considered vacating and reassigning the 2300MHz and refarming the 2600MHz bands to allow YTLC and Webe to thrive as late entrants. With a significantly larger subs base, MergeCo looks to aggressively grow their home segment and convergence play. The MergeCo would keep both Celcom and Digi brands, which we view as a necessary step to retain its existing customer loyalty and subscriptions and a positive step in cross-selling.

AXIATA's use of RM2b cash. Axiata's management hinted that if the deal is successful, Axiata Group will continue to focus on its regional OpCos, some of which, such as Robi (Bangladesh) and Dialog (Sri Lanka), have promising growth prospects. They envisioned the Axiata stock to be one that offers growth with dividends. On the other hand, they hinted that MergeCo would mainly be a dividend stalwart with limited room for capital appreciation. Thus, for Axiata to continue growing its regional OpCo portfolio, it looks to invest the RM2b proceeds into its existing markets with promising growth, as opposed to "less productive" alternatives of paring down debt, which it does not view as a priority, given its large cash pile of c.RM5.8b excluding Celcom.

What about existing collaborations with Maxis? Any collaboration with Maxis has been put on hold at the moment, as per Axiata's management. However, they look to pick up where they've left off as soon as possible. Judging from an industry-wide strive towards a leaner operating model with less asset duplications, whether this deal succeeds or not, we opine that the entities will continue collaborating in rolling out infrastructures, such as fibre, where collaboration makes more sense than competition.

Appendix

Figure 1: Current and Estimated Shareholding



Source: Axiata, Telenor

1. Shareholdings as of 26 Feb 2021 – estimates from publicly available information

Figure 2: Proposed leadership of MergeCo

Malaysian Digital Telco Champion MergeCo will be known as Celcom Digi Berhad

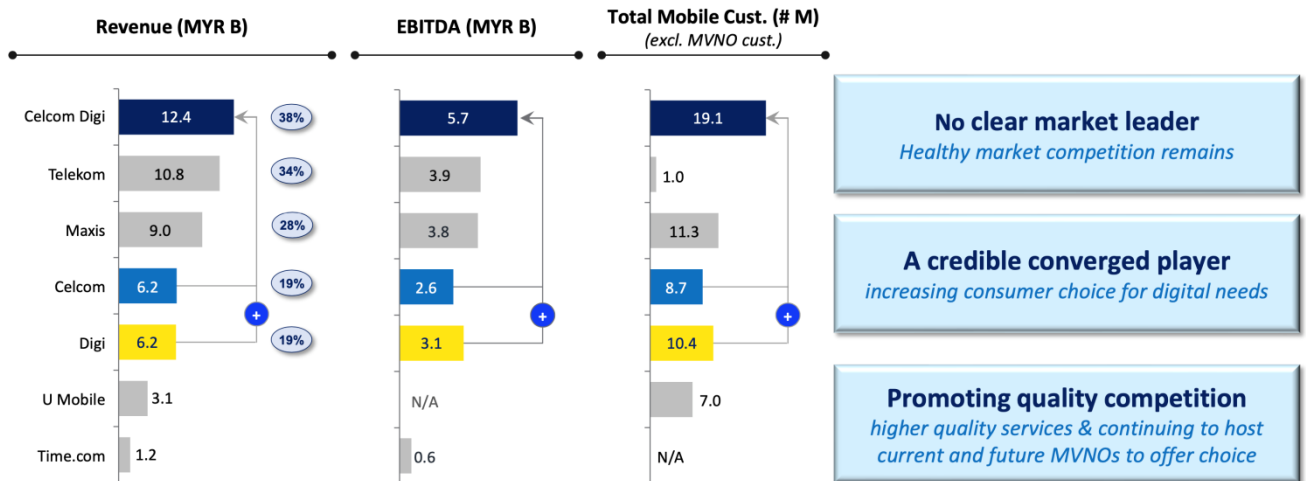


Chairman <i>Dato' Izzaddin Idris</i> <i>(President & Group CEO, Axiata Group)</i>	Deputy Chairman <i>Jørgen C. Arentz Rostrup</i> <i>(Exec. Vice President & Head, Telenor Asia)</i>
Chief Executive Officer <i>Idham Nawawi</i> <i>(CEO, Celcom Axiata)</i>	Deputy Chief Executive Officer <i>Albern Murty</i> <i>(CEO, Digi Telecommunications)</i>

Source: Axiata, Telenor

Figure 3: Financials and subscribers

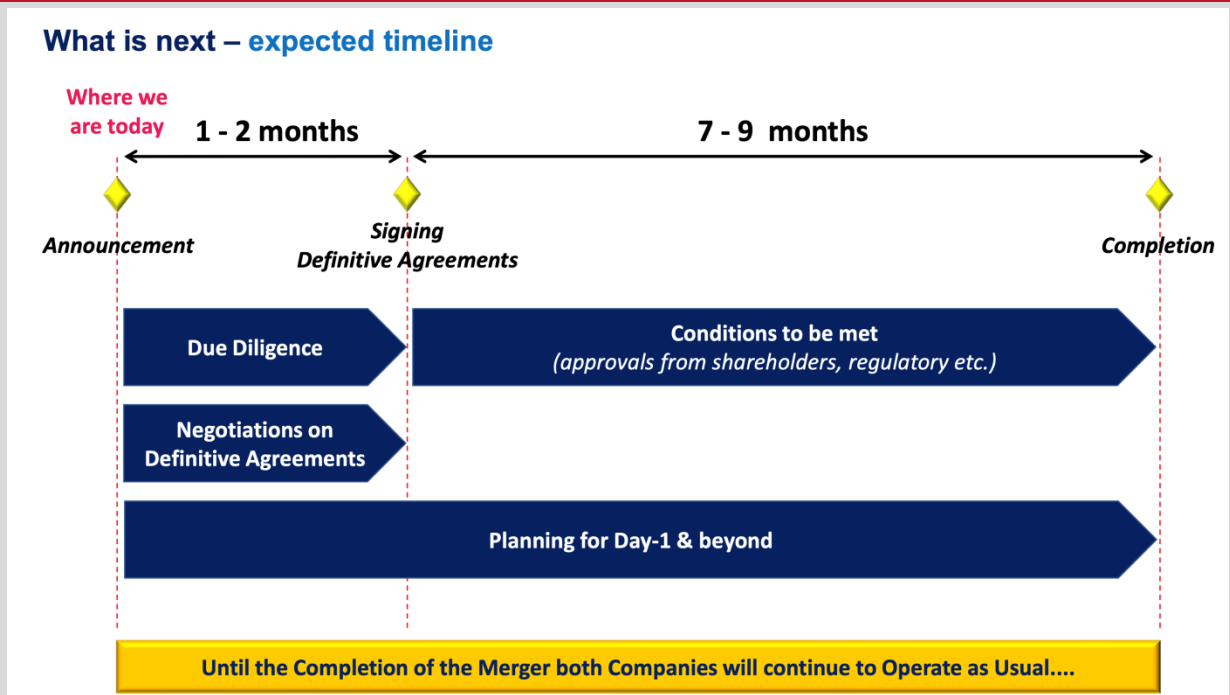
Celcom Digi Berhad will be the leading digital telco champion in Malaysia



1. 2020 Company financials. U Mobile data as of 2019 where available
 2. RMS based on combined base of Digi, Celcom, Maxis and Telekom Malaysia
 3. Total customers for Telekom Malaysia is for mobile only

Source: Axiata, Telenor

Figure 4: Expected timeline of merger talks



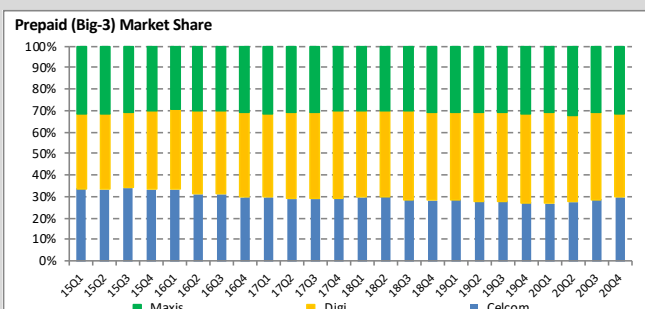
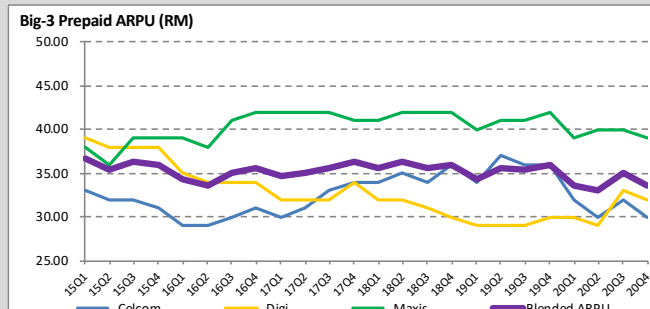
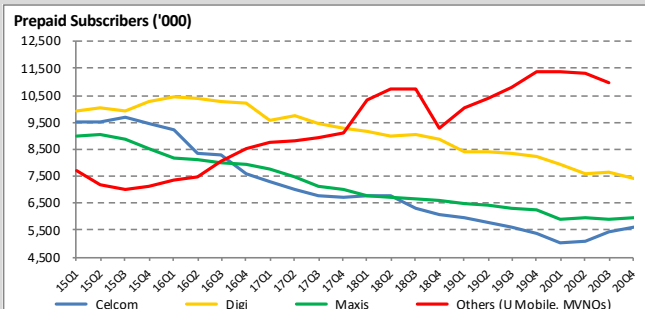
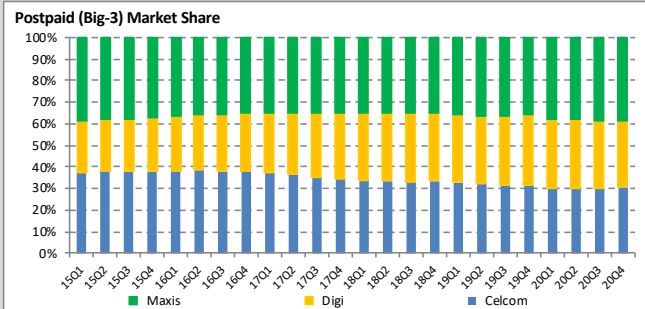
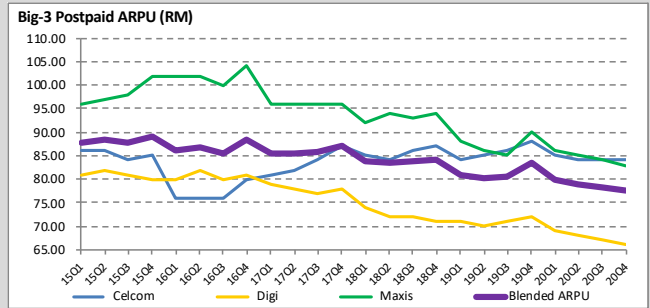
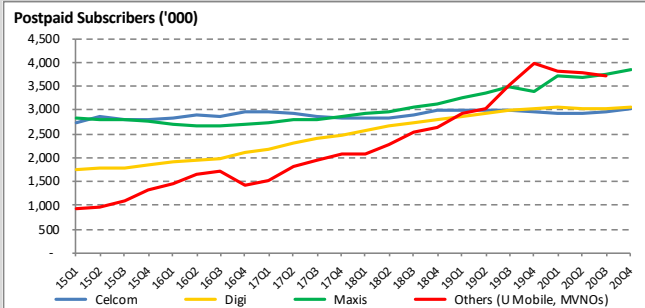
Source: Axiata, Telenor

Figure 5: Potential areas for collaboration



Source: Axiata, Telenor

FY20 Mobile Market Share and Penetration Rate



* 4Q20 total market statistics are yet to be provided by MCMC to compute the performance of Other players
 Source: MCMC, Companies, Kenanga Research

09 April 2021

Peer Table Comparison

Name	Last Price(RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net DivYld (%)	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.			
Stocks Under Coverage																	
AXIATA GROUP BHD	3.80	34,856.0	Y	12/2021	3.3%	5.3%	8.4%	9.7%	40.3	37.1	33.9	1.6	1.6	4.2%	2.1%	4.40	OP
DIGI.COM BHD	3.75	29,156.3	Y	12/2021	-1.6%	1.0%	-25.8%	3.7%	22.7	30.6	29.5	48.1	47.4	155.9%	3.2%	3.55	MP
MAXIS BHD	4.71	36,846.5	Y	12/2021	4.6%	6.0%	8.2%	4.7%	26.7	24.6	23.5	5.2	5.1	21.0%	3.8%	4.90	MP
OCC GROUP BHD	0.515	543.0	Y	12/2021	12.4%	9.4%	20.3%	12.3%	21.2	17.6	15.7	0.9	0.8	4.9%	0.0%	0.540	MP
TELEKOM MALAYSIA BHD	6.06	22,868.6	Y	12/2021	2.8%	6.7%	12.8%	2.0%	23.1	20.5	20.1	3.3	2.8	14.7%	2.7%	6.85	OP
Simple Average					4.3%	5.7%	4.8%	6.5%	26.8	26.1	24.5	11.8	11.5	40.1%	2.4%		

Source: Kenanga Research

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Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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KENANGA INVESTMENT BANK BERHAD (15678-H)

Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my

