

12 December 2024

Axiata Group

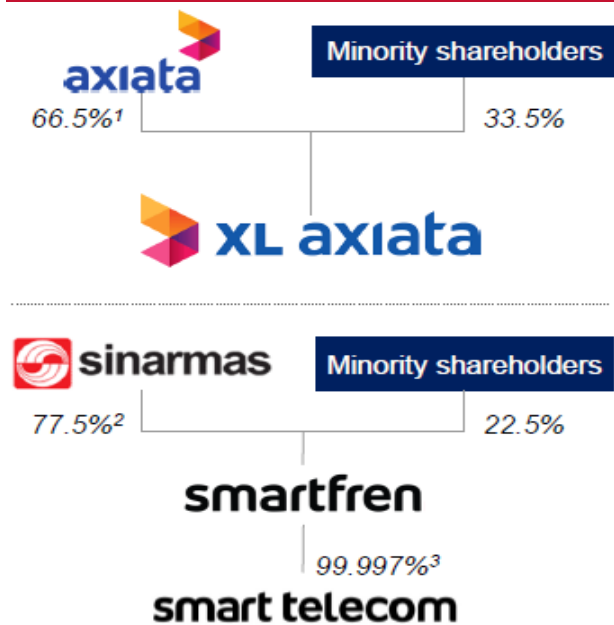
Holding Hands with Smartfren

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Following an earlier MoU, XL Axiata (XL) will merge with Smartfren to form XLSmart via a share-based transaction. To establish joint control with Sinar Mas group, AXIATA will sell its 13% stake in XLSmart for USD475m cash. Overall, we are neutral as the potential benefits (e.g. Smartfren’s reasonable acquisition price, better economies of scale & enlarged spectrum holdings, AXIATA deleveraging) are somewhat offset by potential short-term earnings drag for XLSmart as it absorbs Smartfren’s losses until merger synergies materialize. We maintain our forecasts, TP of RM2.60 and OUTPERFORM call.

Merged entity will be called XLSmart. AXIATA’s 66.5%-owned subsidiary, XL Axiata (XL), will merge with Smartfren to form PT XLSmart Telekom Sejahtera Tbk (XLSmart). XL will remain the surviving entity, renamed XLSmart, and continue to be listed on the Indonesia Stock Exchange (IDX). This development follows a non-binding memorandum of understanding (MoU) signed in May between XL and Sinar Mas group to explore this merger opportunity. We believe this merger was likely encouraged by regulatory authorities to consolidate the Indonesian telecommunications industry. This is underpinned by benefits such as long-term business sustainability, efficient deployment of spectrum, enhanced quality of service etc.

Exhibit 1: Current Shareholding Structure



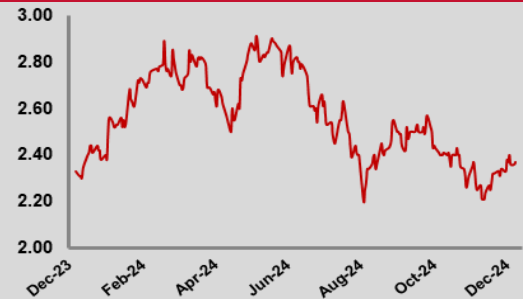
Source: Various, Company, Kenanga Research

Share-based acquisition of Smartfren. Under the merger terms, Smartfren’s assets, liabilities, and operations will be transferred to XL for a total purchase consideration of IDR11.92t (c, RM3.33b). In return, XL will issue 5.07b new shares at IDR2,350 per share to Smartfren’s shareholders, proportional to their existing holdings. The merger ratio reflects a 72:28 equity split between XL Axiata and Smartfren shareholders.

OUTPERFORM ↔

Price : RM2.37
Target Price : RM2.60 ↔

Share Price Performance



KLCI	1,603.20
YTD KLCI chg	10.2%
YTD stock price chg	-0.4%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	AXIATA MK EQUITY
Market Cap (RM m)	21,763.2
Shares Outstanding	9,182.8
52-week range (H)	2.94
52-week range (L)	2.18
3-mth avg. daily vol.	4,311,858
Free Float	43%
Beta	1.3

Major Shareholders

Khazanah Nasional Bhd	36.7%
Employees Provident Fund	18.1%
Skim Amanah Saham Bumiputera	15.3%

Summary Earnings Table

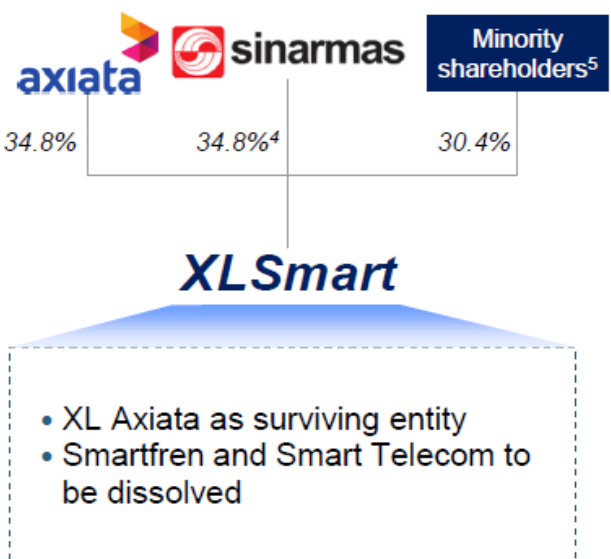
FYE Dec (RMm)	2023A	2024F	2025F
Revenue	22,002	23,190	23,035
EBITDA	9,797	12,490	10,520
EBIT	2,597	4,901	3,555
PBT	793	3,593	2,280
PATAMI	-125	1,258	798
Core PATAMI	542	767	798
Consensus (NP)	-	706.9	926.7
Earnings Revision	-	-	-
Core EPS (sen)	5.6	8.4	8.7
Core EPS Growth (%)	-53.3	48.4	4.1
DPS (sen)	10.0	10.0	10.5
BVPS (RM)	2.4	2.4	2.4
PER (x)	42.1	28.4	27.3
PBV (x)	1.0	1.0	1.0
Net Gearing (x)	0.9	0.8	0.8
Div. Yield (%)	4.2	4.2	4.4

Joint control of XLSmart with Sinar Mas. Post-merger, Sinar Mas group, which is the largest shareholder in Smartfren, will hold a 21.7% stake in XLSmart, while AXIATA's stake will be 47.9%. To establish joint control, AXIATA and Sinar Mas will equalize their shareholdings at 34.8% each, giving them equal influence over XLSmart's strategic direction and decisions. Meanwhile, minority shareholders will own the remaining 30.4%.

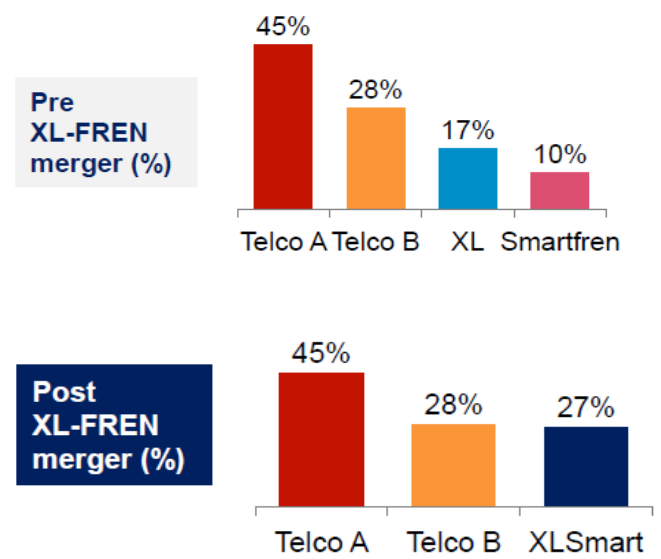
Selling back a smaller stake to achieve parity. To achieve this equal stake, AXIATA will sell a 13.14% stake in XLSmart to Sinar Mas group for USD475m (c. RM2.1b). Sinar Mas will pay AXIATA through split payments: (i) USD400m upon deal completion, and (ii) a deferred payment of USD75m one year after the merger's completion.

Catching up on Indosat in terms of subs base. XLSmart will serve a combined mobile subscriber base of c. 94.51m, representing around 27% of local market share. This will rank it as the third-largest mobile operator in Indonesia, behind Indosat and Telkomsel. This transaction is expected to be completed by 2QCY25 after securing approvals from regulators (i.e. Indonesia's Financial Services Authority and Ministry of Communication and Digital Affairs) and shareholders.

Exhibit 2: Post-merger Shareholding Structure **Exhibit 3: Pre and Post-merger Customer Market Share***



Source: Company

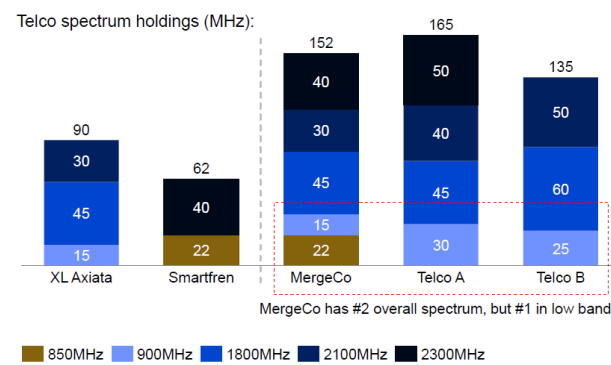


*as at 3QCY24
Source: Company

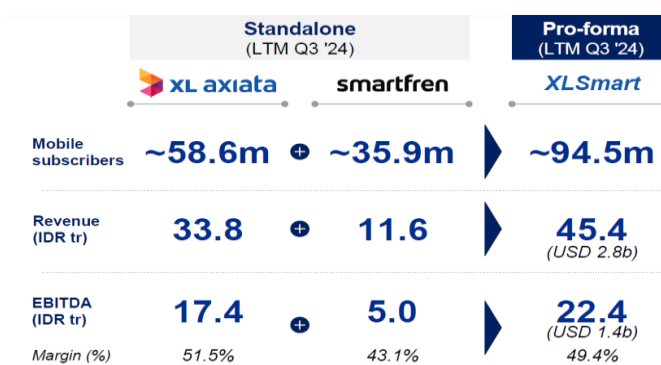
Major expansion of spectrum holdings. Post-merger, XL's spectrum holdings will significantly expand with the addition of Smartfren's 62MHz of spectrum, increasing XLSmart's total spectrum to 152MHz. This will position XLSmart as the operator with the second-largest spectrum holdings in Indonesia. In our view, this factor is the primary driver of the merger, as it addresses the significant disparity in XL's spectrum holdings, which are currently 45%–33% smaller compared to its competitors.

Smartfren may drag on margins. The merger is estimated to drive a 29% increase in proforma EBITDA for XLSmart in 3QFY24 compared to XL's standalone EBITDA in the same period. However, it would compress EBITDA margins by 2.1 pts relative to XL's standalone performance in 9MFY24.

Exhibit 4: Spectrum Holdings **Exhibit 5: Illustrative Impact on 3QFY24 Proforma Figures**



Source: Company



Source: Company

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Expecting ARPU boost and significant merger synergies. AXIATA is optimistic that this merger will drive ARPU growth in Indonesia, drawing on historical trends from previous local consolidations such as XL-Axis (2014–16: +4.3% YoY) and Indosat-Hutchinson 3 (2021–23: +6.9% YoY). Additionally, upon full integration, XLSmart is expected to realize annual pre-tax synergies of USD300m–400m. This will emanate from the combination of economies of scale, cost savings and efficiency gains in opex, capex and leases. Key initiatives to drive these synergies include: (i) decommission 20%–30% of sites that overlap within XLSmart's network footprint of 67K sites, (ii) selective network expansion in targeted cities with a focus on profitability, (iii) leverage volume and price book matching to attain best prices from vendors, and (iv) optimize customer acquisition spend by going direct to retailers and optimizing incentive structure.

Piggyback on Sinar Mas' established ecosystem. AXIATA plans to capitalize on Sinar Mas group's extensive local market expertise, given its position as one of Indonesia's largest conglomerates with a diverse business portfolio (e.g. pulp & paper, agri-business & food, financial services, real estate, communications & technology, energy & infrastructure, and healthcare). In particular, AXIATA is optimistic about leveraging Sinar Mas' data centres to position XLSmart as the preferred Indonesian enterprise service provider by offering end-to-end enterprise solutions.

Fairly reasonable transactions. The combination consideration (payment by XL to Smartfren shareholders) and equalization consideration (payment by Sinarmas to AXIATA) reflect trailing EV/EBITDA multiple of 5.9x and 5.3x respectively. These represent discounts of 8% and 17% relative to the regional average of 6.4x for comparable telco players in Malaysia, Indonesia, and the Philippines.

We view XL's acquisition of a 47.9% stake in Smartfren as reasonably priced, given the discount to regional peers, despite being higher than XL's 3-year historical average EV/EBITDA of 4.6x. Furthermore, the premium over XL's valuation may be justified by the potential unlocking of synergies in the merged entity.

We note that the 13.14% stake sale by AXIATA is at a c. 11% discount to the 5.9x EV/EBITDA acquisition multiple, which appears steep. However, this is partially reflective of the cash nature of the settlement, with the proceeds primarily allocated to pare down AXIATA's debt, resulting in interest cost savings. Moreover, Axiata stands to benefit strategically from leveraging Sinar Mas' extensive local market knowledge.

Expect chunky asset disposal gain. Assuming the merger was effective in 31 Dec 2023, AXIATA is expected to recognize net gain of RM444.6m, after accounting for estimated merger expenses of RM78m. Meanwhile, after accounting for XL's deconsolidation and receipt of the equalization proceeds, AXIATA's 9MFY24 PATAMI is estimated to increase from RM1.17b to RM1.2b, while its net debt/EBITDA will improve from 2.59x to 2.48x.

Smartfren's losses are a concern. Despite achieving positive EBITDA in 3QFY24, Smartfren reported 9MFY24 LATAMI of IDR1t (~RM294m loss), overshadowing XL's normalized PATAMI of RM197.5m during the same period. On a brighter note, looking ahead, XLSmart could achieve profitability post-merger, driven by efficiency gains and operating expense (opex) savings

Balanced pros and cons. Overall, we maintain a neutral stance on this deal. While we acknowledge the potential benefits (e.g. Smartfren's reasonable acquisition price, better economies of scale & enlarged spectrum holdings, AXIATA deleveraging), these positives are somewhat offset by potential short-term earnings drag for XLSmart as it absorbs Smartfren's losses until merger synergies materialize.

Forecasts. Maintained pending more granularity as well as regulatory and shareholder approvals.

Valuations. We also maintain our sum-of-parts TP of RM2.60 (refer below). There is no adjustment to our TP based on ESG given a 3-star rating as appraised by us (see Page 7).

Investment case. We continue to like AXIATA for: (i) its plans to deleverage and strengthen its balance sheet, (ii) growth prospects for digital telcos and tower assets at emerging markets, and (iii) strong asset monetization prospects for Edotco and its digital businesses. Maintain **OUTPERFORM**.

Risks to our call include: (i) widened losses for Dialog following its acquisition of Bharti Airtel that was completed in 26 June, (ii) gestational earnings and cash flow drag from Link Net's aggressive fibre home pass expansion, and (iii) capex up-cycle from looming implementation of 5G in Indonesia.

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AXIATA's Sum-of-Parts Valuation					
Unit	Valuation Methodology	Enterprise Value (RM m)	Effective Stake	Hold Co. Discount	Effective Value (RM m)
Celcom (Malaysia)	CDB TP	44,814	33.0%	10%	13,310
XL (Indonesia)	5.0x EV/EBITDA	21,709	66.5%	10%	12,993
Robi (Bangladesh)	5.0x EV/EBITDA	10,703	61.9%	10%	5,964
Dialog (Sri Lanka)	3.0x EV/EBITDA	3,489	74.0%	10%	2,324
Smart (Cambodia)	3.0x EV/EBITDA	3,171	72.5%		2,299
Link Net (Indonesia)	5.0x EV/EBITDA	1,690.2	79.5%		1,344
EDOTCO	8.0x EV/EBITDA	14,363.2	63.0%		9,049
Digital Services	EV/Sales	955.92	100.0%		956
Total Effective Enterprise Value					48,238
(-) Hold Co Net Debt and MI					-24,188
Total Equity Value					24,050
No. of Shares (m)					9,179
Target Price (RM)					2.60

Source: Kenanga Research

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Peer Comparison – Telecommunication

Name	Rating	Last Price (RM)	Target Price (RM)	Upside	Market Cap (RMm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE	Net Div. (sen)	Net Div Yld
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Telecommunication																	
AXIATA GROUP BHD	OP	2.37	2.60	9.7%	21,763.2	Y	12/2024	8.4	8.7	41.4%	4.1%	28.4	27.3	1.2	5.7%	10.0	4.2%
CELCOMDIGI BHD	OP	3.64	3.82	4.9%	42,702.7	Y	12/2024	15.3	16.3	-5.3%	6.2%	23.7	22.3	2.6	10.3%	15.0	4.1%
MAXIS BHD	MP	3.53	3.80	7.6%	27,650.9	Y	12/2024	18.3	18.3	16.7%	0.1%	19.3	19.3	4.7	24.6%	20.0	5.7%
OCC GROUP BHD	MP	0.485	0.428	-11.8%	518.3	Y	12/2024	2.8	2.9	-29.4%	2.2%	17.2	16.9	0.8	4.5%	1.0	2.1%
TELEKOM MALAYSIA BHD	OP	6.52	7.53	15.5%	25,021.8	Y	12/2024	45.1	45.8	-14.1%	1.5%	14.4	14.2	2.5	17.8%	23.0	3.5%
SECTOR AGGREGATE					117,657.0					0.6%	3.0%	20.5	19.9	2.3	12.6%		3.9%

Source: Bloomberg, Kenanga Research

Stock ESG Ratings:

	Criterion	Rating				
GENERAL	Earnings Sustainability & Quality	★	★	★	★	
	Community Investment	★	★	★		
	Workers Safety & Wellbeing	★	★	★		
	Corporate Governance	★	★	★		
	Anti-Corruption Policy	★	★	★		
	Emissions Management	★	★			
SPECIFIC	Cybersecurity & Data Privacy	★	★	★		
	Network Quality & Coverage	★	★	★		
	Digitalisation & Innovation	★	★	★		
	Supply Chain Management	★	★	★		
	Talent Management	★	★	★		
	Customer Satisfaction	★	★	★		
	OVERALL	★	★	★		

☆ denotes half-star
 ★ -10% discount to TP
 ★★ -5% discount to TP
 ★★★ TP unchanged
 ★★★★ +5% premium to TP
 ★★★★★ +10% premium to TP

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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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