10 September 2019 | Sector Update

Telecommunication

***Maintain* NEUTRAL**

No change in market dynamics

KEY HIGHLIGHTS

- **Axiata and Telenor decided to end talk on the mega merger after four months of discussion**
- **We suspect fallout in the deal was mainly due to difficulty to meet national and staff interest**
- **Post termination of talk, Axiata remain steadfast in its aspiration to become a 'Digital Champion'**
- **We view that consumer would have been at the losing end should the merger materialised**
- **Maintain NEUTRAL stance on the sector, given the competitive landscape expected to persist**

End of discussion. Axiata Group Bhd (NEUTRAL, TP:RM4.68) and Telenor ASA, **Digi.com Bhd's (NEUTRAL, TP:RM4.93)** parent company, have mutually agreed to end discussions regarding a non-cash combination of their telecommunication and infrastructure assets in Asia. This came in four months after both parties began to negotiate to merge their operations by combining Axiata and Teleno's Asian operations within both their ASEAN and South Asia footprint market. To recall, the proposed transaction is expected to be completed in early November 2019.

Possible reasoning behind the fallout. There are three main factors that affect the outcome of the deal which was outlined by Tan Sri Jamaludin Ibrahim, President and Group CEO of Axiata Group Bhd. This includes commercial aspect, national interest and staff interest. He updated that the commercial part of the deal is already 90% agreed upon. As such, we suspect that the fallout was mainly premised on the concern of national interest and staff interest, especially the latter. We view that there would be a need to rightsize the merged entity of Celcom and Digi post the merger due to possible job duplication. Note that Telenor's way of managing human resources can be seen from Digi's lean staff headcount.

Reverting to the original ambition. Initially the merger will allow Axiata to tap in to the expertise of Telenor, given the latter prove track record of delivering cost and efficiency. The envisaged merged entity will also have better bargaining power in terms of purchasing telecommunication equipments and possess a stronger balance sheet with more debt headroom for future expansion plan. Despite the merger fallout, Axiata remain steadfast in its aspiration to become a 'Digital Champion' by 2022 (*refer to Table 1*), with emphasis towards profitability and cash focus.

Table 1: Key focus to become 'Digital Champion'

No.	Initiatives
1.	Focus on profit growth relatively more than revenue market share growth
2.	Spotlight on opex and capex efficiency – RM five billion over five years
3.	Reprioritise / re-scope some investments with long payback (unless point 4)
4.	Fund investments in new growth areas mostly through strategic partnerships / financial investors
5.	Monetise existing investments for cash and validation; and 'sweat' existing assets
6.	Accelerate structural changes through industry consolidation, network sharing and productivity
7.	Aggressive Network & IT modernisation to drive data leadership and improve its economics
8.	Reflect the above in 2019 KPIs for Axiata and all OpCos

Source: Company, MIDFR

Healthy market competition remains. The amalgamation of Celcom and Digi would create the largest telco in terms of revenue market share. Given the size advantage, we view that it would create more pressure on its peers to retain their respective market competitiveness. Meanwhile, for the consumer, it would simply means less one service provider to choose from. In addition, the existing customer of Celcom and Digi could possibly have their service contracts revised. Thus, with the fallout of the deal, we view that there will be no major change in market dynamics.

Maintain NEUTRAL. The termination of the deal would mean that the existing market dynamics will remain. Competition expected to be prevalent given that mobile-cellular penetration is high at 131.4%. Mobile service providers would need to continue to provide attraction service value proposition to retain their respective market share. This would means dilution in profit margin. Thus, having effective cost management strategy in place is essential to defend the profit margin. Notably, **Telekom Malaysia Bhd (Neutral, TP:RM3.54)** has shown drastic reduction in operating cost in recent quarters. With the upcoming NFCP, we view that mobile service providers would need to be more aggressive in its cost optimisation initiatives to maintain a healthy cashflow. As we do not foresee any positive significant catalyst in the telecommunication industry, we are maintaining our **NEUTRAL** recommendation on the sector. Moreover, with the fallout of the deal, we do not expect much excitement for the sector in the near term.

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STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.