

SECTOR UPDATE

Telecommunications – Malaysia

Celcom-Digi Merger Receives MCMC Clearance, Positive For Digi

The regulator has given its clearance for the proposed merger of Celcom and Digi. This is positive for Digi and Axiata. We estimate RM500m in net cost savings (after factoring in the 5G wholesale fee) for the MergeCo, lifting 2023's proforma net profit by 15%. Upgrade Digi to BUY with a lowered RM3.85 fair value. Axiata benefits as its cash flow crunch will ease (RM2b post-merger cash flow in 4Q22). Maintain MARKET WEIGHT.

WHAT'S NEW

- **The green light is given...** Both board of directors of Axiata and Digi.Com (Digi) have announced in Bursa Malaysia that they have received a Notice of No Objection from the regulator, Malaysian Communications and Multimedia Commission (MCMC) to proceed with the proposed merger of Celcom's and Digi's telco operations (MergeCo). To recap, the merger application for Celcom and Digi was submitted to MCMC in Jul 21.
- **...to complete the Celcom-Digi merger by 2H22.** The above clearance from MCMC paves the way for both parties to advance to the next phase of the proposed transaction, including: a) approval by minority shareholders of Digi and Celcom in separate EGMs, b) approval from the Securities Commission (SC) for the proposed merger, and c) approval from Bursa for the listing and quotation of the consideration shares on Bursa Securities. We expect the merger exercise to be completed in 2H22. Upon completion, Axiata and Telenor will hold equal ownership of 33.1% each in the new merged company, which will be named Celcom Digi Berhad and will continue to be listed on Bursa Malaysia. The remaining 33.8% will be held by institutional investors.

ACTION

- **MergeCo to see earnings uplift of 15% in 2023, after paying for 5G wholesale fee.** The regulatory clearance is viewed positive for both telcos. We believe Digi's share price (-25% ytd) has partly reflected uncertainties over the proposed merger exercise. A successful merger exercise can lift the MergeCo's net profit by 15%. We assume the MergeCo to see net cost savings of RM500m in 2023, after factoring in RM864m in 5G wholesale fees (we assume Digi and Celcom will sign a 5G Wholesale Agreement by 15 Jul 22).
- **Upgrade Digi to BUY with a lowered fair value of RM3.85.** This regulatory approval is a key re-rating catalyst for Digi, the listed vehicle of the MergeCo. We upgrade Digi to BUY with a lowered-DCF based target price of RM3.85 (discount rate of 5% vs 4% previously given the rising interest rate environment). At our fair value, the stock trades at -1SD below its mean EV/EBITDA of 12.5x. The stock offers 5% dividend yield for 2023.
- **Easing Axiata's cash flow crunch.** A successful merger exercise will result in RM2b cash flow to Axiata. This will ease the concern of rising debt level (1Q22 gross debt-to-EBITDA of 2.5x) as Axiata undertakes two major acquisitions: a) RM2.5b acquisition of fibre company Link Net (recently completed) in Indonesia; and b) edotco's proposed RM3.42b acquisition of 2,973 towers in Philippines from PLDT Group. More importantly, the MergeCo will be the cash cow for both Telenor and Axiata – which will each hold a 33.1% stake in MergeCo. This will pave the way for Axiata to achieve its 20 sen DPS mandate by 2024 (7% dividend yield, based on current share price). We continue to remain cautious on Axiata as we expect weak 2Q22 earnings due to the economic deterioration in Sri Lanka.

PEER COMPARISON

Company	Tickers	Rec	Share Price 28 Jun 22 (RM)	Target Price (RM)	Market Cap (RMm)	PE (x) FY22F (x) FY23F (x)	EV/EBITDA (x) FY22F (x) FY23F (x)	Dividend Yield (%) FY22F (x) FY23F (x)
Axiata	AXIATA MK	HOLD	2.81	3.50	25,786.8	21.0 17.2	3.6 3.5	3.6 4.6
DiGi.Com	DIGI MK	BUY	3.25	3.85	25,268.8	23.4 19.1	9.6 9.6	4.3 5.2
Maxis	MAXIS MK	HOLD	3.29	3.65	25,748.4	20.6 16.9	8.8 8.5	4.9 5.0
OCK Group	OCK MK	HOLD	0.380	0.450	400.7	15.5 15.0	4.8 4.7	1.3 1.3
TIMEdotCom	TDC MK	BUY	4.35	5.20	7,941.4	19.5 16.8	9.9 9.0	2.6 3.6

Source: Bloomberg, UOB Kay Hian

MARKET WEIGHT

(Maintained)

SECTOR TOP PICKS

Top pick	Rec	Target Price (RM)	EV / EBITDA (x)	Div Yield (%)
TIME	BUY	5.20	9.0	3.6
Digi	BUY	3.85	9.6	5.2

Source: Bloomberg, UOB Kay Hian

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• **RM8b synergies over five years, including terminal value of assets.** The initial estimated cost savings (capex and opex) is estimated to be RM8b over a five-year period, including an undisclosed terminal value of assets. We gathered that 65% of the total savings will be derived from duplicated network sites (rental/ electricity/spectrum fee etc). The remaining 35% savings will come from IT/digital, centralised procurement, point of sales and dealership expenses. This will help to boost earnings for the MergeCo from 2H23 onwards. The pre-synergy equity value of RM50b (market capitalisation) would allow the MergeCo to emerge as one of the top five largest companies. The MergeCo is estimated to have a 45-50% share of the subscriber market.

• **Maintain MARKET WEIGHT; prefer fixed over wireless.** Ytd, the sector has underperformed the FBMKLCI by 7%. This reflects potential headwinds from a single wholesale network model for 5G in Malaysia and the big telco players - Digi, Celcom and Maxis - losing their superior network coverage, and intensifying competition for mobile incumbent mobile players in Malaysia. While warranted, we believe this risk is largely priced in as Digi, Maxis and Axiata all trade at -2SD of 5-year mean EV/EBITDA. That said, we maintain MARKET WEIGHT on the sector given pedestrian near-term earnings and a lack of key re-rating catalysts for the sector. Our top pick is TIME for its good growth prospects and earnings upside from the rollout of Phase 2 Data Centre.

ESSENTIALS

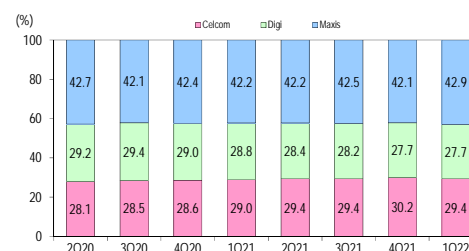
• **Some preliminary issues addressed by the MergeCo.** To address the preliminary issues identified by the MCMC, the parties have offered a set of undertakings to ensure that consumers in Malaysia will continue to benefit from effective competition in the telecommunications sector. The undertakings include:

- Divestment of 70MHz of MergeCo's spectrum across the 1,800 MHz, 2,100MHz, and 2,600MHz spectrums, with the first band to be returned to the MCMC within 24 months after completion of the merger, and the second and third bands to be returned within 36 months after completion of the merger.
- Establishing a separate independent business unit for MVNO wholesale business under the MergeCo within six months after the merger is completed, and ensuring continuity of access to wholesale services for MVNOs at terms no worse off than existing agreements.
- Divestment of Celcom's "Yoodo" brand within the stipulated time after completion of the merger as committed to MCMC, which currently offers fully digital and customisable retail mobile plans to subscribers.
- Enabling non-exclusive distributors in the Sabah, Sarawak, Kelantan, Pahang and Terengganu regions by the end of Year 3 after completion of the merger.
- Positioning the existing Celcom and Digi brands as products under a single MergeCo corporate brand by the end of Year 2 after completion of the merger.

• **2H22 outlook.** Axiata fared well in 1Q22 but we expect a weaker 2Q22 amid the ongoing geopolitical tensions in Sri Lanka and the strengthening US dollar. Positively, we expect the Celcom-Digi merger to be successfully completed by 2H22. Digi guides for a return in service revenue growth (after six consecutive yoy declines) in 2022. Key drivers are postpaid, B2B and fibre. Separately, we expect TIME to report a stronger 2H with higher revenue recognition from Phase 1 Data Centre (P1DC) in Cyberjaya.

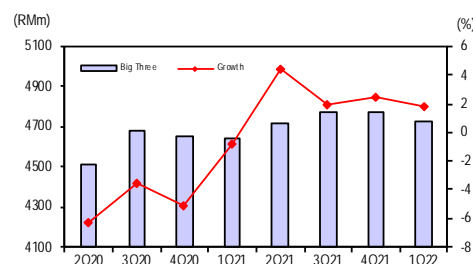
• **Single wholesale network for 5G – decision by end-Jun 22.** We expect Malaysia to undertake a 5G Single Wholesale Network (SWN) model and telcos are expected to sign 5G Wholesale Agreements by 15 Jul 22. A meaningful rollout is expected between 2023-24 as Digital Nasional (DNB) aims to achieve 40% and 80% population coverage by 2022 and 2024 respectively.

MOBILE SUBSCRIBERS' MARKET SHARE



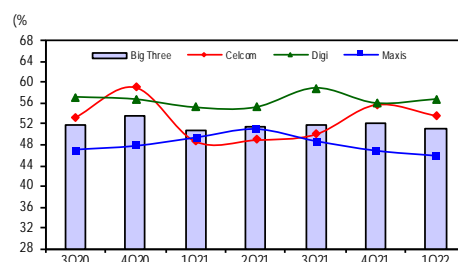
Source: Respective companies

BIG THREE'S QUARTERLY SERVICE REVENUE



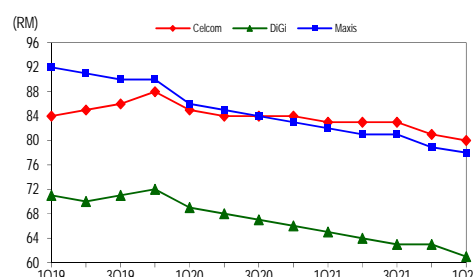
Source: Respective companies

QUARTERLY EBITDA MARGIN



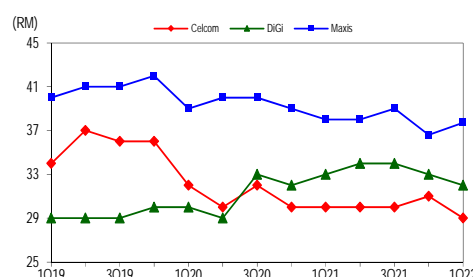
Source: Respective companies

POSTPAID ARPU



Source: Respective companies

PREPAID ARPU



Source: Respective companies

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