

Axiata Group Berhad

(6888 | Axiata MK) Telecommunications & media | Telecommunications service providers

Potential Near-Term Earnings Pressure for XL Axiata

KEY INVESTMENT HIGHLIGHTS

- We are downgrading our recommendation on Axiata to **TRADING SELL** with an unchanged target price of **RM2.42**
- We understand that Axiata is seeking to bridge the market share gap with the second largest player, **Indosat Ooredoo Hutchison**
- Our main concern will revolve around **XL Axiata's profitability** given that **Smartfren is loss-making**
- The merger may also potentially put more pressure on the **XL Axiata** given that **Link-net acquisition has just been concluded in 2022**

XL Axiata profitability will be a concern. We are downgrading our recommendation for Axiata to **TRADING SELL** from neutral previously with an unchanged target price of **RM2.42**. This is following the news on a potential merger between XL Axiata and Smartfren. While the transaction may strengthen XL Axiata's subscriber market share, our immediate concern will be on Smartfren's loss-making position. Also, should the funding involve cash, it would further burden the group's balance sheet.

One step closer to merger. According to newswire, Axiata Group and PT Sinar Mas have sought permission from the Indonesian Government to merge their telco units. Previously, Bloomberg had reported the planned merger will create **USD3.5b** or **RM16.6b** entity.

We are not entirely surprised by the development. We gather that Axiata and PT Sinar Mas has been in discussion on the merger since 2021.

Solidifying its No.3 position in Indonesia. At present, XL Axiata is the third largest telcos in Indonesia with 58m subscribers. Meanwhile, Smartfren's subscribers stand at about 36m subscribers. Should the merger take place, XL Axiata subscriber base will increase to 94m. Nonetheless, this would be insufficient to dethrone the top two telcos in the country namely Telkomsel (subs: 153m) and Indosat (subs: 100m).

Profitability for XL Axiata will be a concern. While XL Axiata has been profit making, we gather that Smartfren has been loss making. Referring to Smartfren's 2023 annual report, the group suffered a net loss of **-IDR108.9b** (**-RM32.2m**). This would potentially affect XL Axiata's profitability, especially in the near term.

On another note, Axiata concluded its acquisition of Link Net in 2022. Thus, we view that the anticipated merger with Smartfren would create more pressure for the management to improve the profitability of XL Axiata.

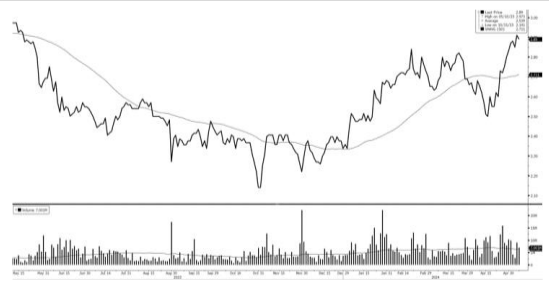
We are keeping our earnings estimates unchanged at this juncture pending the announcement on the transaction.

Downgrade to TRADING SELL
(Previously **NEUTRAL**)
Unchanged Target Price: RM2.42

RETURN STATISTICS

Price @ 8 th May 2024 (RM)	2.89
Expected share price return (%)	-16.3
Expected dividend yield (%)	+3.5
Expected total return (%)	-12.8

SHARE PRICE CHART



Price performance (%)	Absolute	Relative
1 month	-9.3	-9.5
3 months	-5.2	-3.7
12 months	-15.6	-22.4

INVESTMENT STATISTICS

FYE June	2024E*	2025F	2026F
Revenue	23,288.5	24,067.2	24,897.9
Operating Profit	3,102.0	3,292.2	3,500.3
Profit Before Tax	1,603.7	1,998.5	2,374.7
Core PATAMI	698.4	909.3	1,080.5
Core EPS	7.6	9.9	11.8
DPS	10.0	11.0	12.0
Dividend Yield	3.5	3.8	4.2

KEY STATISTICS

FBM KLCI	1,604.75
Issue shares (m)	9,179.08
Estimated free float (%)	24.96
Market Capitalisation (RM'm)	26,535.7
52-wk price range (rm)	2.16 - 3.10
3-mth average daily volume (m)	6.45
3-mth average daily value (RM'm)	17.61
Top Shareholders (%)	
Khazanah Nasional Bhd	36.72
Employees Provident Fund Board	17.94
Amanah Saham Nasional Bhd	14.98

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Merger effort on Sri Lanka on-going. This anticipated transaction is like that of Dialog Axiata. To recall, Axiata is under another merger exercise i.e. with Bharti Airtel. We view that these two transactions may create earnings volatility for the group in the near term. Thus, we do not favour the potential earnings uncertainty for Axiata group, which may lead to a lower dividend payout.

Funding via share swap? Taking cue from the recent announcement of the merger of Dialog Axiata and Bharti Airtel, we do not discount the possibility that the funding of the transaction will be done via share swap. Our view is primarily premised on the group's huge borrowings of RM24.8b as at 4Q2023. Should this happen, this transaction may also dilute Axiata group's current stake (66%) in XL Axiata.



FINANCIAL SUMMARY

Income Statement (RM'm)	2022A	2023A	2024E	2025F	2026F
Revenue	20,020.3	22,022.3	23,288.5	24,067.2	24,897.9
EBITDA	7,613.5	9,501.1	10,411.7	10,842.1	11,313.9
EBIT	-264.5	2,301.1	3,102.0	3,292.2	3,500.3
Profit before tax	-1,809.5	793.4	1,603.7	1,998.5	2,374.7
PATANCI	9,751.1	-1,994.8	698.4	909.3	1,080.5
Normalised PATANCI	1,529.0	542.0	698.4	909.3	1,080.5
EPS (sen)	16.6	4.6	7.6	9.9	11.8
EPS Growth (%)	15.2	-72.2	64.2	30.2	18.8
PER (x)	17	62	38	29	25
Dividend Per Share (sen)	14	8.0	10.0	11.0	12.0
Dividend yield (%)	4.8	2.8	3.5	3.8	4.2
Balance Sheet (RM'm)	2022A	2023A	2024E	2025F	2026F
Fixed assets	27,201.0	27,439.8	26,004.9	25,341.8	24,477.0
Intangible assets	13,442.2	12,237.5	21,722.7	21,722.7	21,722.7
Others	26,303.6	28,156.7	18,113.6	18,806.1	19,539.0
Non-current assets	66,946.7	67,834.1	65,841.2	65,870.6	65,738.7
Cash	7,451.7	4,612.1	5,803.7	6,292.5	7,110.6
Trade debtors	6,943.6	4,808.7	4,609.6	4,763.7	4,928.1
Others	298.7	1,187.1	773.0	778.9	785.2
Current assets	14,694.0	10,607.9	11,186.3	11,835.1	12,823.9
Trade creditors	10,579.6	9,317.4	11,644.0	12,033.3	12,448.6
Short-term debt	7,088.1	2,666.0	4,231.4	4,231.4	4,231.4
Others	3,405.6	3,210.0	2,566.2	2,566.2	2,566.2
Current liabilities	21,073.3	15,193.3	18,441.6	18,830.9	19,246.3
Long-term debt	18,347.5	22,176.2	23,231.2	23,231.2	23,231.2
Others	11,539.6	12,837.2	3,900.7	3,900.7	3,900.7
Non-current liabilities	29,887.1	35,013.4	27,131.9	27,131.9	27,131.9
Share capital	13,914.3	13,920.6	13,905.2	13,905.2	13,905.2
Retained earnings	10,020.8	8,143.5	9,453.3	9,352.5	9,331.0
Other reserve	0.0	0.0	0.0	0.0	0.0
Minority interest	6,745.3	6,171.2	8,095.6	8,485.3	8,948.4
Equity	30,680.4	28,235.3	31,454.1	31,743.0	32,184.5
Cash Flow (RM'm)	2022A	2023A	2024E	2025F	2026F
PBT	-1,809.5	793.4	1,603.7	1,998.5	2,374.7
Depreciation & amortisation	-7,878.0	-7,200.0	7,309.7	7,549.8	7,813.6
Others	18,622.3	14,084.9	-748.0	-1,462.6	-1,651.7
Operating cash flow	8,934.8	7,678.2	8,165.4	8,085.8	8,536.6
Capital expenditure	-9,761.0	-6,969.7	-6,909.2	-6,886.8	-6,948.7
Others	-1,824.0	2,269.6	272.7	299.9	332.3
Investing cash flow	-11,585.0	-4,700.1	-6,636.6	-6,586.9	-6,616.4
Debt raised/(repaid)	5,962.0	-1,543.6	0.0	0.0	1.0
Dividends paid	-504.7	-1,743.9	-734.7	-918.3	-1,010.2
Others	-2,044.9	-1,979.8	0.0	0.0	-1.0
Financing cash flow	3,412.3	-5,267.3	-734.7	-918.3	-1,010.2
Net cash flow	762.2	-2,258.5	610.5	488.8	818.1
Effect of exchange rate changes	-748.3	0.0	0.0	0.0	1.0
Beginning cash flow	6,312.3	6,326.2	3,445.7	4,056.2	4,545.0
Ending cash flow	6,326.2	3,445.7	4,056.2	4,545.0	5,363.1
Profitability Margins	2022A	2023A	2024E	2025F	2026F
EBITDA margin	38.0	43.1	44.7	45.0	45.4
PBT margin	-9.0	3.6	6.9	8.3	9.5
PATAMI margin	48.7	-9.1	3.0	3.8	4.3

Source: Bloomberg, MIDFR

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MIDF AMANAH INVESTMENT BANK: GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> 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 <i>fall</i> 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.

ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell

☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology