INDIVIDUAL FUNDAMENTAL ANALYSIS

Axiata Group Berhad (6888)

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December 20, 2022

Contents:

Company Background

Axiata Group Berhad is one of the four predominant public-listed telecommunication corporations in Malaysia, headquartered in Kuala Lumpur, and is a constituent of the FBMKLCI with approximately RM29bil of market capitalization as of the month ended November 2022. Axiata's operation footprint engaged in 11 countries across ASEAN and South Asia, including Malaysia, Indonesia, Sri Lanka, Bangladesh, Cambodia, Nepal, Pakistan, Myanmar, Laos, Thailand, and the Philippines, and it offers three core businesses of **Digital Telecommunication Services**, **Digital Businesses**, and **Infrastructure**. The vast majority of its revenue is generated by its digital telcos in Malaysia and Indonesia. In Malaysia, Axiata's main competitors are the other three telecom giants who are also listed in the FBMKLCI, namely DIGI, MAXIS, and TM. Axiata is a state-holdings enterprise, the top three shareholders of Axiata are Khazanah Nasional Berhad, with 36.74% shareholdings, followed by Permodalan Nasional Berhad (18.39%) and Employees Provident Fund (EPF) Board (17.03%).

Note: The 5th largest telecommunication services provider, TIMECOM (around RM 9bil market cap), is excluded as Axiata's competitors since TIMECOM offers purely fixed broadband services and does not offer mobile communication and network services while the other four do.

Business Model

As stated above, Axiata has three businesses, digital telcos, digital businesses, and infrastructure. Among them, the digital telcos continue to be the foundation of Axiata, generated the largest proportion of its total revenue with over 93%. Breaking down, 30% of the revenue was generated by **XL Axiata** in Indonesia, followed by **Celcom** (25.6%) in Malaysia, **Robi** (15.3%) in Bangladesh, **Dialog** (11.4%) in Sri Lanka, **Smart** (5.6%) in Cambodia, and **Ncell** (5.6%) in Nepal. Axiata reported has 163.1 million mobile users across ASEAN and South Asia. This business engaged in the provision of mobile communication and network transmission related services.

Apart from that, the second business of Axiata is the digital businesses that operated by **Boost** and **ADA**. Boost is a formidable fintech platform helping the digital economy to grow by advancing digital and financial inclusion for micro-SMEs (micro, small and medium enterprises) via fully digitised financing, payments and insurance based on rich transaction data. It is ranked among the top three eWallets in Malaysia, with a cumulative of 9.7 million active users as of the end of FY2021. Besides, ADA is a data and artificial intelligence (AI) company that designs and executes integrated digital, analytics, and marketing solutions. It has operated across 10 markets in South and Southeast Asia. In 2021, ADA has reportedly helped more than 3300 clients in 10 countries across Asia Pacific grow their market share. Axiata's digital businesses posted a loss position of 1.1% of its total revenue.

Lastly, Axiata's last business is the infrastructure business operated by **edotco**, contributing 7.6% of the group's total revenue in FY2021. Edotco is the first regional integrated telecommunications infrastructure services company in Asia, providing end-to-end solutions in the tower services sector from tower leasing, co-locations, build-to-suit, energy and transmission to operations and maintenance (O&M). As of November 2022, edotco is currently the 6th largest Telecom Tower Company (TowerCo) globally, establishing a regional portfolio of over 54,000 owned and managed towers operates beyond the borders of Malaysia across 8 countries (Indonesia, Bangladesh, Cambodia, Sri Lanka, Pakistan, the Philippines, Myanmar, and Laos).

SWOT Analysis

Strength:

Originally, Axiata's Celcom in Malaysia did not have much competitiveness in the telecommunication sector. In 2021, the overall telecom market share of Celcom only reached 16.4%, and the market share of mobile subscribers of it is only 18.7%, both ranked only the third, same as its market cap ranking. However, since the completion of the Celcom-Digi merger on November 2022, it has occupied over 30% and 40% of the market share in the telecom sector and mobile subscribers respectively, **accounting for the largest proportion** of both, thereby greatly enhancing its competitiveness. In addition, compared with its competitors, Axiata's business footprint engaged in 11 countries across ASEAN and South Asia, which indicating that it has **a better degree of geographical diversity**. The benefits of this include having a <u>larger potential customer base</u>, <u>less vulnerable to domestic economic downturns</u> or <u>other events that could negatively impact a single local economy</u>, and can lead to a <u>more diverse set of revenue streams and customer base</u> that can provide <u>greater stability and resiliency</u>.

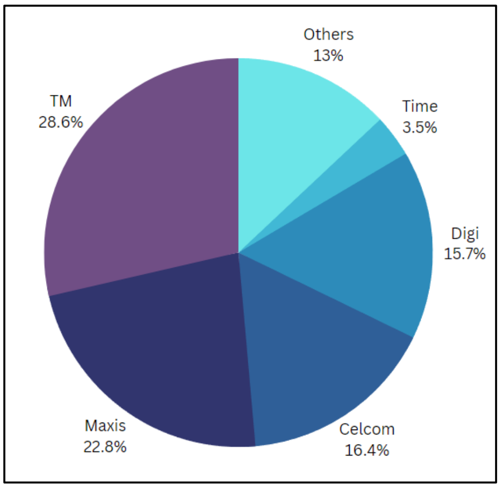

Diagram 1

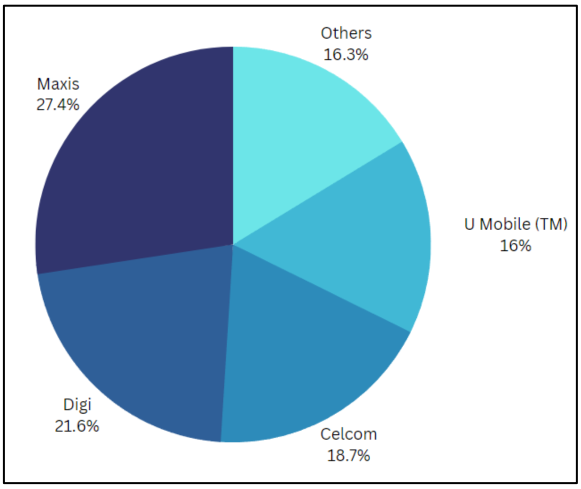

Diagram 2

The diagram 1 and 2 above show the market share distribution of the Malaysian telecommunications sector in 2021, and market share of mobile subscribers in Malaysia in 2021, respectively. Data retrieved from Statista in 2022.

Furthermore, Boost eWallet, as one of the earliest digital payments in Malaysia, is **more well-known and trustworthy** to public than other newly launched digital payments, and its regulatory system would also be relatively more mature under continuously optimization over time, which is an advantage that its competitors do not have. As for edotco, since its establishment in 2012, it has come a long way over the past decade, achieving many milestones, including attaining ASEAN Unicorn status recognised by Credit Suisse and becoming Asia's first and leading regional integrated telecommunications infrastructure services company. In FY2021, edotco's total owned and managed towers grew by 34%, indicating that their **unrelenting pursuit of expansion** for a decade, this determination of expansion is also one of their strengths compared with the other three telecom giants.

Weakness:

Axiata's **PATAMI** (Profit After Tax and Minority Interest) is **the weakest** among the other three telecom giants. Compared with them, each of which has an annual profit margin of around 10% or over, but Axiata's average profit margin over the past five years stood at a loss of -1.35%. If adjusting for one-off items that causes an unprecedented loss position of RM 5.0bil in FY2018 (note: further detail kindly refers to **'Additional information'** at below), the normalised group profit margin stood at 4.19%, with a 5-year average of 3.7%. However, there is still a large gap between this data and the average data of competitors. The reason of causing this is because it has **the highest operating costs** among the other three.

By extracting partial of the large portion of operating costs, including *depreciation, impairment, amortization, domestic interconnection, international outpayment, marketing, advertising promotions, staff costs, taxes and zakat, and 'other operating costs'*, these expenses have already accounted for 90% of Axiata's total revenue, yet these expenses only accounted for 75%, 71%, and 73% of DIGI, MAXIS, and TM's total revenue, respectively. Of these, the most unusual operating costs of Axiata is 'other operating costs', which accounted 30.8% of its total revenue, which is one-third higher than the sum of the percentages (20.7%) of the other three's respective total revenues. It is believed one of the reasons to be due to the **shortcomings of geographical diversity** (note: further detail kindly refers to **'Threat'** at below).

Additional information:

Reported by AXIATA, the group's PATAMI dropped to a loss position of RM 5.0bil in FY2018 as it absorbed the overwhelming one-off ***Idea-related losses of RM3.9 billion*** *(comprised RM 358mil non-cash loss on dilution due to Axiata's non-participation in Idea's issuance of new shares, RM 186mil share of losses from Idea prior to Axiata's derecognition of Idea as an associate, RM 3.3bil technical impairment from the Idea reclassification exercise from associate to simple investment due to the merger of Idea with Vodafone India),* ***RM 1.8bil of assets write-off, impairment and accelerated depreciation*** *as a result of network modernisation primarily at XL and Celcom, and* ***forex and derivatives losses of RM0.5 billion****. Adjusting for these one-off items, the normalised group PATAMI stood at* ***net profit of RM1.0 billion****.*

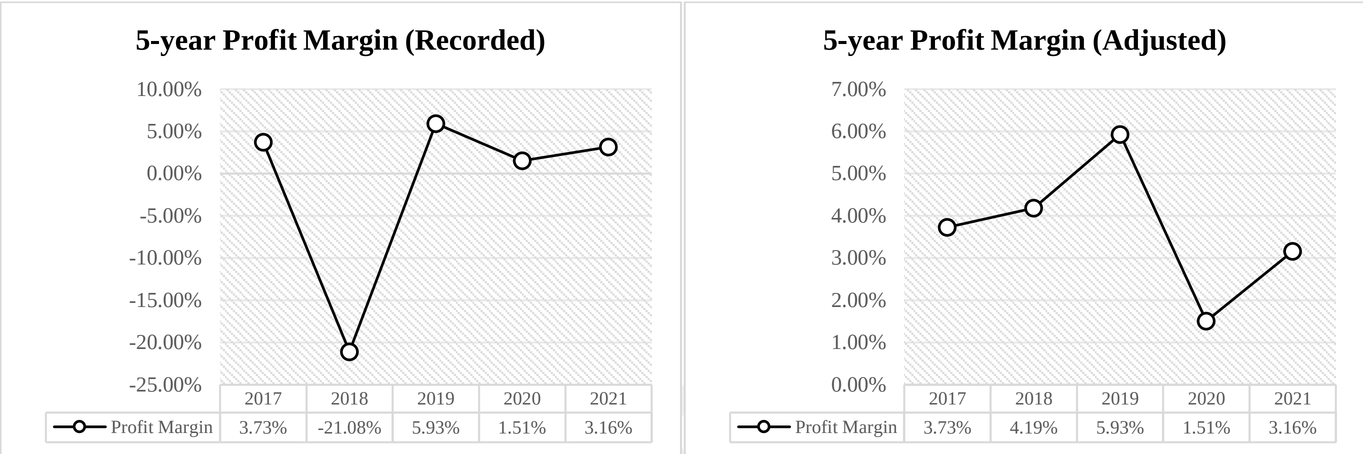

Diagram 3: Recorded and adjusted 5-year profit margin of Axiata

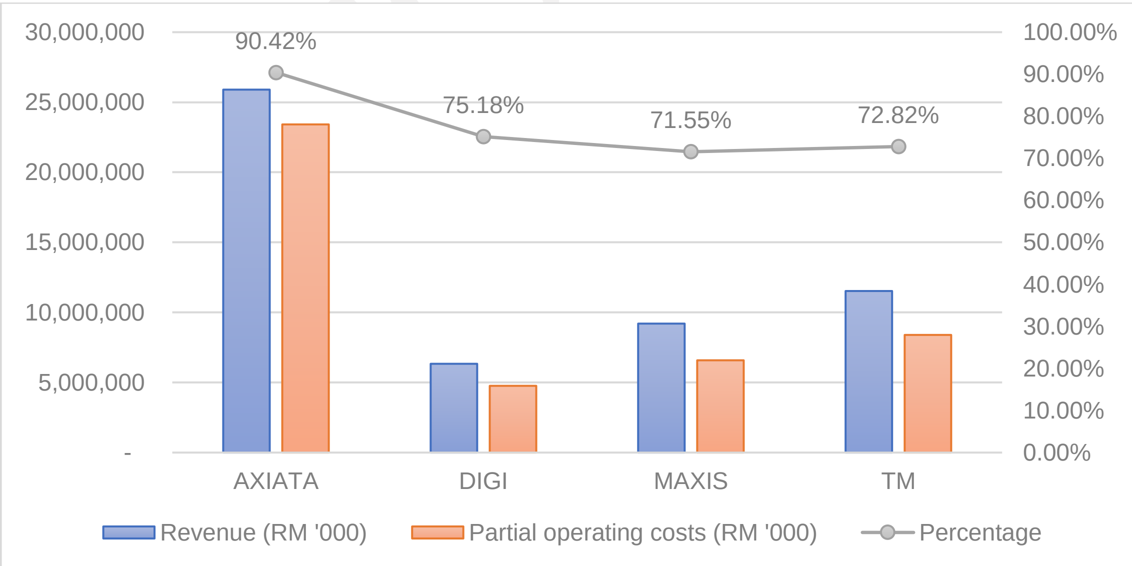

Diagram 4: Comparing the *<u>large portion of operating costs</u>* *of the four telecom giants as a percentage of their respective revenues as of the end of FY2021.*

It is worth mentioning that although Axiata's market capitalization ranks only third among the four telecom giants, it is **the largest in terms of economic scale**. In other words, Axiata is the largest telecommunication operator in Malaysia. Its single total revenue is almost equal to the sum of the other three.

Besides, another weakness of Axiata is its **digital businesses**, which is the only core business of its that are currently **posting losses**. Despite doubling their revenue to RM 980mil with a 65.4% increase in Boost and an 89.4% increase in ADA, the businesses still recorded a net loss of RM 112mil in FY2021. However, the net loss narrowed by 62.1% year-over-year due to the increase in ADA's profit and the decrease in Boost's marketing expenses, implying that this weakness is gradually being diminished by Axiata. According to the CEO of Boost, Sheyantha, Boost remains in the red but losses have been trending downwards since 2019. The reason for Boost's losses is believed to be establishing a sustainable path for its business to grow by consolidating its bottom-line, which is a lot tougher, rather than growing the topline with a lot of cash.

Opportunity:

Axiata has reportedly **done comprehensive preparations in capturing the ongoing 5G trend** with all of its operating companies (OpCos). One of the examples is Celcom merged with its ecosystem partner (DIGI) with the aim of building a stronger company to catalyse the Fourth Industrial Revolution (4IR) digital transformation and strengthen the local ecosystem through the adoption of the Internet of Things (IoT) and 5G. It is believed that the deployment of 5G could bring the following outlooks to Axiata:

- **New revenue streams**: 5G networks will enable the development of new applications and services that require high speeds and low latencies, such as the Internet of Things (IoT), virtual reality, telemedicine, and autonomous vehicles. This will provide Axiata with new revenue streams as a result of diversifying their product and service offerings, and opportunities for growth in the future.
- **Improved efficiency and cost saving**: 5G networks are expected to be more energy-efficient than previous generations, which will enable Axiata to support a higher density of users and devices that could attract more customers (as there are higher capacity) and help it to optimizing their operating costs thus increase their profitability.
- **Increased flexibility and scalability**: 5G networks are expected to have wider coverage than previous generations, the ability to support a wider range of frequencies and bandwidths could allow for the deployment of more advanced and complex network architectures that can better support the needs of different types of applications and devices. This would improve the customer experience for Axiata's subscribers, thereby attracting more potential customers.

Apart from that, **the application of digital banking license by Boost-RHB consortium was approved** by the Minister of Finance Malaysia in April 2022, which means that in the near future (less than 24 months), Axiata's Boost will not only be able to provide digital payment, but also provide fully digitised financial services both domestically and internationally, which also means the further diversification and expansion of its business. In addition, it is worth to mention that Boost is the first fintech firm that announced to jointly form a digital bank with a traditional well-known bank (RHBBANK), hence the credibility of Boost eWallet would be enhanced benefited from the bank's reputation, thereby attracting more users and significantly improving its competitivenesss in digital payment. Furthermore, it is also **expected that digital**

financial services will flourish in Southeast Asia in the next three years, and this prospect is undoubtedly a great opportunity for Boost as it means that its business can continuously growing in the future.

Lastly, after penetrating into the Indonesia market through its proposed acquisition of approximately 1,000 towers from XL in FY2021, edotco declared looking into expanding its operation to Thailand and Vietnam in the near term as the markets offer untapped growth opportunities in December 2022. According to edotco's CEO Adlan, the transition to 5G network, demand for wider and better coverage and quality of service (QoS) induced proliferation of 4G network have made TowerCos' role more crucial than ever, making it even pressed for a regulatory framework reform. Hence, it is quite likely that the revenue of the infrastructure business will further increase in the future, making it to **occupy a larger proportion of Axiata's total revenue**, reduce the proportion of its digital telcos, and attain business diversification.

Threat:

The major threat that faced by Axiata is the **long-standing and unavoidable foreign exchange (forex) risk**. The forex risk has explosive increased in 2022 due to the exposure to abnormal currency volatilities across 11 markets of operation owing to the US Federal Reserve's policy of raising interest rates and quantitative tightening. Also, Sri Lanka, which declared bankruptcy in the middle of the year, has pushed this threat to a pinnacle due to the turmoil of the socio-economic and political crisis and the foreign exchange losses mainly arising from the revaluation of USD borrowings and working capital. This risk could largely affect the group's financial performance of the year (and future), result in inability to pay dividends to shareholders due to losses, thereby impacting investors' willingness and confidence, as well as the sustainable growth of the group.

Diagram 5: A significant depreciation of over 45% the Sri Lankan Rupee (LKR) against the US Dollar (USD) in 2022.

Secondly, another significant threat that Axiata is confronting is the **geographical diversity risk**. The direct causes of the risk include geo-political instabilities, civil unrest, social tensions, adverse regulatory changes, and uncertainty in geo-political policy making. As Axiata operates in various countries, it will undoubtedly be confronting the risk and business complexity while improving its geographical diversity, because it needs to comply with the latest policies promulgated by various countries that are conducive to the current situation of the country, and whether these policies are beneficial to Axiata is full of uncertainties. In the current macro-environment where global inflation continues to hit new highs in decades, the policy of hiking interest rates in various countries is definitely adversely impact Axiata, since its borrowing costs and debt interest have been increased, its low profit margins will also be hit harder and could likely to turn from net profit to net loss. Also, the increased complexity of the business operations may require the company to devote additional resources to manage issues such as maintain multiple facilities, or to comply with different regulatory requirements, thereby involved in higher operating costs. These costs could eat into the company's profitability, resulting in low profit margin. Reported by Axiata, this risk could lead to disruption of business operations, with negative market sentiment eroding investor confidence in the longer term.

Future prospects

In general, Axiata's business model **has somewhat advantageous in terms of competitiveness and potential** among peers, because they have a broader market in South Asia and not just in a single Malaysia. Besides, as mobile communication and network have exponentially become one of the most basic needs of human beings nowadays, Axiata, which engages in the provision of mobile communication and network transmission related services, would doubtlessly have immense market demand in the future, let alone that they are in line with the strong future trend - the gradually developing of the 5G. Ergo, its products and services have long-term and necessary demand and are difficult to be replaced.

In terms of market structure, it is also an oligopoly market, and the barriers to entry and exit are considerably high, and the industry is already saturated, so it is unlikely that new competitors will be born in the future. On the other hand, even if new competitors do emerge, Axiata, as a state-holdings company, is unlikely to be replaced or eliminated in the future, so there is a relatively higher safety factor for investors.

Apart from that, Axiata has gradually repositioned itself as a high-dividend company with a goal of paying out dividends exceed 20sen within 5 years. As of the year ended FY2021, Axiata's dividend per share (DPS) has increased by 2.5sen to 9.5sen, which is 35% higher compared to the previous year. As such, Axiata might be favoured by dividend investors in the upcoming future, going forward as one of the classic defensive stocks.

Financial Performance

Axiata reported a **record-breaking revenue** of over RM 25.9bil in FY2021, 7% higher than the previous year’s RM 24.2bil. Its PATAMI has also increased by 124% compared to the previous year’s RM 365mil, achieving approximately RM 819mil, with a profit margin of 3.16%, which is considered low compared to its peers.

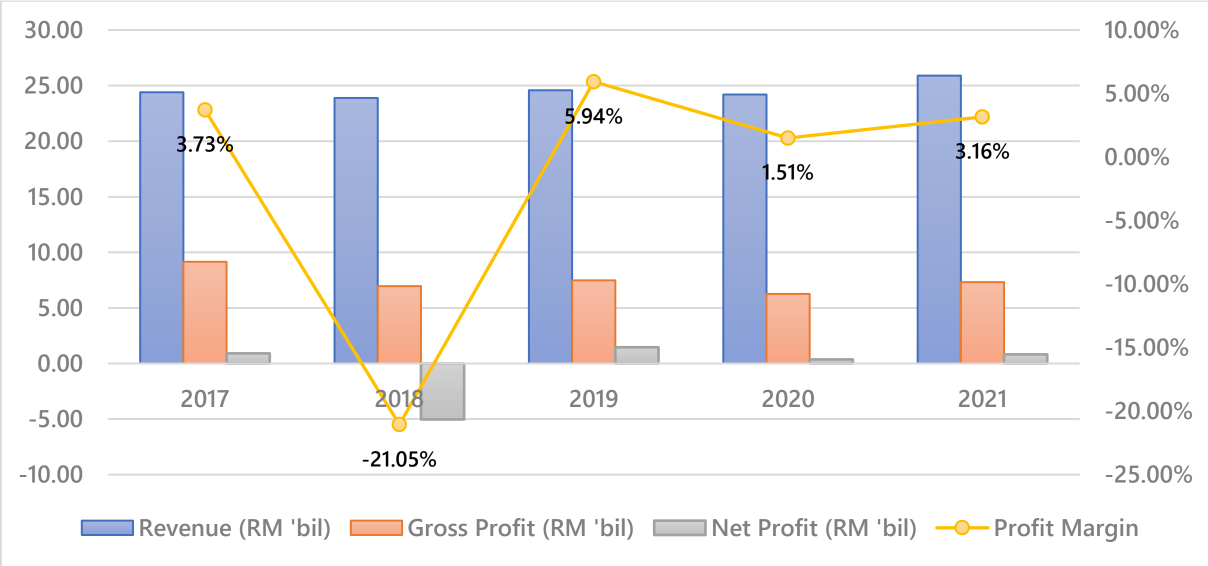

Diagram 6: 5-year Financial Performance of Axiata

As can be seen from diagram 6 above, compared to FY2019, all revenues, gross profit and net profit in FY2020 decreased slightly. According to Axiata, the decline was mainly due to the Covid-19 pandemic and government regulations during the lockdown period across OpCos markets, such as foregone revenue due to free data and bonus recharge in countries (but this has only a slight effect). Besides, adjusting for one-off items mainly from accelerated depreciation and write-off of assets mainly for 3G assets, forex and derivative, the normalised group PATAMI stood at RM 865.4mil in FY2020.

Meanwhile, adjusting for one-off items mainly from impairment of Ncell's goodwill, gains on foreign exchange and derivatives, the normalised group PATAMI for FY2021 stood at RM 1.3bil. As such, this shows that Axiata has recovered strongly from the shock of the pandemic that had little impact on it in the FY2021. Ultimately, after various adjustments, Axiata's normalised 5-year financial performance as diagram 7 below shows:

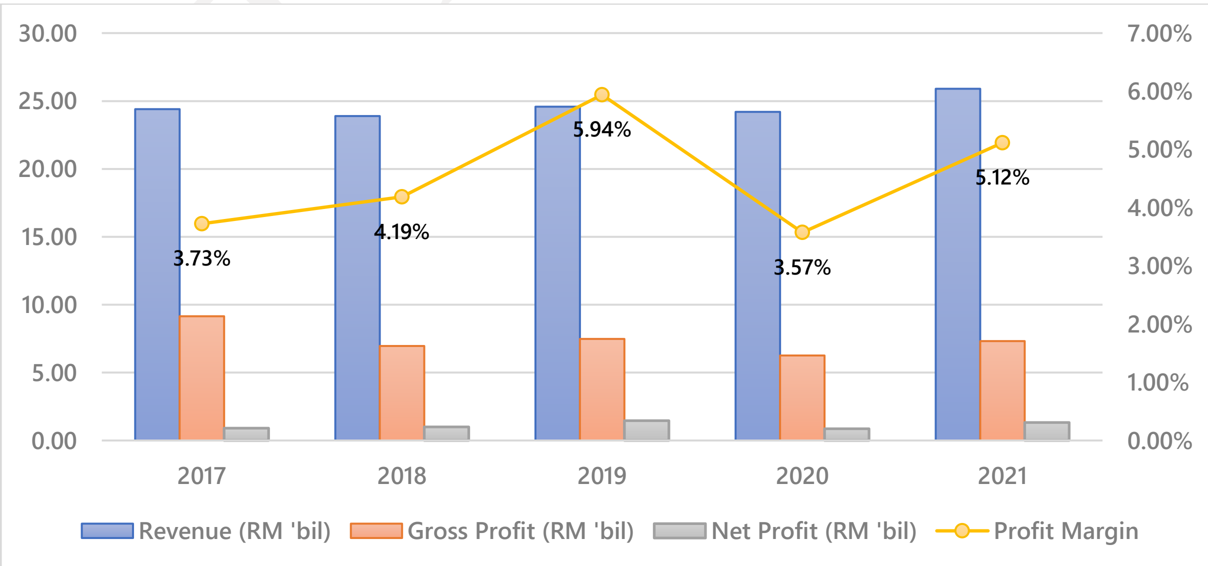

Diagram 7: Adjusted 5-year Financial Performance of Axiata

From the diagram, it is palpable that Axiata kept growing from FY2017 to FY2019, and in FY2020 due to the outbreak of the pandemic, its financial performance has declined, but it has recovered and continued to grow in FY2021. From the previous performance, investors can expect it to hit another record-breaking revenue in FY2022. However, the macro environment of global economic downturn and the turmoil in Sri Lanka will significantly affect the financial performance of Axiata in FY2022, as these factors have created substantial uncertainty for Axiata, making it difficult to continue to grow and be better than FY2021. This can be seen from the fact that its performance of the first three quarters of FY2022 had been in a status of loss.

Cash Ratio Analysis:

Company	Cash Balance (RM '000)	Current Liabilities (RM '000)	Cash Ratio
AXIATA	6,969,352	20,352,706	0.34
DIGI	204,527	2,932,070	0.07
MAXIS	1,191,000	6,274,000	0.19
TM	2,733,800	5,433,700	0.50

Table 1: Cash ratio of the four telecom giants in FY2022.

Compared to the competitors particularly DIGI, Axiata has a relatively strong and healthy cash balance, stands at RM 7.0bil in FY2021 with a cash ratio of 0.34, second only to TM with a cash ratio of 0.5. Despite it was unable to pay off all its current liabilities, but it was able to pay off all short-term borrowings (RM 4.2bil) and lease liabilities (RM 1.76bil) in a lump sum, hence it remains in a good condition in terms of short-term liquidity.

Debt-to-equity Ratio Analysis:

Company	Debt-to-equity Ratio
AXIATA	1.17
DIGI	7.84
MAXIS	1.50
TM	1.04

Table 2: Debt-to-equity ratio of the four telecom giants in FY2022.

Based on the above data, it can be seen that three of the four telecom giants have similar debt-to-equity ratios of between 1 to 1.50, and only DIGI is an outlier with a debt-to-equity ratio of 7.84, which is an extremely unhealthy condition. Therefore, although a debt-to-equity ratio exceed 1 is typically not a healthy level, but after comparing with peers, it is a normal level in this industry, hence there is no problem with Axiata's debt-to-equity ratio.

Personal opinion

Overall, with the gradual development of technology, Axiata is also continuing to expand its business to keep up with the trends (the **5G trend** in South and Southeast Asia and the global **FinTech trend**) of the era. Personally, I would **not recommend** investors to invest Axiata in the short term of a few quarters despite its passable outlook. It is because, Axiata currently faces too many macro headwinds as mentioned above (global inflation that caused global economic downturn and stock market sluggish, and turmoil in Sri Lanka that may cause business disruption), and these unfavourable factors will adversely impact its fundamentals (higher debt interests lead to lower revenue and profits, and higher borrowing costs lead to lower investment and expansion willingness). However, Axiata may be a good pick as **a defensive stock** when the global economy recovers and its overall businesses get back on track, provided they do hit their goal of high dividends.

Valuation:

Company	EPS (sen)	1-year Average Price (RM)	P/E Ratio (x)
DIGI	14.90	4.13	27.72
MAXIS	16.70	4.61	27.60
TM	23.70	5.89	24.85

Table 3: EPS, 1-year average price, and P/E ratio of the three telecom giants excluded Axiata in FY2022.

Based on the data above, the average P/E ratio of the mobile communication and network services providers industry is **26.73x**. However, since Axiata has the largest economic scale, it deserves a higher P/E ratio than the industry's average. Hence by raising its reasonable P/E ratio to 35x, with its EPS of 8.9sen in FY2021, the reasonable price of Axiata can be obtained by the below derivation:

Share price = P/E Ratio * EPS (RM) = (35) * (8.9/100) = **RM 3.120**

Ultimately, the reasonable price of Axiata can be perceived as RM 3.120 per share.

Technical Analysis:

Technically, Axiata's share price has started a downward trend since the year 2015 (as Diagram 8 below shows), and has fallen by 50% from the highest point of RM6.000 per share. Therefore, a stock that keep falling would not be a good investment choice, since even if investors can earn dividends, there is a possibility that they will face losses due to the continuous decline of the average price.

In depth, according to Diagram 9 below, after a one-year consolidation between the price range of RM3.550 to RM4.090 from March 2021 to March 2022, Axiata's share price plummeted in the following three months, falling more than 30% to RM2.620. It is believed that the slump of Axiata's share price is primarily due to the depressed sentiment of market participants and the divestment of institutions both domestic and foreign caused by the macro environment of the Fed shrinking its balance sheet and hiking the interest rates.

Afterwards, an inverse head and shoulders pattern began to form at the lowest bottom since 2010. Technically, if the inverse head and shoulders pattern forms as anticipated, Axiata will have a 14.5% upside potential to RM3.810 after breakout RM3.330, medium-term traders with relatively low-risk tolerance (since Axiata, as a blue-chip stock, has relatively higher safety factors compared to other stocks) can build their positions at the price. Certainly, the fundamentals of Axiata itself will be the dominant factor directly affecting its share price. If its financial performance continues to weaken, its share price will more likely continue to decline. Also, it is worth mentioning that Axiata's share price has formed a resistance level at the evaluated reasonable price, RM 3.120.

Apart from that, as Diagram 10 shows, the average correlation coefficient between Axiata and FBMKLCI is about 80%, indicating that there is a strong positive correlation between them. Meanwhile, as shown in Diagram 11 below, there is an average of 85% of the correlation coefficient between Axiata and TELECOMMUNICATION & MEDIA SECTOR, indicating that there is also a strong positive correlation between them. Thus, if Axiata's share price trend does not keep pace with the board's trend within a certain period of time, and its fundamentals remain constant and have not deteriorated, medium-term traders can consider cooperating with more other technical indicators (such as RSI, MACD, and EMA) to capture a value depression.

Diagram 8: Axiata's weekly technical chart from 2012 to current (December 15, 2022)

Diagram 9: Axiata's daily technical chart from November of 2021 to current (December 15, 2022)

Diagram 10: Daily correlation coefficient between Axiata and FBMKLCI from November of 2021 to current (December 15, 2022).

Diagram 11: Daily correlation coefficient between Axiata and TELECOMMUNICATION & MEDIA SECTOR from November of 2021 to current (December 15, 2022).