Telenor Purchase of Axiata's Regional Assets: Good for Norway, Not so for Axiata

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EXECUTIVE SUMMARY

On 6th May, Telenor Asia and Axiata Group (AXIATA MK) announced that Telenor will acquire Axiata in an all-share deal that will leave Telenor with 56.5% of the MergedCo, with proforma revenue of US$12.5 billion (the largest in its operating region -- ASEAN & SAARC), EBITDA of US$5 billion, and 300 million customers. The deal omits Bangladesh (where the two are fierce competitors, with Telenor's Grameenphone Ltd (GRAM BD) the largest and Axiata's Robi its top rival). Although billed as a "merger of equals", with headquarters and a primary listing in Kuala Lumpur, Telenor CEO Sigve Brekke made it clear at Telenor's AGM (on 7th May) that "We will control that company".

There remains some opacity about pricing. But if the pricing is based on Axiata being paid merely a 15-20% premium on the share prices before the 6th May announcement (i.e., no premium on its average share price of the past 6 months), we would recommend that Axiata shareholders reject the deal. Better value can be obtained by selling the whole of Axiata to a Chinese digital platform (like Tencent Holdings (700 HK) , or Ping An Technology), or to auction off its valuable assets (with dominant positions) in Sri Lanka, Cambodia, Nepal, Indonesia, Bangladesh and Malaysia. Many competitors (Singtel (ST SP), Vodafone (VOD LN) , Bharti Airtel (BHARTI IN) , Etisalat, Chinese and Korean telecom companies) would likely participate in such auctions, helping a superior process of price/value discovery.

Synergies in Malaysia, and a substantial deepening of its capital base (and hence capacity to borrow) make this deal extremely attractive for Telenor shareholders. Malaysia itself will gain fiscally: the all-share deal will be followed by a listing in Malaysia, which will allow Khazanah to sell down its holding in the MergedCo (and pay the proceeds back to the government). The tower company (combining Axiata's Edotco with Telenor's Asian tower assets) will also command a very good valuation (as both have assets in each other's current spheres and in third countries that will be better monetized), so can be listed at better valuations than previously envisaged. So Malaysia (including Khazanah) and Telenor are clear winners from the transaction, but Axiata shareholders lose (based on the information available thus far).

DETAIL

A Malaysia Based Global Champion?

Telenor and Axiata have dubbed their merger (outside Bangladesh) as "The Making of a Malaysia-based global champion". The MergedCo will indeed be a global champion with its tower business (making it potentially the 4th-largest tower player in the world), with synergies and balance-sheet size creating technology opportunities in artificial intelligence (AI), the internet of things (IOT), and fifth generation mobile telephony (5G) -- encapsulated in a Regional Innovation Centre to be based in Malaysia with the intent of producing Global Talent.

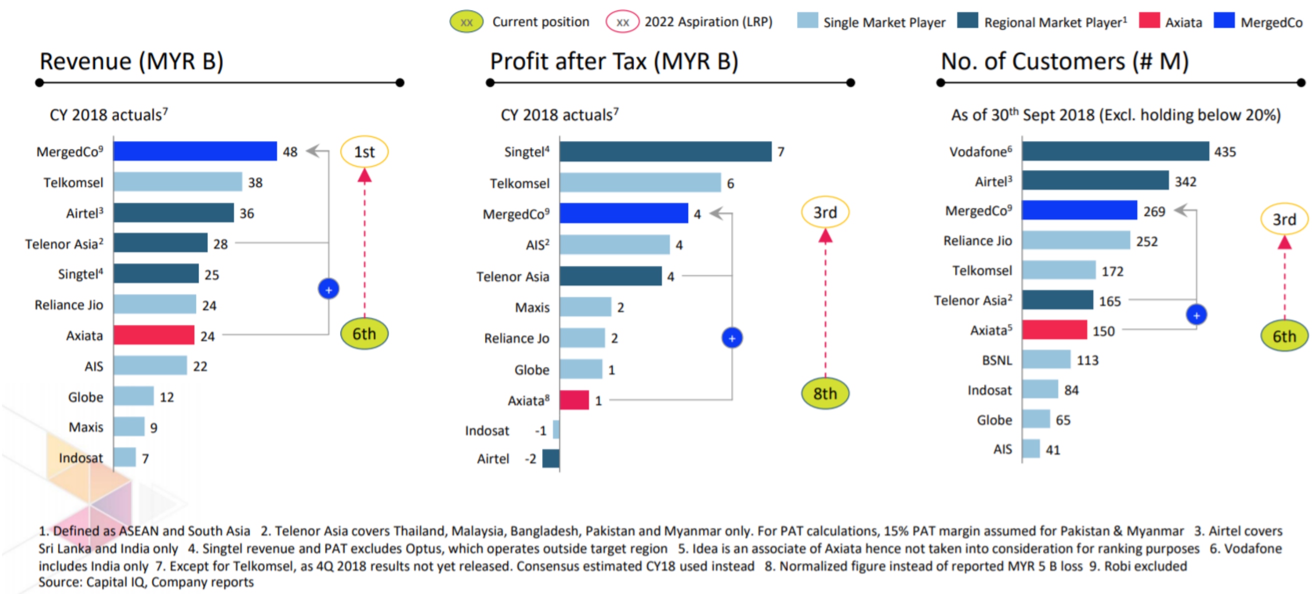
While there is indeed enormous potential in all of this, **Telenor will have 56.5% ownership of the MergedCo, and will consequently be in the driving seat**. Logic therefore suggests that Telenor should be paying a substantial "control premium" for Axiata, since it is effectively gaining control of the company. A reasonable premium for control would be a 50%+ premium on the average share price of the past 6 months -- or the best price that could be obtained for Axiata from unbundling and selling off each of its national assets in a fair auction to the highest bidder.

Great Deal for Telenor, Poor one for Existing Axiata Shareholders

From the standpoint of Axiata (and its ultimate owner, Khazanah Nasional), **the likely pricing of the deal** -- based on share prices before the announcement of the discussions on Monday (6th May) and the announced share ratios for the two companies -- **suggests that Telenor would be obtaining control of Axiata at a 15-20% premium to the depressed share price on 6th May**. In effect, Telenor is acquiring Axiata at below the share-price that prevailed at the start of 2019 -- before the generalized sell-off in Malaysia's GLC stocks in anticipation of Khazanah and PNB diluting the government's stakes in those companies. **This is a great deal for Telenor, but a very poor one for existing shareholders of Axiata**. No amount of packaging of the deal as a "marriage of equals" (with a domicile in Malaysia, and the existence of a Malaysia-based "regional innovation centre") can compensate for the fact that Axiata is being acquired by Telenor, the company that will ultimately be in the driving seat of the MergedCo, especially outside Malaysia.

Axiata is the largest mobile-phone operator in Sri Lanka (via 83%-owned Dialog), Cambodia (100% subsidiary Smart Axiata), Nepal (80%-owned NCell), and second-largest mobile operator in Indonesia (through 66.55% owned XL Axiata), Malaysia (Celcom), and Bangladesh (68.7% ownership of Robi). In Bangladesh, Telenor subsidiary GrameenPhone is Axiata-Robi's fiercest competitor -- and Bangladesh is consequently left out of the merger discussions. Robi will continue to be managed directly by Axiata -- and is clearly a candidate for an early sale to a third party (despite Robi's strong second position in one of the fastest-growing economies in the world, with considerable synergies with Malaysia given the large number of Bangladeshis working in Malaysia). In mid-February 2019, Axiata sold its remaining 28.7% stake in Singapore's M1 Ltd (M1 SP), which was the third-largest player in Singapore's mobile market -- primarily because M1 was on the verge of being taken private by its main local shareholders (Singapore Press Holdings (SPH SP)and Keppel Corp Ltd (KEP SP)).

There are useful complementarities between Axiata and Telenor outside Malaysia and Bangladesh, the two countries where the two compete head-to-head. Telenor is the largest mobile player in Bangladesh (Grameenphone: 55.8% holding), neighbouring Myanmar (with its own subsidiary), the second largest in Pakistan (wholly owned subsidiary), and the third largest in Thailand (through 65%-owned DTAC) and Malaysia (through 49%-owned DiGi). Axiata does not have operating companies in Thailand, Pakistan and Myanmar, but its tower subsidiary (Edotco) owns thousands of towers in all three markets (in addition to Bangladesh, Cambodia, Sri Lanka and Malaysia). The synergies with Telenor on the tower business are considerable -- and they do extend to Malaysia and Bangladesh as well. While combining Celcom and DiGi will indeed create a "Malaysian champion" (the largest mobile player in Malaysia), Maxis is still seen as the best-quality mobile network in Malaysia. Closing the quality gap with Maxis may take time. Even if regulators help ensure that Axiata (Celcom) is in the driving seat of the combined MalaysiaCo, it is unlikely that the Malaysian regulator can influence who controls the non-Malaysian OpCos.



Source: Axiata presentation (6 May 2019)

The combined MergedCo will be the largest by revenue in its region of operations (ASEAN & the Indian subcontinent), with the 3rd largest profit after tax and the 3rd-largest pool of customers (chart above). Currently Axiata is 6th, 8th and 6th on those respective metrics, while Telenor Asia is 3rd, 4th and 5th for revenue, PAT and number of customers in the targeted region. The MergedCo will have proforma revenue of US$12.5 billion, and EBITDA of over US$5 billion. Synergies between the two (especially in Malaysia, and through more optimal use of joint tower assets) should increase the combined profits substantially within the first year, by at least US$1.5 billion. The company will have a very significant pan-Asian presence -- outside the saturated markets of China, India, Korea and Taiwan -- and will be among the world's top-5 tower companies, owning nearly 60,000 towers. The MergedCo will have a dominant presence in the Malaysian market, ahead of Telekom Malaysia (from which Axiata was initially spun off) and Maxis, which is currently the dominant mobile player. The substantially stronger capital base will allow the MergedCo to lever up much more -- and use that to fund an aggressive expansion drive. Given that activist investors in Norway are already seeking to get Telenor to issue more debt, this would be welcomed in Asia as well, particularly to position the MergedCo for emerging new technologies.

The MergedCo would make a very attractive investment at the right price; the current levels being quite attractive for Telenor. It would be particularly attractive since the acquisition is being marketed as a "merger of equals" -- despite the fact that Telenor will own 56.5% of the MergedCo, and will not be paying any control premium for taking over majority control of the MergedCo. This is an excellent arrangement for Telenor, but not such a good one for Axiata shareholders.

Selling to Chinese digital platforms, or piecemeal auctions of valuable assets in each country, could have extracted much better value. In our view, if Axiata is going to be giving up control, Axiata could have extracted substantially better value via several routes: (a) selling the entire company (or parts of it) to large Chinese digital platforms such as Tencent or Ping An Technology; or (b) holding an auction of key assets in each market (Bangladesh, Sri Lanka, Cambodia, Indonesia) in which the likes of Etisalat (of the UAE, West Asia, North Africa), Vodafone, Bharti Airtel (of India and Africa), SingTel, Telstra and Chinese and Korean telecom companies would have been happy to participate. Either of these routes would have unlocked substantially more of Axiata's value. The precise pricing of the Telenor/Axiata deal is unknown, but market talk suggests that Telenor will be paying 15-20% more than the depressed price before the announcement on 6th May 2019. We would recommend that existing shareholders of Axiata should reject the offer as it currently stands -- until much better valuations are offered through a proper process of price/value discovery.

For Malaysia, the fiscal implications are positive. Although the transaction itself will not involve any payment in cash -- and Khazanah will become a minority shareholder in the larger MergedCo -- the MergedCo itself will be listed shortly, unlocking some value for Khazanah (which can also sell down a larger proportion of its shareholding at the time of listing). When the tower company (Edotco plus Telenor Asia's tower assets) is listed separately, it is likely to command a very good valuation as well -- unlocking further value. The Malaysian government, keen to exit its role as a strategic investor a la the Khazanah of 2004-2018, will make substantial fiscal gains from this sale -- although it could have done even better immediately via the various auction options.