AXIATA AND TELENOR

What are the driving forces of the merger plan and where are the synergies?

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INDIA TELECOM MARKET

Why is Reliance Jio investing so heavily in digital technologies?

VALUE PARTNERS

AXIATA AND TELENOR PLAN TO MERGE THEIR ASIAN OPERATIONS

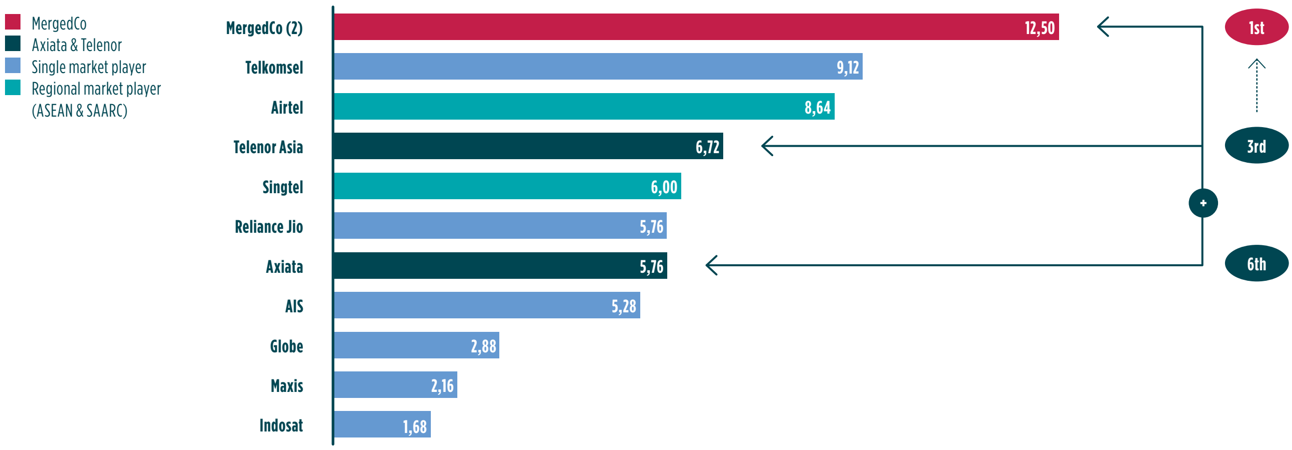
(1) Except for Telkomsel, as 4Q 2018 results not yet released. Consensus estimates CY 18 used instead.

(2) Post merger revenue of MergedCo accounts for Telenor's DTAC, Telenor Myanmar, Grameenphone, and Telenor Pakistan, as well as Axiata's Celcom, XL, Smart, and Dialog. It excludes Robi and Ncell, Axiata's Bangladesh and Nepal OpCos.

Norwegian-based multinational telecom, Telenor, is in discussions to merge with Malaysian-based Axiata Group in an all-share deal that is expected to leave Telenor with 56.5% share of the merged company and Axiata with 43.5%.

The global merger would form three distinct entities: MergedCo, the combination of the two aforementioned companies [which will also become the largest telco group in the ASEAN and SAARC regions by revenue size (See Exhibit 1a and 1b)]; Global Tower Company (i.e. the combination of edotco Group, the tower subsidiary of Axiata Group, and Telenor Asia assets), which is the fourth largest tower company in the world operating roughly 60,000 towers across Asia; and a Regional Innovation Centre, which would develop innovative products and solutions.

EXHIBIT 1a
Ranking of major telco operators in the region by revenue
Revenue in Calendar Year 2018[1], US$ billion



Source: Axiata Investors Presentation, Value Partners analysis.

EXHIBIT 1b
Selected pro-forma financial and operational indicators of MergedCo

ESTIMATED MERGEDCO REVENUE:	ESTIMATED MERGEDCO EBITDA:	NUMBER OF COUNTRIES WITH OPERATIONS:	NUMBER OF COMBINED SUBSCRIBERS:
US$ 12.5 BILLION	US$ 5.0 BILLION	9	>300 MILLION

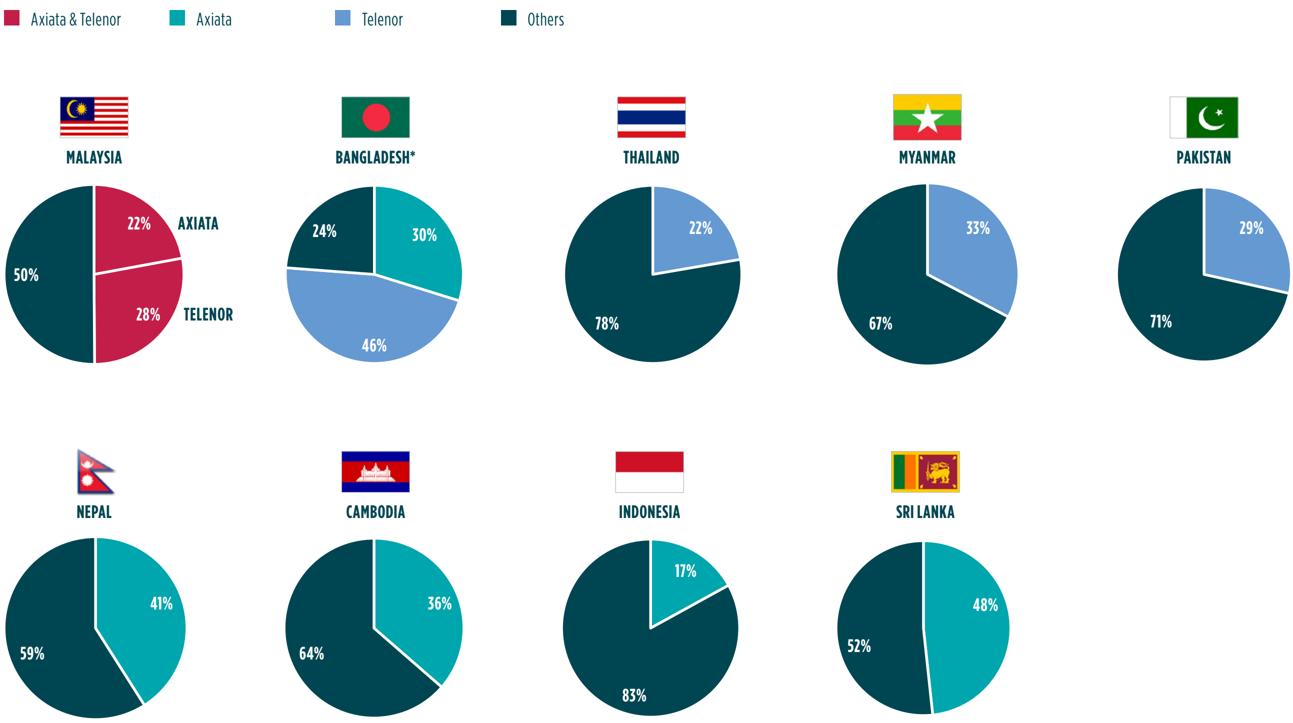
MergedCo would be a leading player in Asia with operations in 9 countries

Currently, the companies share a presence in Malaysia and Bangladesh through their Operating Companies (OpCos). However, only Axiata's Bangladeshi operations, Robi, are not part of the proposed merger. Axiata also has a presence in Cambodia, Indonesia, Sri Lanka, and Nepal. Telenor has OpCos in Thailand, Myanmar, and Pakistan. Post-merger, MergedCo would have mobile operations in 9 markets and be among the top 3 operators in terms of subscriber share in each of these markets (see Exhibit 2).

Synergies from the merger are expected in at least 3 areas: cost savings, digital services, and 5G

"The bottom line is we need the scale, we need the synergy, we need the balance sheet, we need the strong capabilities of both companies. If we can combine that it will be powerful," Axiata group CEO Jamaludin Ibrahim told a news conference after the initial announcement. Through merging the two businesses, not only will MergedCo be saving operational expenditure and internal management costs, but such savings will also enable the innovation that MergedCo needs to compete in the evolving telco market.

EXHIBIT 2
Axiata and Telenor's subscriber share by country



Source: GSMA Intelligence, company annual reports and presentations, Value Partners analysis.
Note: (*) in Bangladesh, only Telenor's operations are included in the merger, Axiata-owned Robi is not part of the merger.

(3) "Leveraging Digital Technologies to achieve new growth: how should telcos act?", July 2019, by Stefano Sorrentino, Adriano Giaquinta, Chin San Ng [www.valuepartners.com/en/leveraging-digital-technologies-to-achieve-new-growth-how-should-telcos-act].

1. Most of the cost synergies are expected to come from MalaysiaCo but concerns have been raised on the headcount reduction

MalaysiaCo, the combined Malaysian entity formed from the OpCos of the two companies (Axiata's Celcom and Telenor's Digi) will be the country's largest mobile operator, functioning as a subsidiary of MergedCo but remaining separately listed. Some estimate that MalaysiaCo will provide approximately US$1 billion in cost synergies for Axiata and Telenor, mainly through operational expenditure savings from the removal of duplicate network sites, sharing of IT system platforms, and rationalization of sales and marketing expenses.

Given these estimates, what is the plan to unlock the true value of these synergies? Usually, telcos' sales and marketing operations account for 20% to 30% of the NPV of the synergy plans.

However, Axiata and Telenor have already claimed that there will be no forced retrenchment of Digi's 1,700 and Celcom's 2,700 employees, in response to concerns raised regarding the expected headcount reduction.

Further, merging two legacy networks into an integrated one is a complex process, and might take 3 years or more on average. The 2 telcos will therefore need to manage the expectations of the various stakeholders affected. Customers, for example, expect stable and consistent services throughout the integration process, while shareholders on the other hand, will push for a more rapid disposal of excess base stations.

2. Digital services from both companies will be integrated into a Regional Innovation Centre, but what is the digital strategy of the combined entity?

Axiata has a vision of being a "new generation digital champion" by 2021, focused around a "triple core strategy of telco, digital, and infrastructure businesses," which all have the potential to become fully integrated and interconnected. It currently owns Boost, a cashless transaction service, ada, a digital advertising agency, and Apigate, an API platform. Additionally, Telenor has a heavy digital / IoT focus, providing cloud storage apps, mobile banking, and data protection services for users. Post-merger, US$23.9 million is expected to be pledged annually to fund the Regional Innovation Centre, which would be responsible for integrating these digital solutions.

However, not all digital technologies will deliver the value that telcos seek. A recent study published by Value Partners (3) shows that, for example, Media & Content, Cloud Computing, and Cybersecurity verticals carry relatively higher risks, and lower synergies for telcos because of higher development costs, stronger competition from non-telcos, and tightening industry regulation, whereas FinTech, IoT, and Blockchain hold the highest synergies and largest monetization opportunities. Axiata's and Telenor's shareholders will expect to see a digital transformation roadmap in the near future that highlights a joint investment strategy in digital technologies.

(4) Licensing basis of 3.5 GHz band is for high speed mobile data services (i.e. not specified for 5G).

(5) Average of prices for 2300 MHz, 2600 MHz, and 3500MHz auctions.

3. Will the combination of technological know-how and financial resources put MergedCo ahead of competitors in the 5G era?

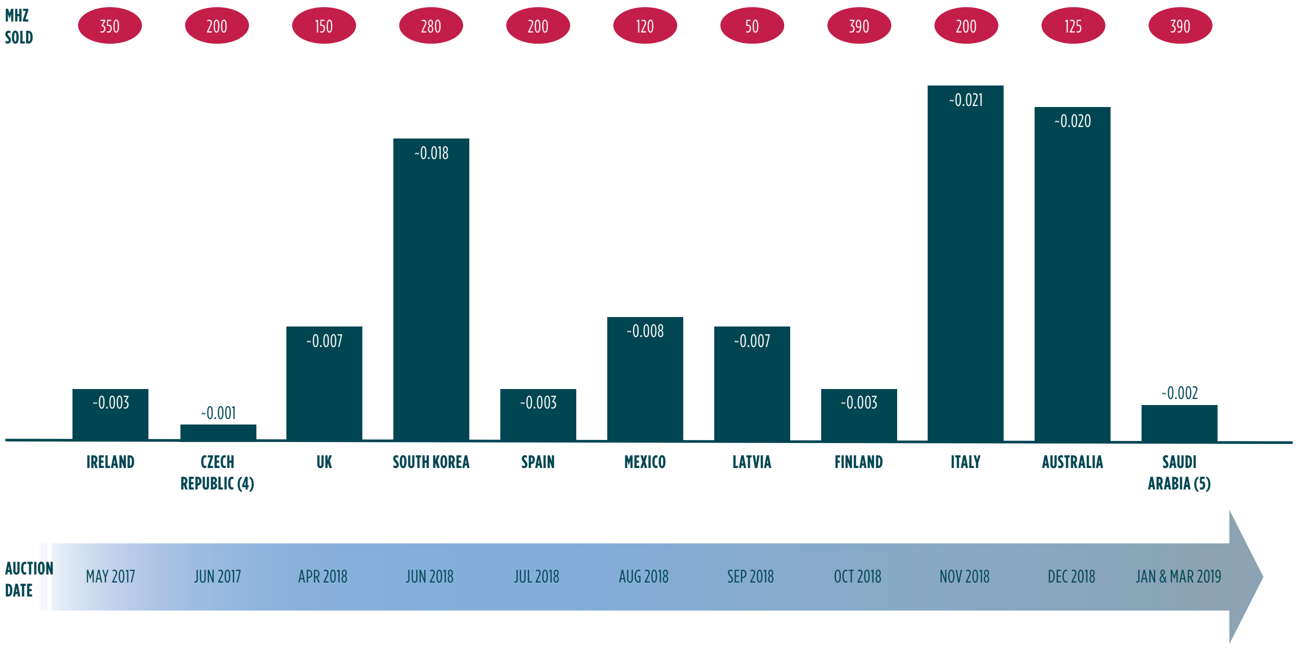
Among all the countries that MergedCo will operate in, 5G has been listed as a top priority in the next 2 to 5 years. Governments from Bangladesh, Myanmar, and Cambodia have announced 5G rollout plans, and 5G trials have already commenced in Thailand, Malaysia, Indonesia, and Sri Lanka.

Combining the financial resources and technological know-how from both Telenor and Axiata, MergedCo should be well equipped to win the race in the 5G era. However, like any other operator, the combined entity will be facing numerous issues surrounding 5G.

From a financial point of view, considering the need for investments in new 5G spectrum license, the increasing capital expenditure for network expansion and upgrades, and the need to operate a high-power consumption 5G network, Axiata and Telenor might be under substantial financial pressure.
They will need to invest separately and simultaneously in multiple countries, and most of the countries that MergedCo would operate in also have similar timelines for 5G spectrum release plans.

Besides, the final prices in spectrum auctions are unpredictable (see Exhibit 3): prices of certain frequency bands could vary significantly due to competition, the number of bidders, different auction structures and auction types, spectrum scarcity in the country's telecom sector, operators' financial constraints, etc.

EXHIBIT 3
Overview of 5G spectrum prices
Mid-band (1-6 GHz) spectrum auctions, final prices, USD / MHz / Pop / Year



Source: ITU, European 5G Observatory, GSMA, Bloomberg, AGCOM, TeleGeography, Value Partners analysis.

Moreover, 5G spectrum investments are likely to include strict network obligations. Often times, regulators release certain spectrum bands under the condition that operators deploy their 5G network within a tight timeframe, or that they reach a target population coverage (e.g. in Hong Kong such obligations are clearly stated ahead of the auctions), increasing financial pressure on telcos.

What does it take for Axiata and Telenor to successfully merge their businesses?

"No merger will be successful without a mutually shared vision and plan for how to integrate the businesses". Telenor CEO Brekke acknowledged that integration risk and differences in organizational culture are a concern. Post-merger, MalaysiaCo would be expecting a blend of cultures, governance, management styles, technologies, etc.

Mergers and acquisitions are a vital means to grow a business quickly, yet many M&As fail to create shareholder value. Shareholders of both parties expect them to set clear directions for the deal (by defining objectives, philosophy and principles of the merger), lay out a clear plan to unlock value from the synergies, design a well-balanced corporate governance structure for the combined entity, and reach a shared understanding on 5G opportunities.

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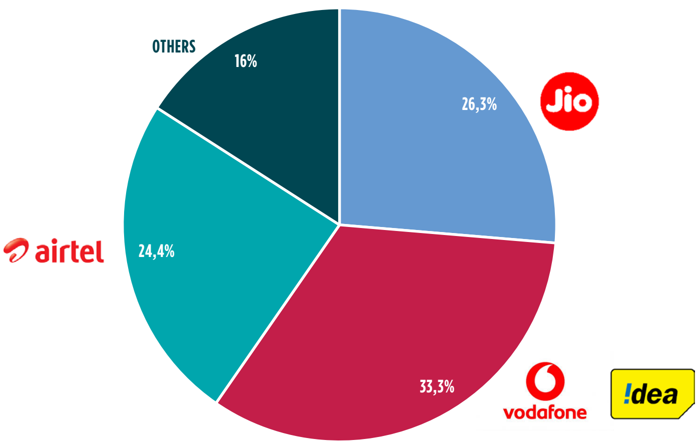
ANOTHER INVESTMENT IN A TECH STARTUP BY RELIANCE JIO

In April 2019, Indian mobile operator Reliance Jio acquired 87% of the Indian startup Haptik, which was founded in 2013, for approximately US$100 million. The startup delivers conversational AI services to more than 100 million devices, and has processed more than 1 billion interactions so far. Reliance Jio, a subsidiary of the conglomerate Reliance Industries, first entered the Indian mobile market in 2016 with an aggressive marketing strategy, offering free voice calls and free 4G data. Today, Reliance Jio is India's #2 telecom operator behind Vodafone-Idea, with over 300 million customers, and capturing about 26% of the subscriber share (see Exhibit 4).

The Haptik acquisition is part of Reliance Industries' broader strategy to drive the transformation of the digital lives of Indian consumers by providing them with a 360 degrees service across connectivity, e-commerce, media, entertainment, financial services, education, agriculture and healthcare.

To drive this transformation, Reliance has set three main objectives: enrich its digital portfolio (which already includes AI services, music streaming, logistic services, and computing software services), strengthen its e-commerce strategy and positioning in India, and achieve technological leadership.

EXHIBIT 4
Indian mobile subscriber share by player, as of March 2019
100% = 1,162 million mobile subscribers



Source: company reports, news articles, Value Partners analysis.

Digital proposition
Objective #1 – Enrich digital portfolio

Besides Haptik, over the last 3 years, Reliance Industries has been acquiring majority stakes in several other digital startups, including Saavn, a music streaming service, and Reverie Language Technologies, a language service that aims to create equality on the Internet (see Exhibit 5 next page).

With these acquisitions, the company aims to enrich its digital portfolio by leveraging the growth in digital content consumption in India, which is driven by media, entertainment, and gaming.

The data below are a testament to this growth:

- By 2020 India is expected to become the 2nd largest video-viewing audience globally, driven by the increasing adoption of mobile services (90% of watch-time happens on mobile devices)
- Revenues from digital music account for more than 70% of the whole music industry in India
- Online gaming is set to grow to US$1 billion in 2021 (vs. US$ 290 million in 2016)

Digital proposition.
Objective #2 - Strengthen e-commerce

Recently, Reliance Industries has been focusing on strengthening Reliance Jio and Reliance Retail's core capabilities, with the ultimate goal of uniting them to create a new e-commerce platform that combines the customers and data of Reliance Jio with the offline extension of Reliance Retail. Reliance Jio has been defined as the highway that will make the development of the digital ecosystem possible, and mobile-based software as a service (SaaS), big data analytics, AI and automation tools, cloud services, and blockchain technologies will be the pillars of this ecosystem.

EXHIBIT 5
Reliance Industries' Acquisitions of AI-based and technology startups

COMPANY	YEAR	SEGMENT	TOTAL INVESTMENT	STAKE
netradyne	JUNE 2016 AND SEP 2018	AI (FLEET MANAGEMENT, AUTOMOTIVE, SECURITY, SURVEILLANCE)	US$24 MILLION	37.4%
Jio saavn	MARCH 2018	MUSIC DIGITAL STREAMING	US$104 MILLION	81.7%
EMBIBE	APRIL 2018	AI-BASED EDUCATION PLATFORM PROVIDER	US$180 MILLION	72.7%
REVERIE Language Technologies	FEBRUARY 2019	LANGUAGE TECHNOLOGIES DEVELOPMENT (VOICE TECH)	US$28 MILLION	83.3%
Sankhya Sutra Labs	FEBRUARY 2019	HIGH-PERFORMANCE COMPUTING (HPC) SOFTWARE SIMULATION SERVICES	US$31 MILLION	83.0%
GRAB	MARCH 2019	LOGISTICS SERVICES PLATFORM	US$20.6 MILLION	83.0%
CSQUARE	MARCH 2019	SOFTWARE SOLUTIONS WITH SPECIFIC FOCUS ON PHARMA SECTOR	US$11.5 MILLION	82.0%
haptik	APRIL 2019	CONVERSATIONAL AI PLATFORM	US$100 MILLION	87.0%

Source: Company reports, news, Value Partners analysis.

With its AI conversational services, the acquisition of Haptik is set to strengthen Reliance's e-commerce strategy and fuel the creation of a digital ecosystem.

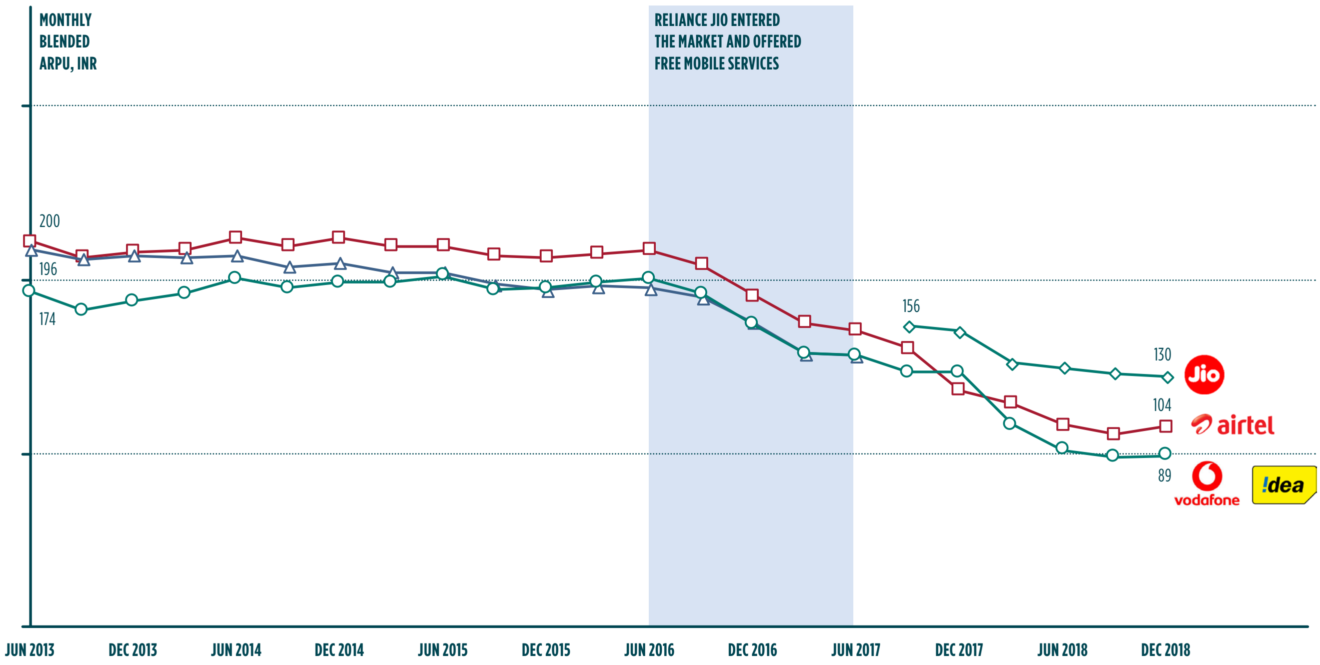
On paper, there could not have been a better time for Reliance Jio to further invest in e-commerce – the market in India is expected to grow to US$200 billion by 2026 (vs. US$38.5 billion in 2017), retail e-commerce sales show an 18% CAGR over the next few years, and new e-commerce regulations aim to protect domestic players, by banning Foreign Direct Investment (FDI) in inventory-driven e-commerce models and prohibiting e-commerce firms from pushing merchants to sell exclusively on their platforms (which was Amazon's and Flipkart's model for some product categories).

Digital proposition. Objective #3 – Establishing technological leadership

The Haptik acquisition also reinforces the company's attempt to establish technological leadership in India, where the low-ARPU environment (see Exhibit 6) makes it tough for operators to compete only on core telecommunication services.

By establishing itself as a technological leader, Reliance Jio might justify a price premium (vs. other competitors whose propositions are mostly around core telecommunication services), capture a larger share of wallet from its existing customers (e.g. by offering new value-added digital services), and acquire new customers (through a more appealing value proposition).

EXHIBIT 6
India: mobile market blended ARPU



Source: BMI Research, Company annual reports, Value Partners analysis.

So far, this strategy has paid off: Reliance Jio has the highest ARPU (INR 130 per month in December 2018, vs. Airtel's INR 104 and Vodafone-Idea's INR 89); the lowest churn rate of the industry (at 0.75% per month); an industry-leading EBITDA margin of 39% (during FY 2018-19); and a healthy customer engagement (average data consumption per user per month of 10.9 GB, and average voice consumption per user per month of 823 minutes).

But will Reliance be able to deliver tangible value from its digital businesses?

As we have seen, most macro factors in India look favorable. Demand for digital services is booming. E-commerce is on the rise. Online retail sales are expected to grow double-digit. Cutting-edge technologies such as AI have the potential to expedite the adoption of new digital services and enhance the customer experience. However, in India, willingness to pay for digital services remains low at this moment, and Reliance Jio might need to wait longer than expected to see its digital businesses delivering tangible value.

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One of Haptik's applications might be within cost centers such as customer care, which hold the largest digitalization opportunities for telcos. AI-based customer care services would help Reliance Jio cut customer-care related costs by at least 10%, based on comparable experiences. To achieve a successful transition towards a high-tech customer care model, Reliance Jio must ensure the incorporation of 3 key success factors: digital mindset across the organization, buy-in of key stakeholders within the organization, and strong engagement from the IT department to integrate new digital solutions into legacy systems.

Haptik might also be able to boost the adoption of Reliance's e-commerce services (similar to what Alexa did for Amazon). However, in the e-commerce space, the company will face tough competition from Amazon, which claims over 150 mn registered users and monthly traffic of 365 mn visits – and Flipkart (invested by Walmart last year), which has 100 mn registered users and 221 mn monthly visits. Despite unfavorable regulations, both players are well-positioned to fight any new entrants and are not new to defending their footholds in foreign markets.

Given these circumstances, when and how will Reliance generate tangible value from its digital investments? What is the plan to unlock the true value from the recent acquisitions? Before closing another deal in the tech space, Reliance should share how much value the company has created from its previous acquisitions. Its shareholders would definitely appreciate that.

ABOUT

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