

## Upgrade to Buy

# Should we really wait for the 'done-deal' to be actually done?

June 27, 2013

<b>Rating</b>	<b>Buy</b>
Up from Neutral	
<b>Target price</b>	IDR 6,000
Remains	
<b>Closing price</b>	IDR 4,500
June 26, 2013	
<b>Potential upside</b>	+33.3%

**Action/Valuations: Upgrade to Buy**

We upgrade XL to Buy with an unchanged IDR6,000 target price. XL has been one of the worst-performing telcos in Asia this year – down 20% YTD. We think this is due to: 1) concerns over a potential merger with Axis; and 2) its weak operating performance due to data competition. On 1), a widely held market view is that “it’s a done deal”. There is limited financial data available on Axis, but its current debt and spectrum could imply around USD1.5bn in EV, which would seem expensive we think – this is 30% of XL’s current EV. There is clearly spectrum appeal (Axis has 15MHz in the 1800MHz band) and there will be future capex savings and market share gain potential too. But we don’t think the deal will be straightforward (*if it happens at all*), and don’t think XL management will rush into it unless it makes strategic and valuation sense. It is possible that the deal could even involve some share swap, debt restructuring or Axiata’s involvement, which could improve the economics. Hence, we think that rather than waiting for the “done-deal” to be actually done, it is worth building positions in the stock at current levels given its 11-12x P/E. If, hypothetically, Axis is an USD1bn deal and is 75/25 debt-equity funded, we estimate 10-30% EPS dilution over FY14-15F, which raises our adjusted P/E to 12-16x. On 2), we understand that XL is starting to regain some traction (and competition has moderated somewhat, too), and the next few operating results should be resilient.

**What would be the catalysts for a re-rating?**

XL’s share price re-rating from here on will be based on a combination of operating trends, macro and clarity on the Axis deal. Our Indonesia strategist Wilianto Ie has recently turned bullish again on Indonesia, driven by the recent fuel subsidy reforms, and its solid underlying economic fundamentals, which could limit the extent of fund outflows.

31 Dec	FY12	FY13F		FY14F		FY15F	
Currency (IDR)	Actual	Old	New	Old	New	Old	New
<b>Revenue (bn)</b>	20,970	22,839	22,839	24,490	24,490	26,148	26,148
<b>Reported net profit (bn)</b>	2,766	3,131	3,131	3,280	3,280	3,433	3,433
<b>Normalised net profit (bn)</b>	3,060	3,131	3,131	3,280	3,280	3,433	3,433
<b>FD normalised EPS</b>	359.62	368.06	368.06	385.48	385.48	403.48	403.48
<b>FD norm. EPS growth (%)</b>	-6.4	2.3	2.3	4.7	4.7	4.7	4.7
<b>FD normalised P/E (x)</b>	12.5	N/A	12.2	N/A	11.7	N/A	11.2
<b>EV/EBITDA (x)</b>	5.2	N/A	5.3	N/A	5.1	N/A	4.8
<b>Price/book (x)</b>	2.5	N/A	2.2	N/A	2.0	N/A	1.8
<b>Dividend yield (%)</b>	3.2	N/A	3.7	N/A	4.3	N/A	4.9
<b>ROE (%)</b>	19.0	19.2	19.2	18.0	18.0	17.1	17.1
<b>Net debt/equity (%)</b>	82.8	84.9	84.9	79.3	79.3	70.7	70.7

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart.

**Anchor themes**

Macro trends are positive in Indonesia, but competition, regulation and coverage challenges remain.

**Nomura vs consensus**

Our target price is in line with consensus.

**Research analysts**
**ASEAN Telecoms**

**Sachin Gupta, CFA - NSL**  
[sachin.gupta@nomura.com](mailto:sachin.gupta@nomura.com)  
 +65 6433 6968

**Pankaj Suri - NSFSPL**  
[pankaj.suri@nomura.com](mailto:pankaj.suri@nomura.com)  
 +91 22 4053 3724

**Neeraja Natarajan - NSL**  
[neeraja.natarajan@nomura.com](mailto:neeraja.natarajan@nomura.com)  
 +65 6433 6961

**Gopakumar Pullaikodi - NSFSPL**  
[gopakumar.pullaikodi@nomura.com](mailto:gopakumar.pullaikodi@nomura.com)  
 +91 22 4053 3733

**Shweta Dixit - NSFSPL**  
[shweta.dixit@nomura.com](mailto:shweta.dixit@nomura.com)  
 +91 22 672 35457

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

# Key data on XL Axiata

## Income statement (IDRbn)

Year-end 31 Dec	FY11	FY12	FY13F	FY14F	FY15F
Revenue	18,261	20,970	22,839	24,490	26,148
Cost of goods sold	-3,210	-4,039	-4,793	-5,140	-5,488
Gross profit	15,051	16,931	18,045	19,350	20,660
SG&A	-10,385	-12,252	-13,267	-14,317	-15,414
Employee share expense	0	0	0	0	0
Operating profit	4,666	4,679	4,778	5,033	5,246
EBITDA	9,349	9,745	9,966	10,524	11,158
Depreciation	-4,683	-5,066	-5,187	-5,490	-5,912
Amortisation					
EBIT	4,666	4,679	4,778	5,033	5,246
Net interest expense	-579	-601	-603	-660	-669
Associates & JCEs	0	0	0	0	0
Other income	-222	-326	0	0	0
Earnings before tax	3,865	3,752	4,175	4,373	4,577
Income tax	-1,035	-987	-1,044	-1,093	-1,144
Net profit after tax	2,830	2,766	3,131	3,280	3,433
Minority interests	0	0	0	0	0
Other items	438	294	0	0	0
Preferred dividends					
Normalised NPAT	3,268	3,060	3,131	3,280	3,433
Extraordinary items	-438	-294	0	0	0
Reported NPAT	2,830	2,766	3,131	3,280	3,433
Dividends	-1,144	-1,224	-1,409	-1,640	-1,888
Transfer to reserves	1,686	1,542	1,722	1,640	1,545

## Valuation and ratio analysis

Reported P/E (x)	13.5	13.8	12.2	11.7	11.2
Normalised P/E (x)	11.7	12.5	12.2	11.7	11.2
FD normalised P/E (x)	11.7	12.5	12.2	11.7	11.2
FD normalised P/E at price target (x)	16.4	17.5	17.1	16.3	15.6
Dividend yield (%)	3.0	3.2	3.7	4.3	4.9
Price/cashflow (x)	4.5	4.3	4.4	4.2	3.9
Price/book (x)	2.8	2.5	2.2	2.0	1.8
EV/EBITDA (x)	5.1	5.2	5.3	5.1	4.8
EV/EBIT (x)	10.3	10.9	11.1	10.6	10.1
Gross margin (%)	82.4	80.7	79.0	79.0	79.0
EBITDA margin (%)	51.2	46.5	43.6	43.0	42.7
EBIT margin (%)	25.6	22.3	20.9	20.6	20.1
Net margin (%)	15.5	13.2	13.7	13.4	13.1
Effective tax rate (%)	26.8	26.3	25.0	25.0	25.0
Dividend payout (%)	40.4	44.3	45.0	50.0	55.0
Capex to sales (%)	35.7	48.5	38.8	34.0	29.7
Capex to depreciation (x)	1.4	2.0	1.7	1.5	1.3
ROE (%)	22.3	19.0	19.2	18.0	17.1
ROA (pretax %)	16.4	14.4	13.0	12.5	12.3

## Growth (%)

Revenue	4.6	14.8	8.9	7.2	6.8
EBITDA	0.7	4.2	2.3	5.6	6.0
EBIT					
Normalised EPS	8.3	-6.4	2.3	4.7	4.7
Normalised FDEPS	8.3	-6.4	2.3	4.7	4.7

## Per share

Reported EPS (IDR)	332.66	325.05	368.06	385.48	403.48
Norm EPS (IDR)	384.13	359.62	368.06	385.48	403.48
Fully diluted norm EPS (IDR)	384.13	359.62	368.06	385.48	403.48
Book value per share (IDR)	1,609.37	1,806.54	2,030.75	2,250.60	2,461.34
DPS (IDR)	134.45	143.85	165.63	192.74	221.91

Source: Company data, Nomura estimates

## Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (IDR)	-11.8	-15.9	-26.8
Absolute (USD)	-13.1	-17.5	-30.4
Relative to index	6.3	-1.7	-34.7
Market cap (USDmn)	3,859.5		
Estimated free float (%)	20.0		
52-week range (IDR)	7400/4200		
3-mth avg daily turnover (USDmn)	3.91		
Major shareholders (%)			
Axiata	66.6		
Public (individually less than 5%)	33.5		

Source: Thomson Reuters, Nomura research

## Notes

Revenue growth should continue to be strong

**Cashflow (IDRbn)**

Year-end 31 Dec	FY11	FY12	FY13F	FY14F	FY15F
EBITDA	9,349	9,745	9,966	10,524	11,158
Change in working capital	795	-953	97	228	198
Other operating cashflow	-1,710	193	-1,438	-1,535	-1,585
Cashflow from operations	8,433	8,985	8,625	9,217	9,772
Capital expenditure	-6,522	-10,176	-8,861	-8,330	-7,760
Free cashflow	1,911	-1,191	-236	887	2,012
Reduction in investments	0	0	0	0	0
Net acquisitions	0	0	0	0	0
Reduction in other LT assets	0	0	0	0	0
Addition in other LT liabilities	0	0	0	0	0
Adjustments	-161	175	-475	0	0
Cashflow after investing acts	1,750	-1,016	-711	887	2,012
Cash dividends	-910	-1,107	-1,224	-1,409	-1,640
Equity issue	0	0	0	0	0
Debt issue	547	2,794	1,978	500	-250
Convertible debt issue	0	0	0	0	0
Others	-755	-878	0	0	0
Cashflow from financial acts	-1,118	809	754	-909	-1,890
Net cashflow	632	-207	43	-23	122
Beginning cash	366	998	792	835	812
Ending cash	998	791	835	812	934
Ending net debt	9,728	12,728	14,663	15,186	14,814

**Notes**

Capex is likely to remain high

Source: Company data, Nomura estimates

**Balance sheet (IDRbn)**

As at 31 Dec	FY11	FY12	FY13F	FY14F	FY15F
Cash & equivalents	998	792	835	812	934
Marketable securities	0	0	0	0	0
Accounts receivable	670	528	539	579	620
Inventories	67	50	61	65	69
Other current assets	1,653	2,290	2,290	2,290	2,290
Total current assets	3,387	3,659	3,725	3,746	3,914
LT investments	0	0	0	0	0
Fixed assets	25,615	29,643	33,831	36,710	38,597
Goodwill	0	0	0	0	0
Other intangible assets	0	0	0	0	0
Other LT assets	2,169	2,153	2,114	2,075	2,036
Total assets	31,171	35,456	39,670	42,531	44,547
Short-term debt	3,820	4,307	4,307	4,307	4,307
Accounts payable	2,815	2,654	2,773	3,045	3,289
Other current liabilities	2,093	1,780	1,780	1,780	1,780
Total current liabilities	8,728	8,740	8,860	9,131	9,375
Long-term debt	6,906	9,213	11,191	11,691	11,441
Convertible debt	0	0	0	0	0
Other LT liabilities	1,844	2,132	2,341	2,560	2,789
Total liabilities	17,478	20,086	22,392	23,383	23,605
Minority interest	0	0	0	0	0
Preferred stock	0	0	0	0	0
Common stock	852	853	853	853	853
Retained earnings	7,427	9,063	10,971	12,841	14,634
Proposed dividends	0	0	0	0	0
Other equity and reserves	5,414	5,454	5,454	5,454	5,454
Total shareholders' equity	13,693	15,370	17,278	19,148	20,941
Total equity & liabilities	31,171	35,456	39,670	42,531	44,546

**Notes**

Gearing could rise on the back of Axis deal

**Liquidity (x)**

Current ratio	0.39	0.42	0.42	0.41	0.42
Interest cover	8.1	7.8	7.9	7.6	7.8

**Leverage**

Net debt/EBITDA (x)	1.04	1.31	1.47	1.44	1.33
Net debt/equity (%)	71.05	82.81	84.87	79.31	70.74

**Activity (days)**

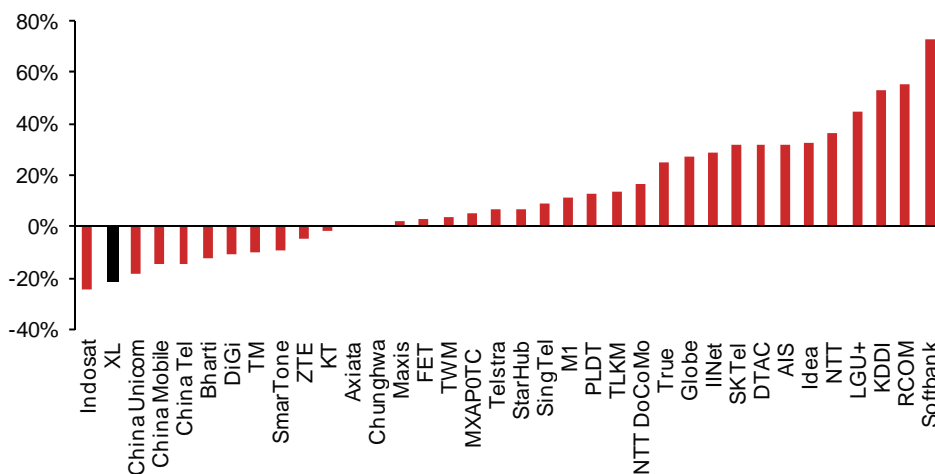
Days receivable	12.0	10.5	8.5	8.3	8.4
Days inventory	7.3	5.3	4.2	4.5	4.5
Days payable	254.4	247.8	206.6	206.6	210.6
Cash cycle	-235.1	-232.1	-193.9	-193.8	-197.8

Source: Company data, Nomura estimates

# Upgrade XL to Buy

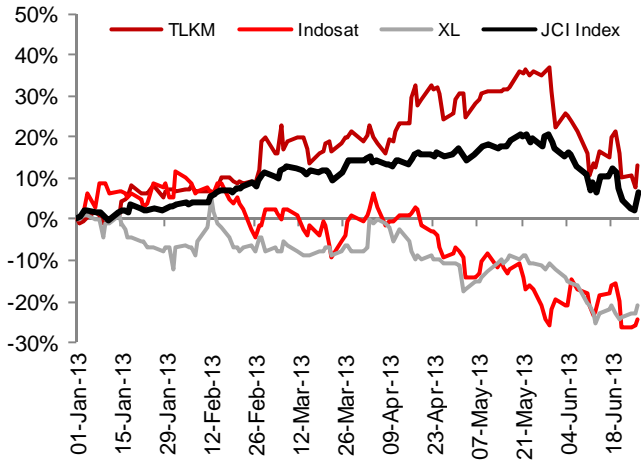
- Given XL’s significant underperformance vs. regional telcos and the local market YTD, we upgrade XL to Buy with an unchanged TP of IDR6,000. This year, it’s been one of the worst performing Asian telcos (down 20%).
- There have been two key overhangs for the stock: 1) concerns around the potential acquisition of Axis; and 2) mixed operating trends.
- On 1), the timing or the even likelihood of the deal isn’t known, but a number of telco operators, suppliers and investors appear to think “it’s a done deal”. Though there are merits in the deal because of XL’s spectrum limitations (see Fig 7), we believe the valuations may not be easy to justify given around USD1.2bn of Axis’ debt (based on limited available financials) and around USD450mn of its spectrum value. We don’t think this deal, if it happens at all, will be necessarily straightforward. Many structuring scenarios are possible for the deal, such as some form of merger or even Axiata’s involvement.
  - If we assume it is an USD1bn deal in a hypothetical scenario of 75/25 debt and equity mix (we are giving XL management the benefit of doubt that it will not overpay for assets), we estimate around 10-30% EPS dilution in FY14-15F. Beyond that, there should be some benefits too – additional spectrum should put XL in a strong position to compete better. The adjusted P/E, in this case, is 12-16x vs. 11x currently. Net debt to EBITDA rises to around 2x.
  - Some of the benefits of the deal could include: 1) additional 1800MHz and 2100MHz spectrum, which will become more critical if and when 4G is rolled out; 2) future capex savings – XL could arguably save USD100-200mn pa as result of additional spectrum (which alone – ex additional revenue potential – could imply 5-8 years payback); and 3) additional market share and revenue share gains (there is an opportunity cost argument too, ie, without spectrum they could lose share too).
- On 2), the market will likely remain volatile going forward, especially due to data competition and it is difficult to say whether the worst is over – we will need to assess it quarter by quarter. After six months of weak operating trends, we understand that XL has gained some traction in recent months and this should continue for the next one-two quarters (3Q is seasonally strong anyway).
- Our Indonesia strategist Wilianto Ie has recently turned bullish again on Indonesia, driven by the recent fuel subsidy reforms, and its solid underlying economic fundamentals, which could limit the extend of fund outflows. See attached link for more details: [Indonesia Strategy - When the dust settles...](#)

Fig. 1: Asian telcos: YTD performance



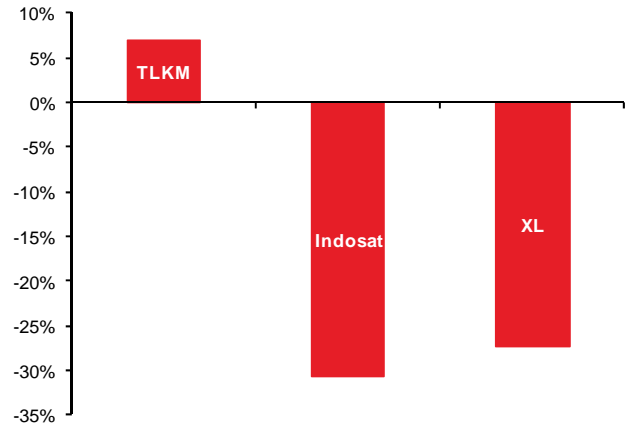
Source: Bloomberg, Nomura research

**Fig. 2: Indonesian telcos: YTD performance**



Source: Bloomberg, Nomura research

**Fig. 3: YTD performances vs. local market**

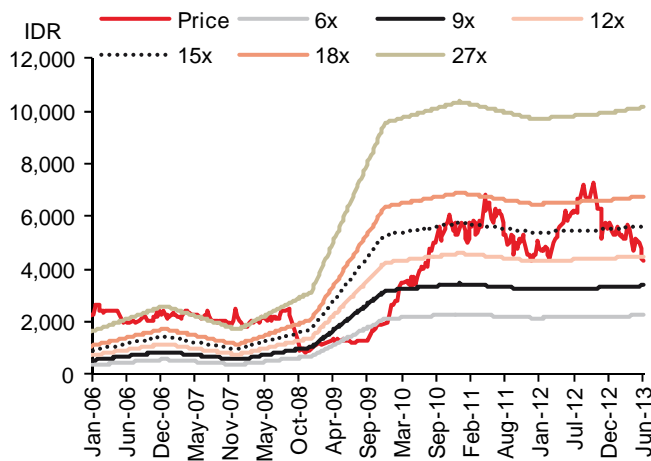


Source: Bloomberg, Nomura research

### Discount on many fronts

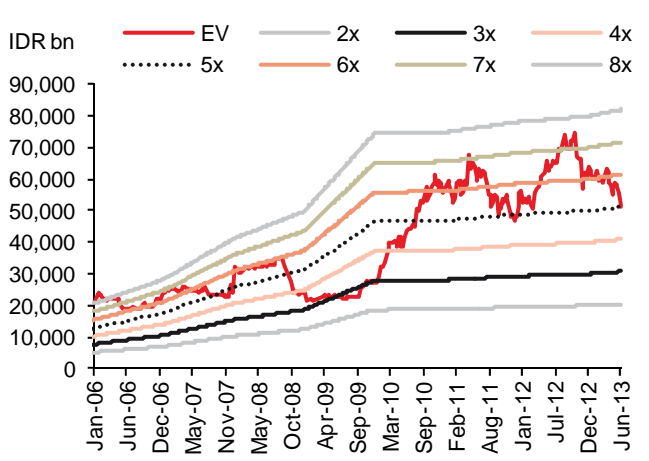
- XL's share price has dropped by c.20% this year on the back of concerns around the potential Axis deal, competitive headwinds, and a weak macro. This is compared with a 24% drop for Indosat, and a 13% rise for Telkom during the period.
  - XL touched its historical peak of IDR7300 in Oct-12; the share price has since then declined by 40%.
- XL's current share price reflects a 20% discount to its past three-year average share price vs. a 10% discount for Indosat; whereas Telkom is trading at a 20% premium.
- Its valuations look appealing at 12x FY14F earnings and 5x EBITDA, which reflect a 20+% discount on an y-y basis.

**Fig. 4: XL: One-year forward P/E**



Source: Bloomberg, Nomura estimates

**Fig. 5: XL: One-year forward EV/EBITDA**



Source: Bloomberg, Nomura estimates

Fig. 6: Valuation summary

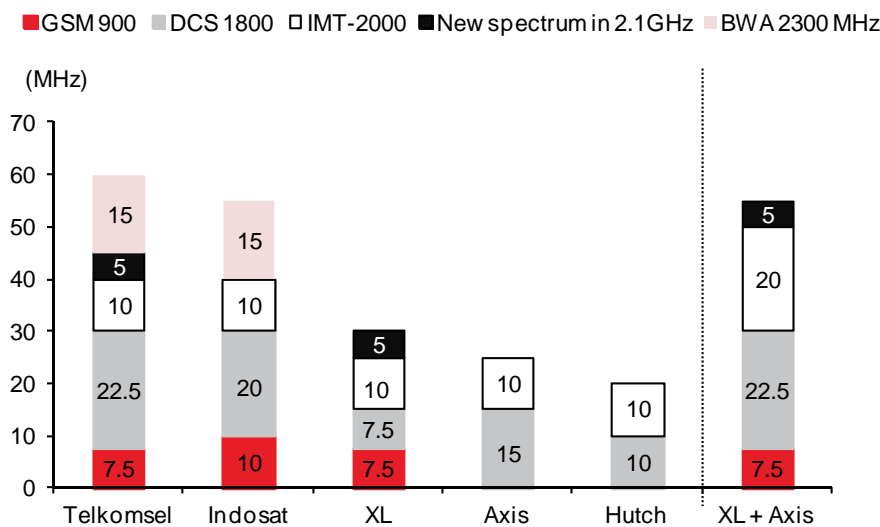
	Bloomberg ticker	Rating	Currency	Local price	Mkt Cap (US\$ mn)	PE (x)			EV/EBITDA (x)			Div Yield (%)			FCF Yield (%)		
						12	13E	14E	12	13E	14E	12	13E	14E	12	13E	14E
<b>Wireless</b>																	
AIS	ADVANC TB	Buy	THB	276	26,359	23.3	21.6	20.6	13.5	13.0	12.0	3.9%	4.6%	4.9%	4.2%	3.3%	0.9%
Axiata Group	AXIATA MK	Buy	MYR	6.6	17,422	20.7	19.3	18.1	8.3	8.0	7.6	5.3%	5.2%	5.5%	2.9%	4.5%	5.7%
Bharti Airtel	BHARTI IN	Neutral	INR	278	17,370	44.8	24.8	18.3	6.6	5.8	5.2	0.0%	0.6%	1.4%	0.6%	5.8%	7.0%
China Mobile	941 HK	Neutral	HK\$	77	199,821	9.6	9.8	9.8	3.4	3.3	3.2	4.5%	4.4%	4.4%	9.3%	3.3%	5.1%
Digi.com	Digi MK	Neutral	MYR	4.70	11,405	22.6	21.1	20.2	12.5	11.9	11.4	5.6%	4.6%	5.0%	4.3%	5.3%	5.2%
Globe Telecom	GLO PM	Neutral	PHP	1,385	4,221	17.5	16.9	15.4	6.8	6.5	6.2	4.8%	5.0%	5.3%	-0.2%	4.5%	8.6%
Idea Cellular	IDEA IN	Reduce	INR	137	7,477	42.4	30.6	23.7	9.6	8.4	7.4	0.3%	0.4%	0.5%	4.5%	2.0%	2.8%
Maxis	Maxis MK	Reduce	MYR	6.8	15,847	24.8	23.6	23.5	13.1	12.8	12.5	5.9%	5.9%	5.9%	4.3%	4.8%	5.0%
MobileOne	M1 SP	Buy	S\$	3.0	2,154	18.4	16.9	16.6	10.0	9.4	9.2	4.8%	5.0%	5.0%	5.6%	4.7%	5.7%
NTT DoCoMo	9437 JP	Neutral	JPY	144,800	61,588	11.7	11.5	11.5	3.6	3.5	3.4	4.1%	4.1%	4.1%	3.8%	6.2%	8.1%
XL	EXCL IJ	Buy	IDR	4,500	3,858	12.5	12.2	11.7	5.4	5.3	5.0	3.2%	3.7%	4.3%	-2.7%	-1.9%	2.3%
RCOM	RCOM IN	Neutral	INR	115	3,902	66.4	33.1	20.5	9.0	8.9	8.1	0.2%	0.3%	0.5%	n/a	n/a	n/a
SK Telecom	017670 KS	Buy	KRW	200,500	12,344	11.3	8.5	7.8	4.9	4.6	4.3	4.7%	4.7%	4.7%	4.2%	12.2%	15.6%
Taiwan Mobile	3045 TT	Buy	NT\$	111	14,003	19.6	18.1	16.0	14.7	14.1	13.1	4.6%	5.0%	5.6%	4.9%	4.9%	5.4%
DTAC	DTAC TB	Buy	THB	117	8,861	24.7	23.8	22.5	11.4	10.4	9.1	4.3%	4.2%	4.5%	2.4%	3.3%	-0.4%
<b>Average</b>						<b>24.7</b>	<b>19.5</b>	<b>17.1</b>	<b>8.4</b>	<b>8.0</b>	<b>7.5</b>	<b>3.8%</b>	<b>3.8%</b>	<b>4.1%</b>	<b>3.4%</b>	<b>4.5%</b>	<b>5.5%</b>
<b>Median</b>						<b>20.7</b>	<b>19.3</b>	<b>17.1</b>	<b>8.4</b>	<b>8.0</b>	<b>7.4</b>	<b>4.5%</b>	<b>4.6%</b>	<b>4.7%</b>	<b>4.2%</b>	<b>4.6%</b>	<b>5.3%</b>
<b>Integrated</b>																	
China Telecom	728 HK	Buy	HK\$	3.7	38,493	15.9	13.3	11.7	4.1	3.0	2.9	2.3%	2.6%	2.6%	4.8%	6.6%	6.5%
China Unicom	762 HK	Buy	HK\$	10	30,799	26.7	17.9	12.9	4.3	3.9	3.3	1.5%	2.0%	2.7%	-8.6%	2.8%	7.0%
Chunghwa	2412 TT	Neutral	NT\$	95	24,536	16.5	16.7	16.3	7.7	7.7	7.6	5.4%	5.4%	5.5%	6.3%	6.3%	6.7%
iiNET	IIN AU	Buy	A\$	5.9	892	17.8	17.6	14.3	5.5	5.2	4.8	2.7%	2.9%	3.6%	8.6%	9.4%	10.7%
KDDI	9433 JP	Buy	JPY	4,660	36,538	12.7	11.0	9.7	4.5	4.1	3.7	1.9%	2.6%	3.0%	1.4%	7.4%	8.2%
KT Corp	030200 KS	Neutral	KRW	34,950	7,903	9.3	10.0	8.8	4.9	4.3	4.1	5.7%	5.7%	5.7%	22.0%	13.8%	15.3%
LG Uplus	032640 KS	Buy	KRW	11,300	5,038	70.3	13.1	10.2	6.5	5.1	4.5	0.9%	1.8%	2.5%	3.4%	6.2%	8.2%
NTT	9432 JP	Buy	JPY	4,940	60,062	10.9	10.6	9.9	3.5	3.5	3.5	3.2%	3.4%	3.6%	9.8%	6.2%	7.4%
PLDT	TEL PM	Neutral	PHP	2,800	13,798	16.1	15.5	14.6	8.8	8.6	8.1	6.1%	6.4%	6.8%	6.0%	6.3%	6.9%
PT Indosat	ISAT IJ	Buy	IDR	4,875	2,669	15.8	15.7	15.4	4.7	5.7	5.7	0.7%	1.0%	1.9%	4.5%	6.3%	9.4%
PT Telkom	TLKM IJ	Neutral	IDR	10,250	20,395	14.9	14.1	13.3	5.2	4.8	4.5	4.1%	4.6%	5.7%	9.5%	9.0%	10.5%
SingTel	ST SP	Buy	S\$	3.6	45,209	15.9	14.9	13.8	8.6	8.2	7.7	4.7%	5.0%	5.8%	6.5%	5.0%	4.0%
Softbank	9984 JP	Buy	JPY	5,420	66,239	20.1	15.0	13.6	8.1	6.4	6.4	0.7%	0.7%	0.7%	-2.1%	1.6%	3.7%
StarHub	STH SP	Reduce	S\$	4.1	5,461	19.3	20.0	19.4	10.2	10.1	9.7	4.9%	4.9%	4.7%	5.8%	4.9%	4.7%
TM	T MK	Neutral	MYR	5.4	6,060	21.1	23.0	23.0	7.1	6.8	6.8	4.1%	3.9%	3.9%	2.6%	2.0%	2.0%
Telstra	TLS AU	Neutral	A\$	4.7	54,072	15.2	15.4	14.5	6.6	6.6	6.5	6.0%	6.0%	6.0%	8.9%	8.9%	9.5%
<b>Average</b>						<b>19.5</b>	<b>15.1</b>	<b>13.9</b>	<b>6.3</b>	<b>5.9</b>	<b>5.6</b>	<b>3.5%</b>	<b>3.7%</b>	<b>4.1%</b>	<b>5.9%</b>	<b>6.3%</b>	<b>7.5%</b>
<b>Median</b>						<b>16.1</b>	<b>15.1</b>	<b>13.8</b>	<b>6.4</b>	<b>5.8</b>	<b>5.7</b>	<b>3.6%</b>	<b>3.7%</b>	<b>3.8%</b>	<b>5.9%</b>	<b>6.3%</b>	<b>7.2%</b>
<b>Towers</b>																	
SMN	TOWR IJ	Buy	IDR	24,500	2,519	44.7	25.9	20.6	16.9	12.8	10.8	0.0%	0.0%	0.0%	-2.9%	-1.3%	0.7%
TBIG	TBIG IJ	Buy	IDR	4,750	2,296	33.4	19.0	15.1	21.4	14.2	11.7	0.0%	0.0%	0.0%	-18.9%	-1.7%	0.7%
<b>Average</b>						<b>39.1</b>	<b>22.4</b>	<b>17.8</b>	<b>19.1</b>	<b>13.5</b>	<b>11.2</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>-10.9%</b>	<b>-1.5%</b>	<b>0.7%</b>
<b>Median</b>						<b>39.1</b>	<b>22.4</b>	<b>17.8</b>	<b>19.1</b>	<b>13.5</b>	<b>11.2</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>-10.9%</b>	<b>-1.5%</b>	<b>0.7%</b>

Source: Bloomberg, Nomura estimates. Ratings and prices as on 26 June 2013

# What would acquiring Axis imply?

- Marketwide discussions and recent press articles (“Axiata Said to Weigh Bid for Saudi Telecom’s Axis Indonesia”, Bloomberg, May 22, 2013) indicate a potential acquisition of Axis (#5 operator with 17mn subs) by XL, primarily driven by XL’s spectrum limitations – XL owns just 7.5 Mhz in 1800 Mhz vs. 20-22.5 Mhz for Indosat and Telkomsel.
- M&A appears to be the focus area for XL’s management too, in our view. Indeed, its Commissioner Mr Jamaludin bin Ibrahim recently noted, “Given all the growth and what we anticipate in the future, we definitely need more spectrum. And either we build more sites in dense areas, which is possible, but costly and challenging, or we acquire new spectrum. So in that context, Axis, or for that matter, other operators who have additional spectrum would be of very important relevance to us.”<sup>1</sup>

Fig. 7: GSM telcos – Spectrum ownership



Source: Presentation on Digital Dividend by Mr Denny Setiawan, Directorate of Spectrum Policy and Planning, July 2012; company data; Nomura research

## How much is Axis worth?

- We don’t have detailed financials for Axis, but its total debt is at around USD1.0-1.2bn, based on STC’s financial statements, and its spectrum could be worth around USD400-500mn, we estimate.
- **Axis has 25MHz of total spectrum** – 15MHz in the 1800MHz band and 10MHz in the 2100MHz band. In the 2006 and 2013 auctions, there was an upfront spectrum fee ranging from USD30mn to USD50mn for the 5Mhz block and then there is a fixed annual charge. The total cost for Axis is IDR848bn (USD90mn) over 10 years for a 5Mhz block. However, considering the license terms, time-value, rollover, etc, we estimate the spectrum value could be in the USD400-500mn vicinity.
- It is difficult to ascribe a clear value to customers (17mn) given their low average revenue per user (ARPU) (we estimate around USD1-1.50) and branding.
- **How would the deal be structured?** It is difficult to ascertain the structure at this stage – whether it’s going to be a 100% acquisition or a merger or something else; however, we do expect this deal (if at all it happens) to be a complex one. For funding, XL is likely to consider other options, too, apart from the debt market, such as issuing new shares, or even an asset sale.
  - XL’s towers could be one of its assets that management could look at for selling to fund the acquisition, in our view. XL currently has 8,200 towers, which imply an EV of USD800mn at EV/ tower of USD100k.

<sup>1</sup> Axiata’s 1Q13 results conference call

## Assessing the impact of the deal on XL's financials

For a hypothetical scenario of an USD1bn deal value, we estimate EPS dilution of around 10-30% for FY14-15F. This is based on:

- Assuming Axis's revenue increases by 15% pa from FY13 levels of IDR2.8tn.
- Assuming 40% combined margin in FY14F (vs. 43% for stand-alone XL currently) and 42% in FY15F. This essentially implies that XL can improve its total cost by just 3% in FY14F and then by 9% in FY15F (network cost savings due to additional spectrum).
- We assume a 7% interest cost and another IDR500mn in additional license amortisation (assuming it is rolled over).
- We assume a 25% stock issue at IDR4,500 levels, which is around 550mn new shares.
- This will increase the net debt to EBITDA to 2.0x vs. 1.5x currently.

**Fig. 8: Pro-forma analysis of the XL-Axis deal at USD1bn**

<i>(IDRbn); 2013-15F</i>	XL standalone		Axis	XL & Axis	
	2014F	2015F		2014F	2015F
Revenue	24,490	26,148	2,841	27,757	29,905
EBITDA	10,524	11,158	(284)	10,964	12,411
<i>Margin on net revenue %</i>	43%	43%	-10%	40%	42%
D&A	(5,490)	(5,912)	(426)	(6,417)	(6,838)
<i>as a % of sales</i>	22%	23%	15%		
EBIT	5,033	5,246	(710)	4,547	5,573
Interest expense	(787)	(794)		(1,312)	(1,319)
<i>as a % of debt</i>	5%	5%		7%	7%
Interest income	127	125		127	125
EBT	4,373	4,577		3,362	4,379
Tax	(1,093)	(1,144)		(841)	(1,095)
<b>PAT</b>	<b>3,280</b>	<b>3,433</b>		<b>2,522</b>	<b>3,284</b>
<b>EPS (IDR)</b>	<b>385</b>	<b>403</b>		<b>278</b>	<b>362</b>
<i>Implied accretion/dilution</i>				<b>-28%</b>	<b>-10%</b>
P/E	11.7x	11.2x		16.2x	12.4x
Shares outstanding (mn)	8,508	8,508		9,064	9,064

Source: Nomura estimates



# Operating trends

**Fig. 9: Indonesia telcos: Wireless revenue – quarterly trends (IDR bn)**

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13
<b>Revenues (Rpbn)</b>													
Telkomsel	10,775	11,393	11,916	11,483	11,297	11,925	12,807	12,704	12,298	13,128	14,432	14,673	13,928
Indosat	3,696	3,982	4,236	4,113	3,964	4,262	4,360	4,164	4,080	4,447	5,124	4,839	4,751
XL Axiata	4,106	4,261	4,442	4,651	4,482	4,556	4,777	4,899	4,893	5,279	5,524	5,273	5,023
<b>Total revenues</b>	<b>18,578</b>	<b>19,636</b>	<b>20,594</b>	<b>20,247</b>	<b>19,743</b>	<b>20,743</b>	<b>21,944</b>	<b>21,767</b>	<b>21,271</b>	<b>22,854</b>	<b>25,080</b>	<b>24,785</b>	<b>23,702</b>
<b>Revenue share</b>													
Telkomsel	58.0%	58.0%	57.9%	56.7%	57.2%	57.5%	58.4%	58.4%	57.8%	57.4%	57.5%	59.2%	58.8%
Indosat	19.9%	20.3%	20.6%	20.3%	20.1%	20.5%	19.9%	19.1%	19.2%	19.5%	20.4%	19.5%	20.0%
XL Axiata	22.1%	21.7%	21.6%	23.0%	22.7%	22.0%	21.8%	22.5%	23.0%	23.1%	22.0%	21.3%	21.2%
<b>Revenue growth rates</b>													
Telkomsel	n/m	5.7%	4.6%	-3.6%	-1.6%	5.6%	7.4%	-0.8%	-3.2%	6.7%	9.9%	1.7%	-5.1%
Indosat	-4.6%	7.7%	6.4%	-2.9%	-3.6%	7.5%	2.3%	-4.5%	-2.0%	9.0%	15.2%	-5.6%	-1.8%
XL Axiata	4.0%	3.8%	4.3%	4.7%	-3.6%	1.7%	4.9%	2.6%	-0.1%	7.9%	4.6%	-4.5%	-4.7%
<b>Total revenue growth</b>	<b>n/m</b>	<b>5.7%</b>	<b>4.9%</b>	<b>-1.7%</b>	<b>-2.5%</b>	<b>5.1%</b>	<b>5.8%</b>	<b>-0.8%</b>	<b>-2.3%</b>	<b>7.4%</b>	<b>9.7%</b>	<b>-1.2%</b>	<b>-4.4%</b>

Source: Company data, Nomura research

**Fig. 10: Indonesia telcos: Quarterly EBITDA trends (IDR bn)**

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13
<b>EBITDA (Rpbn)</b>													
Telkomsel	6,400	6,597	6,841	6,760	6,245	6,877	7,428	6,999	7,075	7,347	8,272	7,870	7,838
Indosat	2,228	2,380	2,520	2,466	2,224	2,276	2,648	2,263	2,338	2,541	2,768	2,893	2,629
XL Axiata	2,142	2,288	2,363	2,497	2,362	2,396	2,272	2,320	2,392	2,546	2,505	2,302	2,025
<b>Total EBITDA</b>	<b>10,770</b>	<b>11,265</b>	<b>11,724</b>	<b>11,723</b>	<b>10,831</b>	<b>11,549</b>	<b>12,348</b>	<b>11,582</b>	<b>11,805</b>	<b>12,434</b>	<b>13,545</b>	<b>13,065</b>	<b>12,492</b>
<b>EBITDA growth rates</b>													
Telkomsel	n/m	3.1%	3.7%	-1.2%	-7.6%	10.1%	8.0%	-5.8%	1.1%	3.8%	12.6%	-4.9%	-0.4%
Indosat	-8.0%	6.9%	5.9%	-2.2%	-9.8%	2.3%	16.4%	-14.6%	3.3%	8.7%	8.9%	4.5%	-9.1%
XL Axiata	9.0%	6.8%	3.3%	5.7%	-5.4%	1.4%	-5.2%	2.1%	3.1%	6.4%	-1.6%	-8.1%	-12.0%
<b>Total EBITDA growth</b>	<b>n/m</b>	<b>4.6%</b>	<b>4.1%</b>	<b>0.0%</b>	<b>-7.6%</b>	<b>6.6%</b>	<b>6.9%</b>	<b>-6.2%</b>	<b>1.9%</b>	<b>5.3%</b>	<b>8.9%</b>	<b>-3.5%</b>	<b>-4.4%</b>
<b>EBITDA margin</b>													
Telkomsel	59%	58%	57%	59%	55%	58%	58%	55%	58%	56%	57%	54%	56%
Indosat	47%	48%	49%	50%	46%	44%	50%	43%	47%	47%	45%	49%	45%
XL Axiata	52%	54%	53%	54%	53%	53%	48%	47%	49%	48%	45%	44%	40%
<b>Total margin</b>	<b>58%</b>	<b>57%</b>	<b>57%</b>	<b>58%</b>	<b>55%</b>	<b>56%</b>	<b>56%</b>	<b>53%</b>	<b>55%</b>	<b>54%</b>	<b>54%</b>	<b>53%</b>	<b>53%</b>
<b>EBITDA share</b>													
Telkomsel	59.4%	58.6%	58.4%	57.7%	57.7%	59.5%	60.2%	60.4%	59.9%	59.1%	61.1%	60.2%	62.7%
Indosat	20.7%	21.1%	21.5%	21.0%	20.5%	19.7%	21.4%	19.5%	19.8%	20.4%	20.4%	22.1%	21.0%
XL Axiata	19.9%	20.3%	20.2%	21.3%	21.8%	20.7%	18.4%	20.0%	20.3%	20.5%	18.5%	17.6%	16.2%

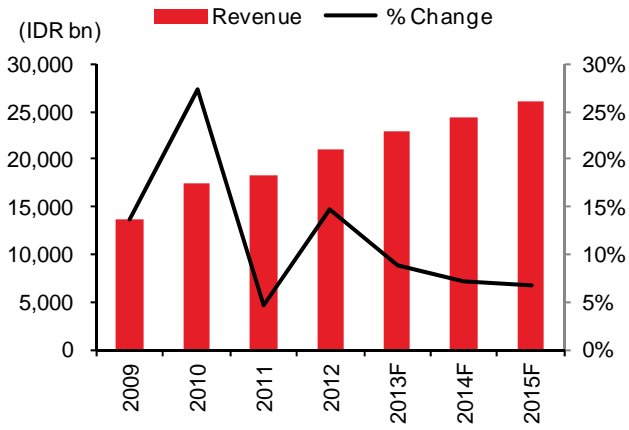
Source: Company data, Nomura research

**Fig. 11: Indonesia telcos: Operational trends**

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13
<b>Mobile subs ('000)</b>													
Telkomsel	81,950	88,316	93,135	94,010	99,365	102,291	104,149	107,017	109,881	117,235	121,477	125,146	120,611
Indosat	37,700	37,800	39,700	44,300	45,700	47,300	51,500	51,700	52,100	50,900	55,400	58,500	55,900
XL Axiata	32,524	35,204	38,497	40,390	39,286	38,896	43,397	46,406	46,413	45,828	42,341	45,755	49,054
<b>Total subs</b>	<b>152,174</b>	<b>161,320</b>	<b>171,332</b>	<b>178,700</b>	<b>184,351</b>	<b>188,487</b>	<b>199,046</b>	<b>205,123</b>	<b>208,394</b>	<b>213,963</b>	<b>219,218</b>	<b>229,401</b>	<b>225,565</b>
<b>Mobile subs share</b>													
Telkomsel	54%	55%	54%	53%	54%	54%	52%	52%	53%	55%	55%	55%	53%
Indosat	25%	23%	23%	25%	25%	25%	26%	25%	25%	24%	25%	26%	25%
XL Axiata	21%	22%	22%	23%	21%	21%	22%	23%	22%	21%	19%	20%	22%
<b>Total subs</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Mobile net adds ('000)</b>													
Telkomsel	306	6,366	4,819	875	5,355	2,926	1,858	2,868	2,864	7,354	4,242	3,669	(4,535)
Indosat	4,600	100	1,900	4,600	1,400	1,600	4,200	200	400	(1,200)	4,500	3,100	(2,600)
XL Axiata	1,087	2,680	3,293	1,893	(1,104)	(390)	4,501	3,009	7	(585)	(3,487)	3,414	3,299
<b>Total net adds</b>	<b>5,993</b>	<b>9,146</b>	<b>10,012</b>	<b>7,368</b>	<b>5,651</b>	<b>4,136</b>	<b>10,559</b>	<b>6,077</b>	<b>3,271</b>	<b>5,569</b>	<b>5,255</b>	<b>10,183</b>	<b>(3,836)</b>
<b>Net adds share</b>													
Telkomsel	5%	70%	48%	12%	95%	71%	18%	47%	88%	132%	81%	36%	118%
Indosat	77%	1%	19%	62%	25%	39%	40%	3%	12%	-22%	86%	30%	68%
XL Axiata	18%	29%	33%	26%	-20%	-9%	43%	50%	0%	-11%	-66%	34%	-86%
<b>BTS</b>													
Telkomsel	32,243	34,005	35,316	36,557	37,830	39,609	41,037	42,623	44,797	47,254	51,005	54,297	57,664
Indosat	17,010	17,372	17,847	18,108	18,368	18,408	18,776	19,253	20,063	21,039	21,642	21,930	22,097
XL Axiata	19,904	20,887	21,623	22,191	23,267	24,971	26,245	28,273	30,732	33,737	36,101	39,452	39,819
<b>Total BTS</b>	<b>69,157</b>	<b>72,264</b>	<b>74,786</b>	<b>76,856</b>	<b>79,465</b>	<b>82,988</b>	<b>86,058</b>	<b>90,149</b>	<b>95,592</b>	<b>102,030</b>	<b>108,748</b>	<b>115,679</b>	<b>119,580</b>
<b>BTS additions</b>													
Telkomsel	1,251	1,762	1,311	1,241	1,273	1,779	1,428	1,586	2,174	2,457	3,751	3,292	3,367
Indosat	657	362	475	261	260	40	368	477	810	976	603	288	167
XL Axiata	555	983	736	568	1,076	1,704	1,274	2,028	2,459	3,005	2,364	3,351	367
<b>Total BTS additions</b>	<b>2,463</b>	<b>3,107</b>	<b>2,522</b>	<b>2,070</b>	<b>2,609</b>	<b>3,523</b>	<b>3,070</b>	<b>4,091</b>	<b>5,443</b>	<b>6,438</b>	<b>6,718</b>	<b>6,931</b>	<b>3,901</b>
<b>BTS share</b>													
Telkomsel	47%	47%	47%	48%	48%	48%	48%	47%	47%	46%	47%	47%	48%
Indosat	25%	24%	24%	24%	23%	22%	22%	21%	21%	21%	20%	19%	18%
XL Axiata	29%	29%	29%	29%	29%	30%	30%	31%	32%	33%	33%	34%	33%
<b>Total BTS</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

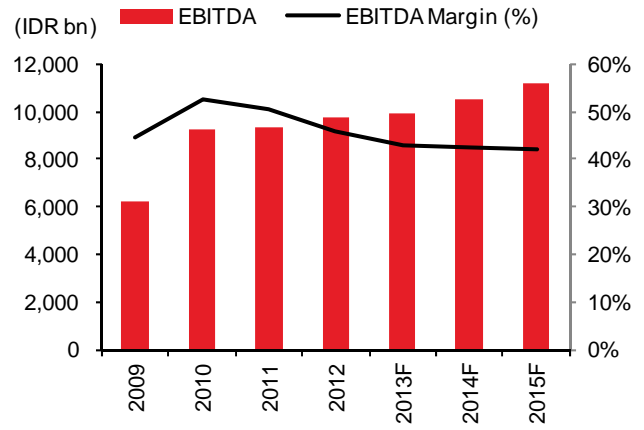
Source: Company data, Nomura research

**Fig. 12: Revenue trends**



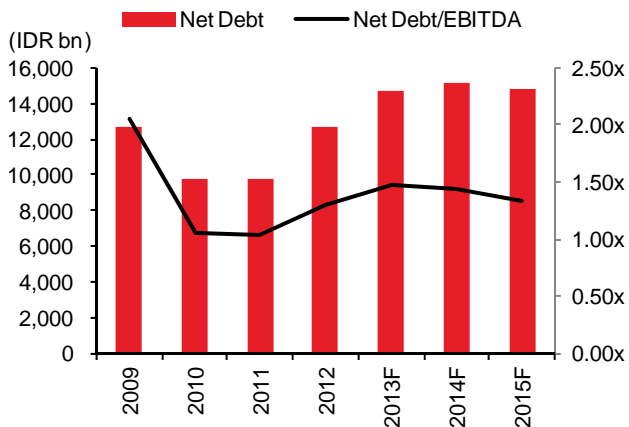
Source: Company data, Nomura estimates

**Fig. 13: EBITDA trends**



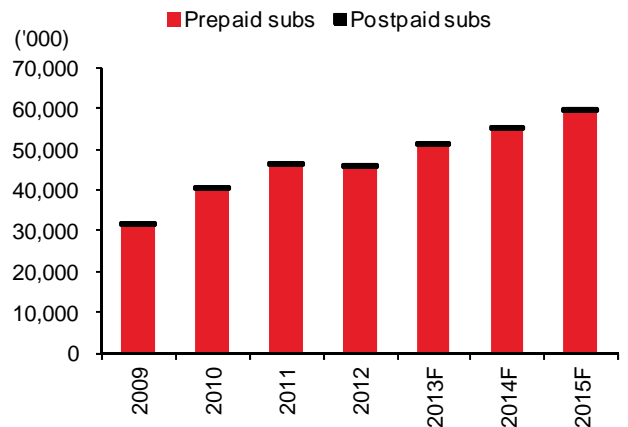
Source: Company data, Nomura estimates

**Fig. 14: Net debt trends**



Source: Company data, Nomura estimates

**Fig. 15: Subscriber trends**



Source: Company data, Nomura estimates

# Appendix A-1

## Analyst Certification

I, Sachin Gupta, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

## Issuer Specific Regulatory Disclosures

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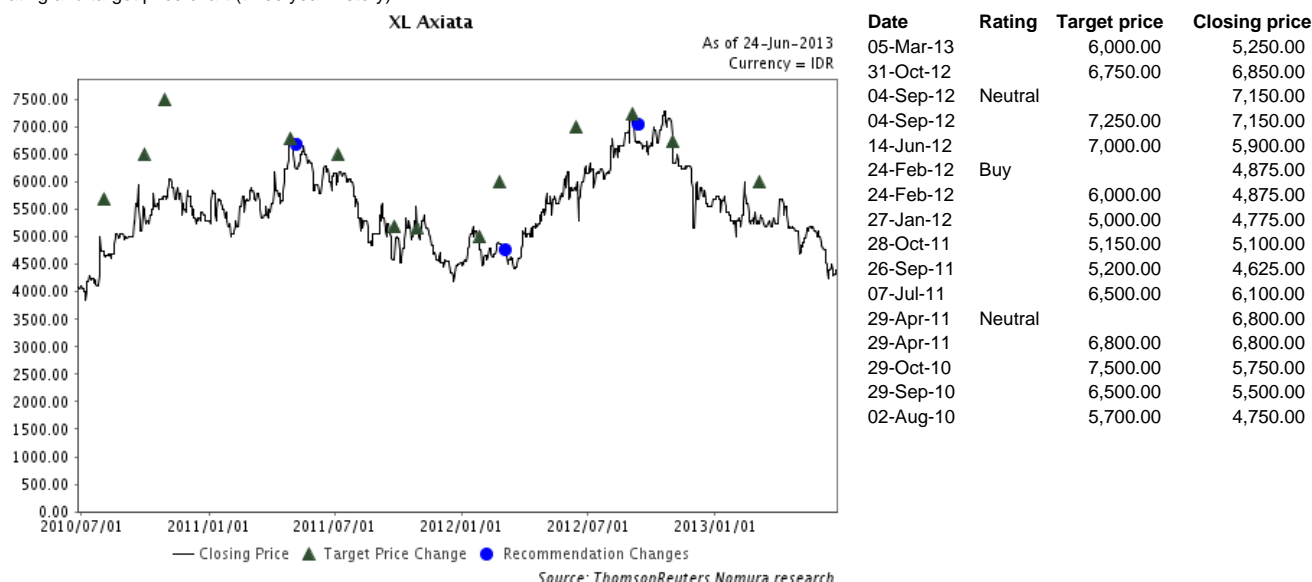
## Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
XL Axiata	EXCL IJ	IDR 4,500	26-Jun-2013	Buy	Not rated	

### XL Axiata (EXCL IJ)

IDR 4,500 (26-Jun-2013) Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** Our DCF-based target price of IDR6,000 assumes a WACC of 10.9% and terminal growth rate of 4%, with cashflows discounted back to FY17F.

**Risks that may impede the achievement of the target price** Key downside risks include limited growth in non-voice services and more-aggressive competition.

## Important Disclosures

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### Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

#### STOCKS

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