

## **CHAPTER 1: Introduction**

### **1.1 Background**

#### **1.1.1 M&A Trends in Telecommunication Industry Worldwide**

Many studies have been conducted on the mergers and acquisition (M&A) in the telecommunication industry in the U.S.A as well as Europe. The M&A activities among telecommunication companies in both regions started after the revision of the American Telecommunication Act in 1996, a WTO Agreement in 1997 and the Integration of the European Union in 1998. The rationale behind these consolidations was primarily explained through an increase in competition and a decrease in profitability as the industry became more privatized and liberalized. By 2000, losses in the sector have caused the equity values to plummet and became substantially less than the debt on the companies' books. Thus, interest in providing new funding, mostly dried up. On the other hand, many of the debt problems in Europe were incurred during the bidding for 3G licenses. These caused much of the corporate restructuring process in both Europe and America.

Contrary to their European and U.S counterparts, Asian telecommunication companies have not been doing as badly although was nonetheless affected by the global economic downturn and the financial crisis of late 1990s according to a research done by KPMG Hong Kong. Asian telecommunication companies have been spared from debt problems such as those in Europe and U.S. This has somehow instilled caution in Asia as Japan has found limited success with its full-blown 3G

rollout. Hong Kong allowed a 3G-license auction to take place based on future royalty payments, which is a more risk adverse stance. In the end, the 3G licenses were bought at the reserve price due to poor investor sentiment<sup>1</sup>. Basically, Asian telecommunication companies are noticed to be more cautious and governments are learning from the West in dealing with the 3G licensing.

Even though the Asian telecommunication companies seemed to be dealing with the situation better than their American and European counterparts, there was an influx in acquisitions among Asian phone companies due to the increasing amounts of competition experienced in markets such as Korea, China, Taiwan, Hong Kong, Singapore and Japan by 2000. This resulted in several M&As in the countries. In total, \$84.1 billion was raised from mergers in Asia excluding Japan and Australia in 2000.

### **1.1.2 M&A Trends in the Malaysian Telecommunication Industry**

Until 1990, the telecommunication industry in Malaysia was monopolized by government controlled Telekom Malaysia (partly privatized with 24% of its shares trading in KLSE). Competition was introduced into the cellular market when Celcom launched its ETACS-based ART 900 cellular network that year. In 1994, Mobikom (majority stake by Telekom Malaysia) launched an AMPS/DAMPS network. By the next year, competition reached its peak with the launching of five more GSM

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<sup>1</sup> KPMG Triband Report 2002

networks. In 1995, there were eight cellular networks, owned by as many as seven companies, competing in the cellular market. The seven companies included TMB, Celcom, Mobikom, Binariang, Sapura Digital, MRCB and Mutiara Communications.

When the digital cellular services were rolled out and made the analogue system obsolete, the industry started on its consolidation specifically involving the cellular-based companies. In 2000, the initial consolidation reduced the original seven to five companies as they compete in the increasingly competitive market. This consolidation involved TMB, which purchased its remaining 43.85% stake from Mobikom and acquired MRCB for RM635 million in cash, creating TM Touch. Thus, leaving the industry with five companies – TMB, Celcom, Maxis Communications Berhad (formerly Binariang), Time dotCom (formerly Sapura Digital) and Mutiara Communications (now Digi dotCom).

Following the announcement of the 3G licensing at the end of 2001 and continuous increase in competition for market share, further consolidation in the industry was expected. By end of 2002, both Maxis and Celcom concluded their M&As on TimeCel (cellular branch of Time dotCom) and TMTouch (cellular unit of TMB) respectively while Digi continued to be controlled by Norway's Telenor ASA.

## **1.2 Purposes and Significance of the Study**

By 2003, the mergers and acquisitions (M&A) left the telecommunications industry in Malaysia with only three companies – Maxis Communications Bhd, Digi Telecommunication Bhd and Telekom Malaysia Bhd (TMB). Maxis acquired TimeDotCom's cellular unit TimeCel while in 2001, TMB took control of Technology Resources Industries Bhd (TRI), which has a 31.25% control of mobile operator Celcom (M) Sdn Bhd. By June 2002, TMB bought 13.2% of TRI for RM717 million (USD188.7 million) from the national asset management agency, Pengurusan Danaharta Nasional Bhd (Danaharta). In the same year, Celcom officially acquired TMB's existing cellular branch TMTouch.

Although the M&As had received its fair share of hype from the media, there has yet to be a well thought-out study on the most recent M&As in the telecommunication industry in Malaysia. This study tries to put into perspective the M&As in the industry.

Specifically, the purpose of this study is to determine the rationale behind the M&A in the telecommunication industry in Malaysia. There is a possibility that the M&A activities in the industry was driven by both strategic and economic motives that results from wanting to control a certain technology-based service (3G license), gain market shares and exploit economies of scale. With only three licenses for the third-generation communications services (3G) to be given out by the government, the M&A activities could be rationalized as an effect of the government restriction.

Malaysia has an adult (assumed as between 15 to 64 years) population of only 14.6 million and the industry initially had 5 players before the M&A activities in the 2002, which were intensely fighting for market share both in the post-paid and prepaid markets.

Also, it attempts to identify the impact of the M&A on the respective firms. The synergistic impact of the M&A could contribute to a higher level of efficiency, in terms of staffing costs, bad debts and capital expenditure, for the firms through economies of scale. The cellular landscape post-M&A will play an important role in how the M&A has benefited the telecommunication industry as the industry is driven primarily by the players in the cellular sector.

On a survey conducted by PricewaterhouseCoopers (Hong Kong) on Asia Pacific, telecom/IT ranked as the most preferred corporate investment focus and comes in second in private equities. It is hope that this study can provide a deeper understanding on the industry's development in Malaysia and thus, generates a clearer picture of the future of this technologically fast-paced industry for investment purposes.

### **1.3 Research Questions:**

The purpose of this research is to answer mainly these 2 questions:

1. How did the level of competition, government regulation and technology provided the strategic and economic considerations of the M&As?
2. What are the strategic and economic impacts of the M&A on the firms involved?

#### **1.4 Scope of the Study**

The focus of the study is on the development of the telecommunication industry through the perspective of its consolidation process, which started with the introduction of the digital system. There is an analysis of its earlier market structure but the focus is on the current one from the impact of the most recent M&A – the merger between Celcom and Telekom's cellular arm TMTouch, and the acquisition of Time DotCom's cellular business by Maxis.

A chronological analysis of the industry for the years preceding the M&A is used to understand the influence of competition on the industry, which reduced from five to three players within a span of 2-3 years. Comparisons between two years pre- and post-M&A in terms of market values, earnings and market share of the firms involved. Additionally, ratios involving efficiency in operations are included to identify any synergistic effects from the M&A. Information would be from secondary data (from year 2000 to latest available figure in year 2004) taken from the KLSE, the financial reports of the respective firms as well as previously conducted market researches on the industry.

### **1.5 Limitations of the Study**

There was problems with the availability of financial statements of Maxis Communications prior to its listing to Bursa Malaysia. As such, profitability ratios pre-M&A had to start in year 2001 instead of year 2000 for TMB. Thus, more thorough comparisons of the pre- and post-M&A profitability and performance of Maxis was unable to be made. Additionally, the usage of financial statements for the accounting method in measuring the M&A success resulted in the reliance on the net profit after taxation figures in the profitability ratios. As a result of taxation procedures, i.e. deferred taxes, the profitability ratios did not accurately represent the profits obtained from the year and that had to be explained for.

The M&A activities in the industry started in 2002 and completed in 2003. Integration of operations, management and the network infrastructure required the whole of year 2003. As such, the post-M&A performance and profitability ratios are more dependent 2004. Thus, the post-M&A landscape of the telecommunications industry needs to be examined through a longer duration of time for more accurate measurements. Capital expenditure for the 3G infrastructure is currently on-going. As such, the CAPEX/Sales ratio for both firms might not be an accurate measurement for the impact of the merger in the case of capital expenditure.