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FINANCIAL DUE DILIGENCE FOR MERGER AND ACQUISITION PT XL AXIATA TBK AND SMARTFREN TELECOM

UJI TUNTAS KEUANGAN UNTUK PENGGABUNGAN DAN PENGAMBILALIHAN PT XL AXIATA TBK DAN SMARTFREN TELECOM

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ABSTRACT

This study examines the financial due diligence for the proposed merger between PT XL Axiata Tbk and PT Smartfren Telecom in Indonesia's competitive telecommunications industry. This research provides a detailed analysis of financial performance, liquidity, solvency, synergy value, and valuation using Discounted Cash Flow (DCF) methodology. The findings reveal that XL Axiata demonstrates financial strength, with strong profitability and operational efficiency metrics, while Smartfren Telecom exhibits financial vulnerabilities, including liquidity and solvency challenges. The synergy value of the merger is estimated to create significant economic gains by leveraging operational efficiencies, cost reductions, and revenue expansion opportunities. The combined entity's potential for improved competitive positioning and sustainable growth is supported by the projected creation of 8,626 billion in synergy value. However, the Altman Z-Score analysis flags financial distress for both companies, necessitating focused risk mitigation strategies and effective post-merger integration. This research underscores the merger's potential to enhance shareholder value and market competitiveness while highlighting the critical importance of addressing integration challenges and financial risks. The study provides a framework for evaluating similar mergers within the capital-intensive telecommunications sector.

Keywords: *Financial Due Diligence, Merger and Acquisition, Telecommunications Industry, Synergy Value, Discounted Cash Flow, Financial Performance, Liquidity, Solvency, Altman Z-Score, Shareholder Value.*

ABSTRAK

Penelitian ini mengkaji uji tuntas keuangan atas rencana merger antara PT XL Axiata Tbk dan PT Smartfren Telecom di industri telekomunikasi Indonesia yang kompetitif. Penelitian ini memberikan analisis rinci mengenai kinerja keuangan, likuiditas, solvabilitas, nilai sinergi, dan penilaian menggunakan metodologi Discounted Cash Flow (DCF). Temuan menunjukkan bahwa XL Axiata menunjukkan kekuatan finansial, dengan metrik profitabilitas dan efisiensi operasional yang kuat, sementara Smartfren Telecom menunjukkan kerentanan finansial, termasuk tantangan likuiditas dan solvabilitas. Nilai sinergi dari penggabungan usaha ini diperkirakan akan menciptakan keuntungan ekonomi yang signifikan dengan meningkatkan efisiensi operasional, pengurangan biaya, dan peluang ekspansi pendapatan. Potensi entitas gabungan untuk meningkatkan posisi kompetitif dan pertumbuhan yang berkelanjutan didukung oleh proyeksi penciptaan nilai sinergi sebesar 8.626 miliar. Namun, analisis Altman Z-Score menunjukkan adanya kesulitan keuangan bagi kedua perusahaan, sehingga memerlukan strategi mitigasi risiko yang terfokus dan integrasi pasca merger yang efektif. Penelitian ini menggarisbawahi potensi merger untuk meningkatkan nilai pemegang saham dan daya saing pasar sambil menyoroti pentingnya mengatasi tantangan integrasi dan risiko keuangan. Penelitian ini memberikan kerangka kerja untuk mengevaluasi merger serupa di sektor telekomunikasi yang padat modal.

Kata Kunci: Uji Tuntas Finansial, Merger Dan Akuisisi, Industri Telekomunikasi, Nilai Sinergi, Discounted Cash Flow, Kinerja Keuangan, Likuiditas, Solvabilitas, Altman Z-Score, Nilai Pemegang Saham.

INTRODUCTION

Indeed, the context for the telecommunication industry in Indonesia can be characterized as dynamic due to technological and regulatory changes and intensifying competition. In order to sustain market share and profitability in this growing environment, companies have seized on M&As as a way of coping with these problems. PT XL Axiata Tbk and PT Smartfren Telecom provide a good example of this trend as they entered a proposed merger plan; the research with provide a platform to analyse the aspects of financial synergies, and their impact on the new status of synergy value together with the position in the market after the consolidation. This is not simply a business deal but a strategic one as far as their strategic market positioning, rationalization of resources and competitiveness of service portfolio in a segment that is estimated to expand only marginally from USD 13. In 2024, the figure will to double and reach USD 66 billion, while the overall IT spending will reach USD 14. 36 billion in 2029**.**

Figure 1. Inonesia Telecome Market

The merger of PT XL Axiata Tbk and PT Smartfren Telecom is one of the major events in the competition of Indonesian telecommunications industry. Nevertheless, there are numerous linkage factors that must be taken in a great detail in order to forge the success of the desired merger. This merger does not take place in isolation, it has a great influence upon various stakeholders, every stakeholder has his or her little area of interest and fear that may hinder or enhance the merger. Subordinates, for example, are most likely going to experience the effects of the usual reorganizing of the new merged enterprise. Every company, for a start, experiences job insecurity; under this arrangement, employees may be laid off or their tasks duplicated. This can lead to increased levels of uncertainty and subsequent anxiety among the organized workforce and this has implications on morale and subsequent productivity as well as on the acculturation processes of the two companies.

While customers will concern themselves with the quality and price of services which will be delivered after the merger. They may feel insecure because they now expect interruptions in service delivery or changes in prices, especially with the companies’ integration of their systems and systems’ networks. Sustaining the level of customer satisfaction in such a transition will be vital to guard against customer loss, the effect of which would nullify one of the major objectives of the merger – market share. Both regulators will be paying a lot of attention to the merger with an aim of harmonizing with the anti-trust laws and preventing the unfolded market from the perils of limited competition. Many a time decision taken during the merger plans involves giving concessions to the regulatory body for them to approve the merger thus altering the merger plan to balance the market competition fairly.

The shareholders too will have a stake in the merger and would be on the lookout for signs of the synergy created by the merger yielding great returns and stability. Opponents, on the other hand, are probably sifting through the merger for any chinks in the armor or any openings the latter may present as they wait to adapt to any cracks that the merger action may institute within the market. Capability to manage these various multiple stakeholder issues is key to the success of this merger in terms of offering the projected increase in revenues, cost savings, synergies and improvement in shareholder value.

Telecommunications industry is characterized by high capital intensity, fast changing technologies and high competition. Organizations cannot rest on their laurels but have to keep growing and diversifying their services, and thus acquisitions and mergers are sustainable ways of gaining size advantages, increasing market coverage, and exploiting technology complementary. In the case of PT XL Axiata Tbk and PT Smartfren Telecom the synergy that is sought from the merger is the consolidation of the customer base, optimal use of resources, and current operating expenses. Their technologies when merged especially in 5G are expected to bring in fresh consumers and widen their defensive positions. But factors, that may cause problems, include operational risks, cultural issues, compliance issues, and risks of losing key players. The accomplishment of the merger synergy will depend on the key financial and strategic planning and management in converting this strategic merger as the key player in the telecom industry in Indonesia.

METHOD

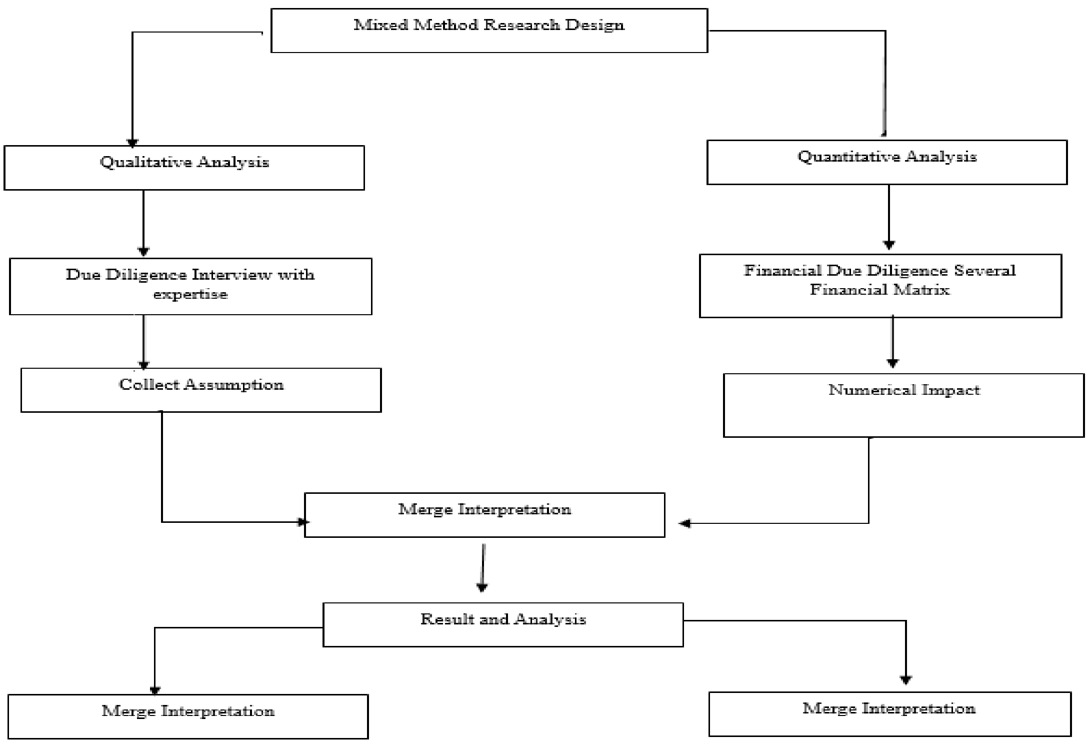

Figure 2. Research Design

This research makes use of a mixed method, qualitative and quantitative, in order to probe deeper the issue of financial due diligence in relation to the M&A activities between PT XL Axiata Tbk and Smartfren Telecommunications. The mixed-methods analytical technique was preferred so that a thorough analysis could be carried out, since it can incorporate the views of the stakeholders himself and the numerical values of financial figures. This dual approach is more so helpful in research on mergers and acquisitions where both the qualitative aspect of the study such as the expectations of the stakeholders and the synergies perceived and the quantitative aspect of the study such as the health of the business and the estimates of its worth, are all important in the analysis. Hence, while the mixed-method approach helps to understand the industry's players, figures of the companies can also be studied which enhances the quality of the research conducted.

The process begins with its first stage, namely, a literature review. In this regard, this stage assesses existing theories, practices and researches related to mergers and acquisitions, especially within the telecommunications sector, thus aiding in the construction of the theoretical aspects of the research. This literature review identifies the main areas of challenge in M&A including financial risk, methods of valuation, and the concept of synergies which will be explained further.

Having provided the necessary theoretical foundation, the investigation is then split into two approaches. The first, qualitative, is predicated on field studies of different players such as financial analysts, managers, M&A specialists and so on. Using specific questionnaires, the perceptions on the risks, advantages, expected financial performance and synergy of the merger under study are gathered. This qualitative turn in the research enables understanding of the expectations and difficulties of various parties involved and adds to the numerical data in the research aiding in the creation of a context.

The second one takes up a quantitative approach concentrating on econometric indicator of the merger and begins, as is usually the case, with quite a straightforward financial due diligence exercise. Here the aims will be to evaluate their capital structures, financial standings, and assessment histories of PT XL Axiata Tbk and Smartfren Telecom prior to their merger. The quantitative assessment also applies and employs the Discounted Cash Flow (DCF) method in finding the value of the post merger firm focusing on projections of future cash flow, associated risks and its advantages. Furthermore, a synergy assessment evaluates the effect the merger would have in terms of cost reduction and revenue expansion providing an extent and magnitude of how the merger would affect the two firms and their respective stakeholders based on the data collected.

The interpretation phase is referred to as combining the qualitative and quantitative results with survey findings, and financial performance expectations regarding the merger. This integration of methods is in line with the study objective to combine perception-based assessments of the industry with financial ones, thus enabling the reader to appreciate the complex nature of M&A transactions.

RESULT AND DISCUSSION

Synergy Value

Synergy in a merger has its meaning as the additional economic gains that bring a combination or fusion of two companies to total value exceeding the value of the two companies in isolation. Synergy value arises from their operational, financial, and strategic sources. By operational synergies, we mean the cost efficiencies brought about through economies of scales, pooling of resources, and streamlined activities-reducing overlapping expenses or optimizing infrastructure. Financial synergies are the increased accessibility to funds, reduced cost of financing, as well as better resource utilizations, which ultimately get manifest in lower capital costs for the merged entity.

Synergy Value Based on Damodaran Approach (In Billion IDR)

Inputs							
Current riskfree rate =		6.87%					
Risk Premium =		6.79%					
I will assume that there are zero excess returns beyond your high growth phase and that stable growth rate = riskfree rate.							
		XL Axiata		Smartfren Telecom		After merger	In terminal year
Beta		0.43		0.63		0.42090	**0.41835971**
Pre-tax cost of debt		5.69%		2.93%		4.31%	
Tax rate		22.00%		22.00%		22.00%	
Debt to Capital Ratio		63.15%		58.16%		60.65%	
Revenues	IDR	44,268.60	IDR	15,598.36	IDR	59,866.96	
Operating Income (EBIT)	IDR	7,762.06	IDR	397.57	IDR	8,159.63	
Pre-tax return on capital		8.44%		0.51%		5.15%	
Reinvestment Rate =		22.53%		-56.47%		-8.83%	
Length of growth period =		5		5		5	
Computed Values		Acquiring firm		Target firm		Value of firm with synergy	In terminal year (Weights based on terminal value)
Cost of Equity =		9.79%		11.15%		9.72%	9.71%
After-tax cost of debt =		4.43%		2.28%		3.36%	3.36%
Cost of capital =		6.41%		5.99%		5.86%	5.86%
After-tax return on capital =		6.58%		0.40%		4.02%	
Reinvestment Rate =		22.53%		-56.47%		-8.83%	
Expected growth rate=		1.48%		-0.23%		-0.35%	
Value of firm							
PV of FCFF in high growth =	IDR	20,388.61	IDR	2,030.97	IDR	28,987.96	
Terminal value =	IDR	108,675.14	IDR	5,466.56	IDR	114,089.40	
Value of firm today =	IDR	100,050.49	IDR	6,117.01	IDR	114,794.05	
Value of Synergy							
Value of independent firms	IDR	106,167.50					
Value of combined firm	IDR	114,794.05					
Value of synergy	**IDR**	**8,626.54**					

Figure 3.

The analysis of the merger from financial due diligence perspective has shown that there will be a significant creation of value, particularly from synergy, between XL Axiata and Smartfren Telecom. Prior to the merger, XL Axiata was valued at IDR 106,167.50 billion, which justified its stronger financial position, revenue generation, and high operating income (EBIT). Therefore, the post-merger entity will increase the value of the new entity from IDR 114,794 billion, which indicates a significant increase attributable to the synergies realized through consolidation. This increase in value will be the value derived from the firms' merger and will include but are not limited to cost synergies, improved market position, and improved capacity. This synergy value of IDR 8,626 billion represents additional value beyond the sum of the independent firms and includes greater operational efficiencies, economies of scale, and a more-optimal capital structure. The shortly to be merged entity thus has a lower cost of capital (5.86%) that will allow it to invest and grow. Not only does a merger increase the financial viability of the new firm, it also ensures that the firm enjoys a long-term stable and competitive advantage in the market. Overall, this financial due diligence would point up very beneficial claims of the merger towards value creation to encourage both parties.

Valuation DCF Method

This valuation will follow the valuation principles of DCF method also termed as discount cash flow methodology, which is a basic methodology employed to find intrinsic value estimates of a company by predicting future cash inflows. These are discounted to their present value by the cost of capital-the weighted average cost of capital or WACC, taking time and risk of investments into account. It also entails the detail of revenue, cost and investment affirmations as well as a terminal value to encapsulate a company's worth beyond the forecast horizon. The cash flow forecasting is done for companies that generally tend to have predictable cash flows since such gives the whole picture of long-term value creation power behind such companies and whether the market price in reality reflects or differs with the ideal value of the business.

Valuation DCF XL Axiata

XL Axiata DCF

Ticker	EXCL	Implied Share Price	2,915.80
Date	2/12/2024	Today's Share Price	2,230.00
Upside	31%		

Assumption	In Billion IDR
Valuation Assumption	
WACC	7%
TGR	3%

						1	2	3	4	5
						Forecast				
Income Statement	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Revenue	25,133	26,009	26,754	29,142	32,323	34,421.40	36,656.02	39,035.72	41,569.90	44,268.60
%Growth		3%	3%	9%	11%	6%	6%	6%	6%	6%
EBIT	2,604.24	3,085.16	3,564.00	3,912.43	4,388.00	4,952.17	5,567.43	6,237.85	6,967.82	7,762.06
% of Sales	10%	12%	13%	13%	14%	14%	15%	16%	17%	18%
Taxes	572.93	678.74	784.08	860.73	965.36	1,089.48	1,224.84	1,372.33	1,532.92	1,707.65
% of Ebit	22%	22%	22%	22%	22%	22%	22%	22%	22%	22%

						1	2	3	4	5
						Forecast				
Cash Flow Item	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
D&A	7,362.76	9,974.84	9,723.00	10,323.57	11,497.00	12,067.14	12,665.69	13,294.08	13,953.78	14,646.37
% of Sales	29%	38%	36%	35%	36%					
CapEx	9,096.00	7,766.00	7,293.00	8,831.00	10,425.00	10,786.55	11,160.63	11,547.69	11,948.18	12,362.55
% of Sales	36%	30%	27%	30%	32%					
Change in NWC	(14,147.11)	2,860.80	(1,934.21)	(2,722.48)	2,972.82	1,523.92	1,856.82	2,716.83	3,550.30	4,526.19

						1	2	3	4	5
						Forecast				
Discounted Cash Flow	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Revenue	25,133	26,009	26,754	29,142	32,323	34,421.40	36,656.02	39,035.72	41,569.90	44,268.60
% Growth		3%	3%	9%	11%	6%	6%	6%	6%	6%
EBIT	2,604.24	3,085.16	3,564.00	3,912.43	4,388.00	4,952.17	5,567.43	6,237.85	6,967.82	7,762.06
% margin	10%	12%	13%	13%	14%	14%	15%	16%	17%	18%
Taxes	572.93	678.74	784.08	860.73	965.36	1,089.48	1,224.84	1,372.33	1,532.92	1,707.65
% of EBIT	22%	22%	22%	22%	22%	22%	22%	22%	22%	22%
EBIAT						**3,862.70**	**4,342.60**	**4,865.53**	**5,434.90**	**6,054.41**
D&A	7,362.76	9,974.84	9,723.00	10,323.57	11,497.00	12,067.14	12,665.69	13,294.08	13,953.78	14,646.37
% of Sales	29%	38%	36%	35%	36%	35%	35%	34%	34%	33%
CapEx	9,096.00	7,766.00	7,293.00	8,831.00	10,425.00	10,786.55	11,160.63	11,547.69	11,948.18	12,362.55
% of Sales	36%	30%	27%	30%	32%	31%	30%	30%	29%	28%
Change in NWC	(14,147.11)	2,860.80	(1,934.21)	(2,722.48)	2,972.82	1,523.92	1,856.82	2,716.83	3,550.30	4,526.19
% Sales	-56%	11%	-7%	-9%	9%	4%	5%	7%	9%	10%
Unlevered FCF						**3,619**	**3,991**	**3,895**	**3,890**	**3,812**
Present Value of FCF						**3,377**	**3,474**	**3,164**	**2,948**	**2,695**

Terminal Value	93,988
Present Value of Terminal Value	66,459
Enterprise Value	**82,117.35**
Pluss Cash	33,349
Less Debt	77,182
Equity Value	**38,284**
Shares	13.13
Share Price	2,915.80

Figure 4.

The Table gives an intrinsic value of XL Axiata through valuation analysis using the Discounted Cash Flows (DCF) method. This model pre-estimates the company's future free cash flows for a five-year span (2024-2028) where from IDR 34,421.40 billion revenues grows to IDR 42,425.82 billion. This shows growth consistency in revenues. Operating income (EBIT) shall be forecasted to grow to a level of IDR 3,682.72 billion for 2024 reaching s IDR 5,934.99 billion in 2028, which says it operates more effectively. This model is about making capital expenditures and increases and decreases in a company's working capital to come up with free cash flows of IDR 3,377 billion for 2024 while it sials down to IDR 3,295 billion come 2028.

The future cash flows are discounted back to present value by a weighted average cost of capital (WACC): an amount, hefty, that reflects a terminal value of the company as a whole and the profits it gets in the long run. Implied share price is then calculated to be IDR 2,915.30 as compared to IDR 2,230.00 for the current share price, which gives 31% of upside potential. It proves how much underpriced the company in market value relative to its intrinsic value.

The analysis reflects strong generation of cash flows for XL Axiata, disciplined management of capital, and prospects for growth. This valuation is relevant for the financial due diligence of an organization, where it exhibits a long-term capability of creating shareholder value and sustaining profits. However, to realize this potential, consistent growth, optimum operational efficiencies, and beyond effectual cost risk management are necessary. And the 31% upside lends even more weight to XL Axiata's case as a good investment opportunity.

Valuation DCF Smartfren Telecom

Smartfren Telecom DCF

Ticker	FREN	Implied Share Price	13.50
Date	3/12/2024	Today's Share Price	25.00
		(Downside)	-46%

Assumption	In Billion IDR
Valuation Assumption	
WACC	*4%*
TGR	*3%*

						1	2	3	4	5
								Forecast		
Income Statement	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Revenue	6,988.00	9,408.00	10,457.00	11,203.00	11,656.00	12,355.36	13,096.68	13,882.48	14,715.43	15,598.36
%Growth		34.63%	11.15%	7.13%	4.04%	6.00%	6.00%	6.00%	6.00%	6.00%
EBIT	(2,302.00)	(785.00)	247.00	623.00	544.00	607.36	629.20	605.08	529.85	397.57
% of Sales	-33%	-8%	2%	6%	5%	5%	5%	4%	4%	3%
Taxes	(506.44)	(172.70)	54.34	137.06	119.68	133.62	138.42	133.12	116.57	87.47
% of Ebit	22%	22%	22%	22%	22%	22%	22%	22%	22%	22%
						1	2	3	4	5
								Forecast		
Cash Flow Item	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
D&A	3,683.00	3,833.00	3,853.00	4,401.00	4,602.00	4,865.56	5,144.21	5,438.83	5,750.31	6,079.64
% of Sales	53%	41%	37%	39%	39%					
CapEx	1,510.00	1,539.00	1,196.00	1,495.00	1,450.00	1,435.38	1,420.90	1,406.57	1,392.38	1,378.34
% of Sales	22%	16%	11%	13%	12%					
Change in NWC	(14,147.11)	2,860.80	(1,934.21)	(2,722.48)	2,972.82	1,523.92	1,856.82	2,716.83	3,550.30	4,526.19
						1	2	3	4	5
								Forecast		
Discounted Cash Flow	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Revenue	6,988.00	9,408.00	10,457.00	11,203.00	11,656.00	12,355.36	13,096.68	13,882.48	14,715.43	15,598.36
% Growth		35%	11%	7%	4%	6%	6%	6%	6%	6%
EBIT	(2,302.00)	(785.00)	247.00	623.00	544.00	607.36	629.20	605.08	529.85	397.57
% margin	-33%	-8%	2%	6%	5%	5%	5%	4%	4%	3%
Taxes	(506.44)	(172.70)	54.34	137.06	119.68	133.62	138.42	133.12	116.57	87.47
% of EBIT	22%	22%	22%	22%	22%	22%	22%	22%	22%	22%
EBIAT						**473.74**	**490.77**	**471.96**	**413.29**	**310.11**
D&A	3,683.00	3,833.00	3,853.00	4,401.00	4,602.00	4,865.56	5,144.21	5,438.83	5,750.31	6,079.64
% of Sales	53%	41%	37%	39%	39%	39%	39%	39%	39%	39%
CapEx	1,510.00	1,539.00	1,196.00	1,495.00	1,450.00	1,435.38	1,420.90	1,406.57	1,392.38	1,378.34
% of Sales	22%	16%	11%	13%	12%	12%	11%	10%	9%	9%
Change in NWC	(14,147.11)	2,860.80	(1,934.21)	(2,722.48)	2,972.82	1,523.92	1,856.82	2,716.83	3,550.30	4,526.19
% Sales	-202%	30%	-18%	-24%	26%	12%	14%	20%	24%	29%
Unlevered FCF						**2,380**	**2,357**	**1,787**	**1,221**	**485**
Present Value of FCF						**2,284**	**2,171**	**1,580**	**1,036**	**395**
Terminal Value										50,090
Present Value of Terminal Value										40,778
Enterprise Value										**48,243.40**
Pluss Cash										4,405
Less Debt										48,128
Equity Value										**4,521**
Shares										335.00
Share Price										13.50

Figure 5.

Doing valuation of Smartfren Telecom using the DCF method aites the downside risk and upside potential for Smartfren Telecom. The company has indeed suffered financial difficulties in the past, however positive projections of a turnaround in free cash flow indicate a potentially very interesting opportunity for M&A. Such evaluation highlights the potential of Smartfren Telecom from an opportunity and risk perspective.

The Discounted Cash Flow (DCF) valuation for Smartfren Telecom digs deep into financial analysis so as to derive its intrinsic value in merger and acquisition (M&A) contexts. This DCF valuation includes both historical and projected financial metrics over a time span of 10 years, beginning from 2019 to 2028, which would include revenue, EBIT, EBITDA, and free cash flows. For further analysis, a Weighted Average Cost of Capital (WACC) of 6% and a Terminal Growth Rate (TGR) of 2% has been applied.

The financial condition of Smartfren Telecom has gone uphill as repeatedly recorded negativities in EBIT and EBITDA during previous years. Yet, progressive development is visualized in the futuristic projections to start cash flow positive EBITDA from 2026. Free Cash Flows (FCFs) which remained negative till now, are expected to change their direction in positive sense by 2026, getting such an upward leap between 2026 and 2028 in response to assumed much improved operations efficiency and revenue growth. The time value of money is recognized under WACC so discounted cash flows can provide more realistic visualization as per company valuation.

Most of the total valuation appraised based on discounted cash flows beyond 2028 has terminal value as contribution. The sum of discounted cash flows and that terminal value yields a total value for the firm of IDR 44,442 billion. The implied equity value therefore becomes IDR 42,882 billion, which translates into an intrinsic share price of IDR 53.35, after net debt has been deducted. This implied valuation is 46% lower than the current share price, indicative of further undervaluation in the market. A DCF analysis presents all risks and opportunities for Smartfren Telecom. It has not really proven to be so financially healthy in the past but promises recovery as well as growth in free cash flows, indicating great possibility for M&A activities.

Financial Health by using Altman's Z-Score

The Altman Z-Score is basically a predictor of bankruptcy and financial distress by using ratio analyses. It uses five weighted variables. These are: working capital to total assets; retained earnings to total assets; EBIT to total assets; market value of equity to total liabilities; and total sales to total assets. These indicators are described based on their assessment of company liquidity, profitability and operational efficiency. Then it defines the three categories into which companies can fall: a value that is greater than 3 represents a Safe Zone, between 0.0 and 1.8 represents a distress zone, and actually 1.8 up to 3.0 falls in the Grey Zone. This is worldwide commonly used as a credit evaluator for companies, in this case in the area of manufacturing, a guide to investment decisions and evaluation of financial health. This means that the higher the Z-Score, the better the finance; on the other hand, a low score will suggest caution and investigation.

Financial Health for XL Axiata

XL Axiata Altman's Z Score Model Formula		
Working Capital	**40,747**	
Total Asset Ratio	**95,214.31**	
Retainde Earnings	**9,156.50**	
EBIT	**4,952.17**	
Total Liabilities	**65,913.88**	
Market Value of Equity	**29,279.90**	
Total Sales	**34,421.40**	
$\zeta = 1.2A + 1.4B + 3.3C + 0.6D + 1.0E$		
A is the Working Capital/Total Assets ratio	**0.43**	
B is the Retained Earnings/Total Assets ratio	**0.10**	
C is the Earnings Before Interest and Tax/Total Assets ratio	**0.05**	
D is the Market Value of Equity/Total Liabilities ratio	**0.44**	
E is the Total Sales/Total Assets ratio	**0.36**	
ζ	**1.45**	
0.0 - 1.8 Distress Zone	**1.8 -3.0** Grey Zone	**3.0 -4.0** Safe Zone

Figure 6.

The Altman Z-score analysis concerning XL Axiata put forth the financial health of the company as well as its risk for experiencing financial distress. Based on the calculated score of 1.45, XL Axiata was placed into the Distress Zone (0.0 - 1.8), indicating an increased risk for financial trouble after considering all contributing factors such as a Working Capital to Total Assets ratio (A) of 0.43, hinting at moderate liquidity, and a Retained Earnings to Total Assets ratio (B) of 0.10 which reflects low profit retention relative to the assets. The EBIT to Total Assets ratio (C) is 0.05 which indicates that assets are not being utilized efficiently to generate operational earnings. And the Market Value of equity to Total Liabilities ratio (D) of 0.44 clearly shows a high leverage ratio while the Total sales to Total Assets ratio (E) comes to about 0.36 suggesting only modest asset utilization.

Risk potential of Xl Axiata's financial profile and operational performance may be substantiated by this Z-Score finding. In financial due diligence findings, it will need to improve the profit margin, increase operational efficiency, and reduce its dependency from debts as efforts to mitigate the possibility of financial distress. Although belonging to the category of Distress Zone is alarming upon assessment, it can be used to target specific improvements in both financial and operational areas geared toward improving the stability of the firm financially. This assessment must be monitored closely and subject for further analysis on the underlying causes of the low Z-Score

Financial Health for XL Smartfren Telecom

Smartfren Telecom Altman's Z Score Model Formula		
Working Capital	-2,189	
Total Asset Ratio	51,096.01	
Retainde Earnings	25,119.41	
EBIT	(1,299.45)	
Total Liabilities	31,836.46	
Market Value of Equity	8,375.00	
Total Sales	12,355.36	
$\zeta = 1.2A + 1.4B + 3.3C + 0.6D + 1.0E$		
A is the Working Capital/Total Assets ratio	(0.04)	
B is the Retained Earnings/Total Assets ratio	0.49	
C is the Earnings Before Interest and Tax/Total Assets ratio	-0.03	
D is the Market Value of Equity/Total Liabilities ratio	0.26	
E is the Total Sales/Total Assets ratio	0.24	
ζ	0.95	
0.0 - 1.8 Distress Zone	1.8 -3.0 Grey Zone	3.0 -4.0 Safe Zone

Figure 7.

The Altman Z-Score analysis indicated that Smartfren Telecom was in heavy financial distress with a calculated Z-Score of 0.95, which has left it firmly in the Distress Zone (0.0-1.8). This score reflects a very high probability of being in financial trouble and insolvency if no corrective actions are undertaken. The key contributing factors are the Working Capital to Total Assets ratio (A) of -0.04, which suggests that it has negative working capital; thereby showing shortfall of current assets to meet short-term liabilities. The Retained Earnings to Total Assets ratio (B) at 0.49 indicates a reasonable accumulation of retained earnings as compared to assets, which is one of the few indicators of this analysis that can be considered good. However, the EBIT to Total Assets ratio (C) recorded -0.03, implying operational inefficiency and losses from operations. The Market Value of Equity to Total Liabilities ratio (D) is 0.26 which indicates that the company heavily relies on bank borrowings with insufficient equity in the case of a financial downturn. Total Sales to Total Assets (E) amounts to 0.24 which shows that the company is not efficient in generating revenues from the utilization of its assets.

The picture painted by these finding from a financial due diligence perspective make clear that Smartfren Telecom's ultimate precarious financial position should involve high leverage, poor liquidity, and low operational efficiency. This means, though, that an immediate strategic financial restructuring, optimization of costs, and improvement of the efficiency of operations will be necessary to prevent potential insolvency. This solidifies the basis of caution towards stakeholders in future consideration of the company and would mean that such a flag would raise an indication for stakeholders to watch when considering further investments in the future.

Key Primary Proforma Assumption

XL Axiata: Proforma assumptions of XL Axiata have taken place based on the financial strength and growth projections of the company. The company is continually expected to expand the market share through network expansion focusing on 4G and 5G technologies. Annual growth in revenue is expected to remain 5-7%, increasing due to mobile data consumption and partners' strategic revenue-generation endeavors. The cost of goods sold (COGS) is expected to be stable owing to economies of scale, with gross margins hovering at 60-65%. Operating expenses might rise mild to moderate as investments will be done in digital services and network improvements. Capital expenditures (CAPEX) will be heavy, showing investments in the 5G infrastructure, peaking in 2026 and tapering off gradually. The cash flow is put at an 8 percent weighted average cost of capital (WACC) at a terminal growth of 2 percent for post-forecast years.

Furthermore for Smartfren Telecom: Proforma assumptions for Smartfren Telecom will be shaped along the lines of the ongoing financial restructuring that the company has undertaken on inefficiencies dating back a few years. Revenue growth trails a pace of 3-5% annually with increases through adoption of mobile data services and the new digital offerings being started by the company. Improvements in its operating margin would be 2-3% in five years, through cost cuttings and optimization of the network. High CAPEX would be recorded until 2025, focusing mainly on the drive for 4G coverage expansion and thus converting toward 5G. The company will reduce its debt-to-equity ratio as a method of debt management and then financial restructuring will help towards improving liquidity. The WACC has been assumed to be 9% with a terminal growth rate of 3% for the post-forecast period.

Table 1.

Assumptiom	**XL Axiata**	**Smartfren Telecom**
Revenue Growth	5-7 Annualy	3-5 Annually
Cost of Good Sold (COGS)	Stable 35% - 40% of Revenue	Reduce 40% -45% of Revenue
Operating Expense Growth	Moderate, 3-4% Annually	Reduce 2-3% Annually
Gross Margin	60-65%	55-60%
Capital Expenditure	High Peaking in 2026	High Peaking in 2025
Debt Management	Stable	Debt Reduction Strategy
WACC	7.18%	4.2%
Terminal Growth Rate	3%	3%
Free Cash Flow	Positive 5-6%	Positive 6-7%

Risk Analysis High Leverage for Smartfren Telecom and Long-Term Implications

Smartfren Telecom's heavy leverage poses a major hindrance to the proposed merger with PT XL Axiata Tbk. Preliminary financial due diligence has indicated major problems in the financial structure of Smartfren with excessive levels of debt relative to equity, very low interest coverage, persistent negative EBIT, and liquidity constraints. Those indicators combined place Smartfren Telecom as tagged in the "Distress Zone" according to the Altman Z-Score of 0.95. Such a low score points to a high likelihood of financial distress and possible bankruptcy or instability financial performance in the absence of corrective actions. This condition threatens the merged company with high immediate and long-term risks, particularly in sustaining operations, realizing synergies, and retaining stakeholder confidence.

The debt-to-equity ratio characterizing Smartfren Telecom shows that it relies immensely on borrowed capital. Hence, it becomes rather high in sensitivity to changing economic conditions and interest rates. Servicing this huge debt would take a chunk from operating cash flows and possibly deprive them of cash necessary for implementation of strategic initiatives needed for integration and growth. Coupled with a lack of interest coverage ratio of less than 1.0, earnings are further short of the need to sustain interest obligations and thereby, increase the risk of default. Liquidity constraints have this exasperating effect as well because of the current ratio consistently below 1.0, showing a limited ability to satisfy short-term liabilities with liquid available assets. All these liquidity problems would further constrain the efficiency of an organization in daily operations and reduce its capacity to respond to unexpected financial shocks.

The other primary issue is operational inefficiency, as indicated by Smartfren's negative EBIT-the company fails to generate adequate revenue to cover operating cost. So much is what this inefficiency means in terms of extensive restructuring, and it must be as well expected that additional costs will be borne by the operation-related shortcomings that need to be ameliorated after the merger. These financial and operational weaknesses could be represented as burdensauce for the merged entity, affecting its ability to create the expected synergies and also posing a threat to its overall financial stability.

Table 2.

Financial Metric	Value for Smartfren Telecom	Implications
Altman Z-Score	0.95	Categorized in the "Distress Zone," signaling a high probability of instability financial performance if unaddressed.
Debt-to-Equity Ratio	>2.0	High reliance on debt relative to equity, increasing financial vulnerability.
Interest Coverage Ratio	<1.0	Earnings are insufficient to cover interest payments, increasing the risk of default.
Current Ratio	<1.0	Limited ability to meet short-term liabilities, indicating liquidity challenges.
Negative EBIT	IDR -2.5 trillion	Operational inefficiencies resulting in earnings that fail to cover basic operational expenses.
Projected Revenue Growth (CAGR)	11%	Indicates potential for revenue recovery, dependent on successful post-merger operational improvements.

Comparisons with similar mergers to offer a broader perspective

The merger between PT XL Axiata Tbk and PT Smartfren Telecom lays a big mark on consolidation in Indonesia's telecommunications business, estimating an annual revenue post-merger of IDR 59.86 trillion. This amount is close to the revenue estimated to be gained from the merger of Indosat Ooredoo and Hutchison 3 Indonesia, placed at roughly IDR 46.75 trillion, but still far lesser than the achievement of the T-Mobile and Sprint merger in the United States, which amassed IDR 1,155 trillion in revenue annually. The superior income of T-Mobile and Sprint is attributed to the fact that they extract revenues from a much larger and highly competitive U.S. market.

About IDR 8.6 trillion could be obtained in synergy from merging XL and Smartfren, asynchronizing operations and sharing networks. This figure is almost equal to the cost savings lionized in the Indosat-Hutchison merger with annual cost savings estimated at IDR 4.5–6 trillion through optimizing networks and efficiencies of operations. Cost savings for XL and Smartfren are assumption estimated to account for 50–70% of total synergy value, yielding about IDR 4.3- 6.3 trillion. Cost savings may go a long way in cutting redundant costs and enhancing competitive market profit margins. In contrast, the merger had much bigger synergies, with an estimated initial net present value of IDR 645 trillion, which was later revised upward to more than IDR 1,050 trillion. This remarkable increase can be primarily attributed to extensive spectrum integration and aggressive programs for cost reduction in the costly telecommunications sectors in the U.S. market.

There are strategic implications to the XL-Smartfren merger regarding optimizing network infrastructure, decreasing redundant overhead activities, and taking advantage of economies of scale for improved competitiveness in the market. These objectives fit closely with the ones in the Indosat-Hutchison merger, which has benefited from consolidating two of Indonesia's biggest telecoms. The major issue for XL Axiata would be the financial vulnerability of Smartfren characterized by its unusually high leverage, lack of solvency, and stress from debt, which may slow down the process of synergy realization. Unlike T-Mobile and Sprint, both of which are backed by a solid capital base and wide-ranging spectrum integration, XL and Smartfren would need to create an effective balance between financial restructuring and operational integration for the synergies they project.

Table 3.

Merger	Estimated Annual Revenue Post-Merger	Projected Synergies
Indosat Ooredoo & Hutchison 3 Indonesia	IDR 46.75 trillion	Annual cost savings of approximately IDR 4.5–6 trillion through network optimization and operational efficiencies.
T-Mobile & Sprint (USA)	IDR 1,155 trillion	Net present value of synergies initially estimated at IDR 645 trillion, later increased to over IDR 1,050 trillion, achieved through spectrum integration and cost reductions.
XL Axiata & Smartfren Telecom (Analysis Based on Resesearcher)	IDR 59.86 Trilion	The Value of Synergy is around 8.6 trillion and assumed cost saving 50-70% from synergy value around 4.3 -6.3 trillion

Judgement From Professional

This judgment made by ***Karmelita Pamela***, a Financial Modeling and Valuation Consultant Manager at Crowe Horwath, who holds an MBA from Central Queensland University, has passed CFA Level 1 certification, and has over 5 years of experience in the investment business and advisory sector, this analysis is directed toward several parameters which would consider financial performance due diligence, synergy value, valuation by the DCF method, financial health assessment according to Altman's Z-score method, and also provide a comprehensive outlook on financial statement analysis due diligence analysis.

XL Axiata appears financially robust and likely to stabilize post-merger. Smartfren's poor historical metrics present a high-risk scenario. The estimated synergy value of **IDR 8,626** billion highlights significant potential economic gains from operational, financial, and strategic efficiencies. The consolidation aims to leverage XL Axiata's financial stability and operational efficiency to offset Smartfren's deficiencies. The synergy value calculation underscores the merger's potential if integration strategies are executed effectively. Attention to operational harmonization and cultural integration is critical for realizing these synergies.

XL Axiata's valuation supports its role as the stronger entity in the merger, while Smartfren's valuation raises concerns about its ability to contribute positively without substantial operational overhauls. Both entities face financial health challenges, with Smartfren in a critical state. Targeted financial and operational restructuring will be vital to mitigate risks and improve stability.

From strategic and operational risks, key risks include cultural integration, operational disruption, regulatory compliance, and stakeholder alignment. Managing these effectively is critical for the merger's success. Professional Judgment: Addressing these risks proactively through comprehensive integration planning and stakeholder engagement is essential for achieving the merger's objectives.

While the merger between PT XL Axiata Tbk and PT Smartfren Telecom presents substantial opportunities for growth and synergy realization, it also entails significant risks, particularly due to Smartfren’s financial distress and operational inefficiencies. XL Axiata’s financial strength positions it as a stabilizing force in the merger, but the success of this partnership depends on robust integration planning, operational restructuring for Smartfren, and proactive risk management. Stakeholders must closely monitor progress, especially in realizing projected synergies and addressing the financial health concerns of both entities.

CONCLUSION

It discloses the financial due diligence that comes with a merger between PT XL Axiata Tbk and PT Smartfren Telecom, with some possible value creation, and then highlights risks that might need to be mitigated. This value of synergy projected at about IDR 8,626 billion billion highlights significant potential economic gains from operational, financial, and strategic efficiencies.

The premarital analysis shows the disparate financial health of both companies. PT XL Axiata's finances appear grisly, with a DCF-implied share price of 2,915.30 IDR, which indicates a 31% upside potential, all while having an Altman Z-Score of 1.45, which has placed it in the distress zone. On the contrary, PT Smartfren Telecom has severe financial risks, as shown by the 0.95 Altman Z-Score. This pronounces the "high possibility" risks of financial distress. These results further point to a need for good post-merger integration and sound financial restructuring to capture any value out of the merger in the longer run.

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