Sustainability Review

Digi.com

By Clement Chua I clement.chua@kenanga.com.my

We introduce this pilot report on sustainability review hoping to bring awareness and help enlighten investors on parameters concerning aspects of sustainability being recognised and measured. We start off with DIGI, having based its disclosures around GRI indicators and taking a page or two from its parent company, Telenor Group. Taking a look at certain key aspects of DIGI's Sustainability Data Book 2019, we found that DIGI has been registering higher energy consumption coinciding with its network expansion of which it aims to reduce by 50% in 2030. Social sustainability warrants tight data privacy and security measures of which DIGI and we believe by extension, other telcos would be commonly practicing. Fundamentally, we have a DCF-driven TP of RM4.65 for DIGI. Banking on its industry-leading dividend yields of c.4% and ROEs of above 200%, we raise our call to OUTPERFORM (from MARKET PERFORM) given the attractive capital upside of c.10% from current levels. Even as our TP is achieved, we believe DIGI would remain a favourable investment on sustainability considerations by ESG-conscious investors.

(This report does not draw conclusions on the entire telecommunications sector. We hope to form such narrative as we progressively review more companies)

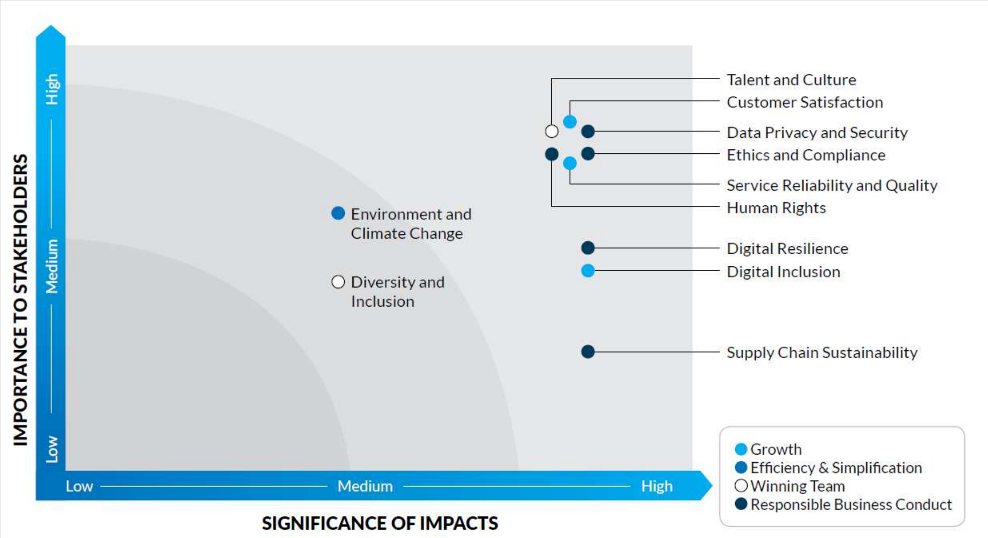
Sustainability reporting a growing importance. Sustainability is gaining global traction with the rise of issues such as high levels of carbon emissions, direct/indirect impact to health, human rights, un-sustainability and over-dependency of non-renewable energy, among others. A growing school of thought implicates that solid sustainability management goes hand in hand with better risk management as the former also works to improve efficiency and resiliency of operations in the long run while incorporating healthy practices as a norm, hence creating greater long term value. Bursa Malaysia took a step into this by introducing the FTSE4Good Bursa Malaysia index in 2014 to formally recognise companies which take major steps in promoting sustainability as well as other key aspects of ESG governance.

DIGI, a maiden choice. In this pilot report, we level DIGI's published annual report on sustainability which we found to be compelling as it blends requirements from GRI indicators, GHG Protocol Corporate Standard for carbon emissions while also incorporating practices for its parent company, Telenor Group where ESG adoption are deemed to be more matured. DIGI was also the first amongst the telcos to publicly publish any measure of sustainability reporting, tracing back since 2009. Typical disclosures encompassing sustainability would concern carbon emissions, business impact to the environment and by extension, its supply chain. Adding to that, social sustainability which has been under a brighter spotlight is also under the purview of DIGI's sustainability, touching base on customer data privacy and security. *(Refer to the overleaf for our review on key matters in DIGI's Sustainability Data Book 2019)*

Overall, we believe DIGI's sustainability efforts and disclosures to be exemplary with records openly presented regarding its carbon footprint performance. The group saw a rise in total energy consumption from 2017 to 2019 but registered strong improvements when measured against the total data consumed by its subscribers. Although there are certain areas which we believe could add great value if provided, such as a breakdown of its renewable energy consumption. DIGI's social pro-activeness and responsibility appears to be deeply embedded in its corporate culture which forms a conducive workplace. Perhaps one could argue that this has translated to its stellar efficiency and profitability, commanding the highest net profit margins of +20% and ROEs exceeding 200%. We believe that industry players could always do more in terms of sustainability disclosure and seeking insight from countries where their practice has some maturity which would assist in building credible reporting. Other widely adopted sustainability reporting standards include the Task Force on Climate-Related Financial Disclosures (TCFD), Carbon Disclosure Project (CDP), and International Integrated Reporting Council (IIRC).

We take this opportunity to also upgrade DIGI's call to OUTPERFORM, from MARKET PERFORM in lieu of share price weakness which makes accumulation attractive. Though we maintain our DCF-driven TP of RM4.65, dividend yields of over 4% could be sought out by yield seeking investors in the currently volatile market and low interest rate environment. The group is weathering through certain hurdles posed by the Covid-19 pandemic and post-MCO economic easing, but we believe this to not be a long-term concern. DIGI already command the largest prepaid market share in the country and lowest overall ARPUs, greatly minimising customer down-trading risks as compared to other market leaders.

DIGI's Materiality Matrix



Source: DIGI Sustainability Data Book 2019

A materiality matrix identifies aspects which may be of greater importance or urgency to an organisation. Based on DIGI's materiality matrix in its Sustainability Data Book 2019, we see that the group places stronger emphasis on human relations, be it with its employees or customers. This could be due to the group being a service-oriented company as opposed to a manufacturing or production-based organisation which could be more inclined to prioritise on environmental matters. That said, a growing adoption of green energy is starting to surface in the global landscape, as heavy uses of non-renewable energy typically leaves behind a significantly higher carbon footprint, not to mention its residual environmental and health hazards. With that, we dive deeper into DIGI's performance in environmental sustainability before taking a gander on its social aspects.

Environmental Sustainability

What makes a good number? Energy consumption needs increases as business functions grow. With what we would expect of DIGI, a progressively expanding network infrastructure would naturally demand larger amounts of energy to operate. From its Sustainability Data Book 2019, we gathered that DIGI's total carbon emissions in tonnes had increased by 11% from 2017 to 2019. This could be stemming from the group improving and supporting its network coverage, of which its 4G LTE coverage expanded to 91% in 4QCY19 (from 1QCY17: 85%) and LTE-A to 72% (from 1QCY17: 42%). DIGI's fibre network had also grown to 9,610km in 4QCY19 (from 1QCY17: 7,700km).

DIGI's annual GHG emissions inventory in accordance to the GHG Protocol Corporate Standard

Digi Climate Metrics/Year	2019	2018	2017
Scope 1: Direct Energy Consumption from Fuel (GwH)	43.47**	48.2**	101
Scope 1: Carbon Emissions (Tonnes)	10,677**	11,738**	24,262
Scope 2: Indirect Energy Consumption from Grid and Green Electricity (GwH)	250.6	230	194
Scope 2: Carbon Emissions (Tonnes)	162,870	153,769	131,926
Scope 3: Indirect Energy from Value Chain (GwH)	8	9	9
Scope 3: Carbon Emissions (Tonnes)	1,653	1,728	1,782
Total Energy (GwH)	302	287.2**	304
Total Carbon Emissions (Tonnes)	175,200	167,235**	157,970

** *In 2019, Digi underwent a review exercise of the methodology used to calculate fuel consumption of our generators used to power equipment for our network, taking into consideration efforts to convert generator powered sites to the grid. Based on our review, we had estimated a higher reporting capacity in prior years. Towards this effect, we have restated our 2018 figures based on the changes in methodology used.*

Note:
Scope 1 emissions - direct emissions from owned or controlled sources
Scope 2 emissions - indirect emissions from the generation of purchased energy
Scope 3 emissions - all indirect emissions (not included in scope 2) that occur in the value chain, including both upstream and downstream emissions

Source: DIGI Sustainability Data Book 2019

Alternatively, DIGI had presented an interesting approach to scoring its carbon intensity, based on data consumed by subscribers, with 2019 successfully shaving off more than half of what it produced in 2017. The market is seeing an escalation of data hungry subscribers in an increasingly digitalised society, suggesting that perhaps this metric could see higher relevance in days to come.

One could argue that better energy consumption at the base stations should be considered; we gather that there are more differentiating factors involved, such as utilisation being dependent on reaching population density and geography. Furthermore, the varying hardware and equipment which could be more energy efficient as its specification-developed, making the formation of a correlation with network abilities with carbon emissions an arduous one.

DIGI's carbon intensity metric

Digi Intensity Metrics/Year	2019	2018	2017
Customer Base (mil)	11.28	11.66	11.75
Energy Usage per Customer (KwH)	26.7	24.6	25.8
Carbon Intensity per Customer	0.016	0.014	0.013
Energy Usage per Data Terabyte (MwH)	0.22	0.31	0.56
Carbon Intensity per Data Usage (tCO^2e)	0.13	0.18	0.29

Source: DIGI Sustainability Data Book 2019

The group expressed its intentions to achieve a 50% reduction in its science-based carbon emissions target by 2030 by adopting low carbon solutions and converting 156 generator-powered sites to grid. While DIGI should be credited for its reduction in direct energy consumption in effort to mitigate greenhouse gases, there is an absence on the percentage of energy consumption being derived from renewable sources. We aspire that soon, such numbers could be publicly presented to encourage greater disclosure and adoption for the use of green energy.

Social Sustainability

An ode to long-term social value. The topic of corporate social responsibility is not something foreign to businesses, as philanthropy has been touted to boost social benefit while establishing personal social equity between communities. Drawing along the lines of sustainable initiatives which result in long-term value, we sought inspiration from the Sustainability Accounting Standard Board's (SASB) which outlined data protection and security to be a key concern for telecommunication services.

As a service provider, DIGI collects personal information and data of its customers, usually through open registration. Importantly, customers have to provide consent for how DIGI would use their information for, though mostly for analytics and ultimately targeted marketing. Publicly disclosed in DIGI's Privacy Note, the group has been upfront about potentially utilising information on how its services are being used by consumers, such as: (i) time and duration of tele-conversations and data, (ii) application and feature usages, and (iii) internet browsing behaviour.

Following discussions and feedback from DIGI's Sustainability Department as well as reviews to the Sustainability Data Book 2019, we found that DIGI has dedicated personnel to oversee its data privacy objectives. In the meantime, frameworks encompassing data privacy are in place for the establishment, maintenance and reviews of policies, such as DIGI's Privacy Requirement Checklist, Data Protection Impact Assessment and Data Processing Agreement. To promote adoption, these frameworks also serve as procedural guidance as part of the Supply Chain Management programme for their vendors. Drawing inspiration from dealings with the Telenor Group further supplements compliance on matters such as big data, where its framework established is in line with local privacy and regulatory requirements. In relation to the effectiveness of its procedures, DIGI represented that it had not received any legal suits with regards to customer privacy.

The SASB also placed importance in reporting the disclosures of customer information to law enforcement. On this matter, we were referred to the Telenor Group's annual "Authority Request Disclosure Report" which offers transparency to the number of cases and the nature of the information requests. From the last available report in 2018, we gathered that almost all of DIGI's customer data disclosure to authorities was on the basis of obtaining historical communication records for the investigation of criminal offenses.

More on the efforts by the Telenor Group, its Asian Privacy Programme initiative had DIGI establishing a data breach response plan to enhance its ability to contain future data security instances. In addition, the programme also extends initiatives and continuous improvement efforts on systemic mapping of assets and processing activities, as well as monitoring consent management across its value chain. Additionally, DIGI has been active in raising awareness of cyber security threats and promote safe internet practices, as it did with its Safer Internet Day 2019 event.

A space for all. Pairing with the above, it should not go unmentioned that DIGI has been actively involved in social outreach programs to spur digital inclusiveness and to enable communities with the usage of digital services. Notable efforts here include: (i) establishing a free digital education platform with the Telenor Group, MDEC and Unicef for specified schools and community centres, (ii) workshops to shape financial and digital competencies for the elderly folk, and (iii) MY Digital SME workshops to assist and empower local business owners and entrepreneurs to digitally prepare their business and to establish an online presence.

In promoting its ideology, DIGI has also taken a step to ensure that its supply chain would adhere to similar sustainability values. According to its Sustainability Data Book 2019, the group would ensure legal accountability by its vendors to carry out responsible business practices and standards to reduce environmental impact and influence social equality, which extends to curbing human rights risks and health and safety risks for its employees. As part of ensuring compliance, the group would provide training and periodic inspections to address the effectiveness or loopholes in place in the supply chain when adopting its sustainability standards.

(This section is intentionally left blank)

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

Published and printed by:

KENANGA INVESTMENT BANK BERHAD (15678-H)
Level 17, Kenanga Tower, 237, JalanTunRazak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my