First Capital Research

First Capital

Analyst: Nisansala Kuruppumudali

SRI LANKA

Earnings Update

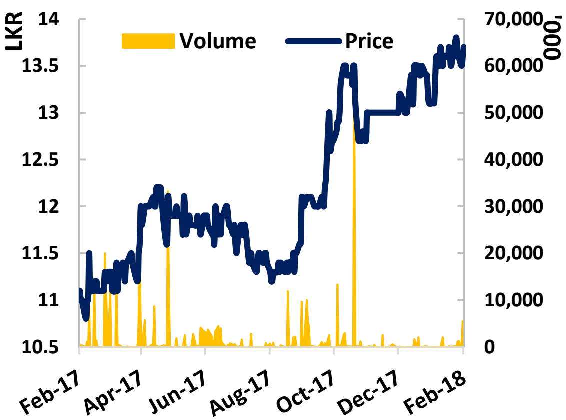
DIALOG AXIATA PLC	CSE: DIAL.N0000	Bloomberg: DIAL SL	Upgrade to STRONG BUY

Feb 2018 | **Current Price – LKR 13.6** | **Fair value – LKR 15.8 [2018E]** | **Buy Below Price - LKR 14.22** | **4Q2017 Earnings ↑ 154%YoY**

"Driven to greater heights with Broadband expansion"

KEY DATA			
Share Price (LKR)			13.60
52w High/Low (LKR)			13.80 / 10.80
Average Daily Volume (Shares)			1,600,149
Average Daily Turnover (LKR)			19,518,701
Issued Share Capital (Shares mn)			8,143.8
Market Capitalisation (LKR mn)			110,755
Price Performance (%)	1 mth	3 mths	12mths
DIAL	30%	7%	25%
ASPI	6%	2%	6%
Major Shareholders as at 31st Dec 2017			
Axiata Investments (Labuan) Limited			83.32%
Employees Provident Fund			2.22%
CITI Bank New York S/A Norges Bank A/C 2			1.62%
BNYM RE-UT SAGA Tree LLC			1.46%
HSBC International Nominees Limited - JPMCB			1.02%
Estimated Free Float			16.68%

Price – Volume Chart



Source: CSE

ANALYST CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 6.

P/E 31 December	2016	2017	2018E	2019E	2020E
Revenue (LKR mn)	86,745	94,196	99,574	105,363	112,010
YoY % Growth	17%	9%	6%	6%	6%
Net Profit (LKR mn)	9,041	10,785	12,598	14,881	17,490
EPS (LKR)	1.11	1.32	1.55	1.83	2.15
YoY % Growth	*74%*	*19%*	*17%*	*18%*	*18%*
Valuations					
PER (x)	**12.3**	**10.3**	**8.8**	**7.4**	**6.3**
PBV (x)	**2.1**	**1.8**	**1.6**	**1.4**	**1.2**
Div Yield (%)	**2.9%**	**3.6%**	**4.2%**	**5.0%**	**5.9%**
NAVPS	6.6	7.6	8.6	9.9	11.4
DPS (LKR)	0.4	0.5	0.6	0.7	0.8
Div Payout	35%	37%	37%	37%	37%

LKR (Mn)	4Q2017	4Q2016	YoY	3Q2017	QoQ
Revenue	24,801	22,775	9% ↑	24,218	2% ↑
Gross Profit	12,279	10,397	18% ↑	11,490	7% ↑
EBITDA	9,100	7,422	23% ↑	9,400	-3% ↓
PBT	3,576	1,629	119% ↑	4,149	-14% ↓
Net Profit (Equity)	3,171	1,251	154% ↑	3,721	-15% ↓

LKR (Mn)	1Q2017	2Q2017	3Q2017	4Q2017
Revenue	22,165	23,012	24,218	24,801
Gross Profit	10,287	10,897	11,490	12,279
EBITDA	7,221	8,130	9,400	9,100
EBITDA Margin	*33%*	*35%*	*39%*	*37%*
PBT	1,976	2,734	4,149	3,576
Net Profit (Equity)	1,546	2,346	3,721	3,171
Net Margin	*7%*	*10%*	*15%*	*13%*

Disclosure on Shareholding:
First Capital Group and its affiliates does not hold shares of DIAL and will not trade in this share for the three trading days following the issue of this document.

"Cost control measures made all the difference"

Target Price upgraded to LKR 15.8 on stronger margins: DIAL's 4Q2017 bottom line shot up 154% partly on the back of lower exchange losses with a stable rupee in the last quarter. However, DIAL core businesses performed strongly on all key business segments due to heavy cost control measures boosting EBITDA margins to 37% in 4QFY17 from 33% in previous comparative quarter (4QFY16). The Mobile segment continued to be driven by growth in Data volume which grew of 39% in 2017. On the back of stronger than expected EBITDA margins First Capital Research stands confident DIAL's performance into 2018E. We have upgraded DIAL margins into 2018E and beyond resulting in an upgrade in its Earnings by +9% to LKR 12.6 Bn. With a possible improvement in consumer spending and business activity we expect a better year ahead compared to 2017 specifically towards 2H2018 likely show stronger revenue performance. First Capital Research estimates upgrades fair value of DIAL to LKR 15.8 from LKR 14.1. At LKR13.6 DIAL provides a total return of 20% including a dividend yield of 4% (annualized return 24.0%) for 2018E. Despite price appreciation in DIAL over last 2 months of 5% from LKR 13.1 to LKR 13.6, we upgrade our recommendation from HOLD to **STRONG BUY** on DIAL.

Risk on Budget Move prevails: Recent budget proposals plan to introduce a Cellular Tower levy of LKR 200,000 per month tax on cellular towers in the 2018 budget however this was halted amidst concerns it could force operators to close towers in unprofitable areas and discourage internet coverage expansion.

Earnings Performance

Earnings up by 154%YoY: DIAL recorded earnings of LKR 3.17Bn for 4Q2017, up by 154% as against LKR 1.25Bn recorded in 4Q2016 on the back of recovery in core revenue streams, cost rescaling initiatives and lower forex losses. The rupee's stability in 4Q supported earnings growth on YoY basis. Direct expenses for DIAL, the largest component of total cost dipped -1% YoY. However, on a QoQ basis, earnings had declined by 15% when compared to LKR 3.7Bn recorded in 3Q2017. DIAL's 1Q-4Q earnings rose +19% to LKR 10.8 Bn. Group EBITDA 4Q2017 jumped +23% to LKR 9.1Bn driven by EBITDA margins increasing to 37% from 33%. EBITDA for full year increased by +16% to LKR 33.9Bn with EBITDA margin improving to 36.0% (+2.3%) in 2017.

Moderate growth in Mobile usage however strong revenue growth through key business segments: Group revenue for the quarter grew by 9%YoY and 2%QoQ to LKR 24.8Bn. Revenue contribution for the year from Mobile segment amounted to LKR 27Bn growing by 8%YoY while DTV recorded a revenue of LKR 1.5Bn however dropped in growth by 1%YoY. DBN's revenue was recorded at LKR 3.3Bn, an impressive growth of 27%YoY.

Mobile segment EBITDA surges +21% on cost improvements: DIAL's mobile EBITDA jumped +60%YoY while earnings grew by +21%YoY to reach LKR 3.1Bn. EBITDA margins improved significantly to 36.9% from 32.5% with cost control measures and cost efficiencies. However, comparatively higher depreciation, finance cost and forex losses saw earnings QoQ registering -6%.

Mobile Broadband revenue drives Group Revenue: Mobile revenue for 4Q2017 grew +6%YoY & +1% QoQ contributing to almost 50% of the group revenue growth. Subscriber growth of 8% YoY & 1%QoQ contributed towards revenue growth. However, the largest portion of the growth was driven by the data segment which registered growth of +39%. Blended ARPU remained broadly flat on a YoY basis but dipped -2%QoQ. Voice segment MoU & ARPU continued its declining path, but strong growth in data ARPU more than compensated for the declines.

DTV subscriber base continued to record strong growth: DTV subscribers increased by +17%YoY and +6%QoQ to 981,000 during 4Q2017. During the quarter DTV's EBITDA improved by 100%YoY to LKR 572Mn, recording an EBITDA Margin of 13.1%. However, earnings continued to remain negative despite a significant improvement.

DBN continues to record net profits: DIAL's fixed broadband business continued to record profits for the fourth consecutive quarter growing over +100%YoY to profitability from losses in the previous year though growth compared to its previous quarter dipped by -12%QoQ to LKR 562Mn. DBN's EBITDA was recorded at LKR 1.9Bn surging +52%YoY but declining in growth by -3%QoQ. EBITDA margin continued strong at 57%, on the back of 27%YoY growth in revenue mainly arising from Home Broadband segment supported by the company's initiative of prepaid offering for Fixed HBB launched in July 2017 to expand the affordability and to reach a wide spectrum of Sri Lankan households.

Investment Case

DIAL to provide an annualized return of c.23.5%: First Capital Research estimates fair value for DIAL at LKR 15.8 over a period of 12 months [DCF based LKR 16.1 and PER based LKR 15.5]. DIAL is expected to provide a total return of *c*.20.0% for 2018E including a Dividend Yield of *c*.4%.

DIAL's mobile and fixed broadband to drive growth: First Capital Research expects Sri Lanka's total mobile broadband subscribers to grow at a CAGR of *c*.30% through 2016-2019E and fixed broadband subscribers to grow at a CAGR of *c*.13% through 2015-2019E resulting in overall mobile and fixed broadband penetration to reach 24% and 5% by 2019E respectively. Sri Lanka's mobile broadband penetration has grown from 4.5% in 2012 to 16.2% in 2015 at a CAGR of *c*.53% while fixed broadband penetration has grown from 2.05% in 2013 to 2.99% in 2015 at a CAGR of *c*.21%.

DIAL's stake in Colombo Trust Finance: Subsequent to the close of mandatory offer on 2nd Nov 2017, DIAL's stake in Colombo Trust Finance PLC will increase to 98.87%. DIAL's investment was aimed at accelerating the drive towards adoption of digital financial services by encouraging digital savings and increase access to financial services. The digital bank is expected to be operational by 2Q2018.

Narrowband Internet of Things (NB-IoT): first to launch in South Asia enables seamless connectivity amongst devices. Digital innovation fund of USD 15Mn launched support emerging companies in the field of digital based services.

Investment risks

Operational Risks: Ever growing Over The Top (OTT) players such as WhatsApp, Viber, Messenger etc. continue to be a disruption to DIAL'S traditional revenue streams.

Exchange rate risk: Foreign exchange difference with the fluctuation of LKR against USD. A clear result of the adverse movement in the local currency DIAL's, borrowing mix shifted to 69:31 by end 2016 from 100% USD denominated borrowing as at end 2015. For FY2017 Sri Lanka Rupee (LKR) depreciated against the United States Dollar (USD) at a moderate 2.3%.

Interest rate risk: DIAL's cash and bank balances including deposits placed with banks and borrowings from financial and non-financial institutions will be impacted with yield curve trend and interest rate movements. Currently DIAL's interest expense is charged at both fixed and floating rates on both local and foreign borrowings.

Regulatory Risk: DIAL's operations are subject to direct income tax, fees and levies as well as consumption taxes in the form of VAT.

Valuation Summary

Expected DIAL price for 2018E	
DCF Valuation based target price	16.1
PER based target price	15.5
Average Target Price	15.8

Return	
Target Price	15.8
Current Price	13.6
Capital Gain (LKR)	2.2
Dividend 2017E (LKR)*	0.5
Capital Gain %	16%
Dividend Yield %	4%
Total Return %	19.7%
Annualized Return %	18.1%

*paid in 2018

DCF Valuation

Valuations	2018E
NPV	151,278,121
(+) Cash	4,093,067
(-) Debt	(24,324,340)
Total Value of Equity	131,046,848
No. of shares	8,143,778
Value of Equity per share	16.1

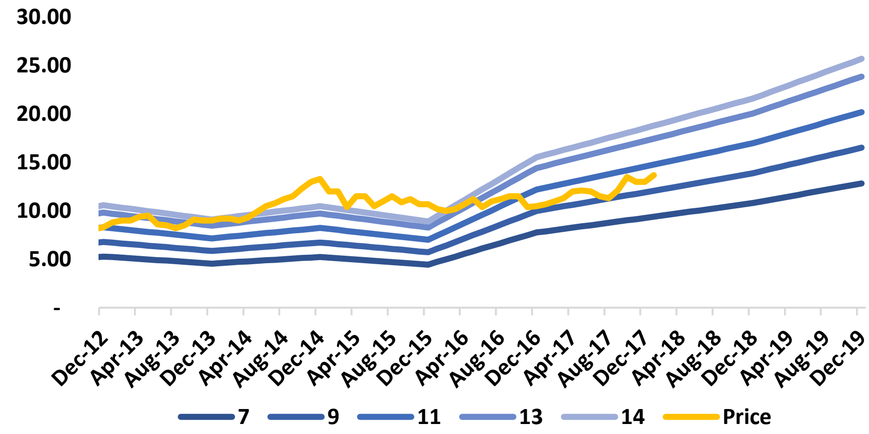
COE (K_e)	
R_f	10%
R_m	18%
β	0.9
$K_e=R_f+\beta (R_m-R_f)$	16%

WACC	
Ke	16%
Kd	14%
D/E Assumption	40 / 60
Terminal Growth (%)	3%
WACC	15%

Scenario Analysis

		WACC				
		13%	14%	15%	16%	17%
Terminal Growth (%)	1%	16.6	15.2	14.0	12.9	12.0
	2%	18.0	16.3	14.9	13.7	12.7
	3%	19.6	17.7	16.1	14.7	13.5
	4%	21.6	19.3	17.4	15.8	14.4
	5%	24.1	21.3	18.9	17.1	15.5

PER Valuation



Source: CSE and First Capital Research Estimates

PER based Valuation	
2018E Earnings (LKR '000)	12,624,204
No. of Shares ('000)	8,143,778
2018E EPS	1.55
Expected Average PER	10x
Price at 10.0x 2018E Earnings	15.5

Recommendation Criteria

Categorization	Company Category	Strong Buy	Buy	Hold	Sell
Grade A	S&P SL20 Companies	T.Bill + 10% & Above	T.Bill + 5% & Above	T.Bill + 1% & Above	Below T.Bill + 1%
Grade B	Rest of the Companies	T.Bill + 13% & Above	T.Bill + 8% & Above	T.Bill + 3% & Above	Below T.Bill + 3%
Grade C	Companies less than LKR 1Bn Market Cap	T.Bill + 16% & Above	T.Bill + 11% & Above	T.Bill + 6% & Above	Below T.Bill + 6%

**1 Year T Bill rate as of 23-02-2018 – 9.53%*

Annex I – Income Statement

Income Statement (LKR Mn) Y/E 31st December	2016	2017	2018E	2019E	2020E
Revenue	**86,745**	**94,196**	**99,574**	**105,363**	**112,010**
Direct costs	-45,978	-49,243	-51,826	-53,586	-55,869
Gross profit	**40,767**	**44,953**	**47,748**	**51,776**	**56,140**
Distribution costs	-13,534	-14,137	-14,420	-15,141	-15,898
Administrative costs	-14,390	-16,059	-16,139	-17,431	-18,302
Other income	72	45	53	57	60
Operating profit	12,915	14,802	**17,241**	**19,262**	**22,001**
Finance income	367	245	286	332	385
Finance costs	-2,730	-2,599	-2,676	-2,056	-1,779
Finance costs - net	-2,363	-2,355	**-2,389**	**-1,724**	**-1,393**
Share of loss from associates - net of tax	-8	-13	0	0	0
Profit before income tax	10,544	12,434	**14,852**	**17,538**	**20,607**
Income tax	-1,517	-1,674	**-2,228**	**-2,631**	**-3,091**
Profit for the year	9,026	10,760	**12,624**	**14,907**	**17,516**
Non Controlling Interest	-15	-26	**-26**	**-26**	**-26**
NetProfit	**9,041**	**10,785**	**12,598**	**14,881**	**17,490**

Source: Company reports and First Capital Research Estimates

Annex II – Balance Sheet

Balance Sheet (LKR Mn) As at 31st December	2016	2017	2018E	2019E	2020E
ASSETS					
Non-current assets					
Intangible assets	16,434	19,119	17,348	18,095	18,845
Property, plant and equipment	89,944	100,018	103,573	106,302	109,274
Investment in subsidiaries	0	0	0	0	0
Investment in associates	72	106	106	106	106
Amount due from related companies	0	0	0	0	0
Financial assets	40	287	287	287	287
	106,490	**119,721**	**121,314**	**124,790**	**128,512**
Current assets					
Inventories	677	863	747	738	784
Trade and other receivables	17,966	15,535	17,923	18,965	20,162
Cash and cash equivalents	8,045	8,411	4,093	5,912	11,073
	26,688	**25,599**	**22,763**	**25,615**	**32,019**
Total assets	**133,178**	**145,320**	**144,077**	**150,405**	**160,531**
EQUITY					
Capital and reserves attributable to equity holders					
Stated capital	28,104	28,104	28,104	28,104	28,104
Reserves	25,903	33,583	42,226	52,463	64,463
Non-controlling interest	14	-6	-6	-6	-6
Total equity	**54,021**	**61,681**	**70,324**	**80,560**	**92,561**
LIABILITIES					
Non-current liabilities					
Borrowings	26,313	25,629	19,459	14,020	11,116
Other financial liabilities		297			
Derivative financial instrument	15	0	0	0	0
Deferred revenue	1,658	1,394	1,394	1,394	1,394
Deferred income tax liability	0	0	0	0	0
Employee benefit payables	1,373	1,354	1,354	1,354	1,354
Provision for other liabilities	1,310	1,738	1,738	1,738	1,738
	30,668	**30,413**	**24,102**	**18,663**	**15,759**
Current liabilities					
Trade and other payables	39,744	41,099	44,232	45,871	47,761
Borrowings	7,872	10,266	4,865	4,673	3,705
Derivative financial instrument	16	0	0	0	0
Current income tax liabilities	858	877	554	637	746
	48,489	**53,225**	**49,651**	**51,182**	**52,212**
Total liabilities	**79,157**	**83,639**	**73,753**	**69,845**	**67,971**
Total equity and liabilities	**133,178**	**145,320**	**144,077**	**150,405**	**160,531**

Source: Company reports and First Capital Research Estimates

Annex III – Statement of Cash flows

Cashflow Statement (LKR Mn) Y/E 31st December	2016	2017	2018E	2019E	2020E
Cash flows from operating activities					
Cash generated from operations	**25,879**	**38,331**	**39,812**	**43,868**	**47,560**
Interest received	381	254	286	332	385
Interest paid	-1,688	-1,740	-2,676	-2,056	-1,779
Tax paid	-1,499	-1,635	-2,218	-2,548	-2,982
Employee benefits paid	-67	-56	0	0	0
Net cash generated from operating activities	**23,005**	**35,154**	**35,205**	**39,596**	**43,184**
Cash flows from investing activities					
Purchase of property, plant and equipment	**-27,513**	**-26,515**	**-25,207**	**-24,559**	**-25,519**
Purchase of intangible assets	-811	-3,845	-2,666	-2,917	-3,115
Investment in associate	0	0	0	0	0
Advances to subsidiaries	0	0	0	0	0
Advances to associate	0	0	0	0	0
Loans to associate	0	0	0	0	0
Purchase of available-for-sale financial assets	0	0	0	0	0
Proceed from sale of property, plant and equipment	214	30	0	0	0
Net cash used in investing activities	**-28,110**	**-31,600**	**-27,873**	**-27,475**	**-28,634**
Cash flows from financing activities					
Repayment of borrowings	-8,686	-7,107	-19,902	-15,295	-14,821
Repayment of finance leases	0	0	0	0	0
Proceed from borrowings	17,371	7,096	12,233	9,664	10,949
Dividend paid to ordinary shareholders	-2,606	-3,176	-3,981	-4,671	-5,516
Dividend received - ESOS Trust	0	0	0	0	0
Proceeds from disposal of shares in ESOS Trust	0	0	0	0	0
Expenses on share issue	0	0	0	0	0
Net cash (used in) / generated from financing activities	**6,109**	**-3,188**	**-11,650**	**-10,301**	**-9,388**
Net increase / (decrease) in cash and cash equivalents	**1,004**	**366**	**-4,318**	**1,819**	**5,161**
Movement in cash and cash equivalents					
At start of the year	6,993	8,045	8,411	4,093	5,912
Increase / (decrease)	1,004	366	-4,318	1,819	5,161
Effect of exchange rate changes	48	0	0	0	0
At end of the year	**8,045**	**8,411**	**4,093**	**5,912**	**11,073**

Source: Company reports and First Capital Research Estimates

Annex IV – Key ratios

Y/E 31st Dec		2016	2017	2018E	2019E	2020E
Growth	Revenue	17%	9%	6%	6%	6%
	Direct Cost	13%	7%	5%	3%	4%
	Gross Profit	23%	10%	6%	8%	8%
	EBITDA	23%	38%	10%	11%	8%
	Net Profit	74%	19%	17%	18%	5%
Margin	GP Margin	47%	48%	48%	49%	50%
	EBITDA Margin	34%	37%	39%	41%	42%
	NP Margin	10%	11%	13%	14%	16%
Gearing	Debt/Equity	63%	58%	35%	23%	16%
	Debt/Debt+Equity	39%	37%	26%	19%	14%

Source: Company reports and First Capital Research Estimates

Research Disclosure

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