



**DIALOG AXIATA PLC**

**CSE: DIAL.N0000**

**Bloomberg: DIAL SL**

**Downgrade to HOLD**

Nov 2017

Current Price – LKR 12.7

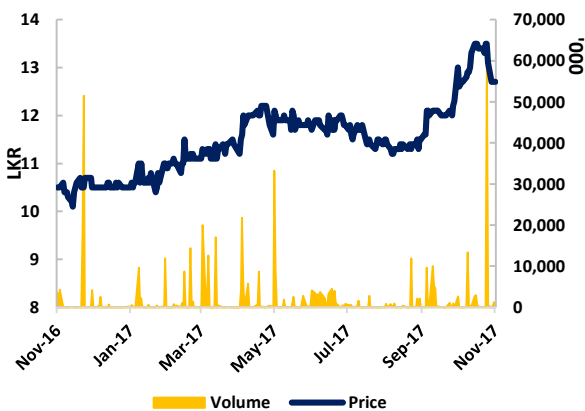
Fair value – LKR 14.1 [2018E]

Buy Below Price - LKR 12.1

3Q2017 Earnings ↑31%YoY

KEY DATA			
Share Price (LKR)	12.70		
52w High/Low (LKR)	13.50 / 10.10		
Average Daily Volume (Shares)	1,968,552		
Average Daily Turnover (LKR)	23,158,265		
Issued Share Capital (Shares mn)	8,143.8		
Market Capitalisation (LKR mn)	103,426		
Price Performance (%)	1 mth	3 mths	12mths
DIAL	-2%	10%	21%
ASPI	-2%	0%	2%
Major Shareholders as at 30th Sep 2017			
Axiata Investments (Labuan) Limited	83.32%		
Employees Provident Fund	2.22%		
CITI Bank New York S/A Norges Bank A/C 2	1.28%		
HSBC Int'l Nominees Ltd - JPMCB	1.02%		
CB NY S/A International Finance Corporation	0.79%		
Estimated Free Float	16.68%		

Price – Volume Chart



Source: CSE

**ANALYST CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 6.**

## “Continue to be driven by Data and Broadband”

P/E 31 December	2015	2016	2017E	2018E	2019E
Revenue (LKR mn)	73,930	86,745	94,016	101,554	109,510
YoY % Growth	10%	17%	8%	8%	8%
Net Profit (LKR mn)	5,188	9,041	9,817	11,579	13,237
EPS (LKR)	0.64	1.11	1.21	1.42	1.63
YoY % Growth	-15%	74%	9%	18%	14%
Valuations					
PER (x)	19.9	11.5	10.5	8.9	7.8
PBV (x)	2.2	1.9	1.7	1.5	1.3
Div Yield (%)	2.5%	3.1%	3.5%	4.1%	4.7%
NAVPS	5.8	6.6	7.5	8.4	9.5
DPS (LKR)	0.3	0.4	0.4	0.5	0.6
Div Payout	50%	35%	37%	37%	37%

LKR (Mn)	3Q2017	3Q2016	YoY	2Q2017	QoQ
Revenue	24,218	21,748	11% ↑	23,012	5% ↑
Gross Profit	11,490	10,600	8% ↑	10,897	5% ↑
EBITDA	9,400	7,714	22% ↑	8,130	16% ↑
PBT	4,149	3,189	30% ↑	2,734	52% ↑
Net Profit (Equity)	3,721	2,833	31% ↑	2,346	59% ↑

LKR (Mn)	4Q2016	1Q2017	2Q2017	3Q2017
Revenue	22,775	22,165	23,012	24,218
Gross Profit	10,397	10,287	10,897	11,490
EBITDA	7,422	7,221	8,130	9,400
EBITDA Margin	33%	33%	35%	39%
PBT	1,629	1,976	2,734	4,149
Net Profit (Equity)	1,251	1,546	2,346	3,721
Net Margin	5%	7%	10%	15%

### 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.

### “Strong revenue growth boosts earnings”

**Downgrade to HOLD on price appreciation:** DIAL’s 3Q2017 results showed a noteworthy performance in earnings following a tough 1H2017 impacted by externalities including flood conditions and increase in consumption taxes. With the easing off of the regulatory pressure by removal of Telco Levy, and restored consumer spending, earnings for the quarter improved by 31%YoY to LKR 3.72Bn. Growth is evident in Mobile and Fixed Line segments with increase in demand observed for data and home broadband. Thereby, we believe that earnings are in line to achieve our 2017E earnings target while we continue to maintain 2018E & 2019E targets as well. FC Research does not change the fair value price of LKR 14.1 providing a total return of 15% including a dividend yield of 4% (annualized return 13.6%) for 2018E. With the price appreciation in DIAL over last 2 months of 7% from LKR 11.9 to LKR 12.7, we downgrade our recommendation from BUY to **HOLD** on DIAL.

**Budget Move:** Recent budget proposals plan to introduce a Cellular Tower levy of LKR 200,000 per tower per month and charge a fee on advertisements done through SMSs at a rate of 25 cents per SMS. If implemented DIAL’s earnings may be revised to reflect the increase in cost of sales.

### Earnings Performance

**Earnings up by 31%YoY:** DIAL recorded earnings of LKR 3.72Bn for 3Q2017, up by of 31% as against LKR 2.83Bn recorded in 3Q2016 on the back of recovery in core revenue streams and cost rescaling initiatives. However, on a QoQ basis earnings grew by of 59% when compared to LKR 2.34Bn recorded in 2Q2017. YTD DIAL’s earnings amounted to LKR



7.61Bn down, by 2% from previous year. DIAL's EBITDA was recorded at LKR 9.4Bn for 3Q2017 compared to LKR 7.7Bn the previous year growing by 22%YoY. Accordingly EBITDA margin improved to 39% from 35% in 3Q2016 and 2Q2017.

**Commendable revenue growth across main business segments:** Group revenue for the quarter grew by 11%YoY and 5%QoQ to LKR 24.2Bn. Revenue contribution for the quarter from Mobile segment amounted to LKR 20Bn growing by 10%YoY while DTV recorded a revenue of LKR 1.6Bn growing by 12%YoY. DBN's revenue was recorded at LKR 3.1Bn, an impressive growth of 31%YoY.

**Dialog Mobile earnings driven by data revenue and subscriber growth:** DIAL's mobile earnings grew by 9%YoY and 41%QoQ to LKR 3.3Bn on the back of 39%YoY growth in data revenue and subscriber growth. During 3Q2017 DIAL's mobile subscriber base increased to 12.7Mn, with postpaid subscribers and prepaid subscribers increasing by 3%QoQ and 2%QoQ respectively. The company EBITDA contribution to the group stood at 79% recording a LKR 7.4Bn, up by 10%YoY and 14%QoQ. EBITDA Margin for the Mobile business was recorded to be 37% for the quarter.

**DTV subscriber base continued to record strong growth:** DTV subscribers increased by 17%YoY and 2%QoQ to 926,000 during 3Q2017. During the quarter DTV's EBITDA improved by 110%YoY to LKR 202Mn, recording an EBITDA Margin of 13%.

**DBN continues to record net profits:** DIAL's broadband business continued to record profits for the third consecutive quarter growing by 93%QoQ to LKR 640Mn. DBN's EBITDA was recorded at LKR 1.9Bn growing by 16%QoQ recording an EBITDA margin of 61% on the back of 31%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.13.6%:** FC Research estimates fair value for DIAL at LKR 14.1 over a period of 13 months. [DCF based LKR 14.0 and PER based LKR 14.2]. DIAL is expected to provide a total return of c.14.8% for 2018E including a Dividend Yield of c.4%.

**DIAL's mobile and fixed broadband to drive growth:** FC Research expects Sri Lanka's total mobile broadband subscribers to grow at a CAGR of c.8% 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%.

**Mandatory offer increases DIAL's stake in Colombo Trust Finance to 98.87%:** Subsequent to the close of mandatory offer on the 2nd November 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.

### Investment risks

**Operational Risks:** DIAL's traditional revenue streams such as voice and messaging may be disrupted continually with ever increasing Over The Top (OTT) players such as Viber, Whatsapp, etc.

**Exchange rate risk:** foreign exchange difference with the fluctuation of LKR against USD. As a 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.

**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. Budget proposals for 2018 included a Cellular Tower levy of LKR 200,000 per tower per month to be charged from mobile tower operators. Currently DIAL owns about 2000 towers and tenancy ratio of the towers average to about 2. Further it is proposed to charge a fee on advertisements done through SMSs at a rate of 25 cents per SMS which DIAL may indeed pass to the customer. However implementation of these proposals are not yet confirmed.



## Valuation Summary

<b>Expected DIAL price for 2018E</b>	
DCF Valuation based target price	14.0
PER based target price	14.2
<b>Average Target Price</b>	<b>14.1</b>

## Return

Target Price	14.1
Current Price	12.7
Capital Gain (LKR)	1.4
Dividend 2017E (LKR)*	0.4
Capital Gain %	11%
Dividend Yield %	4%
Total Return %	14.8%
Annualized Return %	13.6%

\*paid in 2018

## DCF Valuation

<b>Valuations</b>	<b>2018E</b>
NPV	136,343,227
(+) Cash	6,570,008
(-) Debt	(28,696,213)
<b>Total Value of Equity</b>	<b>114,217,022</b>
No. of shares	8,143,778
<b>Value of Equity per share</b>	<b>14.0</b>

## COE ( $K_e$ )

$R_f$	9%
$R_m$	17%
$\beta$	0.8
$K_e = R_f + \beta (R_m - R_f)$	16%

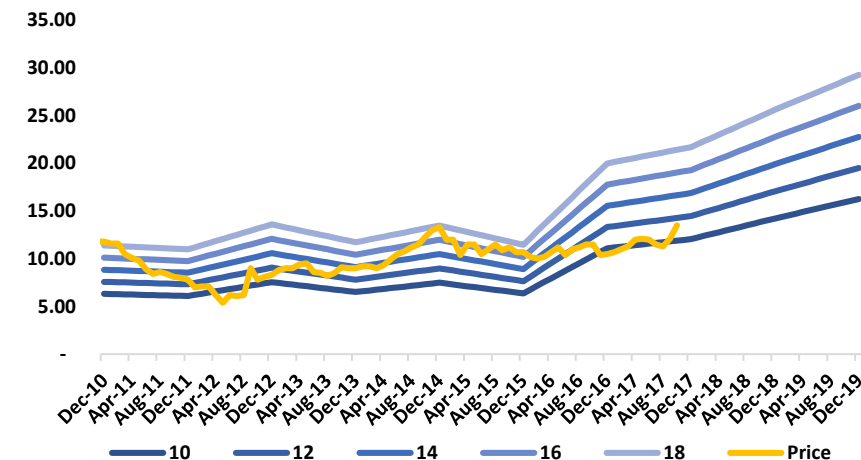
## WACC

$K_e$	16%
$K_d$	14%
D/E Assumption	40 / 60
Terminal Growth (%)	3%
<b>WACC</b>	<b>14%</b>

## Scenario Analysis

		<b>WACC</b>				
		12%	13%	14%	15%	16%
<b>Terminal Growth (%)</b>	1%	14.9	13.3	12.0	10.9	9.9
	2%	16.3	14.4	12.9	11.6	10.5
	3%	18.0	15.8	14.0	12.5	11.3
	4%	20.1	17.5	15.3	13.6	12.2
	5%	22.8	19.5	17.0	14.9	13.2

## PER Valuation



Source: CSE and FC Research Estimates

## PER based Valuation

2018E Earnings (LKR '000)	11,593,909
No. of Shares ('000)	8,143,778
2018E EPS	1.42
Expected Average PER	10x
Price at 10.0x 2018E Earnings	14.2

## 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 15-11-2017 – 9.46%



## Annex I – Income Statement

Income Statement (LKR Mn)	2015	2016	2017E	2018E	2019E
<b>Y/E 31st December</b>					
Revenue	73,930	86,745	94,016	101,554	109,510
Direct costs	-40,828	-45,978	-48,625	-51,435	-54,420
<b>Gross profit</b>	<b>33,102</b>	<b>40,767</b>	<b>45,391</b>	<b>50,119</b>	<b>55,090</b>
Distribution costs	-10,838	-13,534	-15,835	-17,418	-19,160
Administrative costs	-12,799	-14,390	-15,685	-16,940	-18,295
Other income	33	72	90	99	107
<b>Operating profit</b>	<b>9,497</b>	<b>12,915</b>	<b>13,961</b>	<b>15,859</b>	<b>17,741</b>
Finance income	485	367	433	507	588
Finance costs	-3,244	-2,730	-2,827	-2,726	-2,738
<b>Finance costs - net</b>	<b>-2,759</b>	<b>-2,363</b>	<b>-2,394</b>	<b>-2,219</b>	<b>-2,151</b>
Share of loss from associates - net of tax	-33	-8	0	0	0
<b>Profit before income tax</b>	<b>6,705</b>	<b>10,544</b>	<b>11,567</b>	<b>13,640</b>	<b>15,591</b>
Income tax	-1,518	-1,517	-1,735	-2,046	-2,339
<b>Profit for the year</b>	<b>5,187</b>	<b>9,026</b>	<b>9,832</b>	<b>11,594</b>	<b>13,252</b>
Non Controlling Interest	-1	-15	-15	-15	-15
<b>NetProfit</b>	<b>5,188</b>	<b>9,041</b>	<b>9,817</b>	<b>11,579</b>	<b>13,237</b>

Source: Company reports and FC Research Estimates

## Annex II – Balance Sheet

Balance Sheet (LKR Mn)	2015	2016	2017E	2018E	2019E
<b>As at 31st December</b>					
<b>ASSETS</b>					
<b>Non-current assets</b>					
Intangible assets	17,341	16,434	16,669	17,348	18,095
Property, plant and equipment	79,060	89,944	98,088	102,418	103,867
Investment in subsidiaries	0	0	0	0	0
Investment in associates	80	72	72	72	72
Amount due from related companies	0	0	0	0	0
Financial assets	40	40	40	40	40
	<b>96,522</b>	<b>106,490</b>	<b>114,869</b>	<b>119,877</b>	<b>122,074</b>
<b>Current assets</b>					
Inventories	556	677	705	762	767
Trade and other receivables	14,519	17,966	19,472	21,033	22,681
Cash and cash equivalents	6,993	8,045	9,004	6,570	11,108
	<b>22,068</b>	<b>26,688</b>	<b>29,181</b>	<b>28,365</b>	<b>34,556</b>
<b>Total assets</b>	<b>118,590</b>	<b>133,178</b>	<b>144,051</b>	<b>148,242</b>	<b>156,630</b>
<b>EQUITY</b>					
<b>Capital and reserves attributable to equity holders</b>					
Stated capital	28,104	28,104	28,104	28,104	28,104
Reserves	19,214	25,903	32,559	40,515	49,477
Non-controlling interest	-1	14	14	14	14
<b>Total equity</b>	<b>47,317</b>	<b>54,021</b>	<b>60,677</b>	<b>68,633</b>	<b>77,595</b>
<b>LIABILITIES</b>					
<b>Non-current liabilities</b>					
Borrowings	15,943	26,313	30,039	22,957	18,671
Derivative financial instrument	25	15	15	15	15
Deferred revenue	1,723	1,658	1,658	1,658	1,658
Deferred income tax liability	53	0	0	0	0
Employee benefit payables	1,509	1,373	1,373	1,373	1,373
Provision for other liabilities	1,147	1,310	1,310	1,310	1,310
	<b>20,400</b>	<b>30,668</b>	<b>34,393</b>	<b>27,311</b>	<b>23,026</b>
<b>Current liabilities</b>					
Trade and other payables	40,630	39,744	43,145	46,030	49,199
Borrowings	9,464	7,872	5,301	5,739	6,224
Derivative financial instrument	12	16	16	16	16
Current income tax liabilities	766	858	519	513	570
	<b>50,873</b>	<b>48,489</b>	<b>48,980</b>	<b>52,298</b>	<b>56,009</b>
<b>Total liabilities</b>	<b>71,273</b>	<b>79,157</b>	<b>83,374</b>	<b>79,609</b>	<b>79,035</b>
<b>Total equity and liabilities</b>	<b>118,590</b>	<b>133,178</b>	<b>144,051</b>	<b>148,242</b>	<b>156,630</b>

Source: Company reports and FC Research Estimates



## Annex III – Statement of Cash flows

Cashflow Statement (LKR Mn) Y/E 31st December	2015	2016	2017E	2018E	2019E
<b>Cash flows from operating activities</b>					
Cash generated from operations	24,941	25,879	36,348	39,991	44,537
Interest received	468	381	433	507	588
Interest paid	-816	-1,688	-2,827	-2,726	-2,738
Tax paid	-3,079	-1,499	-2,074	-2,052	-2,281
Employee benefits paid	-35	-67	0	0	0
<b>Net cash generated from operating activities</b>	<b>21,478</b>	<b>23,005</b>	<b>31,879</b>	<b>35,720</b>	<b>40,105</b>
<b>Cash flows from investing activities</b>					
Purchase of property, plant and equipment	-14,421	-27,513	-26,692	-25,207	-24,559
Purchase of intangible assets	-2,128	-811	-2,206	-2,666	-2,917
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	-95	0	0	0	0
Purchase of available-for-sale financial assets	-20	0	0	0	0
Proceed from sale of property, plant and equipment	267	214	0	0	0
<b>Net cash used in investing activities</b>	<b>-16,614</b>	<b>-28,110</b>	<b>-28,898</b>	<b>-27,873</b>	<b>-27,475</b>
<b>Cash flows from financing activities</b>					
Repayment of borrowings	-11,958	-8,686	-15,146	-23,479	-20,369
Repayment of finance leases	0	0	0	0	0
Proceed from borrowings	4,362	17,371	16,300	16,835	16,567
Dividend paid to ordinary shareholders	-1,059	-2,606	-3,176	-3,638	-4,290
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
<b>Net cash (used in) / generated from financing activities</b>	<b>-8,654</b>	<b>6,109</b>	<b>-2,022</b>	<b>-10,281</b>	<b>-8,091</b>
<b>Net increase / (decrease) in cash and cash equivalents</b>	<b>-3,790</b>	<b>1,004</b>	<b>959</b>	<b>-2,434</b>	<b>4,538</b>
<b>Movement in cash and cash equivalents</b>					
At start of the year	10,774	6,993	8,045	9,004	6,570
Increase / (decrease)	-3,790	1,004	959	-2,434	4,538
Effect of exchange rate changes	9	48	0	0	0
<b>At end of the year</b>	<b>6,993</b>	<b>8,045</b>	<b>9,004</b>	<b>6,570</b>	<b>11,108</b>

Source: Company reports and FC Research Estimates

## Annex IV – Key ratios

Y/E 31st Dec	2015	2016	2017E	2018E	2019E	
<b>Growth</b>	Revenue	10%	17%	8%	8%	8%
	Direct Cost	5%	13%	6%	6%	6%
	Gross Profit	16%	23%	11%	10%	10%
	EBITDA	14%	23%	35%	12%	11%
	Net Profit	-15%	74%	9%	18%	14%
<b>Margin</b>	GP Margin	45%	47%	48%	49%	50%
	EBITDA Margin	32%	34%	36%	38%	39%
	NP Margin	7%	10%	10%	11%	12%
<b>Gearing</b>	Debt/Equity	54%	63%	58%	42%	32%
	Debt/Debt+Equity	35%	39%	37%	29%	24%

Source: Company reports and FC Research Estimates



## Research Disclosure

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