John Keells Stock Brokers (Pvt) Ltd.
A JKSB Research Publication
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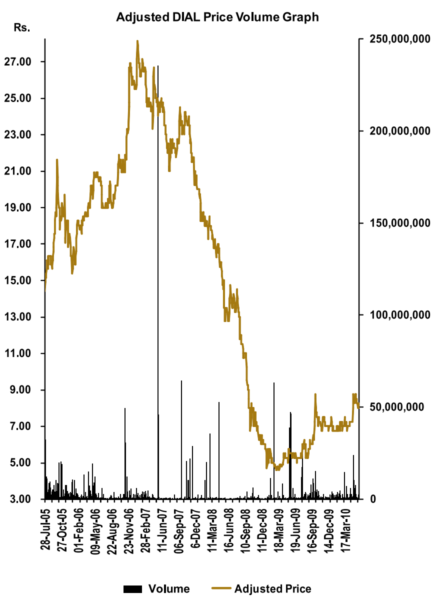
Dialog Axiata PLC (DIAL)

Rs 9.50 | **BUY**

DIAL			
Reuters Code			DIAL.CM
Bloomberg Code			DIAL.SL
Share Price LKR			9.50
Issued Share Capital (Shares)			
Voting			8,143,778,405
12 mth High/Low (Rs.)			10.00 / 5.25
Free Float			14.73%
Total Debt (LKR mn) FY09			33,099
Enterprise Value (LKR mn) FY09			109,331
Average Daily Volume (Shares)			2,697,590
Market Capitalisation Rs. mn			77,366
Price Performance (%)			
	1 mth	6 mth	12 mth
ASPI	2.61	29 .57	90.09
DIAL	5.56	35.71	80.95

Financial Year	NPAT (Rs.m)	NPAT after Pref. Dividend (Rs.m)	EPS (Rs.)	EPS attributable to equity	EPS Growth (%)	PER (x)	EV / EBIDTA (x)	EBITDA Margin (%)
2004	4,801	4,801	0.59	0.59	67.92	16.12	16.97	53%
2005	7,010	7,010	0.86	0.86	46.02	11.04	11.93	51%
2006	10,118	10,118	1.24	1.24	44.33	7.65	8.20	52%
2007	8,969	8,908	1.10	1.09	(11.35)	8.68	8.14	41%
2008	(2,879)	(3,593)	(0.35)	(0.44)	(132.10)	(21.53)	21.58	14%
2009	(12,648)	(13,291)	(1.55)	(1.63)	339.31	(5.82)	15.29	20%
2010E	3,536	2,961	0.43	0.36	127.96	26.13	10.03	27%
2011E	4,913	4,482	0.60	0.55	38.95	17.26	8.63	30%
2012E	5,790	5,467	0.71	0.67	17.85	14.15	7.94	31%



Profile

>> Dialog Axiata PLC (DIAL), a subsidiary of Axiata Group Berhad has spearheaded the local mobile industry since inception and currently boasts an active mobile subscriber base of 6.74 million, accounting for around 45% of the total market.

>> DIAL was once the largest listed corporate on the Colombo Stock Exchange (CSE), being the only company to cross USD 1 billion market cap. Since then, it has seen its share price tumble to an all time low of Rs. 4.50 from an all time high of Rs. 29.75 due to lower earnings posted by the company and the industry as a whole on the back of intensive price competition. In FY09, the company recorded its biggest loss ever of over Rs. 12 billion including non recurring charges (both cash and non cash) of Rs. 11 billion. However, the most recent results released by the company were far more positive with a PAT of Rs. 705 for 1QFY10.

Industry Overview

>> In CY09/FY09, the industry's mobile subscriber base rose to 14 million at a yoy growth of 27% thanks to aggressive customer acquisition strategies among the operators. With mobile penetration levels having accelerated to 69% and plateauing, the industry has seen a decline in the growth rate of mobile subscribers over the years.

>> The end of hostilities in the country in May 2009 enabled most mobile operators to enjoy higher subscriber growth stemming from predominantly, the previously untapped region in the North. Consequently, net additions during 3QCY09 rose to 1.69 million from 410,481 and 182,342 in 1Q and 2Q of CY09 respectively. However, net adds in the 4Q of CY09 dropped to 725,045 but was still higher than those seen during 1HCY09.

>> The local mobile industry now comprises 5 players with the entry of Bharti Airtel in early 2009. Towards the end of CY09, Millicom International sold out of Tigo which was then bought by Etisalat, a UAE based operator. The expectation of lower prices being offered by Airtel with its entry resulted in significant price reductions by all players in the industry.

	2002	2003	2004	2005	2006	2007	2008	2009
Mobile Subs	931,403	1,393,403	2,211,158	3,361,775	5,412,496	7,983,489	11,082,071	14,095,346
Growth in Mobile		**50%**	**59%**	**52%**	**61%**	**48%**	**39%**	**27%**
Dialog Market share	52%	60%	61%	63%	57%	53%	50%	45% *
Dialog's share of incremental subs.		75%	65%	66%	48%	45%	40%	29%
Total Line Population (Mobile & Fixed)	1,814,511	2,332,416	3,202,397	4,605,769	7,296,572	10,725,548	14,528,482	17,531,304
Growth in Line		**29%**	**37%**	**44%**	**58%**	**47%**	**35%**	**21%**
Fixed Line Penetration	5%	5%	5%	6%	9%	14%	17%	17%
Mobile Penetration	5%	7%	11%	17%	27%	40%	55%	69%
Line Penetration	10%	12%	16%	23%	37%	53%	72%	86%

** 48% – as per Company estimates*

Source : TRC & Company data

Regulatory Developments

>> The consequent price war among operators during a time of high inflation resulted in the entire telecommunication industry suffering from declining revenue amid rising costs. This compelled the telecom regulator to set a floor rate of Rs. 2 off net and Rs. 0.50 on net per minute to prevent further price reductions which was hurting the long term potential in the industry. More recently, the regulator has approved the move to a “calling party pays” regime from a “sender keeps all” regime with an interconnect charge of Rs. 0.50 per minute to be implemented from June 2010.

>> In addition to the above, the regulator plans on implementing Mobile Number Portability (MNP) but it is unlikely that such implementations will take place in the next couple of years.

Regional Penetration Levels

>> Sri Lanka records one of the highest mobile penetration levels among regional peers. Despite such high penetration levels, Sri Lanka’s Revenue Per Minute (RPM) is believed to be the lowest in the region while based on Minutes of Use (MoU), the country’s ranked 8th among regional countries. Although the industry may not exhibit greater potential in terms of new subscriber growth, we believe that there is significant upside in usage volumes as well as RPMs.

Operational Review

>> The operations of DIAL span a future oriented quadruple play service offering fixed line, mobile, broadband and media through its fully owned subsidiaries. During FY09, all 4 of its operations suffered from a drastic decrease in profitability.

Mobile

>> Despite declining market share, DIAL is still recognized as the market leader in the mobile industry, capturing 45% of the total subscriber base and a revenue share of 57%.

>> With most operators opting to use price competition to attract customers, DIAL saw its share of the market (both overall market share and its share of incremental subscribers) declining since CY06. In order to avert further reduction in market share, DIAL also followed suit in order to attract and retain its customer base. DIAL’s subscriber base grew to 6.74 million by the end of 1QFY10 with approximately 89% being pre paid subscribers accounting for around 45% of company revenue compared to 48% in FY08.

>> Traditionally, mobile usage has exhibited high elasticity levels but with double digit inflation in CY08 that eroded consumers' disposable income, DIAL saw its revenue slipping despite reductions in call charges - indicating lower elasticity levels. The pre paid segment witnessed a 28% fall yoy in FY09 in ARPU while minutes of use (based on outgoing) recorded only a 17% growth. In addition, the post paid segment (including outgoing roaming) which accounted for 27% of company revenue (29.9% in FY08) saw a 50% growth in usage post price revisions that brought down ARPUs by 24%. However, overall, blended ARPU dropped 29% yoy to Rs. 324 while blended usage increased by an equivalent amount to 124 minutes by the end of FY09.

>> With the introduction of a price floor by the regulator in the midst of heavy price competition, the revenue per minute in both pre and post paid segments have stabilized to a great extent along with minutes of use. Although inflation has subdued, consumers are yet to see a growth in their real disposable income, which should fuel usage in the medium to long term.

>> During FY09, international voice termination revenue grew by 57% from an increase in international traffic, accounting for 20% (12.3% in FY08) of revenue while other revenue accounted for 8%. Revenue from mobile broadband, included in this category has seen significant growth and is likely to be a key revenue driver in the medium to long term.

>> For DIAL FY08 and FY09 were the toughest years of operation with inflation lowering revenue and increasing costs, thus the group had to divert its attention towards rescaling of costs.

>> During FY09, the company took a strategic decision to move from its current GSM network to a 100% NGN infrastructure which necessarily gave rise to a one off amortization charge of Rs. 6 billion. A further Rs. 2,069 million was written off as a non-recurring charge to align capital inventory / Capital Work in progress provisioning policies in line with international best practices. The company also implemented a two-phase Voluntary Resignation Scheme with a total provision Rs. 881 million in FY09. Through its cost reduction strategies the company saved approximately Rs. 2 billion in FY09 over FY08.

>> The cost rescaling efforts undertaken by DIAL in FY09 proved successful as the unit returned to profitability with a PAT of Rs. 1,276 million for 1QFY10, also supported by improved usage over FY09.

Pay TV

>> Double digit inflation that prevailed in the economy hindered new customer acquisitions during 1HFY09. But innovative sales and marketing efforts resulted in a 22% yoy growth in subscribers to nearly 160,000 by the end of 1QFY10. With the increase in subscribers the unit recorded a CAGR of 56% in revenue since its inception in 2007, further growing by 28% in FY09. The monthly subscription fees accounted for 68% of the turnover in FY09 compared to 60% in FY08.

>> The Pay TV segment too has been a heavy burden on the group as the company failed to achieve its estimated breakeven level of around 200,000 subscribers. In FY09, the unit recorded a negative EBITDA of Rs. 245 million but showed 61% improvement from FY08 levels while PAT remained in the red

with a loss of Rs. 769 million. DTV has shown signs of a possible turnaround in the future with an EBITDA of Rs. 26 million for the quarter, improving 116% yoy thanks to a 33% growth in revenue. NPAT too improved 69% yoy and 29% qoq to a loss of Rs. 94 million.

CDMA & Broadband

>> Dialog Broadband Networks (Pvt) Ltd. (DBN), DIAL's fully owned subsidiary is responsible for the provision of fixed wireless telephony services through CDMA technology and broadband services. The unit also manages the group's telecommunication infrastructure along with the mobile arm.

>> The fixed line industry in Sri Lanka, including both wired and wireless, reached saturation levels in FY09 with the subscriber base falling 0.3% yoy to 3.44 million, as subscribers moved to mobile. DIAL had an active CDMA subscriber base of 177,000 by the end of FY09.

>> Sri Lanka's internet and broadband penetration grew to 1.18% in FY09 thanks to a 2.6% increase in the subscriber base indicating heavy under-penetration levels. Broadband and voice bundled products offered by DBN has witnessed significant growth in FY09.

>> Reduction in connection fee revenue for CDMA subscribers resulted in a 7% decline in DBN's total revenue but broadband and internet based service segment exhibited aggressive growth with revenue increasing by 57% yoy. Non-recurring charges of Rs. 1,565 million for DBN in FY09 resulted in a loss of Rs. 2,588 million, diluting group performance.

Earnings Outlook & Valuations

>> The mobile unit has seen intensive price competition over the last couple of years which resulted in rates nearly halving. However, the rates charged by DIAL are still above the industry average, thus giving the company greater leverage over price decisions.

>> With price competition and inflation having subdued, we expect MoUs to grow in tandem with the country's GDP in the medium term. Given such growth, both pre and post paid segments should exhibit nominal revenue growth of around 3% - 4% yoy for the next 2 years. International Termination Revenue will be a significant revenue generator for the mobile unit in the medium term with the growth in international traffic expected. The setting up of the interconnection charge will result in a modest gain for the mobile business. Currently, all operators in the industry have decided to bear the cost of interconnect instead of passing it on to the consumers.

>> DIAL is currently the market leader in the North with a market share of 80%. With the end of the war, DIAL has now access to another 1 million potential subscriber base in the North. The company has established the widest coverage in the country with 1,643 and 673 2G and 3G base station sites respectively.

>> DIAL is likely to realize greater benefits from its cost rescaling activities including the move to a 100% NGN core network. This move is expected to save approximately Rs. 1.5 billion per annum in operational costs while also minimizing the incremental capex required. The cut back in manpower is also expected to lead

to cost savings in the future. The mobile arm has budgeted for a capex of US $ 60 million (including the capex for mobile broadband) for FY10E.

>> DIAL's media business is likely to turnaround this year if the company is able to reach its estimated breakeven levels of 200,000 subscribers. The pay TV business is characterized by a significant fixed cost structure, therefore, the achievement of the breakeven level will ensure a positive bottom line contribution thereafter. The company is also undertaking measures to improve the current ARPU levels to boost the revenue base. We expect the unit to turnaround this year with greater subscriber acquisition.

>> In terms of DBN's operations, we expect the broadband segment to be a key revenue driver for the unit while CDMA revenue is likely to stagnate on lower usage compared to mobile. DBN has undertaken accelerated depreciation of its network which should reduce the depreciation strain on DBN beyond FY2012. DBN is expected to fully depreciate the WiMAX network in FY2011 while the CDMA network will be fully depreciated by FY2012.

>> The group has allocated approximately US $ 20 million for DBN for FY10 for the purpose of laying the Optical Fibre Network (OFN) in the outskirts of Colombo which is expected to be completed by the end of 3QFY10. The Metro project covering all major locations in Colombo has already been completed. The group is expected to enjoy benefits of the completed OFN starting FY11E.

>> By the end of FY09, the group's total assets were funded by a combination of shareholders' funds and short and long term debt in the proportions of 37% and 63% respectively. Its outstanding borrowings included US $ 125 million obtained from OCBC at preferential rates through a corporate guarantee from Axiata.

>> Given the above, we expect DIAL to end FY10E on a positive note with a profit after preference dividend of Rs. 2,961 million. From FY11E onwards, with positive earnings from DTV, we believe that DIAL's earnings could grow at a CAGR of 36% for the next 2 years. Although the group may not enjoy the high EBITDA margins that were recorded in FY04/05, we expect DIAL to sustain an EBITDA margin of around 30% for the next couple of years.

>> The mobile arm is expected to post Rs. 5,248 million in PAT but losses from mainly DBN is likely to limit group PAT to Rs. 3,536 million for FY10E.

>> At a price of Rs. 9.50, the counter is trading at a P/E multiple of 17 times on an EPS of Rs. 0.55 in FY11E. The company trades at an EV/EBITDA multiple of around 10.03 times.

>> Traditionally, the country's telecommunication industry has been trading at a significant premium to the market but has seen the gap narrowing in recent years due to a change in market dynamics. Although, at a P/E multiple of 16 times FY11E, the share is trading at an approximate premium of 36%, we believe that this is justified given high growth potential at both macro and company level. We therefore, recommend BUY.

Profit & Loss Statement (Rs.m)	2003	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E
Year Ended 31 December	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**
Revenue										
Post paid	3,562	4,931	7,282	9,306	10,439	9,852	8,228	9,412	9,711	10,074
Pre-paid	2,263	4,010	6,593	10,816	14,811	15,976	14,667	16,830	17,586	18,244
International Termination Revenue	120	544	1,364	2,221	3,270	4,064	5,839	6,190	6,519	6,762
Other Revenue	209	925	1,178	1,788	3,063	5,192	5,853	6,405	6,672	7,314
International Roaming Revenue	1,323	1,703	1,616	1,548	933	1,083	1,191	1,429	1,601	1,921
Total Revenue	**7,476**	**12,113**	**18,033**	**25,679**	**32,516**	**36,167**	**35,779**	**40,265**	**42,089**	**44,316**
Direct Costs	2,973	3,932	6,214	8,821	13,402	19,989	22,301	21,085	21,838	22,915
Gross Profit	4,503	8,182	11,819	16,858	19,114	16,178	13,478	19,180	20,251	21,401
Other income	17	30	53	123	380	611	704	787	500	482
Administration costs	991	1,597	2,222	3,064	6,076	10,468	18,055	10,355	10,427	10,625
Selling and distribution costs	863	1,562	2,335	3,067	3,774	6,690	6,159	5,161	4,966	5,129
EBITDA	**3,633**	**6,444**	**9,162**	**13,339**	**13,431**	**5,067**	**7,149**	**10,905**	**12,675**	**13,768**
Finance Costs	253	212	263	657	629	2,003	1,748	767	240	96
PBT	2,414	4,840	7,052	10,193	9,015	(2,372)	(11,780)	3,683	5,118	6,031
Tax	445	(39)	(42)	(75)	(45)	(507)	(428)	(147)	(205)	(241)
PAT	**2,859**	**4,801**	**7,010**	**10,118**	**8,969**	**(2,879)**	**(12,208)**	**3,536**	**4,913**	**5,790**

Balance Sheet (Rs.m)	2003	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E
As at 31 December	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**
Fixed Assets	**10,985**	**13,469**	**22,430**	**33,633**	**54,337**	**69,827**	**59,856**	**60,858**	**57,651**	**54,156**
Current Assets										
Inventories	173	229	350	580	954	656	211	238	249	262
Recievables	1,546	2,268	3,726	6,910	10,090	10,743	9,647	10,859	11,351	11,951
Cash and equivalents	611	3,188	6,690	2,302	6,856	1,146	5,295	384	1,986	4,433
	2,330	**5,685**	**10,766**	**9,793**	**17,899**	**12,544**	**15,153**	**11,481**	**13,586**	**16,647**
Total Assets	**13,315**	**19,154**	**33,197**	**43,426**	**72,236**	**82,371**	**75,009**	**72,339**	**71,236**	**70,802**
Ordinary share capital	370	370	7,403	7,403	8,144	8,144	8,144	8,144	8,144	8,144
ESOS Trust Shares			(2,385)	(1,925)	(2,000)	(2,000)	(1,731)	(1,731)	(1,731)	(1,731)
Preference Shares	1,269	1,269	-	-	5,000	4,500	3,750	2,500	1,250	-
Share Premium			5,277	5,277	20,653	20,653	19,912	19,912	19,912	19,912
Retained earnings	3,834	7,068	6,901	14,206	19,096	11,618	(2,102)	(10)	2,897	6,323
Revaluation reserve	5	5	5	21	20	21	136	21	22	22
Shareholders Funds	**5,478**	**8,712**	**17,201**	**24,982**	**50,912**	**42,935**	**28,109**	**28,835**	**30,493**	**32,669**
Non Current Liabilities										
Subscription in advance	3,414	3,414	-	1	0	-	-	-	1	-
Borrowings	2,347	3,137	9,049	8,185	9,256	9,139	25,862	21,209	18,370	15,345
Retirement benefit obligations & Others	29	49	82	112	355	394	1,130	556	612	673
	5,790	6,600	9,131	8,298	9,611	9,533	26,993	21,765	18,983	16,017
Current Liabilities										
Payables	1,515	3,483	5,214	8,866	10,811	11,025	12,668	14,260	14,906	15,695
Current tax liability	-	33	36	63	24	78	3	80	79	78
Borrowings	532	325	1,615	1,216	877	18,800	7,237	7,399	6,774	6,343
	2,047	3,841	6,865	10,145	11,713	29,903	19,907	21,739	21,760	22,116
Total liabilities	**13,315**	**19,153**	**33,197**	**43,426**	**72,236**	**82,371**	**75,009**	**72,339**	**71,236**	**70,803**

Cashflow Statement	2003	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E
Year Ended 31 December	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**	**Rs 'mn**
PBIT	2,414	4,140	7,054	10,193	9,015	(2,372)	(12,220)	3,683	5,118	6,031
Depreciation	1,000	1,452	1,954	2,736	4,547	6,658	18,590	8,029	8,316	8,604
Other non cash items	94	239	156	(959)	220	1,082	2,192	1,364	1,147	1,130
Net change in working capital	(32)	1,139	(152)	238	(1,608)	(141)	3,184	353	(243)	(187)
Net cash generated from operations	**3,476**	**6,970**	**9,011**	**12,207**	**12,173**	**5,227**	**11,746**	**13,430**	**14,339**	**15,578**
Investing activities										
Plant property and equipment	(3,847)	(3,931)	(8,205)	(11,878)	(24,815)	(22,993)	(9,738)	(9,200)	(5,750)	(5,750)
Intangibles	(91)	(136)	(463)	(503)	(187)	(33)	(15)	-	-	-
Acquistition of subsidiary, net of cash reqd.			(1,441)	(849)	(40)	-	-	-	-	-
Others	1	6	36	19	20	-	28	-	-	-
Net cash used in investing activities	**(3,937)**	**(4,061)**	**10,073)**	**13,212)**	**(25,022)**	**23,026)**	**(9,725)**	**(9,200)**	**(5,750)**	**(5,750)**
Financing Activities										
Share premium on issue of shares			491		15,376	-	-	-	-	-
Proceeds from ESOS				460	129	9				
Option Scheme ESOS Shares				1						
Preference Share Issue					5,000	(500)	(750)	(1,250)	(1,250)	(1,250)
Proceeds from issue of shares			5,402		740	-	-	-	-	-
IPO cost set off			(113)							
Repayment of subscription in advance			(2,460)							
Payment to ESOST			(2,399)		(205)					
Finance lease repayment	(22)	(18)	(22)	(23)	(44)	(48)	(47)	(26)	(26)	(26)
Loan repayment	(430)	(424)	(521)	(1,151)	(12,198)	(11,931)	(20,638)	(4,000)	(4,000)	(4,000)
Borrowings	904	1,054	7,061	143	12,736	26,671	25,039	-	500	500
Dividends	(760)	(866)	(2,859)	(2,813)	(4,132)	(5,106)	(755)	(1,591)	(2,211)	(2,606)
Net cash used in financing	**(308)**	**(254)**	**4,581**	**(3,383)**	**17,403**	**9,095**	**2,849**	**(6,867)**	**(6,987)**	**(7,381)**
Inc./dec. in cash and equivalents	(769)	2,655	3,519	(4,388)	4,554	(8,704)	4,870	(2,637)	1,602	2,447
Cash at beginning	1,285	516	3,170	6,690	2,303	6,857	(1,848)	3,022	385	1,987
Cash and equivalents at end	**516**	**3,170**	**6,690**	**2,303**	**6,857**	**(1,848)**	**3,022**	**385**	**1,987**	**4,434**