Dialog Axiata PLC - DIAL

NDB Stockbrokers

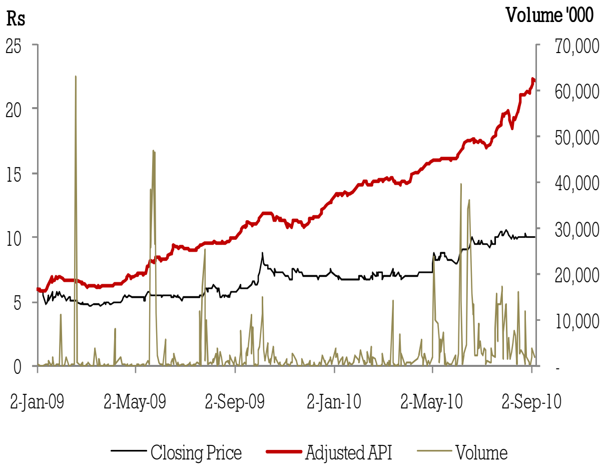
Back in black

Analyst – Ranmini Vithanagama

21st September 2010

Share data	
Market Price (14.09.2010)	Rs 10.60
Intrinsic Value (FCF Method)	Rs 13.20
52-week range	Rs 6.00-10.60
Shares in issue	8,143,778,405
Average Daily Volume	3,265,387
Estimated Free Float	16.68%

Major shareholders as at 30 June 2010	No. of Shares	%
Axiata Investments (Labuan) Ltd	6,785,252,765	83.32%
HSBC - BBH - Genesis Smaller Companies	191,221,640	2.35%
Dialog Telekom Employees ESOS Trust	158,572,462	1.95%
Sri Lanka Insurance Corp. Ltd - Life Fund	74,585,920	0.92%
Employees Provident Fund	72,844,189	0.89%
Other	861,301,429	10.58%



In 2009, DIAL took measures to de-scale its cost structures, which included a shift to the Next Generation Network (NGN), and a Voluntary Resignation Scheme (VRS). Its FY10 earnings so far indicate that the cost-control measures have paid off well.

The floor prices and interconnection fees introduced by the Telecom Regulatory Commission of Sri Lanka (TRCSL) with effect from July 2010 would bode well for the telecommunication companies by preventing unhealthy price competition and ensuring adequate compensation for network usage by competing operators. In our opinion, Dialog Mobile, as the market leader, would benefit the most from the regulatory interventions.

The rise in economic activity with the end of the war, the addition of North and East to the mainstream economy and the promotion of Sri Lanka as a regional knowledge hub would drive communication and information demand. Dialog Mobile, DTV and the broadband segments would likely benefit from the economic prosperity.

DIAL has underperformed the ASPI, indicating headroom for an appreciation in the share price. We believe that the positive growth momentum of DIAL is yet to be factored into the DIAL share price.

Based on a free cash flow method the share is valued at Rs. 13.20, which works out to a forward P/E of 19.4X based on the earnings forecast for FY11. The EV/EBITDA stands at 8.4X. **BUY.**

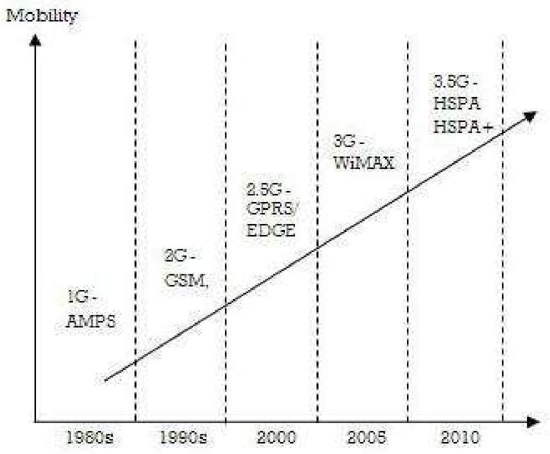
Figures are in Rs Mn	FY06 (A)	FY07 (A)	FY08 (A)	FY09 (A)	FY10 (E)	FY11 (E)	FY12 (E)
Turnover	27,075	34,127	36,278	35,774	41,316	45,396	49,240
Net Profit Attributable to Shareholders	10,119	8,907	(2,879)	(12,208)	4,971	5,776	7,623
EPS (Rs)	1.38	1.15	(0.45)	(1.64)	0.55	0.68	0.94
Forward P/E (X)*	11.96	14.35	NM	NM	24.02	19.43	14.05
DPS (Rs)	0.55	0.55	-	-	0.20	0.50	0.90
Dividend Yield (%)	2.10	2.80	-	-	1.51	3.79	6.81
BV (Rs)	3.08	6.17	5.13	3.45	3.74	3.77	3.65
PBV (X)*	8.60	3.24	1.17	2.10	3.53	3.50	3.62
Total Debt/Equity (%)	27.26	16.58	39.87	53.20	48.80	46.10	43.60

* Forward multiples are calculated using the intrinsic value of the share

NM - Not meaningful

Wireless Telecommunication Technology

Wireless Communication Technology Progression



Source: Wikipedia, NDB Stockbrokers

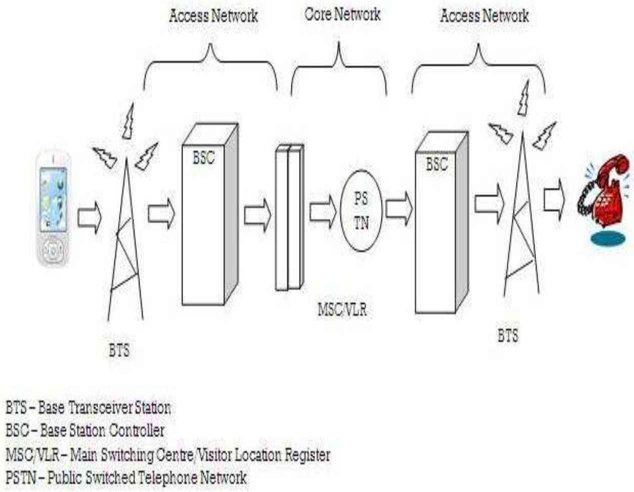
Core Network and Access Network

A telecommunication network consists of two components: the core network (also referred to as the backbone network) and the access network.

The core network is the central part of a tele/mobile communication network consisting of switches and routers. The main function of a core network is to route calls across the Public Switched Telephone Network (PSTN).

The access network connects subscribers to the core network (closest to the subscriber). The access network consists of base stations, base station controllers, transmitters and receivers which transmit the signals received from the subscriber to the core network. GSM technology uses the frequency bands of 900 MHz and 1,800 MHz for communication, while 3G technology operates within a frequency range of 2,000-2,100 MHz.

Wireless Communication Equipment



Source: NDB Stockbrokers

Sri Lanka's Telecommunication industry

Sri Lanka's telecommunication industry is regulated by the Telecommunications Regulatory Commission of Sri Lanka (TRCSL). The telecommunication industry was a state-owned monopoly until early-1991, when the government embarked on a de-regularization and liberalization process.

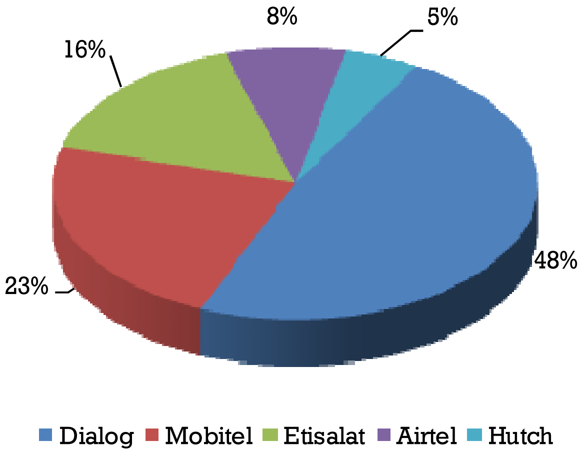
Fixed Wire-line Telecommunication Market in Sri Lanka

Sri Lanka Telecom (SLT) is the only fixed wire-line telecommunications service provider in the country. In 2009, the number of fixed wire-line subscribers was 871,248, down 7% YOY, indicating rising popularity of mobile telecommunication (which rose 27% YOY to 14.1 Mn subscribers in 2009).

Sri Lanka's Mobile Telecommunication Operators

There are five mobile telecommunication operators in the country. Of the five players, DIAL has the largest market share, which stood at 46% as of June 2010 (Source: DIAL FY10Q2 quarterly earnings release).

Mobile Telecommunication Sector Market Share - 2009



Source: Company Sources, NDB Stockbrokers

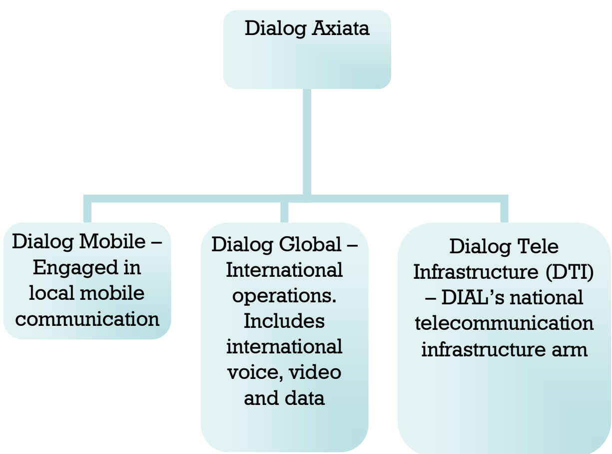
Dialog Axatia: The Group

Dialog Axatia and its subsidiaries are engaged in the provision of communication and media-related services. Its quadruple-product portfolio includes the following:

- Mobile telecommunication
- Fixed wireless telecommunication
- Broadband and internet
- Pay-Television services

The company (excluding subsidiaries) is made up of three strategic business units (SBUs), namely, Dialog Mobile, Dialog Global, and Dialog Tele-Infrastructure (DTI).

Dialog Axiata and its SBUs



DIAL has two fully-owned subsidiaries, Dialog Broadband Networks (Pvt.) Ltd (DBN) and Dialog Television (Pvt.) Ltd (DTV). DBN is engaged in the provision of fixed wireless telecommunication services, broadband internet and data networks, while DTV is a satellite-based direct-to-home (DTH) digital television service provider.

Dialog Mobile

Dialog Mobile commenced commercial operations in 1995, with a technological breakthrough by utilizing GSM technology, the first Global System for Mobile Communications (GSM) operator in South Asia. DIAL was the fourth mobile telecommunication player to enter the Sri Lanka market. Its GSM coverage as opposed to the analogue technology utilized by the existing players helped DIAL quickly establish itself and leapfrog into the market leader position within five years of commencing operations.

DIAL is characterized by technological innovation in mobile communication in Sri Lanka, being the first in South Asia to introduce Short Message Services (SMS), Automatic International Roaming (AIR), Wireless Application Protocol (WAP) and General Packet Radio Service (GPRS).

Furthermore, DIAL was the first mobile telephony operator in Sri Lanka to introduce Missed Call Alert, Multimedia Messaging Services (MMS), 3G and EDGE service.

Dialog Mobile offers pre-paid and post-paid packages. Pre-paid packages have become increasingly popular among subscribers, as is the case with other mobile telecommunication networks.

DIAL provides an innovative range of value added services. They broadly fall into four baskets, namely, call management, messaging, entertainment and information and other services.

Dialog Mobile: Pre-paid: Post-paid Mix 2005Q4 vs. 2010Q2

Source: Dialog Axiata

It has to be noted that although DIAL's mix of pre-and post-paid subscribers has changed gradually, the number of post-paid subscribers of DIAL has risen over time.

Dialog Global

Sri Lanka's External Gateway Operations (EGO) was liberalized in 2003, terminating SLT's monopoly in international telecommunications. Dialog was offered its EGO license in February 2003 for a period of 10 years.

Dialog Global carries out the EGO of the group. Its primary business lines are International Wholesale Services and International Roaming through which it provides voice, video and data transmission facilities. The data segment primarily consists of corporate customers.

DIAL Coverage Network

Dialog has a comprehensive network coverage, which spans across all nine provinces of the country. The coverage is supported by 1,692 base station sites as of end 2009. DIAL plans to increase the total number of base station sites to 2,000 by end-2010 and 3,000 by end 2012 to support the increase in mobile communication (voice, data and video) traffic. It has to be noted that competitors such as Mobitel also have a wide network coverage while, Etisalat is aggressively investing in expansion in the near term.

DIAL provides global connectivity through International Private Leased Circuits (IPLC) over the optical fibre submarine communication cables SEA-ME-WE 3 (maintained by 93 operators) and SEA-ME-WE 4 (maintained by 16 operators). Further, DIAL partners with Telekom Malaysia in providing the Internet Protocol – Virtual Private Network (IP-VPN) service to its geographically dispersed customers.

Dialog Dealer Network

DIAL has the most comprehensive dealer network amongst its competitors, which included over 42,000 retail outlets, 22 Dialog Arcades and Service Centres and more than 100 franchise customer service points as of end-2009. This provides DIAL a competitive advantage over rivals in reaching out to end subscribers.

Competition in the Mobile Telecommunication Sector

Mobile telecommunication sector industry dynamics took a dramatic turn towards mid-2008, when the players started engaging in severe price competition which resulted in profitability erosions of all operators.

In 2009, the telecom sector incurred an overall loss of Rs 15Bn due to this price war, according to the TRCSL.

Tariff Rates Offered by the Leading Mobile Telecommunication Operators

Operator	Prepaid Packages	Outgoing (Rs)		Special Packages
		Same Network	Outside	
DIAL	Call charges	1.00	2.00	Pre-paid Packages
	SMS	0.25	0.25	Post-paid Packages
MOBITEL	Call charges	1.00	2.00	Smart packages
	SMS	0.10	0.25	Upahaara
ETISALAT	Call charges	1.00	2.00	Discover, Dream
	SMS	0.10	0.25	Success, Reach

Source: Company websites

New Regulations in Place

Taking into account the unsustainable nature of the price rivalry among the existing players, the TRCSL intervened in the form of floor price imposition, with effect from 15 July 2010.

In addition, the local mobile telecommunication market was hitherto characterized by the lack of a framework that requires mobile operators to pay other networks for usage of their network infrastructure (the absence of an interconnection charge).

The following new regulations apply to mobile phone operators and fixed line operators.

- Tariff floor rates: Rs 2 per outgoing calls to other network and Rs 1 per outgoing calls within the network (with effect from 15 July 2010).
- Interconnection fees: Rs 0.50 per call and Rs 0.15 for SMSs (with effect from 1 June 2010).

TRCSL expects the new measures to help the telecommunication sector to turn around in 2010, contributing 1% of GDP. We believe the new regulations would lead to a profit-oriented, level-playing field for the companies in the industry by allowing for adequate compensation for network infrastructure usage.

Additionally, the TRCSL is also mulling the implementation of Mobile Number Portability (MNP) that allows subscribers to switch networks while using the same number as a tool to encourage competition and promote operator efficiency.

Floor Prices and Interconnection Fees: an advantage to DIAL

New entrants in the industry tend to offer low tariffs to attract subscribers. Hence, floor prices put at an advantage the network with the largest market share (i.e. DIAL). Since the number of people making calls into the DIAL network would invariably be greater, new subscribers would tend to opt for DIAL (to exploit low tariffs within the same network). This would also act as a deterrent for lowering DIAL's churn rates (churn rate is the rate at which existing subscribers exit the network).

Furthermore, the interconnection fees imposed would ensure that DIAL is compensated for its network usage by competitors. Although DIAL would also be liable for payment for calls generated outside its network, the net result would be positive in our opinion, given that DIAL has the largest subscriber base in the country.

Switch to Next Generation Network (NGN)

In the latter part of 2009, DIAL switched to a 100% NGN core network (which was until then 62% NGN). The investment was Rs 485 Mn.
NGN uses IP as the transport layer, which supports any service (Voice, data, video etc). As such, different transport layers are not required for different services.

Legacy Network vs. NGN

Legacy

NGN

Source: Dialog Axiata

The NGN network has the following advantages and flexibilities over DIAL's former legacy network.

Legacy	NGN
High space and power consumption	Low space and power consumption
Limited evolution	Ability to evolve
Not scalable	Scalable

The transition has allowed lower future capital expenditure requirements, due to an over 80% reduction in per subscriber core-network capital costs, according to DIAL.

The operating cost savings from the network switch are about Rs 1.5 Bn per annum, stemming from lower annual maintenance charges, electricity costs and depreciation charges for the NGN.

DIAL plans to expend US$ 10-15 Mn per annum from 2011 for expanding its fibre optic network (backbone network). It is currently laying a 550 km high capacity fibre optic network linking major towns and cities in the country to improve quality (of speed and clarity) of both data and voice services. The expansion of the routes is likely to be less costly as there will be no requirement to lay the cables underground.

Further, DIAL expects to monetize the network infrastructure by offering capacity to other telecommunications service providers, which would allow the group to recoup its capex much faster, thereby providing the platform for continued investment in latest technology.

Other Cost Re-scaling Measures

DIAL carried out the following cost reduction measures in FY09 as part of its right-sizing activities.

- Human Resources Optimization Scheme

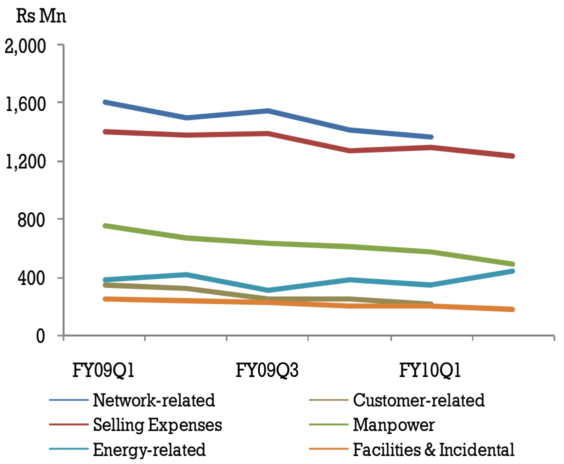
DIAL implemented a Voluntary Resignation Scheme (VRS) to rescale human resource cost. The VRS was taken up by 335 employees, which results in Rs 443 Mn annualized savings in terms of payroll costs and Rs 100 Mn annualized savings of employee maintenance costs, with effect from FY09Q4.

- Renegotiations of Annual Maintenance Contracts and contracts with other suppliers

- Rescaling of overhead and administrative expenses

These measures have helped lower most cost lines.

Dialog Mobile's Direct and Operating Cost Lines



Source: Dialog Axiata

Favourable Economic Outlook for the Mobile Telecommunication Sector

With the end of the nearly 30-year civil conflict, Sri Lanka has entered a new phase of economic growth. Rising macroeconomic and political stability serves as a catalyst as the economy is set to grow at approximately 7% annually for the next 3-4 years.

The telecommunication sector is certain to play a critical role in the economic growth process. On the one hand, the economic revival is likely to drive the requirement for modern and high quality communication services. On the other hand, global connectivity is required for knowledge acquisition and sharing. Therefore, voice, video and data connectivity demand would invariably rise exponentially.

Additionally, the revival of tourism with the end of the war would boost inbound roaming activities while outbound roaming is also likely to increase with the anticipated economic development.

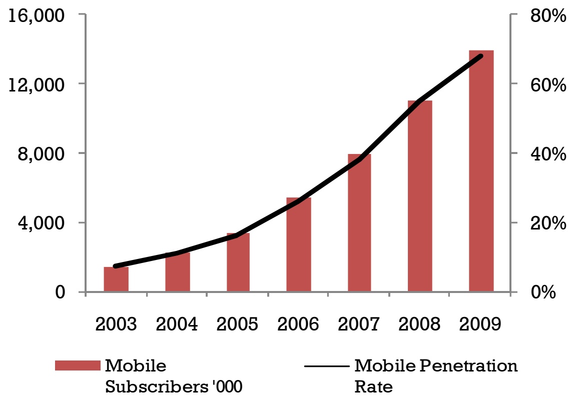
Furthermore, the government plans to develop Sri Lanka into a regional hub for technology and education. Such measures would necessitate high standards of communication and knowledge-sharing.

However, the increasing popularity of Voice Over Internet Protocol (VoIP)-based communication such as Skype, Gmail and Yahoo! Voice would pose stiff competition to mobile telecommunication operators, particular in EGO, as these services provide a free or inexpensive communication platform for global connectivity.

Further room for mobile telecommunication penetration

Sri Lanka's mobile telecommunication penetration rate stood at about 68% in 2009 (Source: TRCSL).

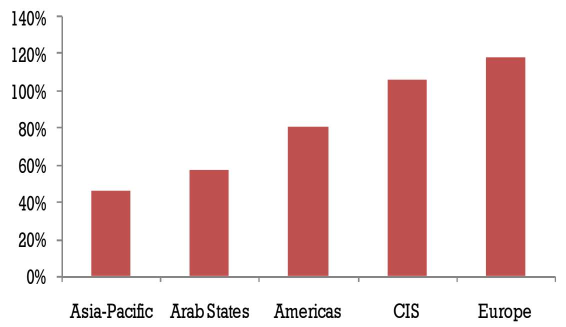
Mobile Phone Subscriber Growth and Penetration 2003-2009



Source: Central Bank of Sri Lanka

However, given that there are mature markets where mobile telecommunication penetration levels are over 100% (For example, Singapore over 135%, Europe over 100%) we are of the opinion that there is further headroom for increasing Sri Lanka's mobile telecommunication penetration level.

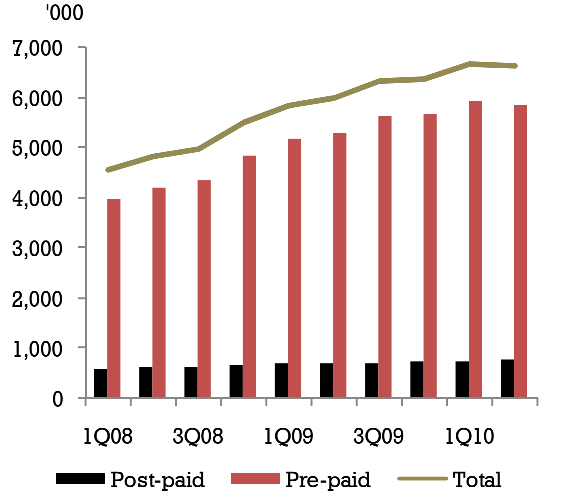
Mobile Cellular Penetration of Selected Regions, 2009



Source: International Telecommunication Union (ITU)

Furthermore, industry experts believe that Sri Lanka's real mobile telecommunication penetration is only 45-50% since about 30-35% of the activated SIM cards represent dual SIM card holders.

Dialog Mobile Subscribers

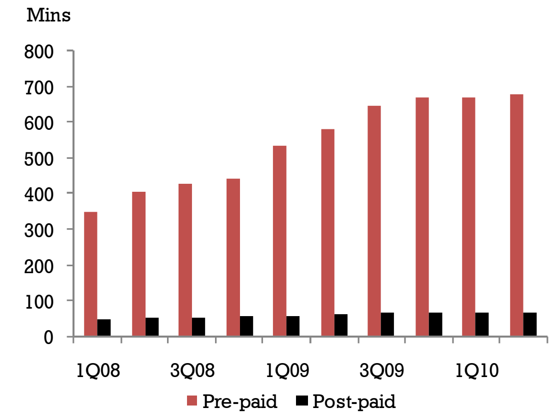


Source: Dialog Axiata

Dialog Mobile's Minutes of Usage and Revenue per Minute

Dialog Mobile's Minutes of Usage (MOU) have gradually stabilized since 2009Q4, as can be seen in the graph below.

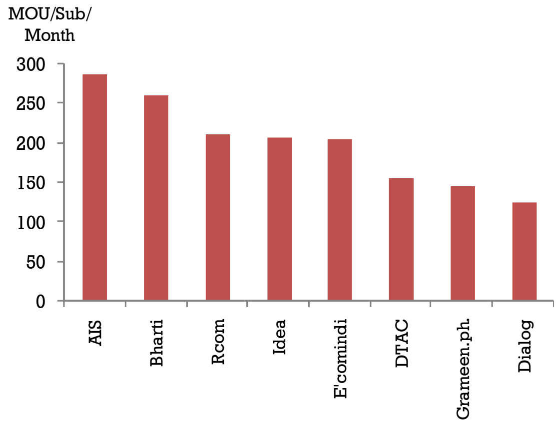
Dialog Mobile's Pre-paid vs. Post-paid MOU



Source: Dialog Axiata

However, compared to regional peers, Dialog Mobile's MOU is at fairly low levels, indicating room for further growth with the economic revival in Sri Lanka.

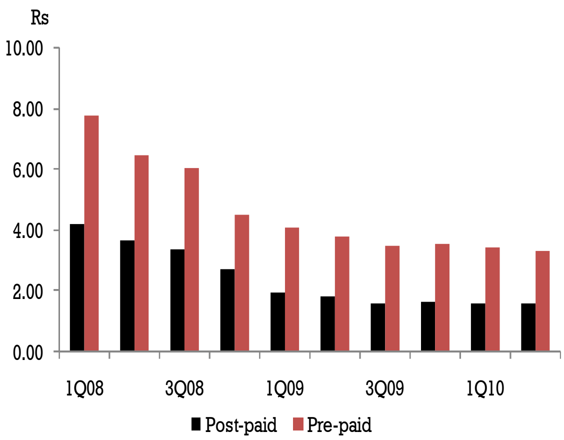
Dialog Mobile's MOU per Subscriber per Month vs. Regional Peers



Source: Dialog Axiata

The easing of the price competition due to the imposition of floor prices would help maintain revenue per minute (RPM) in the future for mobile telecommunication operators. Therefore, we expect Dialog Mobile's RPM to stabilize around existing levels going forward.

Dialog Mobile's Revenue per Minute

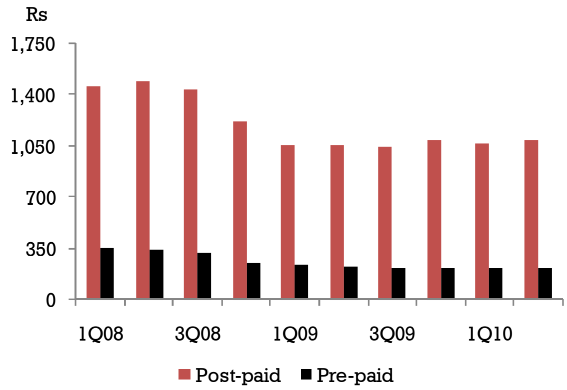


Source: Dialog Axiata

Dialog Mobile's ARPU to Recover

Dialog Mobile's post-paid Average Revenue per User (ARPU) is significantly above the revenue from pre-paid ARPU. As seen in the graph below the company's ARPU seem to be stabilizing around the existing levels.

Dialog Mobile's Pre-paid vs. Post-paid ARPU Mix



Source: Dialog Axiata

We expect ARPU to improve gradually with the increase in MOU. Thus, we estimate DIAL's post-paid ARPU to rise 2% over the next two years. The pre-paid ARPU is expected decline in 2010 (as pre-paid package prices have to be lowered to floor price levels), but would marginally improve going forward.

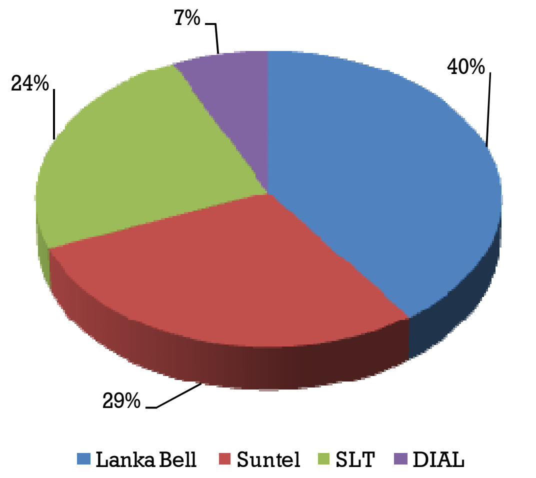
Dialog Mobile's Value Added Services

We believe value added services would play a crucial role in attracting new subscribers, as it is where the mobile telecommunication players would differentiate themselves. Taking into account that Dialog Mobile has pioneered in introducing innovative value added services since its launch of operations in 1995, we believe Dialog is the best-positioned to identify new value added services.

DBN: Fixed wireless telephony segment

This segment has failed to gain popularity amidst competitive prices and value added services provided by the mobile telecommunication segment. Code Division Multiple Access (CDMA) technology has in fact failed to gain popularity outside North America against the more mature and flexible GSM technology.

Fixed Wireless Telephony Market Share, 2009



Source: Company Sources, NDB Stockbrokers

We expect the number of DBN's CDMA subscribers, particularly in the retail segment, to decline within the next 2-3 years. However, CDMA subscribers in the Enterprise, and Small and Medium Enterprise (SME) categories may post a marginal increase, amidst improving economic prospects.

Broadband segment: Mobile and DBN

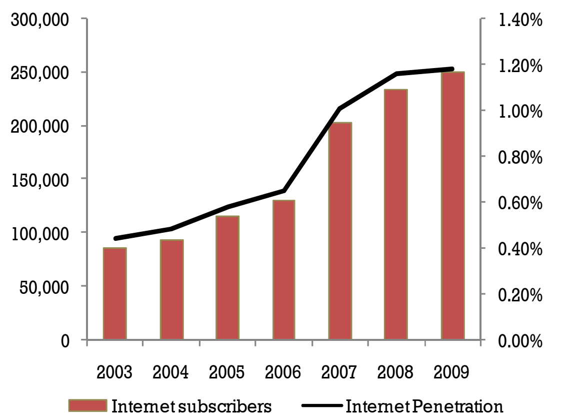
Broadband refers broadly to a telecommunication signal with greater bandwidth which allows for transportation of greater data traffic than through a regular telecommunication signal.
In Sri Lanka, the broadband internet market is dominated by SLT, which commanded a market share of approximately 70% by end-2009.

DIAL offers Wi-Max fixed wireless internet access through the broadband segment of DBN and HSPA/HSPA+ based mobile broadband internet through Dialog Mobile.

We place greater optimism on the broadband segment due to several reasons.

- Sri Lanka's internet penetrations are at low levels (approximately 1.2% as of end-2009) indicating ample headroom for further growth.
- Increasing awareness among people about internet and more affordable prices of computers and connectivity devices (dongles).

Sri Lanka's Internet Penetration Rate



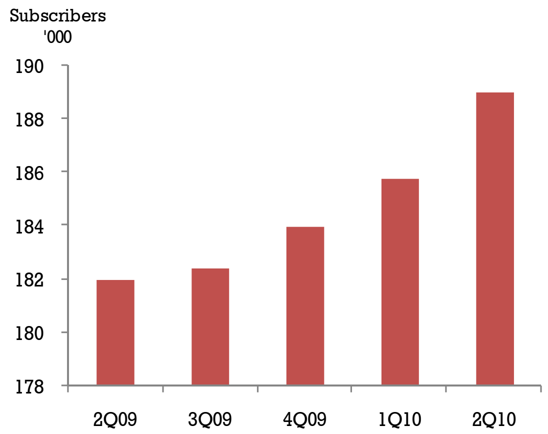
Source: TRCSL

On the other hand, the economic revival of the country would enhance data connectivity requirement.

- Establishing Sri Lanka as a knowledge hub in the future would invariably necessitate high quality and swift connectivity and information availability.
- Sri Lanka's attractiveness as a location for setting up Business Process Outsourcing (BPO) activities would increase the demand for data warehousing facilities.
- Greater connectivity to the outside world would raise demand for video conferencing (e.g. Skype).

Therefore, we believe the broadband segment, particularly of Dialog Mobile, to perform well in the near term.

DBN's CDMA and Broadband Subscribers



Source: Dialog Axiata

Dialog Television (DTV)

Satellite-based pay TV is a broadcasting service that allows subscribers to receive TV signals through a receiver unit (a satellite dish) and a set-top box (STB).

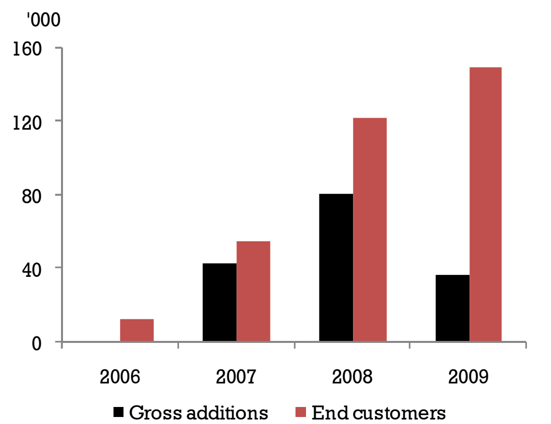
DTV offers 75 channels varying from news to sports and has four packages of channel bundling, namely Pearl (40 channels), Diamond (53), Emerald (53) and Gold (73).

DTV has managed to increase its subscriber base consistently over the years, and thereby maintain the market leader position in the Pay TV market. The other players in this market include IPTV-based Peo TV (a unit of SLT) and Digital cable-based Lanka Broadband Networks.

In 2009, the company claims to have maintained a market share of 83% in the Pay TV segment. However, Sri Lanka's TV entertainment market is dominated by over the air (Analog Terrestrial Network) TV segment, which has both state and privately owned operators.

Payments to content providers and satellite bandwidth costs form the bulk of DTV's cost structure. While the payments to content providers may increase gradually, the company has negotiated a fixed payment for satellite bandwidth costs until 2015.

DTV Subscribers



Source: Dialog Axiata, NDB Stockbrokers

DTV expects its number of subscribers to improve to 200,000 by end-2010, from about 160,000 at present.

Given that the home entertainment segment is still at an immature phase in Sri Lanka, particularly outside the Western province, we believe there is still untapped market potential that Pay TV players could move into. As the market leader, and given its strong brand name, we believe DIAL is well-positioned to explore a possible rise in entertainment demand with rising economic prosperity.

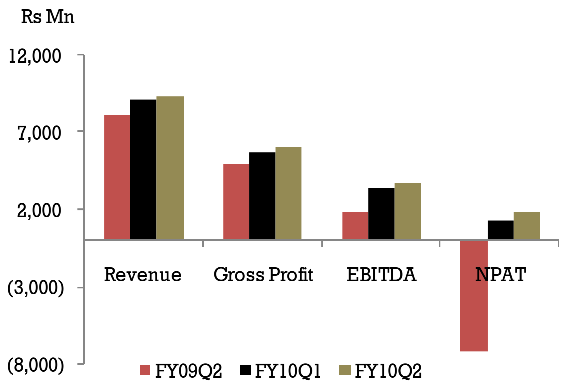
Financial Performance

Dialog Mobile

Dialog Mobile posted revenues of Rs 32,515 Mn in FY09, a 2% YOY drop, amidst aggressive price competition among industry players. Its direct costs rose 11% YOY to Rs 19,361 Mn. Its operating costs also rose 49% YOY to Rs 21,584 Mn, resulting from one-off provisions of Rs 9,989 Mn. These provisions included an impairment charge of Rs 6 Bn on account of network modernization, Rs 2,069 Mn on changes to Capital Work-in-Progress provisioning policies and a further Rs 881 Mn from the VRS.

The company's EBITDA (Earnings before Interest, Tax, Depreciation and Amortization) declined 6% YOY to Rs 7,889 Mn, while its Net Loss after Tax stood at Rs 9,210 Mn.

Dialog Mobile Financial Performance FY10Q2 (vs. FY09Q2 and FY10Q1)



Source: Dialog Axiata

The revenue in FY10Q2 was boosted by a continued growth in pre-and post-paid segments and non-voice revenue. There was a marked rise in inbound roaming while the site sharing revenue gained 53% YOY. Direct costs declined 4% QOQ, but posted a modest 1.4% YOY increase. The 13% YOY decline in operating costs was driven by a reduction in operating overheads, administration and manpower related expenses.

DBN: Financial Performance

DBN	FY09	% YOY	FY10Q2	% QOQ	% YOY
Revenue	2,348	-7%	577	-2%	-1%
EBITDA	(406)	-244%	33	176%	113%
NPAT	(2,588)	-73%	(341)	27%	42%

The company attributed the improvement in its EBITDA and NPAT to its cost management measures.

DTV: Financial Performance

DTV	FY09	% YOY	FY10Q2	% QOQ	% YOY
Revenue	1,641	28%	522	7%	27%
EBITDA	(245)	61%	30	23%	135%
NPAT	(769)	18%	(88)	7%	61%

The growth in revenue was supported by a 17% YOY increase in the number of Pay TV subscribers. The steady increase in usage revenue helped the company post its second consecutive quarter of positive EBITDA.

Snapshot of Group financial performance

Figures are in Rs Mn	FY06	FY07	FY08	FY09	FY10H1
Turnover	27,075	34,127	36,278	35,774	20,111
Gross Profit	16,857	20,973	16,353	13,473	8,417
EBITDA	13,744	8,370	7,853	7,887	7,148
NPAT	10,119	8,907	(2,879)	(12,208)	1,813
EPS	1.38	1.15	(0.45)	(1.64)	0.24
BV	3.08	6.17	5.13	3.45	3.53
Total Debt/Equity (%)	27.3	16.6	39.9	53.2	48.8

Financial Forecast

Dialog Mobile

We forecast a 6% YOY increase in Dialog Mobile subscribers to 6.7 Mn by FY10. This figure is expected to rise to 6.8 Mn by FY11 and 7.5 Mn by FY12.

A 4% YOY decline is estimated for pre-paid ARPU in FY10 owing to reduced tariff on per minute pre-paid package to floor price. The ARPU is expected to remain flat in FY11. However, anticipating an increase in usage we forecast a 3% rise in pre-paid ARPU in FY12. The post-paid ARPU is expected to increase 2% YOY annually during FY10-FY12.

Furthermore, taking into account the cost management measures undertaken by the company in FY09, we anticipate the gross profit margins to improve.

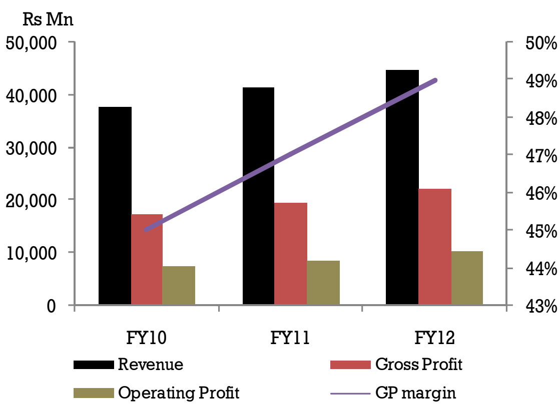
In addition, we believe DIAL's finance cost would decline 78.3% YOY in FY10 due to repayment of loans. It is expected that the finance cost would remain around these levels as heavy capex is not in the pipeline for the next 2-3 years. We have not computed an interest payment on the funds advanced to DIAL by the parent company. The facility is expected to be repaid in the future by DIAL. (However, details pertaining to the repayment have not yet been disclosed by DIAL).

Dialog Mobile is liable for corporate tax from 2013 onwards, upon termination of its 15- year tax exemption period. The company has the option to choose between a concessionary tax rate of 2% on revenue or at the prevailing corporate tax rate for the next 15 years to follow. We expect the company to opt for the concessionary tax rate.

DBN is tax exempt for five years ending March 2011, after which the company is subject to a corporate tax rate of 15% per annum.

DTV was awarded a tax exemption for a period of three years from the first year of assessment, and is subject to a corporate tax of 20% per annum thereafter.

Dialog Mobile Financial Forecast



Source: NDB Stockbrokers

DBN

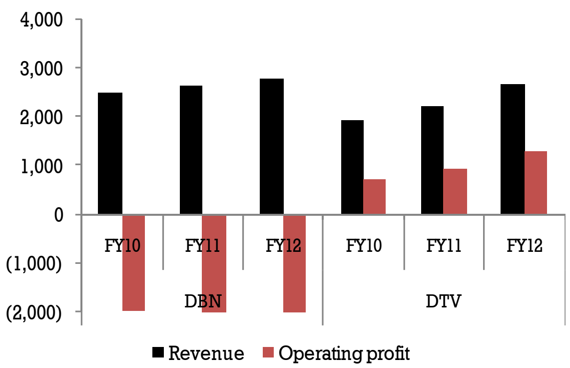
Taking into account the gradual decline in usage of fixed wireless telephony, we have factored in only a 1% YOY increase in CDMA subscribers in FY10. We project the subscriber numbers to remain flat in FY11, and decline 1% YOY in FY11. On the contrary, broadband revenue is expected to rise 20% in FY10, 15% in FY11 and 10% in FY12.

DTV

We anticipate an 18% YOY increase in DTV subscribers in FY10. The number of subscribers is expected to rise a further 15% annually in FY11 and FY12.

Accordingly, DTV revenue is expected to rise 16% YOY in FY10. The revenue is projected to increase 15% and 21% respectively in FY11 and FY12.

DBN and DTV Financial Forecast

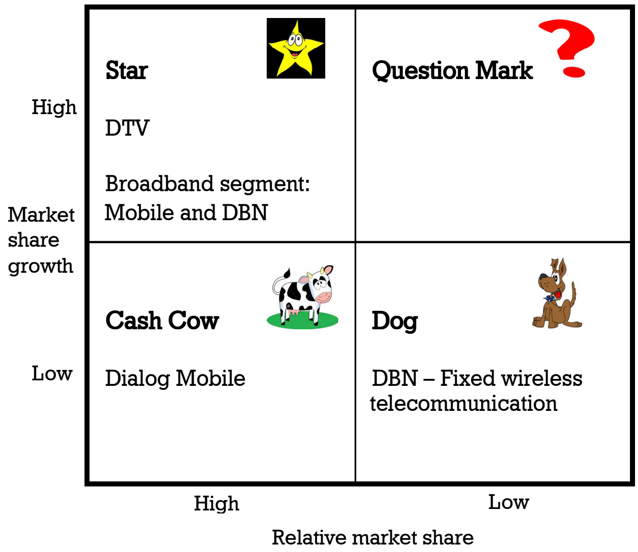


Source: NDB Stockbrokers

Snapshot of Group financial forecast

Figures are in Rs Mn	FY10 (E)	FY11 (E)	FY12 (E)
Turnover	41,316	45,396	49,240
Gross Profit	17,739	20,241	23,096
EBITDA	16,019	17,474	19,377
NPAT	4,971	5,776	7,623
EPS	0.55	0.68	0.94
BV	3.74	3.77	3.65
Total Debt/Equity (%)	48.8	46.1	43.6

Dialog Quadruple Segments in the BCG Matrix



We believe, Dialog Mobile, which enjoys the leadership in a maturing market, to bring in revenue which would support growing sectors such as DTV and the Broadband Segment.

Given the CDMA fixed telephony business is currently in the sunset mode, we believe it is unlikely that DIAL would focus its resources on turning around the segment.

Valuation

DIAL has failed to keep up with the recent rally in the market indices. While the ASPI has gained 77% year to date (YTD), the DIAL share has only risen 51% YTD. In our opinion, this places the stock as an attractive investment given its turnaround momentum. However, the selling pressure may slow down a rapid appreciation in the price.

We have used the free cash flow method to compute the intrinsic value of the share.

A terminal growth rate of 8% was assumed, taking into account a real GDP growth expectation of 7%. Additionally, a medium term growth rate of 15% was assumed from FY13 to FY15.

The required rate of return of 14.60% was computed considering an equity risk premium of 7.0%, taking into account the industry risks stemming from intense rivalry among existing players and technology obsolescence-related risks. A risk free rate of 7.60% (Current 3 year Treasury bond yield) was considered.

Taking into account the above assumptions, the intrinsic value of the share is computed at Rs. 13.20. This translates into a forward P/E of 19.4X, considering earnings for FY11. Further, DIAL's EV (Enterprise Value)/EBITDA stands at 8.4X. **BUY**

Income Statement	FY06 (A)	FY07 (A)	FY08 (A)	FY09 (A)	FY10 (E)	FY11 (E)	FY12 (E)
Figures are in Rs Mn							
Revenue	25,679	34,127	36,169	35,774	41,316	45,396	49,240
Direct Cost	(8,822)	(13,154)	(19,989)	(22,301)	(23,577)	(25,156)	(26,143)
Gross Margin	**16,858**	**20,973**	**16,180**	**13,473**	**17,739**	**20,241**	**23,096**
Other Income	123	368	611	705	139	139	139
Administrative & Distribution Cost	(6,130)	(11,759)	(17,159)	(24,210)	(12,097)	(13,683)	(14,513)
Operating Profit	**10,851**	**9,582**	**(369)**	**(10,033)**	**5,782**	**6,697**	**8,722**
Finance Cost	(657)	(630)	(2,004)	(1,748)	(380)	(444)	(581)
Profit Before Tax	**10,193**	**8,952**	**(2,372)**	**(11,780)**	**5,401**	**6,253**	**8,141**
Tax	(75)	(45)	(507)	(428)	(430)	(477)	(518)
Profit After Tax	**10,119**	**8,907**	**(2,879)**	**(12,208)**	**4,971**	**5,776**	**7,623**
Less: preference dividend	0	0	(714)	(859)	(489)	(245)	0
Net profit/ (loss) attributable to ordinary shareholders	**10,119**	**8,907**	**(3,594)**	**(13,067)**	**4,482**	**5,532**	**7,623**

Balance Sheet	FY06 (A)	FY07 (A)	FY08 (A)	FY09 (A)	FY10 (E)	FY11 (E)	FY12 (E)
Assets							
Non Current Assets							
Property,plant & equipment	30,032	50,666	64,699	55,980	52,398	48,276	44,277
Intangible assets	3,603	3,919	3,902	3,847	3,192	2,537	1,882
	33,634	**54,585**	**68,616**	**59,856**	**55,619**	**50,842**	**46,188**
Current Assets							
Inventories	580	707	656	211	213	207	215
Trade & other receivables	6,910	10,090	10,743	9,646	9,401	9,826	10,226
Cash & cash equivalents	2,301	6,343	1,646	5,295	8,133	10,160	10,412
	9,792	**17,140**	**13,045**	**15,153**	**17,748**	**20,193**	**20,853**
Total assets	**43,426**	**71,726**	**81,661**	**75,009**	**73,367**	**71,036**	**67,041**
Equity and Liabilities							
Stated capital	12,680	33,056	32,556	31,806	30,556	29,306	28,056
ESOS trust shares	(1,925)	(2,000)	(1,991)	(1,991)	(1,991)	(1,991)	(1,991)
Dividend reserve- ESOS	70	173	260	260	260	260	260
Revaluation reserve	21	20	20	136	136	136	136
Retained earnings	14,207	19,036	10,964	(2,102)	751	2,211	2,505
	25,053	50,285	41,809	28,109	29,713	29,923	28,966
Total equity	**25,053**	**50,285**	**41,809**	**28,109**	**29,713**	**29,923**	**28,966**
Non current liabilities							
Borrowings	8,058	5,173	8,828	24,729	23,636	20,836	17,635
Deferred income tax liabilities	40	140	607	1,134	1,134	1,134	1,134
Retirement benefit obligations	112	212	205	395	395	395	395
Provision for other liabilities	87	143	195	521	521	521	521
Deferred revenue	0	0	0	215	215	215	215
	8,297	5,668	9,836	26,993	25,900	23,100	19,899
Current liabilities							
Trade & other payables	8,796	10,930	11,061	12,668	13,039	13,299	13,461
Borrowings	1,216	4,822	18,895	7,237	4,712	4,712	4,712
	10,075	15,772	30,016	19,907	17,753	18,013	18,175
Total liabilities	**18,373**	**21,440**	**39,852**	**46,900**	**43,654**	**41,113**	**38,074**
Total equity & liabilities	**43,426**	**71,726**	**81,661**	**75,009**	**73,367**	**71,036**	**67,041**

Cash Flow Statement	FY10 (E)	FY11 (E)	FY12 (E)
Cash flows from operating activities			
Cash generated from operations	16,633	17,315	19,131
Interest received	168	229	257
Interest paid	(548)	(673)	(838)
Tax/ SRL/ ESC paid	(430)	(477)	(518)
Net cash generated from operating activities	**15,823**	**16,394**	**18,032**
Cash flows from investing actvities			
Expenditure incurred on capital work-in-progres	(6,000)	(6,000)	(6,000)
Net cash used in investing activities	**(6,000)**	**(6,000)**	**(6,000)**
Cash flows from financing activities			
Redemption of rated cumulative redeemable preferance shares	(1,250)	(1,250)	(1,250)
Repayment of finance lease	(31)	0	0
Repayment of borrowings	(6,587)	(4,801)	(5,201)
Proceeds from borrowings	3,000	2,000	2,000
Dividends paid to company's shareholders	(1,629)	(4,072)	(7,329)
Dividends paid to holders of rated cumulative redeemable preferance shareholders	(489)	(245)	0
Net cash generated from financing activites	**(6,985)**	**(8,367)**	**(11,780)**
Net (decrease)/ increase in cash & cash equivalents	**2,838**	**2,027**	**252**
Movement in cash & cash equivalents			
At start of year	5,295	8,133	10,160
(Decrease)/ increase	2,838	2,027	252
At end of year	**8,133**	**10,160**	**10,412**

Key Ratios	FY07 (A)	FY08 (A)	FY09 (A)	FY10 (E)	FY11 (E)	FY12 (E)
Growth Ratios						
Revenue Growth	32.90%	5.98%	-1.09%	15.49%	9.88%	8.47%
Gross Profit Growth	24.41%	-22.86%	-16.73%	31.67%	14.10%	14.11%
Net Profit Growth	-11.98%	-140.35%	-263.62%	134.30%	23.41%	37.80%
Profitability Ratios						
Gross Profit Margin	61.46%	44.73%	37.66%	42.94%	44.59%	46.91%
Net Profit Margin	39.40%	26.10%	NM	NM	10.85%	12.19%
Return on Equity	17.71%	NM	NM	15.09%	18.49%	26.32%
Share Ratios						
EPS (Rs)	1.15	(0.45)	(1.64)	0.55	0.68	0.94
DPS (Rs)	0.55	-	-	0.20	0.50	0.90
DY (%)	2.80	-	-	1.51	3.79	6.81
BV (Rs)	6.17	5.13	3.45	3.74	3.77	3.65

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