

Paltel Group

Attractive dividend yield

We raise our EBITDA and net income forecasts for 2013 and 2014

Paltel Group (Paltel) is the leading telecom operator in Palestine, offering Fixed Line, Mobile, and internet services. Since our initiation of coverage (*"Paltel Group - Bellwether of the Palestinian stock market"*, published 10 December 2012), Paltel's reported results have performed largely in line with expectations.

The company recently reported net income of JOD282m for the first 9 months of 2013, a solid 9.5% increase compared with the same period of 2012. EBITDA improved by 5% during the same period, boosted by a better-than-expected EBITDA margin of 43.9% (42.7% in 9M 2012). We make some minor changes to our forecasts, and raise 2013-2014F EBITDA forecasts by 1% and net income by about 3% on average.

One of the fastest-growing telecommunications markets globally

We continue to believe that despite the economic and political constraints, the Palestinian telecom market offers strong potential for growth: penetration rate is low (82% for mobile services as end of Q3, 2013), GDP/capita should continue to grow and the population is one of the youngest and fastest-growing globally.

Expect steady growth for Paltel

We expect Paltel to lose some market share to Wataniya Mobile, but to continue to hold a dominant market position and to be well-placed to capitalize on future growth. We forecast a CAGR of 5% for 2012-15F in mobile subscriptions, but assume a cautious outlook for ARPUs (declining by 4-5% per year during 2012-15F). These assumptions result in low single-digit net income growth for 2012-15F, but continued healthy FCF generation and strengthening net cash position.

Valuation at low end of peer group, healthy dividend yield of 8.8%

Paltel is currently trading at a 3.8x 2014 F EV/EBITDA multiple, at the low end of the peer group range, discounting the competitive and political situation, in our opinion. We value Paltel using comparable multiples and cross-check with a DCF analysis. Following our increase in forecasts, we raise our target price from JOD6.10 to 6.40 per share, suggesting 12% upside potential. Our TP implies a 2014F target EV/EBITDA of 4.5x. One of the main attractions of the stock, in our opinion, is its healthy 2013F dividend yield of 7.9%, which makes it one of the highest dividend yielding stocks in the MENA region. We think this should provide a solid floor to the share price, given the strength of the balance sheet.

Key Forecasts & Valuation Metrics

year to Dec	2010	2011	2012	2013F	2014F
Revenues (JODm)	338.3	370.2	365.9	379.1	389.1
EBITDA (JODm)	143.3	164.2	153.0	163.8	163.4
Fully diluted EPS (JOD)	0.66	0.69	0.62	0.67	0.75
Dividend per share (JOD)	0.40	0.40	0.45	0.45	0.45
Normalised PE	8.69	8.27	9.13	8.49	7.61
EV/EBITDA	5.0	4.4	4.7	4.1	3.9
Dividend yield (%)	7.0%	7.0%	7.9%	7.9%	7.9%

Accounting standard: IFRS

Source: Company data, Rasmala forecasts

Important disclosures can be found in the Disclosures Appendix.

Buy

Target Price JOD6.40

Key data

Price (close 15 Dec)	JOD5.70
2013 high/low	JOD5.70 / 4.68
Market cap	JOD750m / US\$1,058m
Av (12M) turnover	US\$0.5m/day
Free float	50%
Reuters	PALTEL.PL
Bloomberg	PALTEL PS
Net debt (cash)	(JOD31m)
3yr EPS CAGR 12-15F	2.6%
2013F div yield	7.9%

Source: Bloomberg, Rasmala

Price performance

	(1M)	(3M)	(12M)
Price (JOD)	5.40	5.06	4.90
Absolute (%)	5.6%	12.6%	16.3%

Source: PEX

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Rasmala Equities Forecasts: Paltel Group

Income statement

JODm, year to December	2010	2011	2012	2013F	2014F
Revenues	338.3	370.2	365.9	379.1	389.1
Cost of sales	-78.9	-82.1	-82.1	-76.6	-79.0
Operating costs	-116.1	-123.9	-130.8	-138.7	-146.7
EBITDA	143.3	164.2	153.0	163.8	163.4
DDA & Impairment (ex gw)	-31.6	-37.1	-40.9	-44.7	-46.4
EBITA	111.8	127.0	112.1	119.0	117.0
Goodwill (amort/impaird)	0.0	0.0	0.0	0.0	0.0
EBIT	111.8	127.0	112.1	119.0	117.0
Net interest	-2.2	-2.1	-1.5	-1.5	-1.0
Associates	-9.1	-13.5	-5.8	-3.0	-3.0
Other pre-tax items	-9.9	-10.4	0.8	-0.5	-1.0
Reported PTP	90.5	101.0	105.6	114.0	112.0
Taxation	-4.2	-10.3	-23.5	-25.7	-13.4
Minority interests	0.0	0.0	0.0	0.0	0.0
Other post-tax items	0.0	0.0	0.0	0.0	0.0
Reported net profit	86.3	90.7	82.1	88.4	98.6
Normalised EBITDA	143.3	164.2	153.0	163.8	163.4
Normalised PTP	90.5	101.0	105.6	114.0	112.0
Normalised net profit	86.3	90.7	82.1	88.4	98.6

Balance Sheet

JODm, year ended December	2010	2011	2012	2013F	2014F
Cash & market secs (1)	80.3	71.4	53.6	85.9	113.5
Other current assets	133.0	121.2	128.7	133.3	127.3
Tangible fixed assets	190.2	207.5	198.7	201.9	220.5
Intang assets (incl gw)	33.4	29.7	34.3	34.3	34.3
Other non-current assets	114.4	145.0	201.3	181.2	175.5
Total assets	551.3	574.8	616.5	636.7	671.0
Short term debt (2)	15.6	14.2	15.2	15.2	7.1
Trade & other current liabilities	83.4	84.6	106.5	110.4	112.5
Long term debt (3)	35.5	21.3	7.1	0.0	0.0
Oth non-current liabilities	25.5	26.1	29.2	30.0	30.9
Total liabilities	159.9	146.1	157.9	155.6	150.5
Total equity (incl min)	391.4	428.7	452.0	481.1	520.5
Total liabilities & S/H equity	551.3	574.8	609.9	636.7	671.0
Net debt	-29.2	-36.0	-31.3	-70.7	-106.4

Cash flow statement

JODm, year to December	2010	2011	2012	2013F	2014F
EBITDA	143.3	164.2	153.0	163.8	163.4
Change in working capital	-14.6	-4.9	-16.6	-0.5	8.0
Net interest (paid) / rec	-2.2	-2.1	-1.5	-1.5	-1.0
Taxes paid	-0.2	-4.2	-1.4	-25.8	-12.8
Other operating cash items	16.7	14.9	15.7	35.6	21.6
Cash flow from ops (1)	143.1	167.8	149.1	171.6	179.2
Capex (2)	-51.9	-56.6	-27.2	-46.0	-63.0
Disposals/(acquisitions)	0.7	1.7	0.8	0.8	0.8
Other investing cash flow	-17.0	-51.4	-74.2	-26.3	-20.7
Cash flow from invest (3)	-68.3	-106.3	-100.6	-71.6	-82.9
Incr / (decr) in equity	0.0	0.0	0.0	0.0	0.0
Incr / (decr) in debt	-20.0	-15.6	-14.2	-7.1	-8.1
Ordinary dividend paid	-45.9	-51.5	-50.9	-59.2	-59.2
Other financing cash flow	-2.4	-0.7	-1.4	-1.4	-1.4
Cash flow from fin (5)	-68.3	-67.9	-66.5	-67.7	-68.7
Forex & disc ops (6)	0.0	0.0	0.0	0.0	0.0
Incr/(decr) cash (1+3+5+6)	6.5	-6.3	-18.0	32.3	27.6
Equity FCF (1+2+4)	91.1	111.2	121.9	125.6	116.2

Source: Company data, Rasmala forecasts

Paltel Group – Investment summary

During 2013, Paltel's reported results have performed largely in line with our expectations. The company recently reported net income of JOD282m for the first 9 months of 2013, a solid 9.5% increase compared with the same period of 2012. EBITDA improved by 5% during the same period, boosted by a better-than-expected EBITDA margin of 43.9% (42.7% in 9M 2012). We make some minor changes to our forecasts, and raise 2013-2014F EBITDA forecasts by 1% and net income by about 3% on average.

Palestine Telecommunications Company (Paltel) provides fixed line, cellular and data service and is the largest telecoms operator in Palestine in terms of subscriber base, number of employees and distributors.

Wireless is by far the most important segment for the Paltel Group (90% of revenues in 2012), and revenues grew, on average, by 14% per year between 2007 and 2012. The Data segment is the fastest growing segment (CAGR 37% during that period), but it still represented only 5% of revenues (2012).

Across its service lines, Paltel operates in a market with a youthful population with a relatively low 82% penetration rate for mobile services as of the end of Q3, 2013.

Revenues – growth despite increased competition

Financial Performance during 2013

Paltel's consolidated net revenues increased 2.2% to JOD282m (US\$397m) for the first nine months of 2013 compared with JOD275m (US\$388m) the same period last year.

A significant reduction in operational expenses has resulted in an improvement in profitability margins.

Gross profit increased by 6.0% to JOD225m (US\$317m) and operating income increased 4.2% from JOD88m (US\$124m) to JOD91m (US\$129m) during the 9M 2013 period compared with 9M 2012.

EBITDA increased by 5.3% from JOD117m (US\$166m) to JOD124m (US\$175m), and the EBITDA margin from 42.7% to 43.9%.

Consolidated net profit reached US\$97m compared with US\$88m, increasing by 9.5%. Earnings per share increased to US\$0.73 from US\$0.67.

With a net cash position of JOD49m (end-Q3 2013), the balance sheet is comfortable, in our view, and supportive of a continued dividend pay-out. We expect Paltel to maintain a dividend of at least JOD0.45 per share, given the strength of the balance sheet and limited capex requirements.

Table 1 : Quarterly forecasts (JODm)

	Q3 2012	9M 2012	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013F	9M 2013	2013F	2014F
Revenue	93	275	366	88	95	99	97	282	379	389
% change	-5.6%	-1.8%	-1.2%	-1.6%	1.8%	6.4%	7.8%	2.2%	3.6%	2.7%
Telecommunications services costs	-9	-25	-32	-7	-7	-7	-8	-21	-30	-30
License fees	-7	-20	-27	-7	-7	-7	-7	-21	-28	-29
Other costs	-7	-19	-23	-5	-4	-5	-5	-14	-19	-19
Telecom service costs, license fees & other	-22	-63	-82	-19	-19	-19	-20	-57	-77	-79
Gross Profit	71	212	284	69	76	80	78	225	302	310
Operating and administrative expenses	-42	-124	-172	-43	-43	-47	-50	-133	-183	-193
Operating Income	29	88	112	26	32	33	28	91	119	117
% change	-15.3%	-11.3%	-11.8%	-7.8%	7.0%	13.0%	13.5%	4.2%	6.2%	-1.7%
Gain/Loss from Investments	-2	-5	-7	3	-3	-1.39	-1.05	-1.96	-3	-3
Finance cost	0	-1	-1	-1	0	-0.23	-0.25	-1.25	-2	-1
Foreign Exchange Gain (Loss)	0	0	0	0	0	0.00	0.00	0.00	0	0
Other	0	-1	2	1	1	-1.65	-0.24	-0.26	-1	-1
Pre-tax Income	27	80	106	29	29	30	26	88	114	112
Income tax	-6	-17	-24	-6	-7	-6.4	-6.4	-19	-26	-13
Tax rate	22.5%	21.6%	22.3%	20.2%	24.0%	21.6%	24.3%	22.0%	22.5%	12.0%
Net income before XO	21	63	82	23	22	23	20	69	88	99
Minority Interests	0	0	0	0	0	0	0	0	0	0
Net Inc Avail to Common Shareholders	21	63	82	23	22	23	20	69	88	99
% change	-9.9%	-12.0%	-9.5%	2.7%	17.7%	9.5%	1.5%	9.5%	7.6%	11.5%
Depreciation & Amortisation	10	30	41	10	11	12	12	32	45	46
EBITDA	39	117	153	36	43	44	40	124	164	163
% change	-10.8%	-6.6%	-6.8%	-4.8%	7.1%	13.3%	12.8%	5.3%	7.1%	-0.2%
EBITDA Margin	42.3%	42.7%	41.8%	41.2%	45.3%	45.0%	41.0%	43.9%	43.2%	42.0%
Gross Margin	76.3%	77.0%	77.6%	78.5%	80.0%	80.6%	79.9%	79.8%	79.8%	79.7%
Operating Margin	31.4%	31.8%	30.6%	29.6%	34.1%	33.3%	28.5%	32.4%	31.4%	30.1%
Net margin	22.9%	22.7%	22.4%	26.3%	23.4%	23.5%	20.3%	24.3%	23.3%	25.3%

Source: Company reports, Rasmala forecasts

Performance in the different segments

The number of mobile subscribers (Jawwal) has grown strongly, with 20% per year, on average, in 2007–12, but growth slowed to a still-respectable 6-7% in 2011-12, despite increased competition from Wataniya.

Paltel's number of fixed-line subscribers grew, on average, by a steady 2.5% per year over 2007–12, but grew by 6% in 2011, following a dip of 2% in 2010.

As end of the third quarter of 2013, the Group's subscriber base across all telecom services reached 3.23m customers, a 2.3% increase in the number of subscribers compared with the end of 2012:

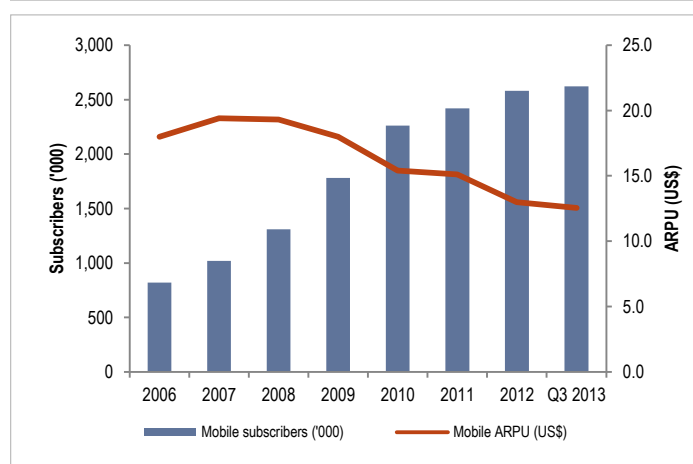
- The number of subscribers at mobile operator "Jawwal" increased 1.7% from 2.58m subscribers at the end of 2012 to 2.63m subscribers at the end of Q3 2013.
- Serviced lines in the fixed line operations increased 1.2% from 396k at the end of 2012 to 401k at the end of Q3 2013.
- The number of ADSL subscribers increased by 12% from 185k at the end of 2012 to 208k customers at the end of Q3 2013.

Paltel achieved growth, despite the increasing level of competition especially in cellular services, as we highlighted in our initiation report.

The monthly average revenue per user (ARPU) declined further during 2013. In the mobile segment, ARPUs have been in steady decline from a high of US\$19.4 in 2007 to US\$13.0 in 2012. Fixed-line ARPUs already dropped from US\$26.6 in 2006 to US\$19.2 in 2012. In the mobile segment, ARPUs continued to drop, reaching JOD8.9 (US\$12.6) by the end of Q3 2013, whereas ARPU of the Fixed and Data segments improved by 1.0% and 4.3% to JOD13.7 (US\$19.3) and JOD10.1 (US\$14.2) respectively by the end of Q3 compared with the end of 2012.

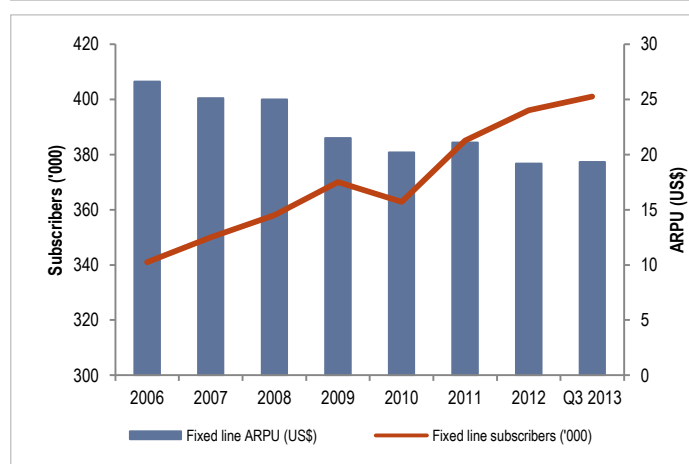
The Data and Fixed segments recorded an increase in revenues by 26.4% and 12.9% during 9M 2013, respectively, compared to 9M 2012; whereas the revenues generated by Mobile and Media segments decreased compared to 9M 2012.

Chart 1 : Mobile subscribers and ARPU



Source: Company reports

Chart 2 : Fixed line subscribers and ARPU



Source: Company reports

No material changes to our forecasts

For our forecast period, we are assuming a CAGR of 5% in the number of mobile subscribers for 2012-15F, based on projected population growth and an expected increase in the penetration rate from to 90% by 2014. We assume that Paltel will be able to maintain growth, despite competition from Wataniya, but our forecasts imply a loss in market share nevertheless.

For Fixed Line, we are forecasting growth of under 3% YoY, but for 2014-15F, we are assuming a growth rate, on average, of about 2.0%, based on estimated population growth and an expected 50% penetration rate of households in 2015F.

We are assuming a further drop in ARPU of 5% to US\$12.3 in 2012, and further declines in 2014F and 2015F, resulting in ARPU of US\$11.8 in 2014F in the mobile segment. For fixed line, we assume a small dip of 1% to US\$19.0 for 2013F, followed by a small increase of 1% in 2014F. For Data, we forecast a small increase of 1% to US\$14.0, followed by a more conservative 3% drop in 2014F to US\$13.6.

We expect revenue and net profit growth to be in the low single digits over our forecast horizon. Paltel's balance sheet remains strong, and, based on its limited capex requirements of less than 15% of revenues, we expect Paltel to maintain a healthy dividend pay-out.

Overall, we make some minor changes to our forecasts, and raise 2013-2014F EBITDA forecasts by 1% and net income by about 3% on average.

Share price performance

Paltel Group is one of the largest companies operating in Palestine in terms of both revenues and market value (about a third) on the Palestine Exchange. Free float is in excess of 50%.

Paltel's shares have increased 16% over the past 12 months and are up 22% from a low of JOD4.68 reached in April of this year. Catalysts for outperformance, in our view, will have to come mainly from strong operational results and positive news flow on the Palestinian economy.

Chart 3 : Paltel 5-year share price performance

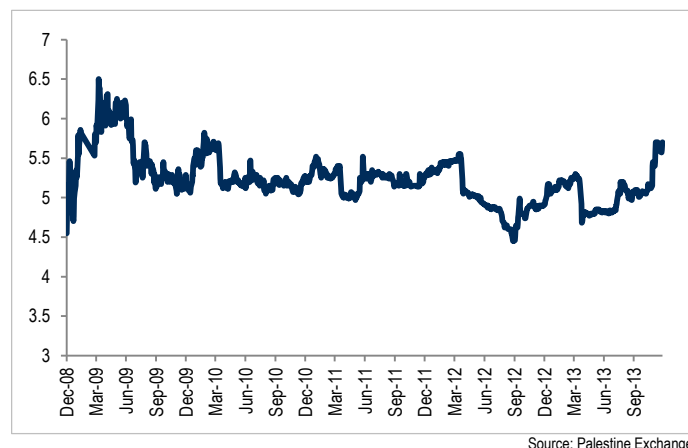


Chart 4 : Paltel 12-month share price performance



Paltel Group – valuation multiples

Because the Palestinian market is not covered by any international and very few regional investment firms, no consensus is available, hence, we cannot cross-check our forecasts or multiples.

We use sector relative valuation multiples for 2014F as the basis for our valuations, and use DCF as a sensitivity check. To derive our target price for Paltel Group, we assume a 12-month forward 2014F multiple of 4.5x EV/EBITDA, implying a fair value of JOD6.40/share.

Disclosure Appendix

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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