Omani Qatari Telecom Company SAOG (Nawras)

Increasing costs & capex slowdown overshadow profitability & future growth

August 21, 2011
CMP: RO 0.630
Target price (Dec '11): RO 0.760

- **Revenue & Net profit for H1 2011 slightly below our estimate on account of increasing competition and higher SG&A expenses.**
- **Company undertakes cost optimization initiatives to improve profitability; revenue growth softens as voice business gets more competitive and we are seeing slow pickup in Data revenue.**
- **Maintain buy rating and target price of cRO 0.76 per share. We believe the c6-7% (2011e) dividend yield is defensive in current environment.**

Subdued performance in Q2 2011: Revenues for the quarter ended June 2011 remains flat at cRO 48.7 million. EBITDA for the period ended June 2011 stood at cRO 19 million (-c10% QoQ, -c5% YoY) and EBITDA margins declined to c39%. Increased cost pressures and lower momentum in revenue growth led to decline in net profit to cRO 10 million (-c17% QoQ; -c13% YoY) and net margins declined to c21% during Q2 2011.

Continued pricing pressure within prepaid segment, Data business & Fixed line has also been slow to pickup- The postpaid subscriber base increased by (+c2% QoQ; +c1% YoY) and revenue from postpaid business stood at cRO14.2 million (+c4% QoQ; +c7 YoY). Revenue has outpaced the growth in ARPU (+c2% QoQ;+c3% YoY) and we believe it was supported by increase in data usage. Nawras was able to increase its Fixed line customers to c13,300 (Q2 2011 end) exhibiting a growth of +c51% on QoQ basis and an increase of +c71% during the six month period from c7,800 at end of 2010. However, the pace of growth in revenue from Data segment & fixed line has been below expectations. The pricing trend (+c7% QoQ;+c3% YoY) within prepaid segment also remains competitive as it is not reflective of revenue growth which exhibited a flattish (+c1% QoQ; -1% YoY) growth trend during Q2 2011. The increase in prepaid ARPU has been due to decline in subs on back of recent regulatory changes to account for active subs from 12 months to 6 months.

Increase in SG&A expense and cost of sales hampers the profitability growth- As per the Management, increase in SG&A expense (+c11% QoQ; +c20% YoY) has been mainly on account of addition of c150 employees, higher repair & maintenance expense (+c23% YoY) and higher sales & marketing expense (+c33% YoY). Cost of sales increased to cRO 7.8 million (c+10% QoQ; +c10% YoY). After getting license for international gateway, Nawras saw reduction in its interconnection expense (contributed c90% of cost of sales in 2010) and improvement in profitability. But the trend over last six month indicates that costs are stabilizing at current levels and we are not going to witness any substantial savings.

Capex spent has been below low during H1 2011- Capex for the first six month period H1 2011 stood at cRO 14 million (-67%; YoY) and has been lower on account of recent unrest and delays from vendors. As per the management, the capex for the full year would fall short by cRO 10-15 million from the earlier guidance of cRO 66 million for 2011. Nawras has indicated total spent of cRO 140 million over 2010 & 2011 for setting up infrastructure for fixed line services rollout in Oman. We reduce our EPS projection for 2011e & 2012e from cRO 0.083 & 0.092 to cRO 0.072 & cRO 0.083 respectively. We remain conservative in our estimates as lower capex would likely result in slower pickup of growth from Data & Fixed line services.

We maintain buy rating on the stock with a target price of cRO 0.76 per share- We are revisiting our estimates based on our recent discussion with the Management. We believe increase in pricing competition within mobile voice or broadband market is a risk to such target. A better-than-expected payout is a potential catalyst. We believe Nawras's healthy dividend yield of c6%-7% (2011e) and balance sheet which is not highly leveraged provides a relatively defensive position in the current market environment.

Recommendation

Buy

Stock Details

Exchange / Code	MSM/NWRS
Bloomberg Code	NWRS
Equity Capital	RO 65.1
Face Value	100 bz
52-Week H/L	0.829/0.615
Market Cap	RO 412 mn

Shantanu Sarkari
971-42222267 (Ext: 206)
Shantanu@bankmuscat.com

Quarterly Snapshot (Q2 2011)

Figures in RO (000')	Q2 2011	Q1 2010	Q1 2010	% QoQ	% YoY	2009	2010	% YoY
Revenue	**48,777**	**48,137**	**45,589**	**1%**	**7%**	**171,623**	**188,856**	**10%**
Operating Expense	7,836	7,114	7,099	10%	10%	37,551	27,828	-26%
SG&A Expense	18,806	16,895	15,678	11%	20%	51,901	64,458	24%
Royalty expense	3,112	3,043	2,826	2%	10%	10,173	11,719	15%
EBITDA	**19,023**	**21,085**	**19,986**	**-10%**	**-5%**	**71,998**	**84,851**	**18%**
% EBITDA margins	*39%*	*44%*	*44%*	*(480.2)*	*(484.0)*	*42%*	*45%*	*298*
Depreciation expense	6,857	6,460	5,882	6%	17%	20,549	24,247	18%
EBIT	**12,166**	**14,625**	**14,104**	**-17%**	**-14%**	**51,449**	**60,604**	**18%**
% EBIT margin	*25%*	*30%*	*31%*	*(544.0)*	*(599.5)*	*30%*	*32%*	*211*
Finance cost	835	948	1,011	-12%	-17%	4,894	3,977	-19%
Other Income	46	211	-	-78%		375	276	-26%
PBT	**11,377**	**13,888**	**13,093**	**-18%**	**-13%**	**46,930**	**56,903**	**21%**
Tax	1,353	1,793	1,561	-25%	-13%	5,399	6,923	28%
Net Profit	**10,024**	**12,095**	**11,532**	**-17%**	**-13%**	**41,531**	**49,980**	**20%**
% Margin	*21%*	*25%*	*25%*	*(457.6)*	*(474.5)*	*24%*	*26%*	*227*

Source: Company report & Bank Muscat research

Financials

Figures in RO Million	2010	2011E	2012E
Total revenue	189	198	214
Cost of sale	28	30	32
Gross Profit	161	168	182
Depreciation and amorization	24	27	30
EBIDTA	85	84	95
EBIT	61	57	65
Other income and expense	(4)	(4)	(4)
PBT	57	53	61
Tax	(7)	(6)	(7)
PAT	50	47	54
EPS	0.077	0.072	0.083

Figures in RO Million	2010	2011E	2012E
Licenses	46	43	39
PPE	166	207	220
Current Assets	**79**	**81**	**120**
Accounts Receivables	30	30	29
Inventories (Stores)	0	1	1
Bank Balances & Cash	49	50	90
Total Assets	**291**	**331**	**380**
Shareholder's equity	143	165	193
Long term debt	55	73	82
Minority Interest	3	3	3
Other non-current liabilities	0	1	1
Current liabilities			
Accounts Payable & Accruals	63	67	73
Deferred Equipment Rental Income	6	6	7
Short term bank borrowings	16	11	16
Other current liabilities	2	2	2
Total Liabilities and shareholders equity	**291**	**331**	**380**

Figures in RO Million	2010	2011E	2012E
Net Income	50	47	54
Depreciation and amortisation	24	27	30
Changes in Working Capital	12	-1	13
Others	5	0	0
Cash from Operating Activities	91	73	97
Capital Expenditures	-73	-65	-40
Sale of Fixed Assets	0	0	0
Purchase/Sale of Investments	0	0	0
Other Investing Activities, Net	0	1	0
Cash from Investing Activities	-73	-64	-40
Repayment of Finance lease	0	0	0
Sale/Repurchase of Stock, Net	0	0	0
Issuance/Reduction of Debt, Net	11	18	9
Other Financing Activities, Net	0	-25	-26
Cash from Financing Activities	11	-7	-17
Net Change in Cash	29	1	40
Net Cash - Beginning Balance	21	49	50
Net Cash - Ending Balance	49	50	90

Ratios	2010	2011E	2012E
Gross Margin	85%	85%	85%
EBITDA Margin	45%	43%	45%
EBIT Margin	32%	29%	31%
Net Income Margin	26%	24%	25%
ROE	43%	30%	30%
ROCE	35%	27%	28%
PE	8.2	8.7	7.6
EV/EBITDA	5.1	5.3	4.4
P/Book	2.9	2.5	2.1

Source: Company report & Bank Muscat research

Disclosure

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