



*Growth at a
reasonable price*

Mobile Telecommunications

Bloomberg Ticker TNM.MW

Reuters Ticker TNM.MV

Target Price MK32,43

Market Data **28 May 18**

Closing Price MK20.00

52 Week High MK20.00

52 Week Low MK10.00

Market Cap (b) MK200.91

Market Cap (m) USD276.6

P/E 15.32x

P/B 8.16x

DPS Yield 3.33%

Price performance

	TNM	MSE Index
YTD	37.93%	28.62%
2017	147.93%	62.14%
2016	0.83%	-8.53%
2013 -Date	1451.72%	350.37%

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MALAWI

Low penetration provides a lot of headroom

Malawi has one of the lowest communication penetration rates with 26% for unique mobile telephone services and only 9% for data as at the end of 2016. This is less than half the regional averages with Zimbabwe, Tanzania and Zambia having attained mobile penetration rates of 58%; 42% and 53%, respectively. The low penetration presents a lot of profitable opportunities for TNM. History attest to this; five years back the penetration rate was around 20% and a 6-percentage point increase to 26% has seen TNM revenues rising by 176%. Earnings have similarly responded.

Healthy margins and fair ARPUs

Average Revenues per User (ARPUs) are beginning to plateau, as the network is beginning to add lower value users. However, at USD2,20, the ARPUs are in line with international levels, although lower than achievable in most low-income countries. TNM, thus, cannot be accused of overcharging its clients and profiteering. This implies a certain amount of sustainability of earnings. Notable however is the fact that TNM has been able to maintain its EBIDTA margins at a healthy 37% and will be able to improve the margins to around 40% in the outlook.

Strong infrastructure base supportive of future growth

TNM has been investing heavily in infrastructure, rolling out the much more efficient 4G technology. The company has been investing approximately 20% of its revenues back into the business, thus setting the backbone for future growth. There has been a strong and positive correlation between capital expenditure and growth in revenues and profits.

Mobile money and data; low hanging fruit

Mobile money is still in its infancy in Malawi and presents a lot of opportunities going forward, especially given the sparsity of physical branch networks. Presenting even more exciting opportunities is internet and data as the smart phone penetration rate increases and financial services become more digitalised.

Valuations still compelling

At current levels, TNM prices at a TTM PER of 15,32x, EV/subscriber of USD53 and EV/EBITDA 7.29x, which are at discounts of c.30% to ex South Africa peers, notwithstanding its ROE of 45%. Our valuation ascribes a fair value of MK32.43, giving a potential 62% upside. **BUY**

Investment Thesis

We initiate coverage on TNM with a strong **BUY** recommendation based on a fair value of MK32.43. This presents a potential upside of 62% from the current share price of MK20.00.

TNM's growth trajectory remains intact and we expect the company to grow significantly on the back of stable economic conditions, stable exchange rate, increased margins due to operational efficiency and increasing penetration rate.

The company operates in a duopoly, tussling for the premier position with Airtel, however, latest indications are that TMN has a 51% market share. Increasing penetration rate in sim cards and increased data usage coupled with better acceptance of mobile money should power volume and revenue growth in the medium term. Furthermore, prudent working capital management is expected to improve margins and reduce the need for short-term bank borrowings, ensuring investors a steadily growing dividend pay-out.

However, exchange rate volatility, impact of the acts of God and the concomitant impact on economic growth remain key risks. In our view, a pay-out ratio of c.50% - 60% will support the stock price as the company continues to expand its bottom line.

TNM has maintained a dividend pay-out ratio of over 40% and we expect this to increase to 50% over the medium term as the group matures. A level pay-out ratio is a key positive, especially as the bottom line is expected to grow over the medium term. A steady dividend pay-out policy augers well for the company's share price by attracting yield hunting investors.

Mk millions	31-Dec-15	31-Dec-16	31-Dec-17	31-Dec-18F	31-Dec-19F
Total Revenues	50 097	65 553	79 590	101 079	121 295
<i>Growth Y-o-Y</i>	24%	31%	21%	27%	20%
Gross Profit	27 233	34 077	42 370	55 594	66 712
<i>Growth Y-o-Y</i>	19%	25%	24%	31%	20%
EBIDTA	17 607	22 995	29 502	40 096	47 666
<i>Growth Y-o-Y</i>	21%	31%	28%	36%	19%
Net Profit/loss	5 414	8 206	13 108	17 788	21 829
<i>Growth Y-o-Y</i>	3%	52%	60%	36%	23%
EPS	0,54	0,82	1,31	1,77	2,17
DPS	0,30	0,33	0,60	0,80	1,09
NAV/share	1,56	2,08	2,90	3,88	4,96
P/E (x)	9,37	7,38	13,79	10,16	8,28
Price/NAV (x)	3,24	2,90	6,20	4,64	3,63
Price/EBIDTA (x)	2,88	2,63	6,13	4,51	3,79
EV/EBIDTA (x)	2,88	2,63	6,13	4,51	3,79

Source: TNM Annual Reports and Cedar Capital Research

Positives

- TNM has the leading network coverage and has rolled out the latest 4G technology which has been strategically deployed to maximise efficiencies.
- TNM has a strong brand presence in Malawi and is the network of choice for many locals, with loyalty driven by the nationalistic “truly Malawian” tag.
- Locally owned international gateway allowing for provision this service at a lower rate.
- Data traffic is expected to grow following massive investment in infrastructure and the company’s efforts to grow smart phone penetration.
- Strong cash generation and manageable debt levels, with a debt/equity ratio of 40%.

Company Overview

TNM was established in 1995 and has since grown to be the leading mobile network operator with just under 4 million subscribers. Due to the convergence currently taking place between communication and information technology, TNM is now focusing on being a dominant player in the information communication and technology sector (ICT).

TNM’s principal activities include the provision of mobile phone voice services, internet, mobile money and data services. Standard products and services across all subscribers are voice, SMS, international SMS, GPRS/EDGE/3G and 4G data connectivity and international roaming, among others. TNM also offers Mpamba, an innovative mobile payment solution that enables users to complete simple financial transactions.

The company’s major shareholders are Press Corporation with (41%); Old Mutual related entities (24%) and Magni Holdings (6%).

Market & Industry overview

The Malawian regulatory authorities granted four mobile network licenses, but only two players; TNM and Airtel are operational, making the market a duopoly. The two players hold almost 50% of the market each. The other two players G-Mobile and Celcom are yet to go live.

The main competitor is, thus, Airtel, which started operations in 2000 trading as Celtel, before changing to Zain in 2008. In 2010, Zain sold its African operations to Bharti Airtel with the rebranding from Zain Malawi to Airtel officially announced in November 2010. The company offers similar products to TNM, although it has a significant upper hand in mobile money, with an estimated two thirds market share.

According to the GSMA's; The Mobile Economy Sub-Saharan Africa 2017 report, Malawi has 4.7 million unique subscribers, which is a penetration rate of 26%, as the chart below shows. (See insert for definition of unique subscribers).

EASTERN AFRICA		
	UNIQUE SUBSCRIBERS (m)	PENETRATION
Burundi	3.8	32%
Eritrea	0.5	9%
Ethiopia	34.7	34%
Kenya	28.3	59%
Malawi	4.7	26%
Rwanda	6.3	52%
South Sudan	2.1	16%
Tanzania	23.7	42%
Uganda	17.0	41%

Source: **GSMA - The Mobile Economy Sub-Saharan Africa 2017**

The same report notes that annual subscriber growth has slowed down to single digit, although there are some pockets which still have lower teen growth rates, Malawi included. Sub-Saharan Africa (SSA) will still record a CAGR of 6.2% over the five years to 2020. Considerable opportunities for subscriber growth arise from the large number of unconnected young adults across the region.

The other trend in the SSA mobile markets is that revenue growth has been trending downwards. Although economic pressures are expected to ease in the coming years, revenue growth will remain subdued for the remainder of this decade due to the increasing cannibalisation of traditional voice and messaging revenues as subscribers shift to alternative overlay platforms such as WhatsApp, Skype, Facebook Messenger and others. With traditional voice accounting for more than 70% of service revenues for many operators in the region, this trend is expected to weigh on overall revenue growth for the foreseeable future.

Understanding the relationship between connections and subscribers

There is an important difference between the number of mobile connections – the metric traditionally used by the industry to measure market size and penetration – and what we term unique mobile subscribers. The latter refers to a single individual that has subscribed to a mobile service and that person can hold multiple mobile connections (i.e. SIM cards).

If one individual actively uses two SIM connections, that person will be counted by the industry as two mobile connections although he or she is only one mobile subscriber. Multiple connections ownership has been distorting mobile market penetration figures for many years, as standard practice for measuring penetration has been to divide the number of registered SIM cards by the country's population. But we believe that studying the correlation between unique subscribers and the population provides a more accurate view of market penetration, maturity and prospects for growth.

Estimating unique mobile subscribers from registered SIM connections helps to derive a more accurate view of mobile market penetration and growth opportunity.

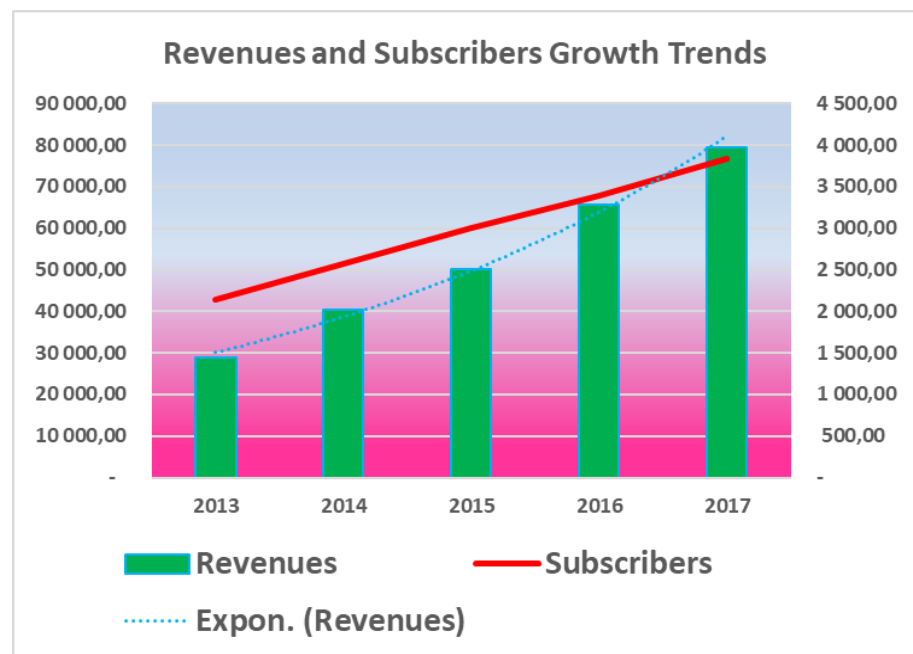
For example, in China, market penetration based on connections is close to 100%, which might be interpreted as a sign that the mobile market is becoming saturated. However, in reality, unique subscriber penetration in China only stands at 46% of the total population (1.39 billion) or 57% of the addressable population base (1.11 billion) - therefore suggesting plenty of room for mobile growth in the country.

<https://www.gsaintelligence.com/research/2014/05/measuring-mobile-penetration/430/>

5- year Operational and Financial Review

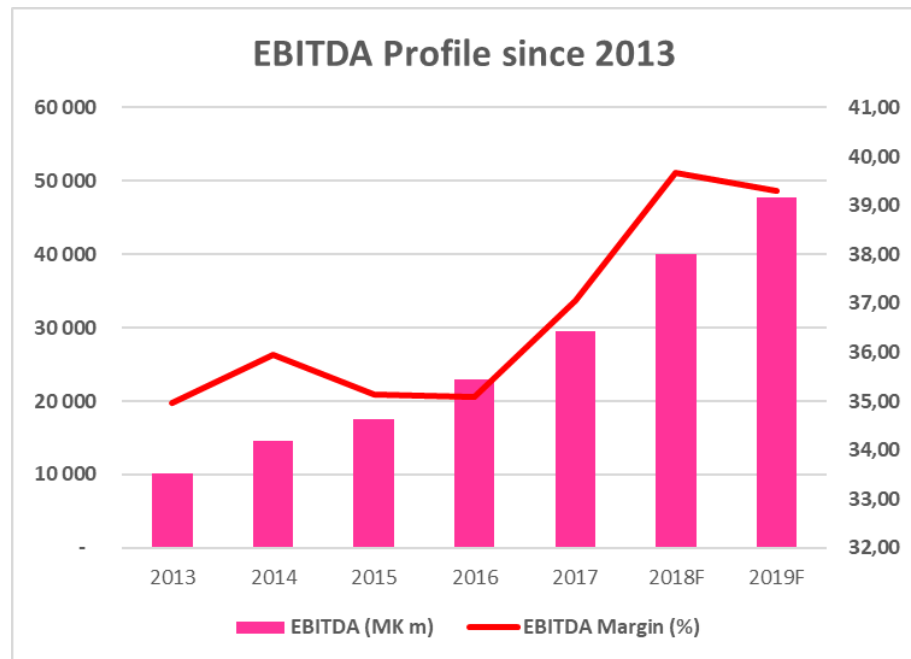
The past five years have been bountiful for TNM. Total capital spend has exceeded MK57,5bn, and this has proved very beneficial with the network recording net subscriber adds every year and revenues have responded positively. We have calculated a five-year compounded annual growth rate (CAGR) of 22%, as subscribers grew from 2,2mn to over 3,8mn. Our estimation is that TNM is still in a positive marginal contribution phase, meaning that a percentage point increase in subscribers has a higher impact on revenue growth. The top line has grown from MK28,9bn in 2013 to MK79,6bn, 2,75x in five years.

As the chart below shows, revenue growth has been exponential to say the least.



Source: TNM annual reports and Cedar Capital Research

The positive performance filtered to the two main operational parameters gross profits and EBITDA. Gross margins have averaged 55% in the past 5 years, which means the growth in the top line has filtered, undiluted to gross profits. In the period under review, gross profits have surged from MK15,8bn to MK42,3bn, almost three-fold. EBITDA margins, which is a proxy for management effectiveness, has revealed a lot of astuteness, with the margins also maintained around 35%. In the last financial year, EBITDA was up 28% to MK29,5bn.



Source: TNM Annual Reports and Cedar Capital Research

On the back of reduced financing costs, (7x interest cover) the bottom line expanded to MK13,1bn, showing a 5-year CAGR of 38%, much higher than the inflation rate, rewarding shareholders with real returns.

Notwithstanding, the aforementioned capital expenditure, which equate to 20% of revenues, TNM has been able to consistently pay dividends at a pay-out ratio close to 40%.

Assets utilisation has been impressive, with the return on assets (RoA) in double digits, closing FY17 at 20% while return on shareholders' funds (RoE) is more than 40%.

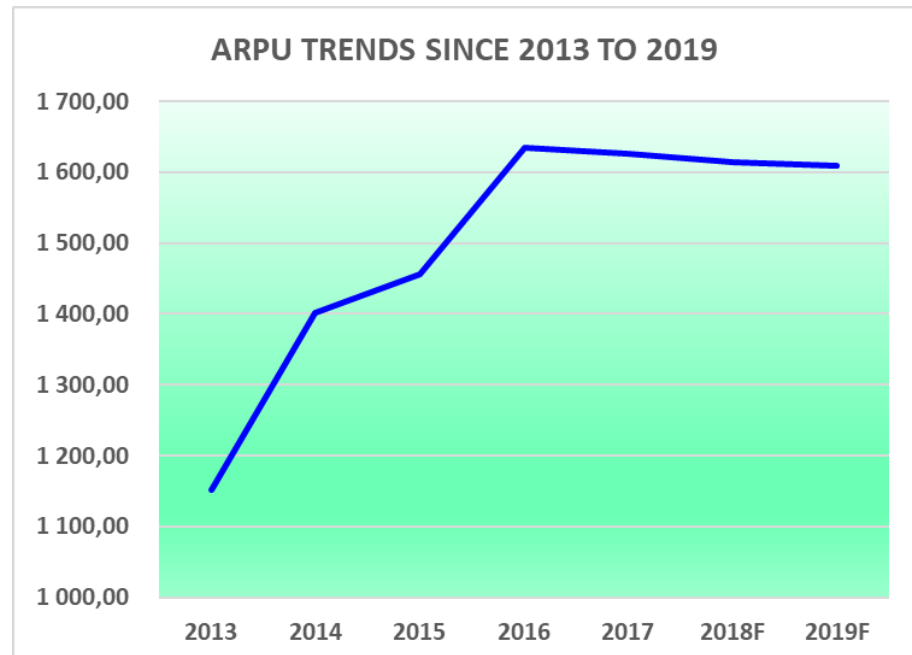
The balance sheet is more than healthy reflecting the strong emphasis on investments in PPE and prudent working capital management. The debt/equity ratio closed FY17 at a manageable 40%. Exposure to foreign currency has been minimal and is reducing every year. As such, we view the balance sheet of TNM as pristine.

Outlook

Malawi's economic outlook is positive with a real GDP growth inching to 3.5% and 5.5% in 2018 and 2019 respectively. Consequently, there will be an implied improvement in GDP per capita, which bodes well for Malawian consumer facing businesses. Population growth is projected to average 3% in the next five years. This combined with the current low

penetration rate of 26% against peer countries' average penetration of 50%, translate to potential growth opportunities for TNM.

The demand for TNM products remain elevated, with other non-telecom business products being rolled out in by the company, including data packages and mobile money.



Source: TNM Annual Reports and Cedar Capital Research

We see APRUs, although, showing marginal weakness in FY17, stabilising as the dilution impact from new subscribers is limited whilst per capita incomes of the existing subscriber base increases. Voice revenues are expected to grow at a declining rate, but poses no threat to profitability and dividend payments.

Valuation and Recommendation

We have opted to use the Relative Valuation methodology, in which we value TNM based how similar telecom companies are priced in the regional markets. This entails converting prices into multiples and finding comparable listed telecom companies. We have selected, as peers, those listed mobile telecom operators in Africa which have operations in only their home countries. These are *Safaricom*; *Airtel Zambia* and *Econet Wireless Zimbabwe*.

Name	P/E (x)	P/B (x)	EV/EBITDA (x)	P/EBITDA (x)
Safaricom Kenya	20.65	10.14	10.79	10.12
Airtel Zambia	10.00	7.84	10.05	8.00
Econet Wireless	22.50	3.00	5.18	9.10
Average	17.72	6.99	8.67	9.07
TNM Malawi	15.32	6.89	7.29	6.81

Source: Company annual reports, Reuters and Cedar Capital Research

In all the instances, TNM is trading at a significant trading discount to peers, notwithstanding that it has the highest ROE.

Valuation

In our view, TNM's top-line growth will flow downstream to the group's profit relatively undiluted by cost of sales, operating costs and financing expenses, but will actually be enhanced by expanding margins along each line to the bottom line.

We expect the group to retain a pay-out ratio of c.50% over the medium term, ensuring a steady return to investors. TNM's appeal comes from significant potential for growth in data and mobile money while voice revenues will continue to anchor the business.

P/E Valuation

Comparable mean P/E (x)	23,69
Forward EPS FY18 for TNM	1,77
Implied fair Price for TNM	41,97

EBITDA Multiple

Comparable mean EV/EBITDA (x)	7,51
Forward FY18E EBITDA (MK m)	40 095,54
Implied EBITDA valuation	351 465,77
Number of shares (m)	10 040,45
Fair Value per share	29,99

We have used relative valuation methods, the earning multiple and P/EBITDA are shown above. For the final valuation figure, in addition to the above, we also applied the capitalised earnings, price to book and market value per subscriber method, on a weighted basis, to arrive at a fair value price for TNM of MK32.43, reflecting a potential upside of 62% on the current price. **BUY.**



k'000	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec -18F	Dec -19F
Total Revenues	28 875	40 517	50 097	65 553	79 590	101 079	121 295
Growth Y-o-Y		40%	24%	31%	21%	27%	20%
Gross Profit	15 818	22 858	27 233	34 077	42 370	55 594	66 712
Growth Y-o-Y		45%	19%	25%	24%	31%	20%
EBIDTA	10 096	14 568	17 607	22 995	29 502	40 096	47 666
Growth Y-o-Y		44%	21%	31%	28%	36%	19%
Operating Profit	7 005	10 523	12 309	16 308	21 775	28 180	35 537
Growth Y-o-Y		50%	17%	32%	34%	29%	26%
Profit/Losses Before Taxes	3 877	7 637	7 855	12 058	18 965	25 411	31 184
Growth Y-o-Y		97%	3%	54%	57%	34%	23%
Net Profit/loss	2 600	5 244	5 414	8 206	13 108	17 788	21 829
Growth Y-o-Y		102%	3%	52%	60%	36%	23%

Technical Data	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec -18F	Dec -19F
Number of subscribers	2 139 200	2 567 040	3 003 437	3 393 884	3 835 088	4 218 597	4 682 643
Growth Y-o-Y		20%	17%	13%	13%	10%	11%
Capital Expenditure	3 085	14 204	12 027	9 176	19 037	18 194	18 194
Capital Expenditure/Revenue (%)	10,68	35,06	24,01	14,00	23,92	18,00	15,00
Revenue per Subscriber (MK) - ARPU	1 152,00	1 401,00	1 456,00	1 634,00	1 626,00	1 615,00	1 610,00
Growth Y-o-Y		21,61%	3,93%	12,23%	-0,49%	-0,68%	-0,31%
Market Value per Subscriber	6 007,75	12 555,26	16 882,08	17 839,13	47 124,88	42 840,80	38 595,32

Market Information	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec -18F	Dec -19F
EPS	0,26	0,52	0,54	0,82	1,31	1,77	2,17
DPS	0,09	0,19	0,30	0,33	0,60	0,80	1,09
NAV/share	0,99	1,32	1,56	2,08	2,90	3,88	4,96
Price (K)	1,28	3,21	5,05	6,03	18,00	18,00	18,00
Mkt Capitalisation (MK mn)	12 851,78	32 229,84	50 704,27	60 543,91	180 728,10	180 728,10	180 728,10
P/E (x)	4,94	6,15	9,37	7,38	13,79	10,16	8,28
Price/NAV (x)	1,30	2,43	3,24	2,90	6,20	4,64	3,63
Price/EBIDTA (x)	1,27	2,21	2,88	2,63	6,13	4,51	3,79
EV/EBIDTA (x)	1,27	2,21	2,88	2,63	6,13	4,51	3,79
EV/Subscriber(x)	6 007,75	12 555,26	16 882,09	17 839,13	47 124,89	42 840,81	38 595,32
Tax rate (%)	32,94	31,33	31,08	31,95	30,88	30,00	30,00
Dividend Yield	7,03	5,92	5,94	5,47	3,33	4,43	6,04

Profitability Ratios	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec -18F	Dec -19F
Gross Profit Margin (%)	54,78	56,42	54,36	51,98	53,24	55,00	55,00
EBIDTA Margin (%)	34,96	35,96	35,15	35,08	37,07	39,67	39,30
Operating Profit Margin (%)	24,26	25,97	24,57	24,88	27,36	27,88	29,30
Interest Cover (x)	2,24	3,65	2,76	3,84	7,75	10,18	8,16
PBT Margin (%)	13,43	18,85	15,68	18,39	23,83	25,14	25,71
Return on Assets (%)	10,55	13,24	11,69	16,55	19,96	20,41	21,57
Return on Equity (%)	26,23	39,58	34,59	39,37	44,99	45,71	43,80

Liquidity Ratios	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec -18F	Dec -19F
Current Ratio	0,38	0,41	0,44	0,49	0,65	0,59	0,56
Quick Ratio	0,31	0,36	0,38	0,38	0,45	0,45	0,40
Cash Ratio	0,06	0,15	0,03	0,08	0,12	0,16	0,08
Cash Conversion Efficiency	47,77	54,75	66,93	49,14	55,46	51,10	51,10

Solvency Ratios	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec -18F	Dec -19F
Debt to Assets Ratio (%)	34,66	16,37	22,90	18,21	17,01	16,75	13,44
Net Debt to Equity Ratio (%)	78,29	21,36	63,01	34,27	28,43	23,24	21,22
Debt to Equity Ratio (%)	86,14	48,95	67,78	43,31	38,35	37,52	27,30
Equity to Total Assets (%)	40,24	33,45	33,79	42,05	44,35	44,65	49,23
Financial Leverage Ratio (%)	248,50	298,94	295,99	237,81	225,47	223,97	203,12
Interest Coverage (x)	2,24	3,65	2,76	3,84	7,75	10,18	8,16



Equity research | Company Research Report

	<u>Dec-13</u>	<u>Dec-14</u>	<u>Dec-15</u>	<u>Dec-16</u>	<u>Dec-17</u>	<u>Dec -18F</u>	<u>Dec -19F</u>
Current Assets	4 953	9 793	10 128	10 986	15 756	20 598	21 035
Non Current Assets	19681	29814	36197	38585	49931	66564,824	80183,0625
Total Assets	24 634	39 607	46 325	49 571	65 687	87 163	101 218
Interest Bearing loans & borrowings	6 921	6 207	5 608	4 029	1 173	4 603	3 606
Current portion of deferred payment facility		2 229	4 509	3 862	3 422	6 906	5 408
Dividend Payable	301	703	1 004	1 004	2 008	2 312	2 838
Creditors	3 729	11 679	9 187	10 292	12 317	15 010	18 012
income tax	802	922	764	1 670	2 114	2 668	3 274
Deferred Income	1 176	1 900	2 096	1 420	3 068	3 682	4 418
Current Liabilities	12 929	23 640	23 168	22 277	24 102	35 182	37 556
Interest Bearing loans & borrowings	1 618	278	5 000	5 000	10 000	10 000	10 000
Long term portion of deferred payment facility	-	2 408	2 508	1 449	2 451	3 064	3 830
Tax Liabilities	174	32					
Long term liabilities	1 792	2 718	7 508	6 449	12 451	13 064	13 830
Share Capital	402	402	402	402	402	402	402
Share Premium	2 347	2 347	2 347	2 347	2 347	2 347	2 347
Retained Earnings	7 164	10 500	12 902	18 096	26 385	36 168	47 083
Shareholders Equity	9 913	13 249	15 651	20 845	29 134	38 917	49 832
Minority Interest							
Total Equity	9 913	13 249	15 651	20 845	29 134	38 917	49 832
Total Equity and Liabilities	24 634	39 607	46 327	49 571	65 687	87 163	101 218

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