

Telecom Egypt

Growth across all business segments boosted profitability

1Q23 Net profit higher than our estimate

Telecom Egypt (the company) reported robust growth in the net profit more than doubled to EGP 3,813 Mn in 1Q23 as compared to EGP 1,366 Mn in 1Q22, higher than our estimates of EGP 2,531 Mn. The profitability was driven by the strong growth in revenue and organic growth in income from associates partially offset by a significant rise in finance cost and a hike in selling and overhead expenses.

P&L Highlights

Telecom Egypt recorded revenue growth of 48.2% YOY to EGP 13,959 Mn in 1Q23 mainly driven by a solid across the segment. Revenue from Home & Consumer Services rose 17.2% YOY to EGP 5,864 Mn in 1Q23 due to an increase in data and voice operations coupled with a growth in the subscriber base and healthy ARPU. Revenue from the Enterprise Solutions business rose 42.9% YOY to EGP 1,689 Mn in 1Q23. Furthermore, the voice subscriber base rose 5.0% YOY to 11.7 Mn in 1Q23 while the data customer base inclined 7.0% YOY to 8.9 Mn. Wholesale segment revenues recorded solid growth owing to USD appreciation against EGP, and higher international traffic. Revenue from the Domestic Wholesale segment reported robust growth of 82.8% YOY driven by one-off revenue from Indefeasible Right of Use (IRU). International carrier business also reported strong growth of 76.7% YOY to EGP 1,828 Mn in 1Q23 due to the higher international incoming traffic and USD appreciation against EGP. While International Customers and Networks reported revenue more than doubled to EGP 2,022 Mn in 1Q23 as compared to EGP 797 Mn in 1Q22 due to the higher IRU capacity sales to tech giants and ancillary services. On the other hand, Operating costs rose 34.4% YOY to EGP 7,785 Mn in 1Q23 driven by growth in inter-connection call cost, D&A expenses, and salaries & wages partially offset by a decline in operating cost. Thus, gross profit rose significantly 70.2% YOY to EGP 6,174 Mn in 1Q23 with a margin expansion of 571 bps YOY to 44.2% in 1Q23. Selling and overhead expenses rose 21.9% YOY to EGP 2,186 Mn in 1Q23 due to an increase in salaries & wages and agents' commissions partially offset by a decline in other expenses. Other operating income declined from EGP 31 Mn in 1Q22 to an expense of EGP 54 Mn in 1Q23. As a result, operating profit rose from EGP 1,865 Mn in 1Q22 to EGP 3,933 Mn in 1Q23. The Company's EBITDA rose significantly 68.8% YOY to EGP 6,040 Mn in 1Q23 with an improved EBITDA margin of 43.3% in 1Q23 as compared to 38.0% in 1Q22. Share of profit from associates rose from EGP 317 Mn in 1Q22 to EGP 894 Mn in 1Q23 and excluding the FX loss related to revaluation obligation in 1Q22 income rose 82% YOY to EGP 894 Mn in 1Q23. Net finance cost increased significantly from EGP 309 Mn in 1Q22 to EGP 1,029 Mn in 1Q23 mainly due to a rise in net interest expense owing devaluation of the local currency. The Company recorded a tax reversal of EGP 15 Mn in 1Q23 as compared to an income tax expense of EGP 506 Mn in 1Q22 supporting the profitability.

Rating : BUY

First Look Note – 1Q23

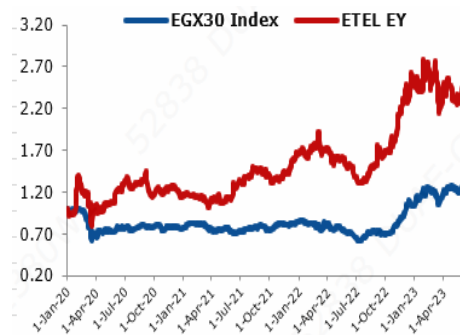
Sector: Telecom

Recommendation

Current Price (14-Jun-23)	27.46
Target Price (EGP)	32.00
Upside/Downside (%)	+16.5%

Stock Information

Market Cap (EGP, mm)	46,876.20
Paid Up Capital (mm)	17,070.72
52 Week High	28.99
52 Week Low	12.77
3M Avg. daily value (EGP)	45,636,890



Financial Ratios

Dividend Yield (12m)	4.55
Dividend Pay-out (%)	21.67
Price-Earnings Ratio (x)	4.55
Price-to-Book Ratio (x)	1.08
Book Value (EGP)	25.41
Return-on Equity (%)	24.28
Earning Per Share (EGP)	6.04
Beta	0.75

Stock Performance

5 Days	6.31%
1 Months	18.36%
3 Months	17.10%
6 Months	16.11%
1 Year	81.61%
Month to Date (MTD)	13.33%
Quarter to Date (QTD)	11.17%
Year to Date (YTD)	9.40%

Balance Sheet Highlights

Telecom Egypt's cash and cash equivalents stood healthy at EGP 12.4 Bn in 1Q23 as compared to EGP 6.8 Bn in 4Q22 due to a significant increase in bank deposits and treasury bills. Similarly, the company's net cash flow from operating activities stood at EGP 5.8 Bn in 1Q23. Telecom Egypt's annualized net debt to EBITDA ratio stood at 1.2x in 1Q23 as compared to 1.4x in 4Q22 despite an increase in gross debt by 34.3% QOQ due to a currency revaluation. Further, the Company's total debt rose to EGP 41.4 Bn in 1Q23, up from 30.8 Bn in 4Q22. Also, Telecom Egypt's in-services capex stood at EGP 1.3 Bn in 1Q23 whereas cash capex stood at EGP 6.1 Bn in 1Q23 out of which EGP 2.1 Bn is incurred for the license purpose. The Company's free cash flow stood at EGP 0.6 Bn in 1Q23 whereas excluding the payment of the new spectrum, free cash flow stood at EGP 2.6 Bn.

Target price and recommendation

We maintain our BUY rating on Telecom Egypt with a target price of EGP 32.00. The company's total revenue recorded a robust growth of 48.2% YOY to EGP 14.0 Bn in 1Q23 is mainly driven by strong growth in wholesale revenue supported by robust IRU sales in the local and international markets. Revenue from the wholesale segment grew 98% YOY owing to the higher revenue growth in the transmission and infrastructure segment. Revenue of mobile segment grew 19% YOY as the Company is focused on expanding its customer base across all fronts and reported 5% and 7% growth in fixed voice and broadband segment subscribers respectively. Mobile customers increased 22% YOY to 12.4 Mn in 1Q23. Similarly, the retail segment revenue grew 22% YOY to EGP 7.6 Bn due to the higher customer base and healthy ARPU trends. Meanwhile, Telecom Egypt EBITDA rose 68.8% YOY to EGP 6.0 Bn in 1Q23 with an improved EBITDA margin of 43.3% in 1Q23 as compared to 38.0% in 1Q22 owing to the strong revenue growth across all segments, cost saving, and new national roaming agreement assisting in reducing the inflationary expenses seen across other items. Moreover, the Company's revenue is growing in line with its 2023 expectation of double-digit growth. Recently, the Company announced that the National Telecom Regulatory Authority (NTRA) accepted the proposal of financial and technical offer, which will add 5MHz of spectrum in the 1800 MHz band using FDD technology leading to an improvement in its service quality which will allow it to expand its customer base. Furthermore, Telecom Egypt successfully completed the landing of the 2Africa subsea cable and mark the second and final 2Africa landing in Egypt, further enhancing its value proposition. The Company's capex is expected to decline during 2023 which will result in a significant growth in free cash flow in the forthcoming period. Hence, based on our analysis we maintain a BUY rating for the stock.

Telecom Egypt - Relative valuation

(at CMP)	2018	2019	2020	2021	2022	2023F
P/E	18.00	12.86	11.69	6.22	5.02	4.55
P/B	1.43	1.31	1.19	1.04	0.99	0.95
EV/EBITDA	10.05	10.48	5.78	4.15	3.74	3.32
Dividend Yield	0.9%	0.9%	2.8%	3.7%	4.6%	4.8%

FABS Estimates & Co Data

Telecom Egypt - P&L

EGP mm	1Q22	4Q22	1Q23	1Q23F	Var.	YOY Ch	QOQ Ch	2022	2023F	Change
Revenue	9,417	11,999	13,959	10,409	-25.4%	48.2%	16.3%	44,273	51,509	16.3%
Cost of revenue	-5,790	-7,560	-7,785	-6,053	-22.3%	34.4%	3.0%	-26,038	-30,391	16.7%
Gross profit	3,627	4,439	6,174	4,356	-29.4%	70.2%	39.1%	18,235	21,119	15.8%
SG&A Expenses	-1,793	-2,379	-2,186	-1,926	-11.9%	21.9%	-8.1%	-8,083	-9,066	12.2%
Operating Profit	1,865	1,664	3,933	2,462	-37.4%	111.0%	136.4%	10,037	12,105	20.6%
EBITDA	3,578	3,629	6,040	4,702	-22.1%	68.8%	66.4%	17,102	19,271	12.7%
Finance income	317	647	894	684	-23.5%	181.9%	38.2%	2,695	3,369	25.0%
Finance cost	-309	-16	-1,029	-512	-50.2%	NM	NM	-2,078	-3,967	90.9%
Other income	1,873	2,295	3,799	2,634	-30.7%	102.8%	65.5%	10,655	11,507	8.0%
Share of assoc & JV's	-506	719	15	-99	NM	NM	-97.9%	-1,467	-1,381	-5.9%
Profit for the year	1,367	3,014	3,814	2,535	-33.5%	179.0%	26.5%	9,187	10,126	10.2%
NCI	-1	-5	0	-4	NM	-46.2%	-93.1%	-5	-4	-19.5%
Net Profit	1,366	3,009	3,813	2,531	-33.6%	179.1%	26.7%	9,182	10,122	10.2%

FABS Estimates & Co Data

Telecom Egypt – Margins

Margins	1Q22	4Q22	1Q23	YOY Ch	QOQ Ch	2022	2023F	Change
Gross Profit	38.5%	37.0%	44.2%	571	723	41.2%	41.0%	-0.5%
EBITDA	38.0%	30.2%	43.3%	528	1303	38.6%	37.4%	-3.1%
Operating Profit	19.8%	13.9%	28.2%	838	1431	22.7%	23.5%	3.7%
Net Profit	14.5%	25.1%	27.3%	1281	224	20.7%	19.7%	-5.3%

FABS estimate & Co Data

Valuation:

We use Discounted Free Cash flow (DCF) and Relative Valuation (RV) method to value Telecom Egypt. We have assigned 70% weight to DCF and 30% to RV method.

Valuation Method	Target	Weight	Weighted Value
DCF	30.72	70.0%	21.50
Relative Valuation	34.99	30.0%	10.50
Weighted Average Valuation (EGP)			32.00
Current market price (EGP)			27.46
Upside/Downside (%)			16.5%

1) DCF Method:

Telecom Egypt is valued using free cash flow to firm. We have discounted the cash flow using the weighted average cost of capital of 13.9%. It is arrived after using cost of equity of 19.1% and cost of debt of 8.2% with a debt-to-equity ratio of 1:1. Cost of equity is calculated by using Egypt 10-year government bond yield of 21.5%, beta of 0.80 and negative equity risk premium of 3.0%. We arrive at a negative risk premium due to a higher risk-free rate as compared to expected equity market return. Cost of debt is calculated using a cost of 9.6% after adjusting a tax rate of 15.0%. Also, assumed a terminal growth rate of 2%. We also added the book value of Vodafone Egypt to arrive at the valuation of Telecom Egypt.

Sum of PV (EGP, Mn)	23,267
Terminal value (EGP, Mn)	43,123
FV to Common shareholders (EGP, Mn)	52,433
No. of share (Mn)	1,707
Current Market Price (EGP)	27.46
Fair Value per share (EGP)	30.72

DCF method

(All Figures in EGP Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
NOPAT	9,079	15,081	16,057	14,505	15,402
D&A	7,167	8,009	8,834	9,667	10,524
Changes in Working Capital	-4,321	-45	-1,812	-644	-1,755
(-) Capex	-14,423	-13,665	-13,834	-13,941	-14,612
Free Cash Flow to Firm (FCFF)	-2,498	9,380	9,246	9,588	9,558
Discounting Factor	0.93	0.82	0.72	0.63	0.56
Discounted FCFF	-2,324	7,658	6,625	6,031	5,277

2) Relative Valuation:

We have used local as well as international peers to value Telecom Egypt and it is valued using the EV/EBITDA multiple. We applied a discount to peer valuation since it operates in a region which faced considerable currency risk and expects this discount to be maintained as the risk will not fade out any time sooner. It is valued at EV/EBITDA of multiple of 3.9x compared to peer multiple of 5.1x.

Company	Market (USD Mn)	EV/EBITDA (x)		PE (x)		Yield (%)	
		2023	2024	2023	2024	2023	2024
OOREDOO	7,863	4.1	3.9	11.5	11.9	4.2	4.8
Maroc Telecom	8,506	5.2	5.2	24.0	14.3	3.6	6.2
Emirates integrated telecommunication company	6,750	4.3	4.6	19.9	18.5	4.6	4.8
Mobile telecommunication company	7,882	5.5	5.1	10.4	9.9	5.8	6.5
Deutsche Telekom AG	111,000	5.6	5.3	15.7	15.0	3.4	3.7
Mobily	7,249	6.2	5.6	19.4	18.0	2.8	3.5
Average		5.1x	5.0x	16.8x	14.6x	4.1%	4.9%
Median		5.3x	5.1x	17.6x	14.7x	3.9%	4.8%
Max		5.6x	5.3x	19.8x	17.3x	4.5%	5.8%
Min		4.5x	4.7x	12.6x	12.5x	3.5%	4.0%

Research Rating Methodology:

Rating	Upside/Downside potential
BUY	Higher than +15%
ACCUMULATE	Between +10% to +15%
HOLD	Lower than +10% to -5%
REDUCE	Between -5% to -15%
SELL	Lower than -15%

FAB Securities Contacts:

Research Analysts

Ahmad Banihani +971-2-6161629 ahmad.banihani@Bankfab.com

Sales & Execution

Abu Dhabi Head Office

Trading Desk +971-2-6161700/1 [Online Trading Link](#)
+971-2-6161777

Institutional Desk +971-4-4245765

Sales and Marketing +971-2-6161703

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