

Recommendation Change	Dialog Telekom Limited (DIAL)	Underweight
	Downgrade to Underweight	26th July
Summary		

<p>Strategic View Underweight</p> <p>Analyst Amal Sanderatne, CFA</p> <p>Share Price Rs22.50</p> <p>ASPI 2460.05</p> <p>MPI 3387.33</p>	<p>We are again downgrading our recommendation on Dialog Telecom to an Underweight position from the Neutral Position we had just upgraded the counter to at the start of this week. The counter has risen by 7.1% in the four days since our upgrade. However given the high trading costs in Sri Lanka, we would not have any fundamental disagreement with any client views that this downgrade has come too close to the upgrade for it to have offered them much significant actionable and profitable trading opportunities based on the two quick recommendation changes.</p> <p>We are however downgrading the stock, as the fall in global markets since our downgrade on 23rd July has boosted the relative out-performance of Dialog compared to global comparables by a greater percentage than Dialog's actual stock price performance in absolute terms. A key reason for our upgrade on the 23rd of July which was <i>"the particular sharp underperformance the counter has seen against comparable international Telco's"</i> since our downgrade of the counter earlier in the year. Thus on the 23rd of July we felt <i>"This under performance of Dialog has led to a significant improvement in the relative valuations of Dialog on an international comparison since what relative valuations were at the time we downgraded Dialog. The widening of the discount at which Dialog is trading to comparable companies internationally would make Dialog far more attractive from an FII perspective than it was earlier"</i> Thus on 23rd July we upgraded with a view that <i>"Our Neutral recommendation is based on an assumption that global markets and comparable telecom companies continue to perform strongly."</i></p> <p>The fall in global markets reverses this assumption on which our Neutral Recommendation was made. Global markets have looked increasingly fragile with Thursday seeing particular sharp drops on US and European markets. At present(Friday Morning) the fall on Wall Street appears very well set to continue in Asia as Asian ADR's trading on Wall street have</p>
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fallen sharply overnight setting the stage for falls in the underlying counters in the domestic markets. On Thursday, the Bank of New York Co.'s Asia ADR Index, tracking the region's American depository receipts, tumbled 3.5 percent to 166.14, the biggest decline since Feb. 27 when a Chinese stock sell off impacted most global markets including Sri Lanka.

Thus given the fall seen in global markets the relative valuation of Dialog to global comparables has deteriorated not just by the 7% appreciation Dialog has seen but also by the amount global comparables have fallen by. The fall in global markets has also been led by greater risk aversion, with many emerging markets in Latin America falling by a greater percentage than the developed markets on Thursday night with their currencies also weakening against the dollar. Thus emerging markets including Sri Lanka could also be hit along with mainstream global markets with particular negative impacts on a FII dominated stock like Dialog.

Furthermore in addition to this relative performance impact the second quarter results just released by Dialog, very much continue to display the fundamental challenges for growth in profits in real terms for the Core Mobile operations as a result of the high inflation and highly competition environment we discussed in our detailed report released in February. There also could be some concern in the apparent sharp rise in the cost base of Dialog TV on a QoQ basis with a relatively low QoQ growth in revenues. We would have a more comprehensive view on this issue post the Dialog investor briefing as we believe one off and seasonal factors might be the cause of this.

However on account of the relative out performance since our upgrade on 23rd July as well as the growth challenges been increasingly confirmed by the quarterly result, we renew our underweight recommendation on Dialog. We again believe Dialog will under-perform an ASPI index which can come off by over 10% in the near term and even on a twelve month horizon could be trading at a level just slightly lower than today' level. We therefore continue to believe that Sri Lanka fixed income instruments including high quality corporate debt offer a far more attractive option to most investors than investment in most equity instruments.

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