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Digicel Group Limited

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Company Overview

Digicel is a leading provider of communications services in the Caribbean and South Pacific regions. The Company provides a range of mobile communications, Business Solutions, Cable TV & Broadband and other related products and services to retail, corporate (including small and medium-sized enterprises) and government customers. Digicel currently provides mobile communications services to 13.6 million subscribers in 31 markets with an aggregate population of approximately 32 million people. They offer HSPA+ or long-term evolution ("LTE") mobile technology in 30 markets and hold the number one mobile market position in 21 markets, with a mobile subscriber market share of more than 50% in 20 markets as determined by internal Company data. Digicel launched mobile services in Jamaica, its first market, in 2001 and became the market leader there within 15 months of launch, based on a strategy that Digicel has since replicated successfully across many of its markets.

Financial Performance – Second Quarter ended September 30, 2016 (USD)

Profitability

Digicel Group Limited reported revenues of $637.9M for the three months ended Sept. 30, 2016, a 7.0% decline year-over-year. Depreciation of local currencies against the US dollar (Haiti, Papua New Guinea, Suriname, Jamaica and Trinidad & Tobago) was the main driver behind this performance. Service revenues were down 6% year-over-year to $615M but on a constant currency basis was up 1% to $664M. Equipment sales amounted to $23M, which was down from $28M in the prior year quarter due to lower handset sales in Papua New Guinea (PNG).

Revenue by Market								
US$m	Constant Currency Quarter ended Sept 30		Reported Quarter ended Sept 30			Reported Six Months ended Sept 30		
	2016	Change	2016	2015	Change	2016	2015	Change
Jamaica	111	17%	106	95	11%	210	191	-10%
Haiti	111	3%	95	108	-15%	191	221	-13%
French West Indies	40	0%	40	40	0%	80	79	1%
Trinidad & Tobago	69	5%	66	66	0%	129	131	-1%
El Salvador	20	-13%	20	23	-13%	39	45	-14%
Papua New Guinea	100	-10%	89	111	-20%	178	223	-20%
Other Markets	214	-1%	201	216	7%	389	407	-4%
Service Revenues	**664**	**1%**	**614**	**658**	**-6%**	**1,215**	**1,296**	**-6%**
Handset/Equipment Revenues	24	-16%	23	28	-20%	44	55	-19%
Total Revenues	**688**	**0%**	**638**	**686**	**-7%**	**1,259**	**1,350**	**-7%**

Total subscribers as at September 30, 2016 stood at 14.2M, up 2% from 13.8M as at September 30, 2015, driven by growth in both Mobile and Cable TV, Broadband & Fixed subscribers. Digicel reported that 250,000 subscribers were added since June 30, 2016. Voice revenues were down 14%, or 6% in constant currency terms, as voice-to-data substitution continued across Digicel's markets. Data revenue for the

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quarter was up 6% in constant currency and down 2% on a reported basis as smartphone penetration rose to 48%, up from 37% in the prior year period, with 55% of smartphone users on a data plan.

Revenue by Product								
US$m	Constant Currency Quarter ended Sept 30		Reported Quarter ended Sept 30			Reported Six Months ended Sept 30		
	2016	Change	2016	2015	Change	2016	2015	Change
Voice	342	-6%	316	366	-14%	639	743	-14%
Data	211	6%	194	198	-2%	382	392	-3%
Business Solutions	46	21%	42	38	11%	83	72	15%
Cable TV, Broadband & Fixed	39	87%	38	21	80%	68	36	89%
Other Revenue	25	-27%	25	35	-27%	42	53	-21%
Service Revenues	**664**	**1%**	**614**	**658**	**-6%**	**1,215**	**1,296**	**-6%**
Handset/Equipment Revenues	24	-16%	23	28	-20%	44	55	-19%
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Cable TV, Broadband & Fixed revenues of $39M reflected organic growth across the Caribbean, driven by Fibre to the Home (FTTH) RGUs and Pacific cable businesses. Business Solutions' revenues for the quarter increased by 21% as a number of significant new businesses were won. Other revenues of $25M fell by $10M due to the inclusion of $7M in the prior year period of Myanmar Tower revenue which was divested in 3Q16, lower Myanmar Top-up revenue in 2Q17 along with adverse exchange rate movements relative to the US dollar on CPL revenue. Increased revenues from financial services and the contribution from Sky Pacific partly offset the decline. Recurring business solutions service revenues increased by 11% to $42M which represented 7% of service revenues. On a constant currency basis, Business Solutions revenues increased by 21%.

Cost of sales rose 1.3% to $181.4M in 2Q17. This increase contributed to the 10% decline in gross profits which amounted to $456.5M. Direct costs amounted to $134M, an 11% increase compared to the prior year quarter. Direct costs were higher due to costs related to newly acquired businesses (Allcom, Prism, Paymaster and Sky Pacific) of $2M and direct costs associated with Digicel's FTTH/cable activities of $7M.

Subscriber Acquisition Costs (SAC), including cost of handsets sold, amounted to $39M for the second quarter, compared to $45M in the prior year period due to a targeted smartphone handset strategy in Haiti and PNG leading to lower handset distributions. The weighted average per unit SAC for the Group was $38.7, compared to $28.2 for the quarter ended Sept. 30, 2015, reflecting Digicel's focus on the higher value smartphone segment.

Operating expenses amounted to $303.7M, down 5% from $319M in the prior period, a performance that was attributed to cost discipline and foreign exchange movements. Depreciation & Amortisation charges of $101M were unchanged for the quarter while a foreign exchange gain of $0.4M was recognized, down from a gain of $3M in 2Q16. Operating costs related to the newly acquired businesses were $4M and operating costs associated with new FTTH/cable activities were $18M. Excluding these costs, operating costs declined by 15% on the prior year to $181M. Despite the success of cost containment strategies, operating profit fell 19% to $152.8M. The operating profit margin weakened to 23.9% in 2Q17 from 27.5% in 2Q16. Earnings before interest, taxation, depreciation & amortisation (EBITDA) amounted to $252.9M, down 14.3% from a year prior.

Profit before taxation amounted to $29.6M, down 5.9% or $1.8M year-over-year. Finance costs fell 13.4% to $120.5M due mainly to the inclusion of a $23M foreign exchange loss on loans in the prior year quarter, compared to the inclusion of a $5M foreign exchange loss on loans for 2Q17. A net loss of $2.3M was reported for the period as taxation of $31.9M was booked for the period.

Solvency & Liquidity

As at September 30, 2016 total assets were down 4% to US$4.3B while liabilities were up 1% to US$7.6B. Tangible fixed assets fell by $156M to $1.8B due to the sale of the Myanmar Tower assets, the Jamaican offices and exchange translation. Intangible fixed assets amounted to $1.5B, down $105M as result of amortization and exchange translation in both the Pacific and Caribbean markets.

Current assets amounted to $795.4M, down 1% year-over-year. Accounts receivable and prepayments were relatively unchanged, amounting to $508.3M while cash & cash equivalents were up 1% to $240.7M. Inventories were down 14% to $38.8M due to foreign exchange translation and lower handset inventory. The cash ratio declined to 0.25x from 0.27x a year prior while the current ratio fell to 0.82x, which compares to 0.82x at the prior year quarter-end.

Cash flows from operations amounted to $236M, down 19% year-over-year due to lower EBITDA and movement in the working capital position. Working capital net outflow amounted to $15M for the quarter due to growth in post-paid cable, mobile and business solutions revenue and general timing differences in the working capital cycle. Net cash used in investing activities was down $49M to $101.7M as capital expenditures fell $37M to $100.6M in the quarter, investments in acquisitions fell $4M and Central American investment fell by $9M. Net cash provided by financing activities amounted to $96.7M, which compares to net cash used of $30.1M in the prior year quarter. This was due to $127.6M in long-term debt received in 2Q17, compared to $5.2M in 2Q16. Loan repayments amounted to $27.5M, down from $28.7M in 2Q16.

Non-current liabilities amounted to $6.6B, relatively unchanged from a year prior, as long-term loans rose $13.4M to $6.3B but was partially offset by a $10.4M decline in provisions, which amounted to $90.9M. Current liabilities rose 9% to $967.1M as trade and other payables rose 10% or $65.3M to $725.1M. The current portion of long-term loans rose 15% or $25.4M to $190.4M. The debt profile is structured such that the company has no significant obligations until 2020, as displayed below.

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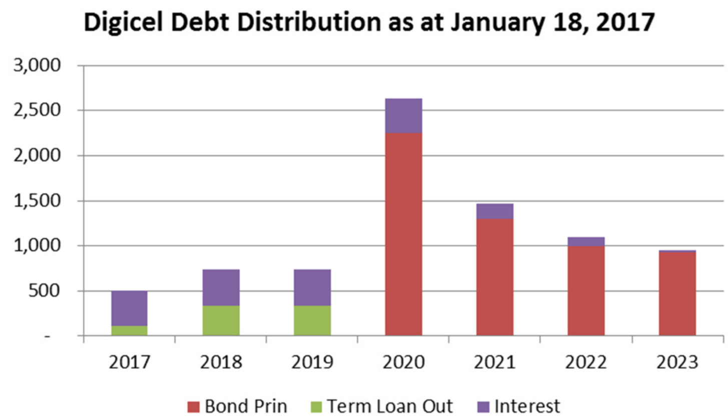

Digicel's ability to service its debt deteriorated slightly as the interest coverage ratio stood at 1.27x, which compared to 1.35x in 2016. Net debt/EBITDA stood at 6.0x, up from 5.40x due to the increase in debt and fall in EBITDA. Digicel's accumulated deficit was relatively unchanged at $2.9B while the foreign exchange translation reserve increased to negative $693.3M. As such, shareholders' deficit increased by 8% to $3.3B.

Outlook & Recommendation

Our outlook for Digicel has not altered since our July 2016 report in which we noted that Digicel's mobile subscriber growth has stagnated while the Cable TV, Broadband & Fixed lines of business are not growing at a fast enough rate to offset foreign exchange translation losses. As at September 30, 2016, Digicel had 235,000 Pay-TV RGUs, 118,000 Fixed Broadband RGUs and 115,000 Fixed Line RGUs across the Group. The FTTH business had performed well since its launch in Jamaica in September 2015 and towards the end of the quarter ended December 31, 2015 in Barbados and Trinidad & Tobago. As at the end of 2Q17, Digicel had 94,000 subscribers and 255,000 RGUs for its FTTH services with an ARPU of $55.

The chart below displays the Digicel 8.25% 2020 bond's yield performance over the past year. In the past month, the yield has contracted 5.6% to 12.02% and for the year, the yield has contracted 15.6% from 14.25%. The spread between the 2020's yield and the risk free rate, the interpolated US Treasuries Curve, has also narrowed over the past year. As at January 19, 2017, the 2020 bond was trading 1,034 basis points above the risk free rate, down from a spread of 1,281 basis points a year prior.

This could be interpreted as improving confidence in Digicel's ability to service its debt or greater willingness to take risk by investors as they seek out higher yields in a low interest rate global environment.

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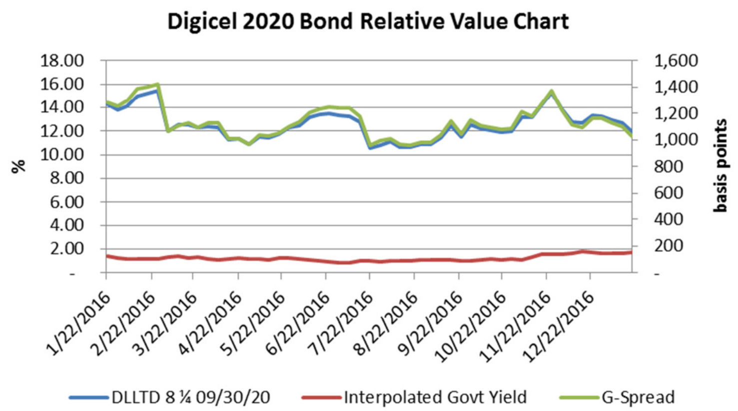

With an interest coverage ratio in excess of 1.3x and a current ratio just above 0.8x, it appears as though Digicel should be able to meet its obligations. However, erratic profitability due to stagnant growth and weakening local currency revenues and a large debt burden remain causes for concern. Given stiff competition and the fast pace of innovation in Digicel's business lines, constant capex is required and will continue to put pressure on cash flows which will require greater leverage if funding is not generated at a sufficiently level internally. As such, ***Digicel continues to be recommended as UNDERWEIGHT and is suitable for investors with a high risk tolerance and who are also comfortable with the likely volatile in security prices***.

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IMPORTANT DISCLOSURES

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

UNDERWEIGHT—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

HOLD/MARKETWEIGHT—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

OVERWEIGHT/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

Source: JMMB Investment & Research, Various Company Financial Statements, Bloomberg