

ON THE RADAR

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Equity Research Report

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This individual company report forms part of On the Radar, a comprehensive fundamental AltX equity research report produced by Merchantec Research. On the Radar offers the investment community a better understanding of a number of small cap entities, as well as the AltX sector in general.

Other companies covered in the first edition of On the Radar are:

- 1Time Holdings Limited;
- African Dawn Capital Limited;
- Alert Steel Holdings Limited;
- B & W Instrumentation and Electrical Limited;
- Blue Financial Services;
- Dialogue Group Holdings Limited;
- Dynamic Technology Holdings Limited;
- Quantum Property Group Limited;
- RACEC Group Limited;
- SA French Limited;
- Simeka Business Group Limited;
- Taste Holdings Limited;
- Total Client Services Limited; and
- Telemaster Holdings Limited.

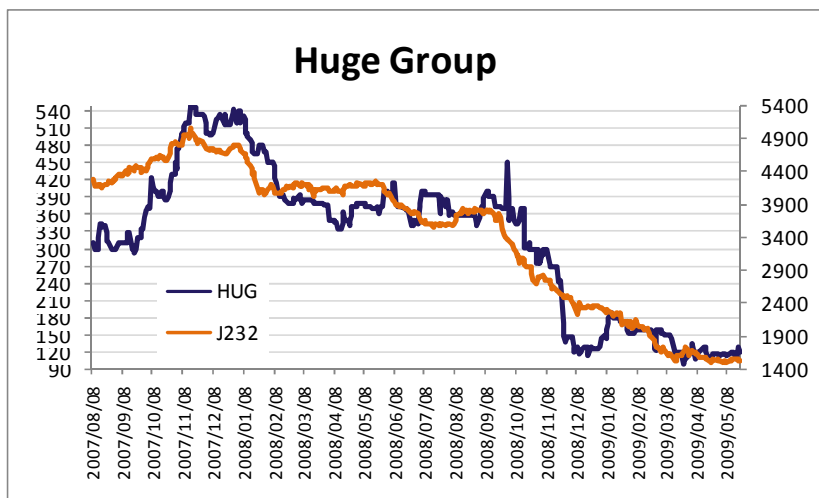
For more information or to obtain research on the above listed companies, please call Merchantec Research on 011 325 6363.

Huge Group

Supersized growth

Telecommunication

Price & price relative



Huge announced interim results to 31st August 2008 on 8th October 2008.

Revenue reached R308.9m at an EBIT margin of 10.9%. Fully diluted interim HEPS reached 26.2 cps.

Huge is expected to produce strong revenue and operating profit growth, however several adjustments for exceptional items including losses on derivative positions make it difficult to forecast full year results.

Based on Huge's high annuity income, we forecast revenue growth of 152% to R613.8m in FY09 which, at an EBITDA margin of 12.0% yields HEPS of 13.4 cps, however if we exclude the effects of the exceptional items we forecast adjusted HEPS of 43.2 cps. We forecast a further growth in revenue of 18% in FY10 to 724.3m, which at an EBITDA margin 12.5% yields HEPS of 49.7 cps.

Both our DCF and relative PE valuation models indicate the stock is currently undervalued.

Note: Huge issued a cautionary announcement on 3rd April 2009 regarding a cash offer and possible de-listing.

Price	R1.19
PE fair value	R2.38
DCF fair value	R2.17

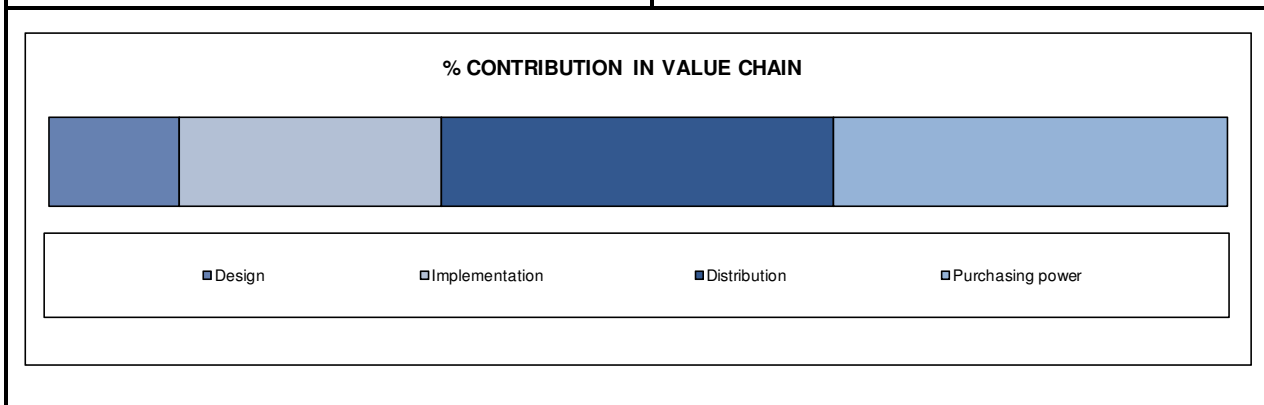
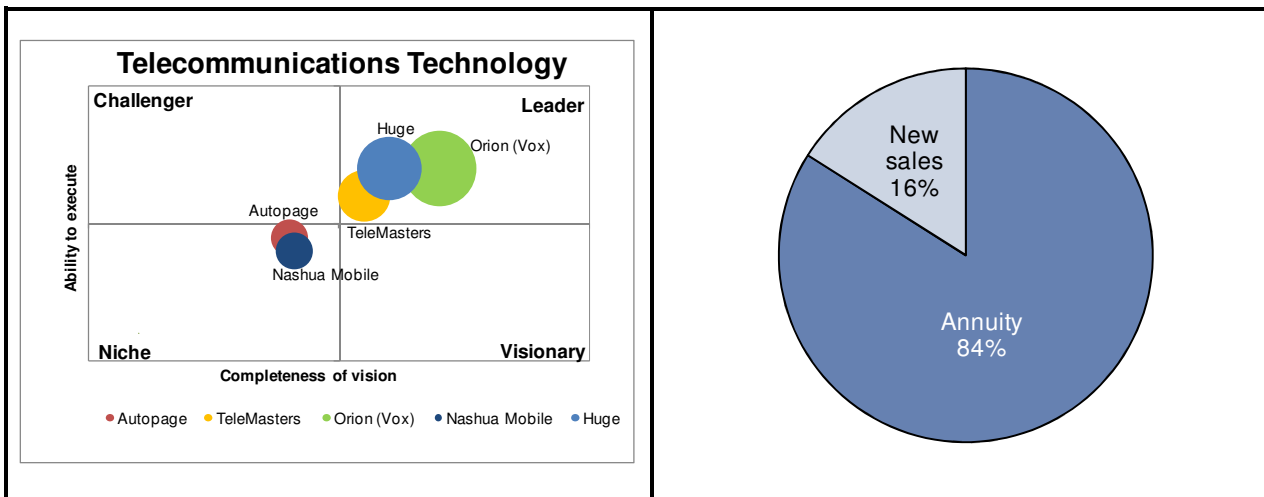
Upside (downside) to PE fair value (%)	99.6%
Upside (downside) to DCF fair value (%)	82.4%

Price performance		
	Absolute	Relative to FINDI
1month	-5%	-8%
3 month	-29%	-29%
12 month	-70%	-61%
12 month (SA cents)	High 415	Low 110

Forecasts				
Yr to February	2007	2008	2009F	2010F
Turnover (Rm)	-	244	614	724
EBITDA	-	36	74	91
EBIT	-	31	59	76
PAT	-	26	-1	54
HEPS (cents)	-	44.1	13.4	49.7
DPS	-	12	0	25
PER (x)	-	2.7	8.9	2.4
EV/EBITDA	-	2.8	2.4	13
DY%	-	10.1%	0.0%	20.9%

Share data			
No. of shares (m)	59	EV (Rm)	177
Monthly t/o (Rm)	10.3	Mkt cap (Rm)	134
		Price/NAV (x)	0.6

Key ratios				
Yr to February	2007	2008	2009F	2010F
EBITDA margin (%)	-	14.6%	12.0%	12.5%
EBIT margin (%)	-	12.9%	9.7%	10.5%
Net debt/equity (%)	-	11.1%	21.6%	-3.4%
ROCE (%)	-	-	26.2%	30.5%
ROE (%)	-	-	-0.4%	23.2%



Strengths	Weaknesses
Established communications solutions provider Capital investment low Ability to provide one invoice Aggressive young executive management	Larger client market approaching saturation Competitive industry
Opportunities	Threats
Cross selling of services New direct marketing business Changes in regulation National footprint with distribution capability	Reliance on networks for balance of terms Fluid regulatory environment Negative publicity relating to Single Stock Futures

Customer size	Large	Mid-range	Small
	X	X	X
Sales model	Direct	Resellers	Retail
	X	X	
Sectors	Financial	Manufacturing	Mining
	X	X	X
	Govt/Utilities	Telecomms	Retail
	X	X	X

Company profile

Started call back services 1993

Huge has its origins in the international call-back services company TelePassport (Pty) Ltd which was established in 1993 and under the leadership of its previous Managing Director, Anton Potgieter, embarked on a strategy to transform from traditional least-cost-routing (LCR) to managed telecommunications services. TelePassport (Pty) Ltd provided the national footprint for the transformation and Huge acquired the company, renaming it to Huge Telecom. Huge successfully listed on the AltX on 8th August 2007.

Listed August 2007

Voice routing and telephone auditing

Huge acquired the business of Centracell (Pty) Ltd shortly after listing (in February 2008) which specialised in voice routing applications and telephone auditing solutions.

Critical mass for service providers

Huge provides outgoing telecommunication cost reductions mainly for corporate businesses, through call routing and management equipment which it installs for clients at their premises. Traditional LCR provides a benefit to clients through the correct selection of networks to minimize call costs as well as a provision of a per-second billing model for all fixed-line (through a router) to cellular calls which it is able to offer as a result of commercial agreements with GSM service providers (Vodacom, MTN and Cell C). The acquisition of Centracell allowed Huge to achieve critical mass which is crucial for the negotiation of competitive rates from service providers as well as increasing operational leverage.

Call routing and management systems

Huge has focused its strategy towards moving up the value chain from a sole LCR solutions provider into the managed telecoms sector. Huge's managed telecommunication solution provides SMS as well as web based telephone management systems. Huge is able to provide savings to clients by call management (eliminating employee call abuse), the use of alternative communications technology (such as SMS) and on-net routing which automatically routes calls through the most cost effective network (thereby saving on inter-connection fees that are charged by service providers).

National footprint

Huge operates from four local offices situated in: Johannesburg, Durban, Port Elizabeth and Cape Town. The international offices operate out of Windhoek and Swakopmund (Namibia) offering mainly LCR solutions to businesses.

Direct marketing

The company has recently acquired Eyeballs Mobile Advertising which provides direct marketing via mobile handsets and management believes that potential for growth is high in this sector. Huge's recent unsuccessful acquisition of iTalk Cellular has meant that it is not exposed to the cellular consumer retail sector (the provision of airtime and bandwidth).

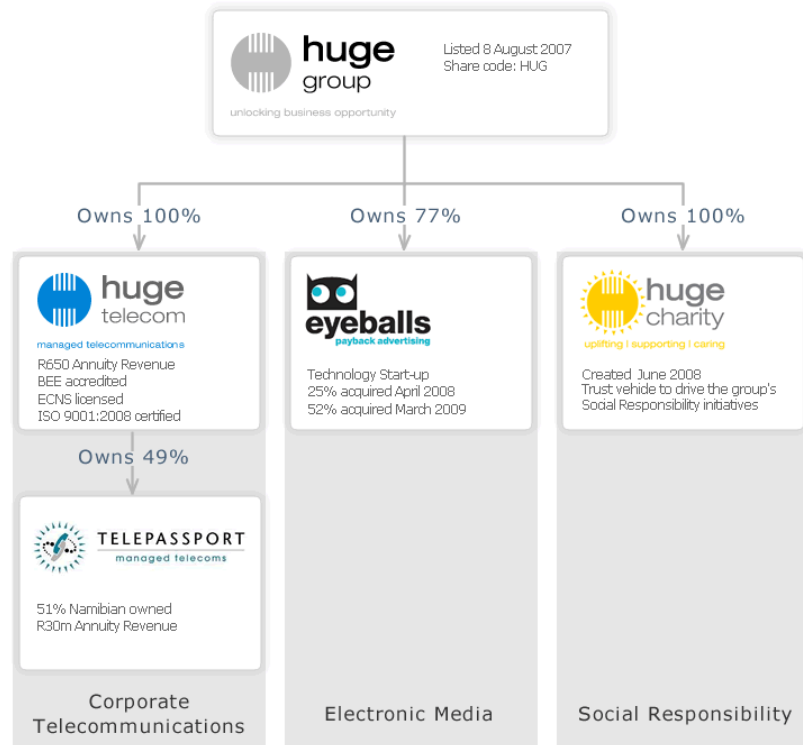
Divisional analysis

Huge's divisions are as follows:

LCR and managed telecoms

Huge Telecom: supplies corporate customers in South Africa with cost-saving managed telecommunications solutions, centred on controlling and reducing outgoing call spend. These solutions include live call management services, corporate SMS services and LCR of outgoing calls utilizing fixed cellular terminals, VoIP and international media exchange technologies.

Divisional breakdown



Source: HUG

Namibian operations

TelePassport Namibia: (49% owned) provides LCR solutions and value added application communication services to corporate clients in Namibia with an estimated market share of over 70% in Namibia.

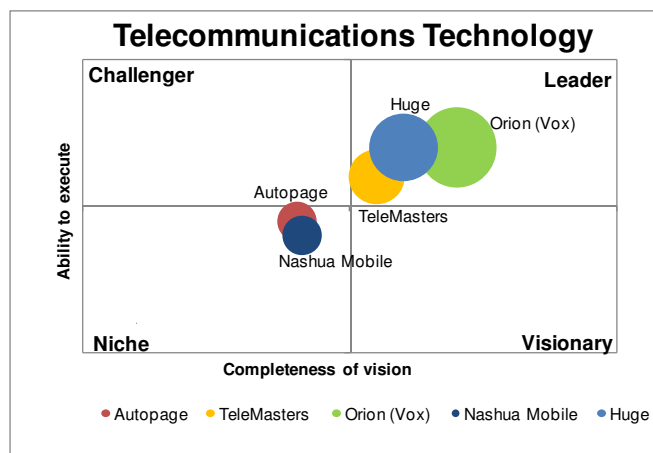
Direct marketing

Eyeballs Mobile Advertising: (77% owned) delivers advertising content to GSM mobile subscriber handsets and provides an alternative to SMS and MMS advertising. The technology (developed by Eyeballs Mobile Advertising) is an application that is downloaded to a mobile handset by the user with an advertising message being displayed every time the handset sends and receives a call or an SMS. The user gets rewarded by receiving credits for either pre-paid airtime or other offers.

Competitive position

Challenger / leader

We position HUG as a challenger / leader in the telecommunication technology space. HUG does not compete directly with fixed line or cellular network operators (such as Telkom, Verizon, Vodacom, MTN etc), as these are considered suppliers. HUG acts as an intermediary between the service provider and end user.



Managed telecoms provider

Huge's traditional LCR business is in direct competition with Orion (Vox Telecom) and TeleMasters, although as a managed telecoms service provider it believes it has a competitive advantage over traditional LCR providers as it can provide value added services.

Higher margin business

The provision of value added services leads to higher margin business when compared to traditional LCR services where one delivers largely unmanaged services at wholesale levels, or through a dealer network such as Autopage Cellular and Nashua Cellular. Huge has access to a relatively high portion of contracted annuity income with several large blue chip clients such as Netcare, Medi-Clinic and Virgin Active.

High annuity income

R3bn LCR Market

The estimated size of the cellular LCR market in South Africa was R3.28bn at the end of August 2008 (Huge media release, 2008) and Huge foresees cross selling opportunities within its existing customer base which it believes will further improve revenue and margins going forward. Discussions with management indicate that for the six month period ending 31st August 2008 Huge's market share was at 19% of the total LCR market, with Orion Telecom's estimated share at ~42%.

Huge has 21% market share

Complexity of telecoms to increase

Management believes that the complexity of the telecommunications industry is expected to increase and as the number of routing options and infrastructure providers grows, correct telecommunication management for both fixed line and radio transmission (cellular, WiFi) will become more critical which will underpin demand for Huge's services going forward.

Gauteng biggest revenue contributor

Huge currently focuses on the domestic market and derives the majority of its income (currently 57%) from the Gauteng region, with the Western Cape providing the second highest at 21%. TelePassport Namibia, a subsidiary of Huge, has an estimated 70% of the market for LCR solutions in that country.

VoIP not a threat

Huge does not view new telecommunication technologies such as VoIP as a threat to its business model as it does not deal with the infrastructure, but rather with the efficient management of telecommunications which reduces a client's total expenditure.

Caveats

Cautionary - cash offer and de-listing

Huge issued a detailed cautionary announcement on 3rd April 2009 regarding a possible cash offer and potential de-listing. Management states that it is in preliminary discussions with regards to a transaction that would result in an offer to shareholders for them to sell (on a voluntary basis) all or some of their shares for cash.

Support transaction

The holders of a significant number of the issued shares (excluding treasury shares) have irrevocably undertaken to support the transaction and to accept an offer for all their shares at a price of not less than 160 cps.

SSF contracts

Huge entered into CFD's (contracts for differences) and SSF (single stock futures) contracts over its own ordinary shares between 27th June 2008 and 15th October 2008. The directors had also sold their shares into SSF's contracts and were given 89% (initial margin at 11%) of the cash value of the shares back.

Margin increased to 33% The initial call margin on the Huge SSF's was increased from 11% to 33% on 15th October 2008.

Shares expropriated The directors refused to meet the imposed increased initial margin and consequently (in accordance with the Derivative Rules of the JSE) the SSF contracts were closed and expropriated from the directors (representing an approximate 4% holding for each director in the share capital of Huge) on 16th October 2008 and transferred into the broker's account. On the same day, Huge agreed to acquire the SSF contracts at an average price of 362 cps.

Related parties The JSE announced on 19th March 2009, that it informed Huge (in terms of an earlier letter dated 28th October 2008) that the above transactions were concluded with related parties and it was therefore in contravention of section 85 of the Companies Act. Huge exercised its right to object to the decision the JSE however dismissed the objection.

Increase in margin call payment As a result of the global economic downturn and crash of global equity markets, the Huge share price declined which implied that the directors and Huge had to increase payments in order to meet CFD and SSF margin calls.

IFRS specialist appointed Huge announced on 30th March 2009 that it was consulting with an IFRS specialist in order to show both the pro forma effects of the SSF and CFD contracts.

Divisional Forecasts

Results

Results not comparable Huge announced interim results to 31st August 2008 on 8th October 2008. The results for the previous interim period (ending 31st August 2007) only contained the trading results of TelePassport for one month after listing and are therefore not comparable.

HEPS 26.2 cps Revenue reached R308.9m which forms 50.3% of our full year forecast for FY09. The EBITDA margin reached 14.2% for the interim period. This yields fully diluted interim HEPS of 26.2 cps. A final maiden dividend of 12 cps relating to FY08 was declared.

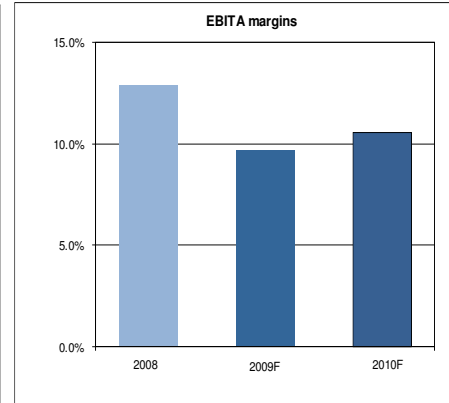
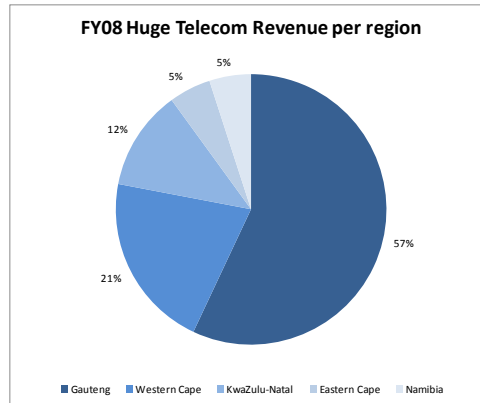
Outlook and forecasts

Management bullish Management remains bullish despite the economic downturn and states that the industry growth rate is currently averaging 18% per annum and expects demand for its services to remain robust.

Revenue growth 152% Based on the high annuity revenue, we forecast that Huge will achieve revenue of R304.9m in H2 which yields growth in revenue of 152% (which includes the results of both Centracell and TelePassport for the full twelve months) to R613.8m in FY09. We forecast a further growth in revenue of 18.0% to R724.3m in FY10.

EBITDA margin 12.0% in FY09 We forecast the EBITDA margin at 12.0% in FY09 with an increase to 12.5% in FY10 as operational leverage is achieved from the growth in revenue.

Stable working capital Despite the current economic climate, we forecast stable working capital for Huge as debtors are effectively funded through creditors. Our estimate of debtor and creditor days are at 110 and 120 respectively and we project a growth in inventory of 36% in FY09.



SSF and CFD

The negative impact of the SSF and CFD transactions (dependent on the current share price) is estimated at ~R26.0m (including share repurchases) which in our view will affect both EPS and HEPS and our model indicates that this will result in a decrease in cash balances for FY09, although we forecast a recovery in FY10 and thereafter. Integration costs, restraint of trade agreements and costs arising out of the unsuccessful bid for iTalk amounting to a total of ~R15.5m, will further decrease attributable earnings.

Forecast HEPS 13.4 cps

In summary, we forecast a decline in HEPS from 44.1 cps to 13.4 cps in FY09 which excludes the effects of the integration costs, restraint of trade agreements and costs for the unsuccessful bid but includes the costs of the SSF and CFD contracts. If we exclude the negative effects of the derivatives (which is a once off cost) we estimate adjusted HEPS of 37.3 cps (compared to 44.1 cps in FY08) with the decline attributable to the increase in the number of shares in issue from 59.4m to 108.9m. We forecast HEPS of 49.7 cps in FY10, barring any repeated exceptional items.

Maiden final dividend 12 cps

Management declared a final dividend of 12 cps (which was paid in September 2008), however owing to the pressure on cash reserves, we forecast no dividend in FY09 resuming to 24.9 cps in FY10 (based on a dividend cover of 2 times declared by management).

Valuation

DCF value R2.17

We have considered a discounted cash flow analysis and have taken cash flow forecasts out to FY11, and then utilised a terminal cash flow growth of 6% to yield the following sensitivity table, for which we select a discount rate of 30% to yield a DCF value of R2.17:

Growth rate	Discount rate				
	20.00%	25.00%	30.00%	35.00%	40.00%
0.00%	2.93	2.26	1.83	1.52	1.29
2.00%	3.19	2.42	1.92	1.58	1.34
4.00%	3.52	2.60	2.03	1.66	1.39
6.00%	3.95	2.82	2.17	1.74	1.45
8.00%	4.52	3.09	2.32	1.84	1.51
10.00%	5.32	3.44	2.51	1.95	1.58
12.00%	6.51	3.89	2.73	2.08	1.67

PE relative value of R2.38

With reference to the table below, we believe it is appropriate to compare Huge to similar sized companies in SA. With a large portion of annuity income, we maintain its rating to par with the peer group. The implied forward PE valuation of 4.1 places Huge at a price of R2.38:

ICT Services	Price (R)	Mkt cap (Rm)	1 year fwd PE
DTH	0.85	42.50	3.7
Huge	1.19	132.99	2.0
SimekaBSG	0.30	180.60	1.7
TCS	0.09	35.11	2.4
Telemasters	1.90	79.80	4.7
Vox	0.65	757.11	9.5
Average			4.1
			-50%
Huge: Actual current	1.19	133	2.0
Premium (Discount) applied to average:			0%
Huge: Implied current (gain):	2.38	100%	4.1

Recommendation

Losses likely

Huge is expected to produce strong revenue and operating profit growth, however several adjustments for exceptional items including losses on derivative positions make it difficult to forecast full year results.

The full impact of the SSF and CFD transactions remains to be decided, although our view is that it will have a material effect on HEPS in FY09.

Urge caution

Both our DCF and relative PE valuation models indicate that the share is currently undervalued although given the difficulty of forecasting derivatives losses in the current economic climate we would urge caution in investing in the share.

Appendix

Forecasts

Income Statement to February	2007	2008	2009F	2010F
Turnover	-	244	614	724
Trading profit	-	31.3	59.3	76.4
Amortisation	-	-	-	-
Net interest received	-	4.5	(3.8)	(2.0)
P B T (incl exceptionals)	-	35.8	14.1	74.4
Taxation	-	9.6	14.9	20.0
Attrib earnings	-	26.2	(0.9)	54.4
Attrib earnings - (Headline)	-	26.2	14.6	54.4
Issued shares ave (m)	-	59.4	108.9	109.4
EPS (R) - (Headline)	-	0.441	0.134	0.497
EPS growth %	-	-	-70%	271%
DPS (R)	-	0.12	0.00	0.25
Div cover	-	3.68	-	2.00

Balance Sheet at February	2007	2008	2009F	2010F
Share capital	-	221.6	221.6	221.6
Non-dist. reserves	-	0.2	0.2	0.2
Dist. reserves	-	26.3	(0.6)	26.6
S/holders equity	-	248.1	221.2	248.4
Total s/holders interest	-	248.1	221.2	248.4
Interest bearing debt	-	47.4	47.4	47.4
Deferred tax	-	1.5	1.5	1.5
Capital Employed:	-	296.9	270.0	297.2
Employment of capital	-	296.9	270.0	297.2
Fixed assets	-	57.3	59.3	71.4
Investments/Non-current assets	-	229.9	229.1	218.6
Net current assets	-	9.7	(18.4)	7.3
Current assets	-	104.2	189.6	280.9
Cash	-	19.8	(0.3)	55.9
Current liabilities	-	94.4	208.0	273.7

Cash Flow to February	2007	2008	2009F	2010F
Pretax profit	-	35.8	14.1	74.4
Non cash items:				
Depreciation & amortisation	-	4.3	14.2	14.3
Other adjustments	-	(0.6)	-	-
Work. cap. decrease (increase)	-	(9.1)	14.3	1.2
Tax paid	-	(3.0)	(14.7)	(18.7)
Net cash flow	-	27.4	27.9	71.2
Dividends paid	-	-	(7.1)	-
Capital expenditure :				
Maintenance	-	(0.3)	(4.9)	(15.0)
Capacity increases	-	(10.6)	-	-
Investments	-	(123.4)	(10.0)	-
Financing activities	-	126.7	(26.0)	-
Increase (decr) in net cash		19.8	(20.1)	56.2
Net cash(debt) at start		-	19.8	(0.3)
Net cash(debt) at end	-	19.8	(0.3)	55.9

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