

## CEE Telecom sector: safe haven, though not immune to recession

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“Our peer group valuation shows, that the CEE incumbents are no longer favourably valued compared to their Western European peers: they are traded slightly cheaper than their Western European peers in terms of EV/EBITDA, but with around 30% premium in terms of P/E. Nevertheless, the CEE telecoms’ shares are still cheaper than other sectors. In addition, the CEE incumbents offer higher margins from the EBITDA to the net profit level than companies in the other sectors. Furthermore, they generate strong and steady cash flows. These factors should make them an attractive and defensive investment, especially during the current economic downturn”, states Vera Sutudja, the CEE telecom analyst at Erste Group.

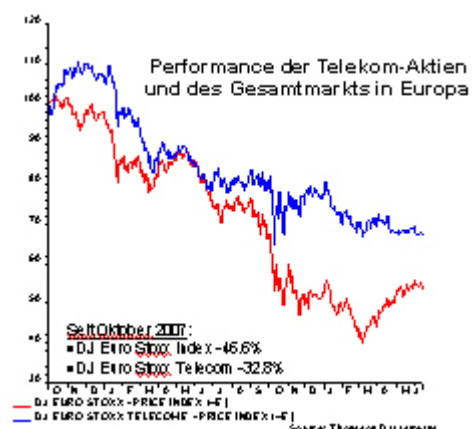
### Overview of target price and recommendations

Companies	Currency	Current price	Target price	Potential upside	Recommendation
T-Hrvatski Telekom	HRK	214.0	300.0	40%	Buy
Telefónica O2 CR	CZK	424.0	550.0	30%	Buy
TP SA	PLN	17.6	20.5	16%	Accumulate
Telekom Austria	EUR	10.5	11.0	5%	Hold
Magyar Telekom	HUF	611.0	625.0	2%	Hold
Telekom Slovenije	EUR	172.1	160.0	-7%	Reduce

Source: Erste Group estimates

### Telecom stocks outperformed market

Telecom stocks have outperformed the market during the current recession period, as can be seen in the following graphs. We assume that the bear market started in October 2007, when the DAX index reached its peak level. Furthermore, telecom stocks have outperformed cyclical stocks, such as banks, industrial, technology and oil/gas: The DJ Euro Stoxx Financials fell by 57.8%, followed by the DJ Euro Stoxx Technology (52%), the DJ Euro Stoxx Industrials (47.6%) and the DJ Euro Oil/Gas (36.2%). Meanwhile DJ Eurostoxx Telecom fell by only 32.8%.



### Incumbents are resilient, but not immune to recession

Telecom stocks did not fall as much as other sectors during the recession period due to their steady and strong free cash flow, as well as conservative debt levels. Although free cash flow fell during

the economic downturn, its decline remains limited to single digits, which was supported by several factors preventing consumers from reducing their spending: 1) the basic nature of telecom services; 2) falling prices, even as quality and services improve; 3) the already low telecom spending compared to overall expenditure (3.3%) and earnings (1.5%); 4) new services and bundled products, which help to retain customers. All CEE incumbents in our coverage universe expect declining revenues and EBITDA for 2009. "Overall, we think that the telecom sector offers greater resilience compared to other sectors, due to its defensive revenues and cash flow, low leverage, important role as a basic services for households and corporates, new services/products to reduce the churn rate and its already low retail prices", believes Sutedja.



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### Intensifying regulatory pressure: severe MTR reductions, extension of Eurotariff

In our view, the most influential regulatory measures at present are the reductions of the Eurotariff (the roaming tariff within EU member states) and the Mobile Termination Rate. "We expect regulatory decisions to continue reducing incumbents' future revenues and profitability. The EU roaming tariff will be further reduced, affecting Telekom Austria the most. The MTR reduction across the region will reduce mobile revenues and, in our opinion, EBITDA. It will also bring a new wave of retail price reduction", is Sutedja almost sure.

#### Eurotariff regulation

Euro cents	EU roaming rules 2007			New EU roaming rules 2009		
	30-Aug-07	30-Aug-08	30-Aug-09*	01-Jul-09	01-Jul-10	01-Jul-11
Calls made from abroad	49	46	43	43	39	35
Receive calls whilst abroad	24	22	19	19	15	11

Source: EU Commission

\*) superseded by new EU roaming rules 2009

### Competitive market with falling prices

Incumbents continue to dominate both fixed and mobile markets in their respective countries. The covered incumbents held more than 74% of the fixed lines in their domestic markets in 2008, ranging from 35% (Telefónica O2 CR) to 90% (T-Hrvatski Telekom) in 2008. In the mobile market, the share ranges from 32.3% (TPSA) to 58.9% (Telekom Slovenije) in 2008. Despite their market leadership, incumbents face a real challenge in growing their revenues. This is due to continuing fixed-to-mobile substitution and intensifying competition with cable, alternative and mobile operators. Wholesale Line Rental and unbundled local loop accelerate fixed access losses Bitstream access and mobile broadband slow down fixed broadband growth. "Mobile revenues are expected to decline, due to the saturated penetration level, falling prices, rationalization of double/triple SMS card owners during the recession, MTR reduction and the roaming tariff cut. Incumbents therefore rely on bundled products to retain customers. Overall, the telecom market remains very competitive, marked with falling prices", foresees Thomas Unger, the CEE telecom analyst at Erste Group.



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Vera Sutedja and Thomas Unger come to the following conclusions:

- We keep our target prices and recommendations for T-Hrvatski Telekom (Buy, HRK 300), Telefónica O2 CR (Buy, CZK 550) and Telekom Austria (Hold, EUR 11) unchanged.
- We reduce our target price for TPSA from PLN 21.6 to PLN 20.5, after considering the weak 1Q09 results and the price war in the mobile segment. Even after lowering our estimates, the current share price level offers a decent upside. We therefore upgrade TPSA from Hold to Accumulate.
- We downgrade Magyar Telekom from Accumulate to Hold, while reducing our target price from HUF 635 to HUF 625. Considering the worsening economic situation in Hungary, we regard the company's 2009 outlook as unattainable and think a downgrade is likely.
- We downgrade Telekom Slovenije from Hold to Reduce, whilst lowering our target price from EUR 270 to EUR 160. We lower our 2009e EPS estimate by 36% to EUR 9.91.

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