

Bruised by recession, facing new investments

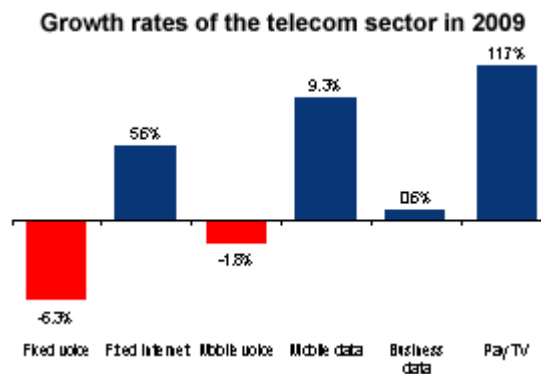
[Back](#)

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- Slow fall, slow recovery: CEE incumbents to return to a growth path only in 2011 or 2012
- Harsh competition: Fixed-line shrinking, mobile and fixed broadband slowing down, heavy price falls
- Future growth drivers and challenges: FTTH just matter of time, LTE not before 2012
- Turk Telekom top pick, Magyar Telekom down to Hold, Telekom Slovenije up to Hold, Telefonica O2 CR, Telekom Austria, T-Hrvatski Telekom and Turkcell unchanged on Hold

Telecom not safe haven in 2009 after all

“The telecom sector was not immune to recession, as the revenue growth in the sector was close to zero”, says Vera Sutedja, CEE Telecom analyst at Erste Group. “During the economic crisis, our covered incumbents were able to maintain or even raise their dividend level providing around 76% of the investor return. In some cases, such as Magyar Telekom, T-Hrvatski Telekom and Telekom Slovenije, the share price performed poorly and diluted the contribution from the dividend.” The traditional fixed and mobile voice segments were hit the most, showing a decline of 6.3% and 1.8% y/y in 2009, respectively. Pay TV, mobile data and fixed Internet were the growth drivers, but their combined share of revenues was not large enough at 33% to compensate for the decline in voice revenues.



Some weak signs of recovery in 2Q10

“In 2Q10, we saw some signs of recovery, such as a slowdown in the rate of revenue and EBITDA decline. TPSA showed the strongest signs of recovery, especially in the mobile segment, and even upgraded its FY10 outlook. On the other side, Magyar Telekom continued to suffer under macroeconomic and regulatory measures and hence downgraded its FY10 outlook. The rest of our covered incumbents confirmed their FY10 outlooks. Overall, the target for FY10 still includes falling revenues and EBITDA. We expect our covered CEE incumbents to return to a growth path only in 2011 or 2012”, predicts Sutedja.

Wide investments ahead

The traditional fixed and mobile voice segment continues to shrink, while fixed broadband can no longer be considered a growth driver. In addition, fierce competition with mobile and cable operators leads to pricing pressure. TV products, IT services and mobile broadband are currently the growth drivers for CEE incumbents. This creates challenges for both the fixed-line and mobile networks. Future web-based applications will increase bandwidth requirements further. Fiber to the home (FTTH) would be the future-proof solution, in that it can handle most bandwidth-intensive applications. The associated investments with FTTH are very high, ranging from USD 500 to USD 2,500 per household. Nevertheless,

the Fiber rollout is just a matter of time. Long Term Evolution (LTE) or 4G technology could address the mobile network congestion problem caused by strong mobile broadband growth. The CAPEX requirement for LTE excluding the license fee is not significant. A commercial launch is not expected before 2012. “When the FTTH or LTE investments start to kick in, we question whether the current dividend levels of our covered incumbents will be

sustainable”, suspects Sutedja.

Outlook

CEE incumbents offer superior dividend and FCF yields compared to their Western European counterparts. The margins of CEE incumbents are still higher than those of Western European peers, but the gap has continued to narrow. Investments in fiber to the home (FTTH) or to the building (FTTB) and LTE are necessary to support future revenue streams from fixed and mobile data, as well as to avoid network congestion problems. It is more a question of when the incumbents will start their investments and how broad the coverage will be. The impact on CAPEX is substantial for FTTH/FTTB, but not as significant for LTE, leading to a possible temporary strain on dividend payment capabilities. Incumbents with strong balance sheets, such as T-Hrvatski Telekom and Telefónica O2 CR, are in a much stronger position to afford both high CAPEX and a high dividend. The return on investment is a big question mark, depending on coverage, price and the regulatory and competitive environment. “In any case, we see little chance that incumbents could escape making the investments, as they are necessary to maintain the service quality of triple play, mobile broadband and value added services, such as gaming and video on demand”, summarizes Vera Sutedja, CEE Telecom analyst at Erste Group.

Potential impact of FTTH and LTE rollout

Criteria	Impact
FTTH	
CAPEX per household	EUR 400-1500
CAPEX growth during FTTH rollout	+10-30%
FTTH broadband prices, depending on speed	EUR 23-140
Expected payback period	10-25 years
LTE (4G)	
CAPEX growth during LTE rollout	+3-10%
Incremental CAPEX/sales ratio	+3-4%
LTE broadband prices, depending on promotion	EUR 38-63
LTE spectrum cost, not included in CAPEX above	varies widely

Source: Erste Group Research

Turk Telekom as top pick

- Our top pick remains Turk Telekom. The company delivered solid 2Q10 results, which confirmed the margin recovery of its mobile business Avea and its strong position in the fixed-line business. Its double-digit earnings growth, generous dividend policy and attractive peer group valuation - with around a 30% discount to peers in terms of P/E 2011e-2012e - are the key arguments for our positive recommendation.
- We downgrade Magyar Telekom from Accumulate to Hold, as the reduction in governmental spending should impact 2H10 revenues and earnings.
- We upgrade Telekom Slovenije from Reduce to Hold, as it showed signs of cost control.
- We continue to assign Telefónica O2 CR, Telekom Austria, T-Hrvatski Telekom and Turkcell our Hold recommendation, lacking positive catalysts in the near future.

Overview of target price and recommendations

Companies	Currency	Current Price	Target price	Potential upside	Recommendation	Previous target price	Previous recommendation
Turk Telekom	TRY	6.2	8.0	30.1%	Buy	7.0	Buy
Magyar Telekom	HUF	667.0	720.0	4.8%	Hold	770.0	Accumulate
Telefónica O2 CR	CZK	395.0	425.0	7.6%	Hold	470.0	Hold
Telekom Austria	EUR	10.4	11.0	5.5%	Hold	10.0	Hold
T-Hrvatski Telekom	HRK	260.0	280.0	7.7%	Hold	300.0	Hold
Telekom Slovenije	EUR	91.5	94.0	2.8%	Hold	95.0	Reduce
Turkcell	TRY	9.9	10.4	5.6%	Hold	9.4	Hold
TP SA	PLN	16.6	16.0	-3.6%	Reduce	16.0	Reduce

Source: Erste Group estimates

- ADSL Asymmetric Digital Subscriber Line - A gateway is commonly used to make an ADSL connection (ADSL) is one form of the Digital Subscriber Line technology, a data communications technology over copper telephone lines than a conventional voiceband modem can provide.
- IPTV Internet Protocol television (IPTV) is a system through which Internet television services are deli

Internet access networks, instead of being delivered through traditional radio frequency broadcast, s (CATV) formats.

LTE Long term Evolution is the latest standard in the mobile network technology tree that previously real UMTS/HSxPA network technologies. It is a project of the 3rd Generation Partnership Project (3GPP

FTTB Fiber-to-the-building or Fiber-to-the-basement - fiber reaches the boundary of the building, such as unit, with the final connection to the individual living space being made via alternative means.

FTTH Fiber-to-the-home - fiber reaches the boundary of the living space, such as a box on the outside wa

DSL Digital Subscriber Line (DSL) is a family of technologies that provides digital data transmission over network.

VoIP Voice over Internet Protocol (VoIP, Voice over IP) is a general term for a family of methodologies, c transmission technologies for delivery of voice communications and multimedia sessions over Intern the Internet.

EDGE Enhanced Data rates for GSM Evolution (EDGE) (also known as Enhanced GPRS (EGPRS), or IM Enhanced Data rates for Global Evolution) is a digital mobile phone technology that allows improve backward-compatible extension of GSM. EDGE is considered a 3G radio technology.

Quelle: Wikipedia



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[Back](#)