

CEE Telecom sector: seasonality and mobile data growth as key driver in H2 2011

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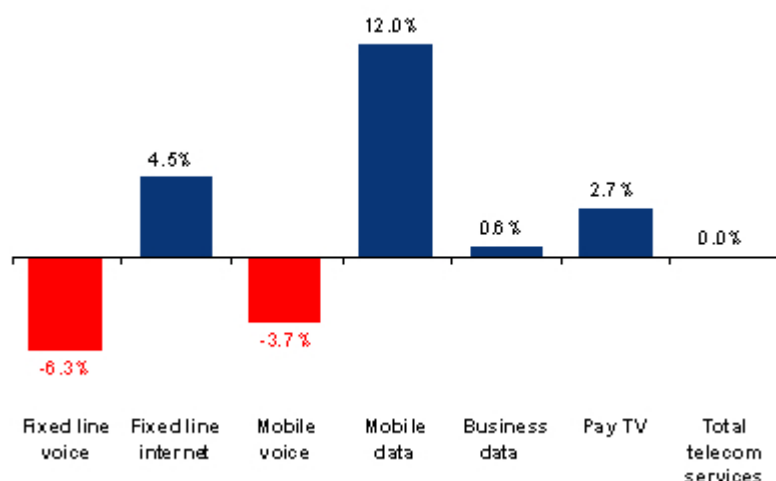
Telecom sector continues to struggle from slow consumer and public spending – Stabilisation to be expected in 2012

Despite weak operating performance, valuation of CEE Telecom sector already well ahead

Low mobile and fixed-line voice revenues to be compensated by mobile broadband Internet, smartphones, pay TV and fixed broadband Internet

Turk Telekom remains top pick, Telekom Slovenije unchanged on Accumulate, Magyar Telekom down to Hold, Telekom Austria unchanged on Sell, Turkcell up to Hold, Telefonica O2 CR and T-Hrvatski Telekom remain on Hold and TPSA up to Reduce

Telecom sector in 2011e: Growth rate



Source: EITO

“The 2Q11 results showed that a recovery in the sector has not taken place. Most of our covered CEE incumbents, such as Telefónica O2 CR, Telekom Austria, TPSA and Magyar Telekom reported an acceleration of their revenue decline in 2Q11 compared to the previous quarters. Even though the operating performance of the CEE telecom sector is still rather weak, the valuation of the sector is already well ahead”, says Vera Sutedja, CEE Telecom analyst at Erste Group. Lower mobile and fixed-income voice revenues continue to be a major problem in the sector. This was driven by fixed-to-mobile substitution, migration to VoIP, lower bundled tariffs, reduction in mobile termination and roaming tariffs, as well as competition. To compensate for the falling voice revenues, incumbents are pushing mobile broadband Internet, smartphones, pay TV (IPTV, satellite and cable), fixed broadband Internet and other services, such as IT and energy trading. “We expect the 2H 2011 results to be stronger than those for 1H 2011, driven by the seasonality factor, as well as the growth in the mobile data and ICT[1]segments.”

Consumer and public sector spending to fuel growth in 2H 2011

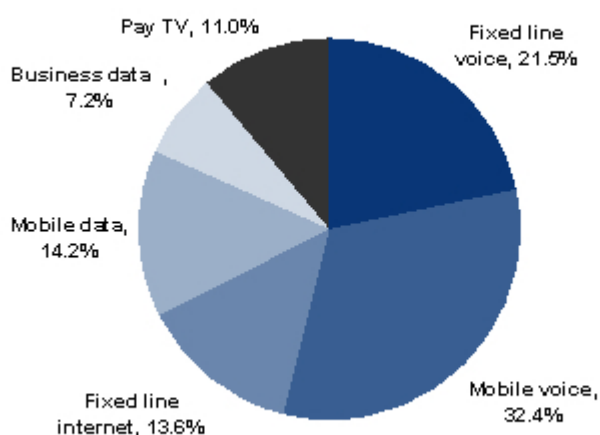
“The recent results for 2Q11 confirmed that the sector continued to struggle with the slow consumer and public sector spending, with corporate clients renegotiating their contracts or trying to reduce their communication costs. We expect the sector to start stabilizing in 2012, in the context of the rate of revenue and EBITDA declines no longer accelerating. This would be driven largely by improvements in consumer and public sector spending”, predicts Sutedja.

Mobile data growth as sector driver

The revenues of fixed and mobile voice segments, which represent around 53.9% of the EU 25 telecom services in 2011, should fall by 4.31% y/y to EUR 152.2bn in 2011[2]. The fixed voice revenue decline is driven largely by fixed to mobile substitution. Incumbents tried to slow down or even reverse the rate of access loss by offering bundled minutes or bundled products at low prices and 12-24 months of minimum loyalty period.

Competition, market saturation and the mobile termination rate (MTR) cut have led to falling mobile calling prices. According to the EU Commission report by Teligen, mobile prices in 2010 were 30-40% lower than those in 2006. As a comparison, fixed-line call charges did not decline much during this period, at -4% for national calls and even +18% for local calls. As the biggest competitor to fixed broadband, mobile broadband access using data cards or dongles continued to grow rapidly.

Telecom services 2011e: revenue share



Source: EITO

Services (EURbn)	2009	2010	2011e	2012e
Fixed line voice	68.914	64.172	60.807	58.298
Fixed line internet	35.119	36.761	38.427	40.129
Mobile voice	98.787	94.89	91.394	89.304
Mobile data	31.807	35.731	40.030	43.842
Business data	20.699	20.306	20.429	20.786
Pay TV	28.557	30.344	31.165	32.558
Total telecom services	283.883	282.204	282.252	284.917
Growth rate y/y	2009	2010	2011e	2012e
Fixed line voice	-8.2%	-6.9%	-5.2%	-4.1%
Fixed line internet	4.3%	4.7%	4.5%	4.4%
Mobile voice	-4.9%	-3.9%	-3.7%	-2.3%
Mobile data	9.3%	12.3%	12.0%	9.5%
Business data	0.1%	-1.9%	0.6%	1.7%
Pay TV	5.4%	6.3%	2.7%	4.5%
Total telecom services	-2.0%	-0.6%	0.0%	0.9%

Source: EITO

Outlook

Erste Group analysts expect the revenue and EBITDA of the telecom sector in the CEE region to start stabilizing in 2012, driven largely by improvements in consumer and public sector spending. The economic recovery in CEE was essentially based on foreign trade. The next step on the road to a full recovery would be stronger growth of private consumption. The labor markets in the area have hardly rebounded at all and the consolidation of public sector budgets also eats into the propensity to consume. Erste Group analysts expect this area to improve significantly next year. Thus, the regulatory pressure remains an issue. The EU Commission recommends that the MTR decline to 1.5-3 eurocents/minute by the end of 2012. Hungary, Croatia and the Czech Republic are faced with a steep MTR reduction this/next year. The competitive

pressure remains as intense as before. Only the focus of the promotions has shifted towards mobile data.

Turk Telekom remains top pick

Erste Group's analyst's top pick is **Turk Telekom**. The company offers the strongest operating performance compared to other telecoms in our coverage universe. Thanks to the low infrastructure-based fixed-line competition in Turkey, Turk Telekom can sustain its 49-50% fixed-line EBITDA margin. The low broadband and pay TV penetration offer growth potential for ADSL and IPTV. Through its mobile subsidiary, Avea, Turk Telekom can benefit from the mobile broadband and mobile penetration growth.

Accumulate recommendation on **Telekom Slovenije** was confirmed by Erste Group investors.

Erste Group analysts downgrade **Magyar Telekom** from Accumulate to Hold, as the OPEX reduction is running out of steam. In addition, the high CHF-denominated household and local government debt should weaken the consumer and public sector spending recovery.

Sell recommendation on **Telekom Austria** confirmed by analysts, considering its very weak equity ratio and extremely high net gearing.

Analysts confirm Hold recommendation on **Telefónica O2 CR**, while reducing the target price, due to the lower earnings estimate.

Erste Group analysts upgrade **TPSA** from Sell to Reduce, while keeping the target price unchanged.

The analysts stick to their Hold recommendation on **T-Hrvatski Telekom**, as the current share price level should already reflect the potential lower roaming revenues following EU accession.

Overview of target price and recommendations

Companies	Currency	Current Price	Target price	Potential upside	New Recommendation	Previous target price	Previous recommendation
Turk Telekom	TRY	8.1	10.0	23%	Buy	10.2	Buy
Telekom Slovenije	EUR	71.0	80.0	13%	Accumulate	85.0	Accumulate
Turkcell	TRY	7.7	8.3	8%	Hold	8.5	Reduce
Magyar Telekom	HUF	514.0	550.0	7%	Hold	640.0	Accumulate
Telefónica CR	CZK	413.0	410.0	-1%	Hold	450.0	Hold
T-Hrvatski Telekom	HRK	253.0	265.0	5%	Hold	290.0	Hold
TP SA	PLN	17.2	16.0	-7%	Reduce	16.0	Sell
Telekom Austria	EUR	7.6	5.5	-28%	Sell	5.5	Sell

Source: Erste Group Research

ADSL

Asymmetric Digital Subscriber Line - A gateway is commonly used to make an ADSL connection. Asymmetric Digital Subscriber Line (ADSL) is one form of the Digital Subscriber Line technology, a data communications technology that enables faster data transmission 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 delivered using the architecture and networking methods of the Internet Protocol Suite over a packet-switched network infrastructure, e.g., the Internet and broadband Internet access networks, instead of being delivered through traditional radio frequency broadcast, satellite signal, and cable television (CATV) formats.

LTE

Long term Evolution is the latest standard in the mobile network technology tree that previously realized the GSM/EDGE and UMTS/HSPA 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 the basement in a multi-dwelling 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 wall of a home.

DSL

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

VoIP	Voice over Internet Protocol (VoIP, Voice over IP) is a general term for a family of methodologies, communication protocols, and transmission technologies for delivery of voice communications and multimedia sessions over Internet Protocol (IP) networks, such as the Internet.
EDGE	Enhanced Data rates for GSM Evolution (EDGE) (also known as Enhanced GPRS (EGPRS), or IMT Single Carrier (IMT-SC), or Enhanced Data rates for Global Evolution) is a digital mobile phone technology that allows improved data transmission rates as a backward-compatible extension of GSM. EDGE is considered a 3G radio technology.

Source: Wikipedia

[1] Information and Communications Technologies

[2] Source: EITO

[Erste Sector Telecom - Presentation \[pdf; 377.9 KB\]](#)

[Erste Sector Telecom - Report \[pdf; 589.5 KB\]](#)