

December 01, 2009

Pakistan Market**Telecom: PTA's take on the sector in FY09****MORNING BRIEFING**

KSE100 Index: Closing 9206.21 ↑ (+1.64)

Pakistan Telecom Authority (PTA) in its recently released report gave an overview of the sector for FY09. The year was marred by depleting fixed line connections and a marked slowdown in cellular growth. Although cumulative sector revenues rose by 19% to Rs334bn, investment in the sector dropped by 47% to US\$1.6bn as most of the foreign operators faced difficult times given tough economic conditions. On a positive note however, broadband emerged as a potential force during the year.

Fixed Local Loop: Reeling from quality issues

The Fixed Local Loop (FLL) segment was the worst performer in FY09 as the subscriber count continued to dwindle. As of Jun 09, subscribers stood at 3.5mn, dropping by over 20%YoY, as infrastructure related issues and lack of investment saw consumers switching to the more convenient Wireless Local Loop (WLL) and cellular technology. Interestingly, the FLL data for Apr-Jun paints a slightly better picture as subscriber base remained flat – hinting that the worst may be over. The move to bundle fixed line with broadband could provide a cushion going forward, in our view. Further, the growing clout of WLL should limit the damage to the local loop segment.

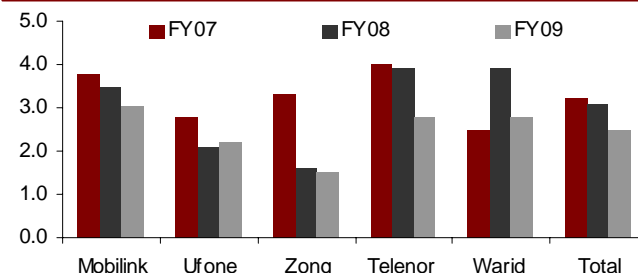
LDI – Outgoing traffic drives growth in FY09

The Long Distance & International (LDI) segment performed well as revenues rose by 119% to Rs48bn. Total international traffic (incoming + outgoing) reached 8.9bn mins from 7.1bn mins in FY08 mainly led by 73% growth in outgoing traffic. A combination of cheaper rates and improved package plans offered by operators helped outgoing minutes reach 2.9bn; however, increase in Approved Settlement Rates (ASR) curbed growth in incoming traffic to single digits after a 3 year (FY05-FY08) CAGR of 86%. PTA has recently taken steps to resurrect the situation, with a downward revision in ASR which is likely to assist LDI traffic and reduce the flow of grey traffic. LDI segment has always remained a major revenue

contributor to PTCL (14-15% of total revenue) and is expected to remain so in the years to come.

Cellular: Gearing up for M&A activity

Amid higher penetration levels (54.7% in Jun 08), growth in cellular segment slowed to 7% in FY09. Penetration reached 58.2% while cumulative revenues reached Rs212bn, up 17%. Industry wide ARPU's have fallen to US\$2.5 per month from US\$3.1/month in FY08 driven by a combination of high degree of low income prepaid customers and intense competition. Resultantly, all major operators barring Ufone (low infrastructure cost thanks to PTCL) are in the red, indicating consolidation is around the corner.

Graph: Cellular ARPU (US\$/month)

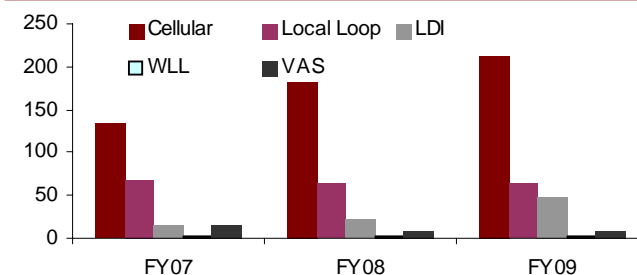
Source: PTA

Additionally a detailed observation of the Industry statistics, suggests that while urban penetration approaches the maturity phase, there remains untapped potential in the rural areas of Pakistan. Hence, we expect increased focus from the major operators towards the rural areas particularly in NWFP and Baluchistan. The security situation there though remains a major bottleneck in achieving higher penetration.

Broadband: Ready to takeoff

The broadband sector remained a major outperformer as 246k subscribers were added in FY09, taking the total to 414k - with PTCL, Worldcall and Wateen having a combined share of 79%. Low penetration level of 0.26%, suggests massive room for growth, in our view. Hence we have witnessed an

influx of new operators investing in technologies such as DSL, Fiber, WIMAX and more recently EVDO all pointing towards take off in subscriber base in the next few years. Official estimates too expect a similar trend as USF is targeting a 1% penetration level by end 2010, while the PTA expects broadband subscribers to rise to 4.35mn by 2013.

Graph: Telecom revenues by service (Rs bn)

Source: PTA

Outlook

We expect FY10 to be another challenging period for the sector with low investment and limited avenues for growth. M&A activity, particularly in the cellular segment seems to be on the cards as the segment continues to consolidate. Broadband and other value added segments are likely to drive growth while FLL may see consolidation at current levels. Amid these realities, we expect PTCL to post limited revenue growth. However, given its attractive valuations FY10E EV/EBITDA of 2.3x and dividend yield of 10%, we reiterate our liking for the scrip at current levels.

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