

July 03, 2009

**Pakistan Market****PTCL: USF update and outlook****MORNING BRIEFING**

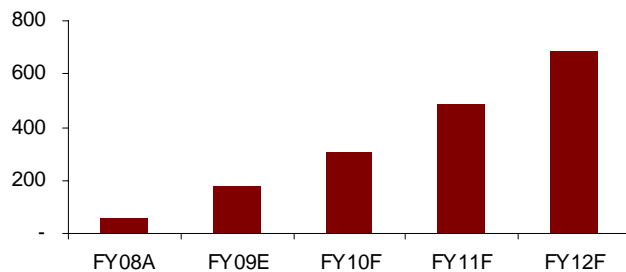
KSE100 Index: Closing 7498.34 ↑ (+227.62)

PTCL is in the news again after winning Universal Service Fund (USF) contracts for two further telecom regions namely, Multan Telecom Region (MTR) and Southern Telecom Region 1 (STR-1). This we believe will provide support to revenues in the long term as PTCL continues to grapple with a depleting subscriber base on the fixed line front.

Along with earlier approved Faisalabad Region (FTR) project, the three USF projects are expected to add a total of 159k broadband connections to the subscriber base over the next 18 months. These developments strengthen our belief that the broadband segment (2% share in revenue currently), is going to play an important role in the longer term growth and improve its share in revenue to an expected 7% by FY12.

**What are the new USF projects?**

The USF projects aim to provide telecom services in under and un-served areas of the country by inviting bids for various projects on offer and providing subsidy for infrastructure development. After jointly winning the Rs1.4bn FTR broadband contract with Wateen telecom in May 09 (PTCL's share 72.5k connections), the company has followed this by winning contracts for MTR and STR-1. MTR contract is valued at Rs1.2bn and is expected to add 63k subscribers to its broadband base; while STR 1 is valued at Rs550mn & will add 23.5k subscribers in the next 18 months.

**Graph: Broadband subscribers (000's)**

Source: PTC, JS Research

Thus we believe the company's broadband subscribers to reach 690k by FY12. Additionally, PTCL has also participated in bidding for Hazara Telecom Region (HTR) results of which are expected to be announced later this month.

Although the contract does not offer any exclusive rights of operation in the region, huge infrastructure spending to tap a limited market without subsidy would act as a major deterrent for new entrants.

**What are major challenges for PTCL?**

Rising activity in the broadband segment is a positive sign, however, the company still faces some key challenges in the other segments none more so than fixed line. The segment has been continuously witnessing depletion in customer base with a major shift from fixed to wireless as reflected by a decline of 1.5mn (31%) subscribers over the last two years to currently stand at approx. 3.3mn. This is expected to largely negate the positives of recent regulatory measures such as revision in Access Promotion Contribution (APC) charges to 7.5 cents. Moreover, lack of proper marketing with regards to new packages and rates has also generated negative publicity.

**Table: SWOT analysis**

Strengths	Weakness
Largest LL network infrastructure	Depleting revenue in fixed line segment
Opportunities	Threats
Consolidation on the cards Broadband market	Increased fixed to mobile switch

Source: JS Research

**Outlook: 'Buy maintained'**

Despite challenges with regards to its domestic fixed line revenues, PTCL's attractive FY10E PE and EV/EBITDA of 8.63 and 2.2, respectively – discount of 38% and 67% to regional peers offers good value to investors. Moreover, Ufone continues to be a strong performer compared to its peers and with consolidation on the cards, any acquisition by PTCL will lead to an upward revision to our estimates.

Broadband remains an area with huge potential for penetration. We expect the company to post full year earning of Rs1.9 in FY09, however we don't expect any final dividend after the recent interim dividend of Rs1.5/share. Offering a FY10F dividend yield of 9.8%, we reiterate our 'Buy' stance at current levels.

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**Pakistan Telecommunication**

<b>Market Price:</b> Rs17.87	<b>Kats Code:</b> PTC
<b>Market Cap:</b> Rs67.4bn (US\$827mn)	<b>Bloomberg Code:</b> PTC PA
<b>1-yrs Avg. Daily Volume:</b> 4.3mn shares, Rs76.7mn (US\$0.9mn)	<b>Reuters Code:</b> PTCA.KA
<b>1-year High/Low:</b> Rs38.85/12.00	

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