

Telecom: Second tier stocks in the limelight

KSE100 Index: Closing 9777.59 ↑ (+23.75)

Second tier telecom stocks outshined last week as Telecard, TRG and Worldcall all recorded significant gains. We believe, this commendable performance has been due to the recent 10 paisa reduction in mobile termination rates, which is expected to bode well for the smaller Fixed (FLL) and Wireless Local Loop (WLL) operators, helping reduce the interconnect charges paid by the operators. Activity in TRG has been driven by positive expectations from its SATMAP software, and potential cash generation from the divestment of some of its less affluent subsidiaries.

Table: Stock performance

	TRG	TELE	WTL
1-Week return	24%	36%	12%
YTD return	54%	59%	14%
Last week avg. vol (mn shares)	19.6	9.0	6.6
12-month avg. vol (mn shares)	3.7	1.0	3.0

Source: KSE

MTR reduced to Rs0.9/ min; +ve for FLL and WLL

Pakistan Telecommunication Authority (PTA) has cut the termination rates on cellular calls from Rs1/min to Rs0.9/min, effective January 1, 2010. This is the charge paid by the call generating party to the cellular operator at which the call is terminated. Currently the average charge from a landline to a cellular connection is Rs2.5/min, of which the contribution as termination charge is Rs0.9 (previously Rs1). Thus, if tariffs remain the same, the fixed and WLL operators will benefit from the 10paisa per min reduction in interconnect charges. However, cellular operators are bound to lose out on some revenue from the calls terminated on their networks.

Table: Mobile termination charges (Rs/min)

Jun 08- Dec 08	1.1
Jan 09- Dec 09	1.0
Jan 2010 onwards	0.9

Source: PTA

Table: Call termination on PTCL (Rs/min)

Metropolitan	0.7
National 25-80Km	0.8
National >80km	1.2

Source: PTA; w.e.f June 2009

According to the breakup available in the latest available annual accounts, interconnect charges contribute an average of 38% to the operating costs for PTCL, Telecard and Worldcall. Although a detailed break up is not available – we estimate that termination charges to cellular calls make up 20-25% of the interconnect charges. Thus, the operating costs for the local loop operators are expected to drop starting 3QFY10, helping GP margins improve.

Table: Interconnect Charges (Rs mn)

	FY09		FY08	
	Interconnect charges	% of Operating costs	Interconnect charges	% of Operating costs
PTCL	4,104	11%	5,250	14%
Telecard	1,245	48%	1,006	46%
Worldcall	1,231	54%	1,233	43%

Source: Annual reports

TRG rallies on strong outlook for SATMAP

Another technology stock in the limelight in recent weeks is TRG Pakistan which has posted a return of 54% in the current month because of a positive outlook for its high margin SATMAP software, which has begun making an imprint on the company's revenues. Moreover, reports of cash flow generation from divestment of some of the less affluent subsidiaries, has led to enhanced investor interest in the scrip off late.

SMS termination rate also on the cards

PTA appears to be exploring the possibility of introducing SMS termination rates in the future too, which will bring in an additional revenue stream for the cellular operators and help curb the upsurge in junk SMS traffic. Just to recall the GoP

had tried to impose a SMS tax of Rs0.2/SMS in the Budget FY10, but it was never implemented owing to pressure from the cellular operators. SMS termination rates though would benefit the cellular players and hence its application will not meet the same level of resistance.

Outlook: 'Buy' reiterated on 'PTCL'

The recent rate revision by PTA augurs well for the incumbent operator, which holds a 96% and 48% share in the fixed and WLL segment. Although, the potential impact calculation is difficult because of the limited data availability, we expect earnings to get a positive taste from the recent action. We reiterate our 'Buy' call on PTCL, with a fair value of Rs24. The stock currently trades at a FY10E PE and EV/EBITDA of 9.4x and 2.2x with an attractive dividend yield of 9%.

mustafa.bilwani@js.com
92 (21) 111-574-111 (ext. 3100)

Also in focus

LSM grows by a meager 0.28% in Nov 09

According to the Federal Bureau of Statistics, LSM grew by a mere 0.28%YoY in Nov 09 led by a 16.93% growth in the petroleum products segment. The rise in production of petroleum products has primarily been on the back of increased demand for furnace oil from the dual based power plants, and production overhaul by PARCO and PRL last year. In contrast, the increase in the OCAC sector output was offset by decline in production of key sectors such sugar, cigarettes, cement and cotton yarn which contracted by 5.33%, 16.67%, 2.07% and 2.98%, respectively. Given cumulative production growth of 0.66% in (July-Nov) FY10 and a low base in 2HFY09, we expect LSM growth to arrive at 4% in FY10 as against a contraction of 8.2% in FY09.

JS Global Capital Limited

6th Floor, Faysal House, Main Shahrah-e-Faisal, Karachi
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