

Target Price: Rs24

KATS Code: PTC

Bloomberg Code: PTC PA

Reuters Code: PTCA.KA

Market Price:
Rs18.58

Market Cap:
Rs70.1bn
US\$848mn

1-yr Avg. Daily Volume:
4.9mn shares
Rs82mn
US\$1.0mn

1-yr High/Low:
Rs34.99/12.00

Estimated free float:
580mn shares (15.0%)

Mustufa Bilwani
mustufa.bilwani@js.com
Analyst
92 (21) 111-574-111
(ext. 3100)

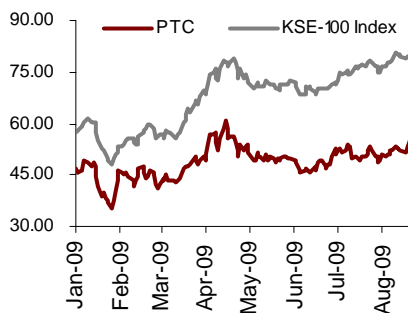
Rebalancing its strategy

We reiterate our liking for Pakistan Telecommunications Company Limited (PTC) with a fair value of Rs24. The scrip is currently trading at a price of Rs18.58 and offers a potential upside of 29.2% to our fair value. Flourishing broadband segment and value added service portfolio of the company are expected to increase their shares in revenue and swathe the depleting income from the fixed line segment. Due to the lack of major earning's growth triggers, the scrip has largely underperformed at the KSE with YTD adjusted return of 19% as against the KSE 100 index return of 36%. However, at current levels we believe market seems to largely ignore the value of its cellular subsidiary Ufone. Despite increasing competition and slowdown in subscriber's growth, Ufone remains one of the most well managed and profitable cellular operators in the country. The key risks to our thesis are: (1) significant deterioration in fixed line subscriber base (2) intense competition in the broadband and WLL segments and (3) regulatory changes.

Valuation: A handsome upside of 29%

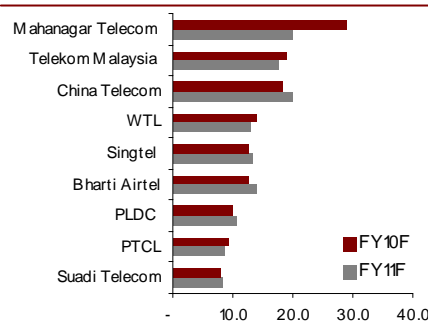
Our sum of the part based fair value of Rs24 is based on separate valuation for fixed line & mobile phone businesses of PTCL (Ufone). Using the discounted cash flow methodology with a risk free rate of 11% and required return of 17% we arrive at standalone value of Rs18 per share for PTCL. The intrinsic value of Ufone is estimated at Rs6 per share. Hence, at the current price, the market seems to completely ignore the value of its cellular arm, we believe. The scrip is currently trading at an attractive FY10F EV/EBITDA multiple of 2.2x, while it trades at an FY10 PE of 8.4x. Moreover, PTCL offers a decent dividend yield of 9.4%. Compared to this, regional peers such as China Telekom, Singtel, Telekom Malaysia trade at an average FY10F PE and EV/EBITDA multiple of 15.4x and 6.1x, respectively. This implies that PTCL is trading at an attractive discount of 64% on EV/EBITDA and 40% on PE to the region.

Graph 1(a): Relative performance



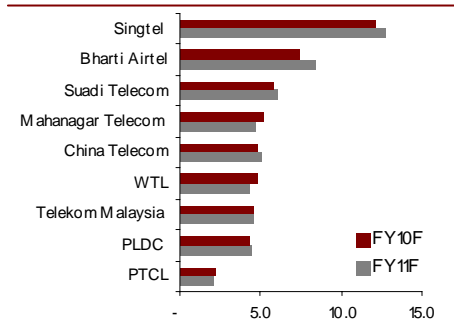
Source: Reuters, JS Research

Graph 1(b): Regional PE(x)

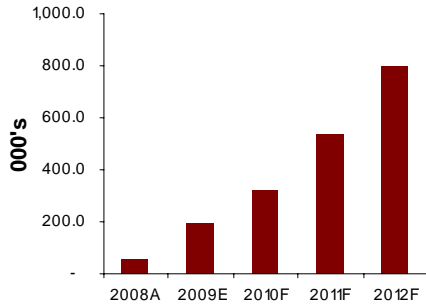


Source: Reuters, JS Research

Graph 1(c): Regional EV/EBITDA(x)



Source: Reuters, JS Research

Graph 2: Broadband subscribers

Source: PTC, JS Research

Broadband – The way forward

With depleting fixed line revenues and a maturing cellular market, we expect the broadband segment to provide much needed growth to the industry going forward. Amid low penetration levels and a countrywide subscriber base of ~300k, the broadband market holds great potential. PTCL has moved swiftly to tap this opportunity, and has increased its subscriber base from 56k in June 08 to 156k in Mar 09. Moreover, the company has actively participated in four USF broadband projects, three of which are projected to add an additional ~159k subscribers by Dec 2010.

The addition of USF projects would play a major role in strengthening PTCL's position as the dominant broadband player in the market. The USF additions coupled with potential subscribers in urban metropolises, share of broadband in total revenue is likely to reach to ~8% by FY12 (~2% currently). Our projections are based on expected subscriber base of 800k by June 2012.

Table 1: USF Broadband projects

Regions	PTCL subscriber projections	Contract Worth for PTCL ((000's)	Expected completion date
Faisalabad Telecom Region FTR-1	72,500	1,200 *	Nov-08
Southern Telecom Region STR-1	23,500	550	Dec-08
Multan Telecom Region- MTR	63,000	1,200	Dec-08
Hazara Telecom Region- HTR	-	-	-

Source: USF

*Total Subsidy for FTR is Rs1400mn

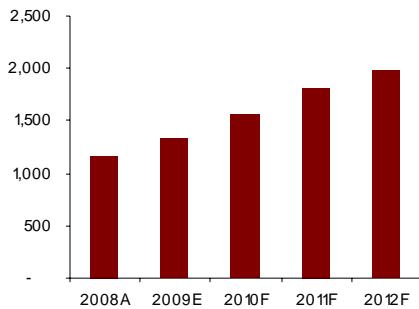
* HTR results are yet to be announced

WLL – Growth trajectory to continue

WLL has emerged as a catalyst for growth in the local loop segment of Pakistan's telecommunication industry, as fixed line customer base has continued to shrink amid issues of line/service quality. While fixed local loop business shrunk by 16% in 1HFY09, Wireless Local Loop (WLL) has continued its growth momentum as subscribers grew by 15.7% (or 355k) in FY09. PTCL maintained its market leader position (50% market share), adding 117k subscribers in FY09. We believe, growth in this segment would continue as more and more customers shift towards reliable wireless transmission instead of the traditional fixed line. Moreover, low density areas such as Balochistan, where the company has signed a Rs1.2bn contract for laying 1,166 Km Optic Fiber cables, offers growth potential for WLL as traditional fixed line installation would prove very costly. Accordingly, we estimate subscriber base to grow at a 4 year (FY10-13) CAGR of 14% and reach 1.95mn by FY12; thus propelling the share of WLL in total revenues to 7.8% as against 5.7% estimated currently.

APC rates revised again, Int'l revenues to remain robust

PTA has again revised downward the Access Promotion Contribution (APC) rate to 5.5 cents/min from 7.5cents/min, while the Approved Settlement Rate (ASR) has been reduced to 10.5 cents/min from 12.5 cents w.e.f. July 20th 2009. Main reason behind this was the increase in grey traffic as these charges are passed on to the final consumers leading to higher prices. We believe declining ASR rates would bolster international incoming traffic, hence leading to a more stable revenue stream from the international segment.

Graph 3: WLL subscribers (000's)

Source: PTC, JS Research

Moreover, as ASR and APC were 12.5 cents/min and 7.5cents/min respectively in 4QFY09; we could see higher international revenues in the financial results for FY09.

Table 2: ASR and APC (US\$ cents)

	ASR	APCL	LDI
May-08	10.0	5.0	5.0
Feb-09	12.5	7.5	5.0
Jul-09	10.5	5.5	5.0

Source:PTA

Ufone – The cellular outperformer

The 100% subsidiary of PTCL despite operating in a very competitive business environment remains a very profitable venture and continues to outperform its peers in terms of profitability. While Ufone is the third largest operator behind Mobilink and Telenor with a subscriber base of 20mn (21.6%), its financials remain stronger than both Mobilink and Telenor.

Amid cut throat competition in the industry, ARPUs have dropped to among the lowest in the world. However, there is a general consensus within the sector that the intense competition cannot continue for much longer, fuelling rumors of M&A activity. Both PTCL's and Zong's top management have earlier expressed their interest in making such investments; however we believe Zong, with the financial backing of its parent company – China Mobile, to be the active player.

Table 4: Pakistan Cellular market snapshot

Operator	Major Shareholder	Subscribers (million)	Market share (%)	FY09 additions
Mobilink	Orascom (Egypt)	29.1	30.9%	(2.9)
Telenor	Telenor SA (Norway)	20.9	22.1%	2.8
Ufone	PTCL	20.0	21.2%	1.9
Warid	Al Nahyan group, Singtel, Bank Alfalah	17.9	19.0%	2.4
Zong	China Mobile Limited	6.4	6.8%	2.4
Insta	Private (Currently operator is inactive)	0.0	0.0%	(0.3)
Total		94.3	100.0%	6.3

Source: PTA, As of June 2009

With cellular industry moving towards maturity (growing by 7.1% in FY09 as compared to a CAGR of 90% from FY06-08), we expect the company to increase its focus towards offering value added services so as to increase its revenues. Interestingly, Telenor has attained a license to offer financial services to its customers by acquiring a 51% stake in Tameer Bank, which would diversify its revenue base. Any similar move by Ufone would bode well for the company.

Table 3: Regional Cellular data

Country	Subscribers (million)	Cellular teledensity (%)
Pakistan	94.3	58.2
India	415.3	35.6
China	664.5	N/A
Iran	50.0	70.5
Honk Kong	11.7	166.3
Malaysia	28.9	100.1
Bahrain	1.4	131.0
Srilanka	11.1	54.6
Singapore	6.5	133.8

Source: Regional Telecom regulators

Latest available data

Table 5: Recent deals in the telco sector

Date	Target company	Bidder Company	Deal Value	Description
Recent International Deals				
Jul-09	Sotelma (Mali)	Maroc Telecom	US\$382mn	Maroc telecom to acquire a 51% stake in Sotelma, Mali based telecom service provider
Jun-09	Telemobil (Romania)	Cosmote-MobileTelecom	US\$290mn	The Greek mobile company is to acquire Telemobil SA, Romanian provider of integrated wireless communication services .
May-09	Jordan Mobile Telephone	Palestinian Telecom	N/A	Paltel has agreed to acquire Zain (Jordan), mobile service provider, for an undisclosed equity consideration
May-09	BiBoB AS	Telenor AS	US\$17mn	Telenor ASA, the listed Norway mobile service provider has agreed to acquire BiBoB AS, the Denmark based mobile telecom carrier
Apr-09	Far EastTone Telecom	China Mobile Limited	US\$526mn	China Mobile, Honk Kong based mobile telecom carrier, has launched an offer to acquire a 12% stake in Far East Tone, the listed Taiwan based teleco.
Apr-09	Sonatel SA (Senegal)	France Telecom SA	US\$312mn	France Telecom SA has signed a definitive agreement to acquire a 9.87% stake in Sonatel SA from Govt of Senegal.
Apr-09	MobiNil Telecom	France Telecom SA	US\$715mn	France Telecom has agreed to acquire the remaining 28.75% stake in Mobinil Telecom, Egypt base holding Co. for ECMS, the Egyptian mobile operator.
Last local Deals				
Jul-07	Warid Telecom	Singtel	US\$758mn	Singapore Telecommunicatins acquired a 30% stake in Warid Telecom.
Jun-07	Mobilink	Orascom Telecom	US\$290mn	Orascom Telecom of Egypt bought the remaining stake of 11.3% in Mobilink.
May-07	Paktel	China Mobile Limited	US\$460mn	China Mobile acquired a 100% stake in Paktel, now operating under the brand name 'Zong'.
Last Indian deals				
Mar-09	Unitech Wireless	Telenor	US\$1.1bn	Norwegian Telecom operator Telenor has acquired a 60% stake in Unitech Wireless
Sep-08	Swan Telecom	Etisalat	US\$900mn	Dubai based Etisalat has acquired a 45% stake in Swan Telecom for US\$900mn
Mar-09	Tata Teleservices	NTT Docomo	US\$2.7bn	Japan's NTT Docomo acquired a 26% stake in Tata Teleservices for US\$2.7bn
Jan-08	Shyam Telelink	Sistema Joint Stock	-	Russia's Sistema Joint Stock Financial Corp acquired 73.7% shares in Shyam Telelink and named the company Shyam-Sistema

Source: Company and media reports, Internataional deals are on a sample basis

Real estate – Heading towards conclusion

We believe the ongoing issue with regards to transfer of properties under PTCL's name would be resolved in the near term. As per our talks with the management, the company is actively working towards a solution and with three installments of US\$133mn stalled (media reports), and government in need of funds, the probability of a near term resolution is high. As per reports, there still remain ~161 properties (71 in Punjab and 45 in Sindh) whose titles need to be transferred to PTCL. As per the SPA, the company will be able to use such land for redevelopment purposes, which could increase non operating income. Furthermore, as per the company's policy of valuing its properties at historical costs, any change in policy to fair value in the future, is likely to strengthen the Balance Sheet.

Risks to our thesis

Fixed Line – Where is the bottom?

Fixed line segment has continued to decline as subscribers have now dropped from a high of 5.27mn in June 05 to 3.7mn in Dec 08. Although official figures have not been released since Dec 08, we estimate the subscribers to have fallen to 3.3mn as of Jun 09. As per our estimates, fixed line accounted for 57% of the revenues in FY08, which we expect to decline going forward.

A nationwide advertisement campaign to restore fixed line connections is currently running on air however, there remains question mark on the campaign's effectiveness in improving the image of the fixed line. Due to frequent backhaul issues, we remain downbeat on this segment and expect to see continued pressure on traditional fixed line from WLL and cellular connections. However, a faster than anticipated decline in subscribers remains a downside risk to our call.

Increasing competition in broadband market

We expect broadband to be an integral part in the revenue stream of PTCL going forward and anticipate the subscriber base to grow at a 3-year (FY10-12) CAGR of 44%. As it has been witnessed historically, telecom services are prone to severe competition, such as the cellular sector, and any similar rivalry in the broadband market could lead to adjustments to our forecasts as ARPUs could fall drastically.

M&A Activity – Long Term positive play

M&A activity in the cellular segment would be an overall positive development for the industry. Facing rock bottom ARPU's, acquisition in this segment would help give operators some breathing space and place them in a better position to increase their revenue from the customers. Moreover, any acquisition by PTCL in the cellular, LL or LDI market remains an upside risk to our thesis. To recall, PTCL management in June 2009 had stated that PTCL will be on the lookout for investments.

Regulatory Changes

With frequent adjustments in the past, further changes in ASR/APR would remain a risk to our call. New license issues and other changes in the regulatory environment could lead to a change in our estimates. As a fact, APC and ASR rates have been revised thrice in the past 14 months. Moreover, PTA has issued a consultation paper recently to discuss changes in how data is recorded and reported, emphasizing on a unified industry wide approach with a focus on how an operator defines an active subscriber. When a decision is finalized, it could lead to a more accurate reported data providing a better picture of the sector.

Table 6: ASR and APC (US\$ cents)

	ASR	APCL	LDI
May-08	10.0	5.0	5.0
Feb-09	12.5	7.5	5.0
Jul-09	10.5	5.5	5.0

Source:PTA

Pakistan Telecom

Year ended June (Rs mn)	FY07A	FY08A	FY09E	FY10F	FY11F	FY12F
Income Statement						
Revenue	65,277	61,086	60,887	61,579	64,363	67,447
Operating Costs	46,564	44,720	48,290	48,965	51,317	53,263
EBITDA	36,466	9,330	28,490	29,623	31,027	33,108
Operating Profit / (Loss)	18,713	16,366	12,597	12,614	13,047	14,183
Other income	5,541	3,958	3,458	3,724	4,019	4,252
PBIT	24,254	(3,615)	16,055	16,339	17,066	18,436
Financial Charges	510	848	1,195	490	325	329
PBT	23,744	(4,463)	14,860	15,849	16,740	18,106
Tax	8,105	(1,638)	5,201	5,547	5,859	6,337
PAT	15,639	(2,825)	9,659	10,302	10,881	11,769
Balance Sheet						
Issued, subscribed and paid-up capital	51,000	51,000	51,000	51,000	51,000	51,000
Reserves	59,913	46,888	56,529	59,175	60,892	63,438
Shareholder's Equity	110,913	97,888	107,529	110,175	111,892	114,438
Non current liabilities	17,460	17,646	16,145	14,415	14,763	15,125
Current Liabilities	24,448	24,451	24,764	26,713	28,258	29,260
Total Liabilities & Equity	152,821	139,985	148,437	151,303	154,913	158,823
Operating Fixed Assets	76,192	82,800	78,816	78,420	77,980	77,495
Other Assets	22,426	15,044	17,454	17,624	17,009	17,106
Total Current Assets	54,203	42,140	52,168	55,259	59,923	64,222
Total Assets	152,821	139,985	148,437	151,303	154,913	158,823
Ratio Analysis						
Earning / (Loss) per share	3.07	(0.55)	1.89	2.02	2.13	2.31
Dividend per share	2.00	-	1.50	1.75	1.75	2.00
Book value per share	21.7	19.2	21.1	21.6	21.9	22.4
Price to earning ratio (x)	17.9	NM	9.8	9.2	8.7	8.1
Dividend Yield (%)	3.6%	0.0%	8.1%	9.4%	9.4%	10.8%
Price to book value (x)	2.5	1.0	0.9	0.9	0.8	0.8
EV/EBITDA (x)	7.0	6.8	2.4	2.2	2.1	2.0
Profitability						
Operating Margin	28.7%	26.8%	20.7%	20.5%	20.3%	21.0%
EBITDA Margin	55.9%	15.3%	46.8%	48.1%	48.2%	49.1%
Net margin	24.0%	-4.6%	15.9%	16.7%	16.9%	17.4%
Return on assets	10.2%	-2.0%	6.5%	6.8%	7.0%	7.4%
Return on equity	14.1%	-2.9%	9.0%	9.4%	9.7%	10.3%
Momentum						
Sales growth	-5.5%	-6.4%	-0.3%	1.1%	4.5%	4.8%
EBITDA growth	-16.9%	NM	NM	4.0%	4.7%	6.7%
Net profit growth	-24.7%	NM	NM	6.7%	5.6%	8.2%

Source: JS Research & Company Accounts

About the company

Pakistan Telecommunication Company Limited (PTCL)

Pakistan Telecommunication Company Limited (PTCL) is the largest telecommunication service provider in the country, providing fixed line, cellular, broadband and a range of value added services in the country. The company provides cellular services through its 100% owned subsidiary, PTML. Etisalat, the U.A.E based telecom service provider acquired a 26% stake in the company for US\$2.58bn in 2005. Govt. of Pakistan holds a 62.2% stake of the company.

Pakistan Telecom Mobile Limited (PTML–UFONE)

Pak Telecom Mobile Limited (PTML) was incorporated on July 18, 1998 as a public limited company to provide cellular mobile telephonic services in Pakistan. PTML commenced its commercial business in different phases starting Jan 2001, under the brand name Ufone. In June 2009, the company became the third operator to cross the 20mn subscriber mark. As of June 2009, the company had a market share of 21.3%.

Emirates Telecommunication (Etisalat)

Etisalat has been the premier telecommunications service provider in the UAE since 1976, building up a modern telecom infrastructure and establishing itself as an innovative and reliable operator. The company was listed on the Abu Dhabi Exchange in March 2002, and is amongst the leading telecom service provider in the Middle East region with operations spreading across 17 countries in Asia and Africa. The company provides cellular services through its subsidiary (27.5% stake), Etihad Etisalat - Mobily. The government of U.A.E owns 60% stake in the company.

Pakistan Telecommunication Authority (PTA)

Pakistan Telecommunication Authority is the regulator of the telecom industry in the country. The authority has been actively involved since the deregulation of the sector and has been praised for its effective role in developing the sector. PTA has its headquarters at Islamabad and zonal offices located in Karachi, Lahore, Peshawar, Quetta, Rawalpindi and Muzaffarabad.

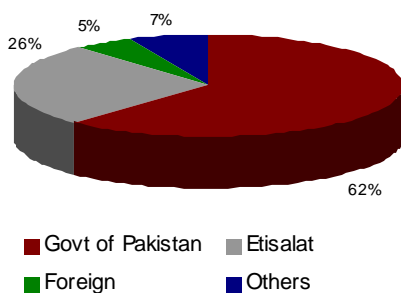
Universal Service Fund (USF)

The company operates under the jurisdiction of Ministry of Information Technology, Govt. of Pakistan. USF promotes the development of telecommunication services in un-served and under-served areas throughout the length and breadth of the country. The company was established in the later part of 2006, and consists of contributions (1.5% of adjusted revenues) made by the telecom operators. The company then provides a subsidy to the bidding operators for infrastructure development in specific regions.

Ministry of Information Technology (MOIT)

Ministry of Information Technology (MoIT) is the national focal Ministry and the enabling arm of the Government of Pakistan for planning, coordinating and directing efforts to initiate and launch Information Technology and Telecommunications programs and projects aimed at economic development of the country.

Graph 4: Shareholding detail



Source: Reuters, JS Research

Research Team

Muzzammil Aslam	Economy	(92-21) 111574111 (ext. 3035)	muzzammil.aslam@js.com
Farhan Rizvi	Banks, Insurance, Fertilizer	(92-21) 111574111 (ext. 3096)	farhan.rizvi@js.com
Farhan Mahmood	Strategy, Energy	(92-21) 111574111 (ext. 3103)	farhan.mahmood@js.com
Syed Atif Zafar	Cement, Autos, Chemicals	(92-21) 111574111 (ext. 3118)	atif.zafar@js.com
Mustufa Bilwani	Telecom, Paper & Board	(92-21) 111574111 (ext. 3100)	mustufa.bilwani@js.com
Bilal Qamar	Textile	(92-21) 111574111 (ext. 3099)	bilal.qamar@js.com
Raheel Ashraf	Technical Analyst	(92-21) 111574111 (ext. 3098)	raheel.ashraf@js.com
Adeel Jafri	Database Manager	(92-21) 111574111 (ext. 3098)	adeel.jafri@js.com
Muhammad Furqan	Librarian	(92-21) 111574111 (ext. 3105)	muhammad.furqan@js.com

Equity Sales

Junaid Iqbal	(92-21) 32799511	junaid.iqbal@js.com
Atif Malik	(92-21) 32799513	atif.malik@js.com
Raza Abbas	(92-21) 32799563	raza.abbas@js.com
Faiza Naz	(92-21) 32799505	faiza.naz@js.com
Muzammil Mussani	(92-21) 32799508	muzammil.mussani@js.com
Abid Jamal	(92-21) 32799516	abid.jamal@js.com
Abdul Aziz	(92-21) 32799507	abdul.aziz@js.com
Asim Ali	(92-21) 32799509	asim.ali@js.com
Samar Iqbal	(92-21) 32800152	samar.iqbal@js.com
Irfan Iqbal	(92-21) 32799502	irfan.iqbal@js.com
Irfan Ali	(92-21) 32462567	irfan.ali@js.com

Main Office

6th Floor, Faysal House,
Main Shahrah-e-Faisal
Karachi. Pakistan
Tele: 92-21-111-574-111
Fax: 92-21-32800163-66
Website: www.js.com

KSE Office

2nd Floor, Room No. 75,
Karachi Stock Exchange Building,
Stock Exchange Road, Karachi.
Tele: 92-21-32425692 (2427458)
Fax: 92-21-32418106

Lahore Office

307 – Upper Mall,
Lahore – 54000
Pakistan
Tele: 92-42-111-574-111
Fax: 92-42- 5789109

Islamabad Office

Chaudhary Plaza, 65 West,
Fazal-e-Haq Road, Blue Area
Islamabad, Pakistan.
Tele: 92-51-111-574-111
Fax: 92-51-2806328

JS Global Capital Limited



ANALYST CERTIFICATION

I, Mustufa Bilwani, the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

DISCLAIMER

This report has been prepared for information purposes by the Research Department of JS Global Capital Limited. The information and data on which this report is based are obtained from sources which we believe to be reliable but we do not guarantee that it is accurate or complete. In particular, the report takes no account of the investment objectives, financial situation and particular needs of investors who should seek further professional advice or rely upon their own judgment and acumen before making any investment. This report should also not be considered as a reflection on the concerned company's management and its performances or ability, or appreciation or criticism, as to the affairs or operations of such company or institution. JS Global does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Warning: This report may not be reproduced, distributed or published by any person for any purpose whatsoever. Action will be taken for unauthorized reproduction, distribution or publication.