Pakistan Telecommunication Company Limited

Negatives priced in already

Thursday September 03, 2015

PTC - BUY

Target Price: PKR 24

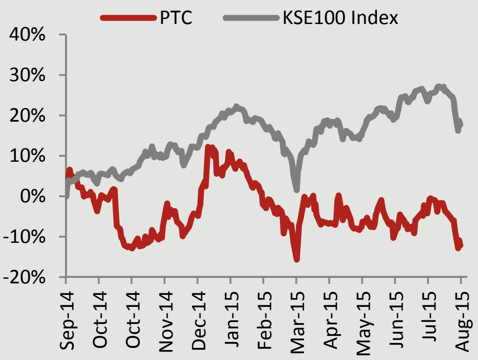
Current Price: PKR 19

PTC Performance

	1M	3M	12M
Absolute %	-12%	-7%	-12%
Relative to KSE %	-8%	-9%	-33%

Bloomberg	PTC.PA
Reuters	PTCA.KA
MCAP (USD mn)	912
12M ADT (USD mn)	0.9
Shares Outstanding (mn)	5,100

PTC vs. KSE100 Relative Chart



Source: BMA Research

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Pakistan Telecommunication Company (PTC) has underperformed the KSE-100 index by 10% since Jun'15. The underperformance comes on the back of decline in profitability where the company's 1HCY15 consolidated profitability declined by 61%YoY to PKR3.2bn (EPS: PKR0.6). The decline in earnings comes on back of decline in profitability of its subsidiary PTML which announced a loss of PKR2.9bn (LPS: PKR0.57). Going forward, we do not see any significant improvement in the profitability on back of cut throat competition in cellular arena as PTML has been losing its customer base to competition. The imposition of new taxes on telecom sector by provincial governments in the budget FY16 also does not bode well either; especially for the 3G/4G services which only debuted in the country last year and may cap the growth potential of these segments going forward. Since its inception, 3G/4G services have posted robust growth and the customer base has increased rapidly with the total subscribers base now at 14.6mn. However, U-fone's share has contracted to only ~18% against ~22% it stood earlier in the year. The valuations have opened up on back of significant underperformance by the scrip and the stock offers a total return of 40% on last closing.

Disappointing trend in profitability: PTC's consolidated earnings clocked at PKR3.2bn (EPS: PKR0.6), posting a decline of 61%YoY. The decline in earnings came on the back of poor profitability of the subsidiary company, PTML, which posted a loss of PKR2.9bn (LPS: PKR0.57). In this regard, the top-line of the company declined by 11%YoY as the consumer base of the subsidiary contracted to 17.9mn subscribers (down 27%YoY) while the ARPUs only increased by 4%YoY. The gross margins of the subsidiary also remained under pressure due to higher depreciation and amortization expense.

Imposition of new taxes on telecom services: After the imposition of new taxes on Internet and data services in Federal Budget FY16, the country leapt to secure first position in the world for highest tax regime on telecom services. The new regime includes 19.5% on call and voice services, 14% on withholding tax and now 19.5% on additional service on above 2 Mpbs speed, hence technically imposing charges on 3G/4G/LTE of telecom services. While we do not expect the customer base to shrink because of such heavy taxation, we however believe that the pace of growth will slow down going forward.

Lower DR will be countered by PKR depreciation: The benign inflation in the country may continue to keep the interest rates on the lower side, going forward. This bodes well for the company as it is carrying loans of PKR19bn on its books, translating into Debt to Assets of 18%. However, the benefits of lower DR rates will be somewhat diluted by PKR depreciation as company is also carrying FC loans of USD74mn which is to be paid in 5 equal annual installments with interest rates of LIBOR+3%.

Absence of One-timers to support earnings: We believe that the unconsolidated earnings of PTC are likely to improve in CY15 due to absence of one-timer write-offs in CY14 (VSS and loss due to fire incident). However, the prospects of PTML are likely to remain depressed on back of huge cost base and cut throat competition in the cellular arena.

Investment Perspective: We believe that negatives have already been priced after the stock underperformed index by 10% since Jun'15. Currently the stock is trading at a forward P/E multiples of 7.9x and offering an attractive dividend yield of 10.5%. Our current TP of the stock stands at PKR24/sh, offering an upside of 26% on its last closing.

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