CEE Telecoms

31 October 2007

Ringing the changes

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	Rating	Market cap (€)	Price	Fair value	Upside to FV (%)	Revenue growth (%)		Dividend yield (%)		EV/EBITDA (x)		P/E (x)	
						2008F	'07F-'10F	2008F	2009F	2007F	2008F	2007F	2008F
TEF O2	BUY	7.2	560	646	15.3	1.3	0.8	7.1	8.2	6.5	6.3	19.0	14.6
MTEL	BUY	3.9	932	1,070	14.8	0.1	0.2	8.2	8.4	5.4	4.8	19.3	11.9
NETIA	HOLD	0.4	3.9	4.0	2.1	5.9	4.6	0.0	3.3	9.3	7.0	-6.6	-8.5
TPSA	HOLD	8.2	24.1	24.1	-0.2	-1.4	-0.2	7.1	7.8	5.7	5.7	15.2	14.5

Source: KBC Securities (Priced at COB 26 October 2007)

We resume coverage of CEE3 telecoms with a slightly positive view on the sector. Restructuring, regulation and remuneration are key sector drivers in the near term. The markets have widely diverged between operators and we recommend investing in companies where the risk is most transparent. TEF O2 is best in class on all drivers, while TPSA's restructuring and remuneration prospects are offset by regulatory risk.

- **Buy TEF 02:** ***Remuneration*** overhang has lifted as we believe the outlook for lower dividends is now fully priced-in. Benefits of stronger revenue growth and corporate tax cuts should lead to broker upgrades. Our earnings estimates of CZK 9.5bn for 2007 and CZK 12.3bn for 2008 are 1% and 18% respectively above the consensus. We believe TEF O2 deserves the 12.5% premium it trades at relative to peers and should re-rate in-line with Western peers.
- **Buy MTEL:** ***Restructuring*** is critical in sustaining margins and mitigating top-line pressure and the shift to lower-margin revenue growth drivers**.** The recently announced 15% headcount reduction is expected to lead to HUF 13bn in annual savings. New management guidance implies that without the headcount reduction, EBITDA would fall by 5.0% y/y and margins would contract by 180bp.
- **Hold Netia:** ***Refocusing*** on its core competence should ensure business sustainability. Start-up losses from P4 and the new strategy to take advantage of the newly deregulated Polish telecom market will put pressure on margins in the near term. However, we have more confidence in the new business model and upgrade the stock to Hold with a fair value of PLN 4.0 per share.
- **Hold TPSA:** ***Regulation*** impact will continue to weigh on the stock and we see revenue erosion continuing in 2008. Optimism on regulatory moderation may be premature as any revision and revenue uplift is likely to be limited. At 5.7x 2008F EV/EBITDA, TPSA now trades slightly above the regional average of 5.6x, as the improving outlook is priced-in. Hence we see no further catalysts for significant re-rating.

Pamela Antay
+32 2 429 37 01
pamela.antay@kbcsecurities.be

Aleksandra Kostrzewa
+ 32 2 429 36 18
aleksandra.kostrzewa@kbcsecurities.be

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