CEE Telecoms Update

02 February 2006

2006 Outlook: A rough ride ahead

CEE Telecoms

	Rating	Market Cap (€)		Price	Fair Value		Upside to FV (%)	Revenue Growth (%)		Dividend Yield (%)	EV/EBITDA (x)	P/E (x)	
						2006F	'06F-'11F	2006F	2007F	2006F	2007F	2006F	2007F
CTEL	Sell	6.8 bn	CZK 525	480	-8.6	-1.4	0.3	9.2	9.4	6.8	7.1	22.0	21.3
MTEL	Buy	4.2 bn	HUF 995	1,150	15.5	1.8	0.7	7.5	8.1	5.2	5.0	12.1	11.4
NTIA	Sell	0.6 bn	PLN 5.5	4.7	-14.5	0.0	0.0	1.8	1.8	5.9	5.7	19.8	22.8
TPSA	Buy	8.1 bn	PLN 23.2	28.0	20.7	-2.4	1.4	4.3	5.5	5.5	5.6	14.0	11.8

Source: KBC Securities (Priced at close of 01 February 2006)

We expect regulation, consolidation and valuation to be the sector cornerstones for 2006. The sector is likely to continue to underperform the broader market as fundamentals remain under pressure and other sectors offer higher growth in the short-term. However, we still expect to see outperformance from undervalued names.

- **Buy TP:** With strong mobile growth and robust cashflow, TP warrants a higher valuation than its current 2006F EV/EBITDA of 5.5x, which puts it on a discount of 19% to CT. Regulatory concerns are overdone, in our view. Visibility on regulatory changes and the FT-driven strategy and slower competitive developments in the mobile market are key catalysts this year.
- **Buy MT:** Revenues are set to grow by 1.8% in 2006, the best in the sector, whilst a merger of the fixed-line and mobile operations, as well as acquisitions, should boost future earnings growth. With modest growth and a stable dividend yield, MT does not warrant a 23% discount to CT on the basis of its 2006F EV/EBITDA of 5.2x. The shares offer 15% upside to our fair value estimate. An easing on the outlook for the HUF, confirmation of dividends, and future growth of investments could provide catalysts in 2006.
- **Sell CT:** Prospects of increased dividends are priced-in. On a 2006F EV/EBITDA of 6.8x, CT now trades at a 24% premium to TP and a 30% premium to MT. The key catalyst for 2006 is dividends, which are likely to disappoint. The risk to consensus earnings and dividend estimates lies on the downside.
- **Sell Netia:** The stock is overvalued at a 2006F EV/EBITDA of 5.9x, given lack of growth prospects. The prospects of P4's mobile operations are challenging at best and it is less attractive as an MVNO. The key driver of recent stock price appreciation, upside from a potential takeover, has greatly diminished with the increase in Novator's stake and the absence of any competing buyer.

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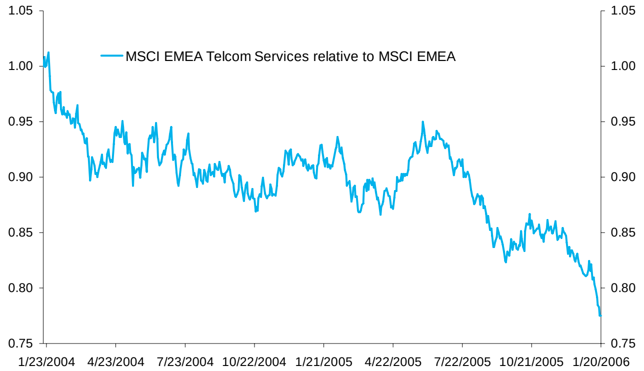
Investment summary

We expect regulation, consolidation and valuation to be the sector cornerstones for 2006

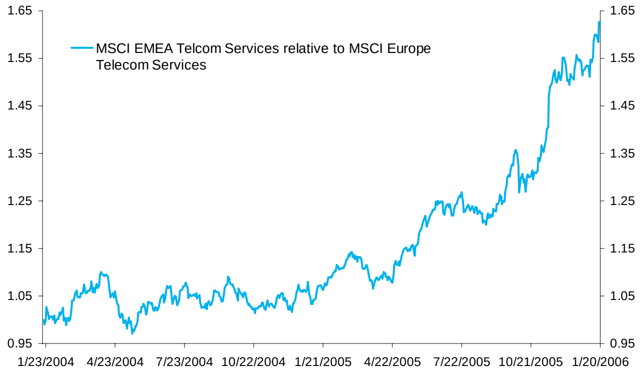
EMEA telecoms outperformed their global peers by 36% in 2005, although they underperformed the broader emerging market by 11% during the year. We expect continued sector underperformance relative to EMEA in 2006 as revenues bottom out and market-specific newsflow drives share prices. We therefore recommend identifying undervalued names that have better prospects of surprising on the upside. With regulation, consolidation and valuation as sector cornerstones for 2006, we maintain our Buy ratings on TP and MT. Regulatory concerns for TP are overdone and potential market share erosion is already more than priced-in. MT is a potential beneficiary from sector consolidation in the region, as it increases the opportunity to execute on its growth-driven M&A strategy. We maintain Sell ratings on CT and Netia. We believe that a potential dividend and earnings disappointment could lead to a correction at CT. Whilst Netia remains a takeover target, much of the potential upside is already in the price, whilst the increase in Novator's stake and the absence of a competing buyer diminishes M&A as a driver for the stock going forward.

EMEA Telecoms Rel to the Region



Source: MSCI, KBC Securities

EMEA Telecoms Rel to European Telecoms



Source: MSCI, KBC Securities

Regulation affects the whole sector, TP more than others

Imminent de-regulation is likely to cause greatest volatility in TP's (Buy) share price. We would recommend buying into weakness

Poland stands out as the market with the highest regulatory risk following pronouncements from the incoming regulator but Hungary and the Czech Republic are not far behind. Though a significant impact on TP is expected, our below-consensus estimates for 2006 already incorporate related market share erosion. We believe that the regulatory risk discount of TP is overdone and that once management has announced its 2006 guidance (expected to incorporate a higher level of competition) the stock could surprise positively thereafter. We expect share price volatility at TP in 1H06, on the back of newsflow on regulation and would recommend buying on weakness.

Consolidation supports MT's M&A strategy

Consolidation is supportive of sector valuations. MT (Buy) benefits most in the M&A stakes

While M&A activity should support valuations, we would view consolidation in the alternative sector more positively as it effectively consolidates and reduces competition. Of the listed operators in CEE3, we see MT as the biggest beneficiary of consolidation, as it adds opportunities to execute on its growth-driven acquisition strategy. Additionally, we do not believe the market has fully priced-in the benefits of the Magyar/TMH merger. Although Netia has been in the spotlight since 2H05, we believe Novator's increasing stake in the company reduces the likelihood of a competing buyer appearing on the scene, thereby limiting further speculative upside

Valuation Matters! Look for undervalued names

CT (Sell) trades at a 20% premium to its peers, and presents a 9% downside to our fair value estimate

In a sector expected to underperform the broader market, we believe that only undervalued companies will outperform. Both MT and TP remain attractively valued, trading at 5.2x and 5.5x 2006F EV/EBITDA respectively, at a wide discount to CT on 6.8x. Given similar fundamental operating pressures and cash generation profiles, we believe the discount of MT and TP is unjustified. Meanwhile, CT trades at a hefty premium not only to its regional peers but also to Western telcos, more than pricing in prospects for a higher dividend that we believe are likely to end in disappointment. Finally, Netia, on a 2006F EV/EBITDA of 5.9 x, trades at a 7% premium to TP, driven by M&A speculation which we believe will dissipate over time.

Comparables

Stock data

	Reuters Code	Exchange	Free Float	Market Cap		Fair Value	Current Price	Upside	Recomm
				Local	Euro				
Cesky Telecom	SPTTsp.PR	Prague	30.7%	CZK 169	6.8 bn	480	525	-8.6%	Sell
MTELEKOM	MTEL.BU	Budapest	40.9%	HUF 1,043	4.2 bn	1,150	995	15.5%	Buy
Netia	NTIA.WA	Warsaw	68.8%	PLN 2.2	0.6 bn	4.7	5.5	-14.5%	Sell
TPSA	TPSA.WA	Warsaw	48.6%	PLN 32	8.1 bn	28.0	23.2	20.7%	Buy

Source: KBC Securities, company reports, Bloomberg

Growth

	Revenue Growth			EBITDA Growth			EPS Growth		
	06/05	07/06	5 Yr CAGR	06/05	07/06	5 Yr CAGR	06/05	07/06	5 Yr CAGR
Cesky Telecom	-1.4%	-1.1%	0.3%	-2.2%	-3.8%	-1.4%	25.1%	3.2%	9.3%
MTELEKOM	1.8%	0.1%	0.7%	4.3%	3.2%	1.2%	8.9%	6.0%	8.3%
Netia	0.0%	0.0%	0.0%	-0.5%	-2.4%	0.0%	10.2%	-13.1%	0.0%
TPSA	-2.4%	0.9%	1.4%	-3.3%	0.4%	0.8%	6.6%	18.0%	11.6%

Source: KBC Securities, company reports

Profitability & valuations

	Net Gearing		Dividend Yield			EFCF Yield		EV/EBITDA		P/E	
	2006	2007	2005	2006	2007	2006	2007	2006	2007	2006	2007
Cesky Telecom	7.7%	7.5%	0.0%	9.2%	9.4%	9.2%	8.2%	6.8 x	7.1 x	22.0 x	21.3 x
MTELEKOM	34.8%	32.1%	7.0%	7.5%	8.1%	8.7%	10.2%	5.2 x	5.0 x	12.1 x	11.4 x
Netia	N/A	N/A	1.8%	1.8%	1.8%	7.2%	7.1%	5.9 x	5.7 x	19.8 x	22.8 x
TPSA	35.9%	37.2%	2.1%	4.3%	5.5%	10.0%	9.3%	5.5 x	5.6 x	14.0 x	11.8 x

Source: KBC Securities, company reports

TP (Buy) – Volatility creates opportunity

Regulatory risk is priced-in and strong mobile growth prospects provide upside

We reiterate our Buy recommendation on TPSA, as we believe that regulatory risk is overdone. We recommend buying on weakness, resulting from regulation-related newsflow. At current levels, TP provides 20% upside to our fair value estimate, a 10.0% normalised free cash yield, and a 4.3% dividend yield with upside potential. TP also offers a 2006-2011F revenue and earnings CAGR of 1.4% and 12.0% respectively. At 5.5x 2006F EV/EBITDA, it trades at a 19% discount to Cesky Telecom and a 7% discount to its domestic fixed-line competitor, Netia. TPSA offers a good risk/return profile, even on forecasts we believe to be very conservative. We are forecasting a 2.4% total revenue decline in 2006 versus a consensus estimate of flat growth. We have factored in aggressive assumptions on the rate of decline in fixed-line traffic (-11%) and overall fixed-line revenues (-7%), which we believe folds-in much of the risk of market share erosion. Note however that our 8% forecast mobile growth for 2006 offsets some of the fixed-line deterioration. Furthermore, we see greater visibility on consolidation and M&A opportunities in Poland (Dialog, PTC and Polkomtel) than anywhere else, which should be supportive of valuations.

TP : KBC versus consensus

	Revenues 05	Revenues 06	EBITDA 05	EBITDA 06	Net Profit 05	Net Profit 06
Consensus	18,505	18,538	8,171	8,052	2,165	2,339
KBC	18,346	17,905	7,961	7,698	2,182	2,326
Difference from cons	*-0.9%*	*-3.4%*	*-2.6%*	*-4.4%*	*0.8%*	*-0.6%*

Source: KBC Securities, Bloomberg

MT (Buy) – Not just a cash machine

Growth from acquisitions and slower mobile market share erosion could surprise on the upside

Stable cash flows, a clear dividend policy, and attractive valuations warrant a Buy recommendation for MT, in our view. There is 15% upside to our fair value estimate of HUF 1,150 per share. MT has set a clear guideline on its M&A policy, and we believe that the company is well-positioned to play a role in regional consolidation. Although the Hungarian telecom market is one of the most liberalized in the region, we believe that MT's fixed and mobile market shares, plus its ability to leverage technology to drive growth, should allow the company to protect its cashflows and deliver value to shareholders. Our aggressive forecast on TMH's market share contraction provides upside, in our view, as the erosion has so far been slower than we expected. Finally, at a 2006F EV/EBITDA of 5.2x and a 2006F P/E of 12x, MT trades at a hefty discount to CT of 23% on an EV/EBITDA basis and 45% on a P/E basis respectively. In our view, the discount is unwarranted given MT's superior growth (0.7% 2006-2011F revenue CAGR versus 0.3% at CT), similar cash yields, and a clearer dividend policy..

MT : KBC versus consensus

	Revenues 05	Revenues 06	EBITDA 05	EBITDA 06	Net Profit 05	Net Profit 06
Consensus	614,608	624,853	249,981	253,986	78,834	82,149
KBC	618,122	629,221	245,753	256,247	79,015	86,070
Difference from cons	*0.6%*	*0.7%*	*-1.7%*	*0.9%*	*0.2%*	*4.8%*

Source: KBC Securities, Bloomberg

CT (Sell) – Show me the money

Windfall dividend is unlikely to be realised, and could lead to a 10% correction in valuation

We maintain our Sell recommendation on CT, based on its challenging valuation at a premium of more than 20% to its regional peers on the basis of a 2006F EV/EBITDA of 6.8x. The premium has been driven primarily by speculation of an increase in dividends but, in our view, this has been more than fully priced-in. CT's fundamentals are under pressure, similarly to its peers, and we see downside risk to consensus forecasts for both earnings and dividends. Fixed-line margins are likely to contract, as GTS accelerates its campaign to win over fixed-line corporate customers, following the acquisition of Aliatel and Nextra, and as Tele2 continues to take market share of fixed-line voice traffic in the residential segment. ET is also set to lose market share on the mobile side, as Oskar VOD intensifies its marketing to gain customers, following the launch of MNP. Our fair value estimate of CZK 480 per share implies 8% downside for CT.

Continued pressure in the fixed business and tighter competition will continue to push revenues and margins down

CT : KBC versus consensus

	Revenues 05	Revenues 06	EBITDA 05	EBITDA 06	Net Profit 05	Net Profit 06
Consensus	60,892	60,939	27,210	26,721	6,302	7,964
KBC	59,797	58,944	26,525	25,945	6,145	7,685
Difference from cons	*-1.8%*	*-3.3%*	*-2.5%*	*-2.9%*	*-2.5%*	*-3.5%*

Source: KBC Securities, Bloomberg

Netia (Sell) – Roll of the dice

M&A premium should disappear following Novator's acquisition of a 23% stake

We maintain our Sell rating on Netia. Novator's increasing stake in the company, now 22% with 33% targeted within 12 months (purchases likely to be made on the open market) and the absence of any competing buyer should lead to a dissipation of M&A speculation, that has been the main share price driver in the last 5 months. In our view, Netia should trade at a discount to the integrated operators' average valuation of 2006F EV/EBITDA 5.7x given a lack of growth in its existing fixed-line business (we are forecasting -0.1% growth in 2006 and a 0% 2006-2011F revenue CAGR) and no mobile exposure. At a 2006F EV/EBITDA of 5.9x, Netia's shares are clearly overvalued. Having looked at P4's prospects in detail, we do not believe that they justify an uplift to Netia's value, given operational and execution risk and the company's limited equity participation

Netia : KBC versus consensus

	Revenues 05	Revenues 06	EBITDA 05	EBITDA 06	Net Profit 05	Net Profit 06
Netia						
Consensus	917.1	908.2	351.4	351.3	99.6	96.5
KBC	919.9	918.8	356.0	354.3	101.7	112.0
Difference from cons	*0.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*17.0%*

Source: KBC Securities, Bloomberg

Cesky Telecom

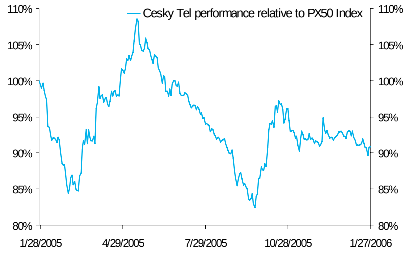
02 February 2006

Show me the money

Telecom

Czech Republic

Current price	CZK 525	**Sell**
Fair Value	CZK 480	Rating maintained



	2004	2005F	2006F	2007F
Sales (CZK m)	62,142	59,797	58,944	58,321
EBITDA (CZK m)	29,265	26,525	25,945	24,957
Pre-Tax (CZK m)	8,114	8,303	10,247	10,572
Net profit (CZK m)	5,768	6,145	7,685	7,929
EPS (CZK)	18	19	24	25
Dividend Yield (%)	3.2	0.0	9.0	9.3
EFCF (%)	11.6	9.9	9.2	8.2
EV/EBITDA (x)	6.6	6.7	6.8	7.1
P/E (x)	29.3	27.5	22.0	21.3

Source: KBC Securities

Reuters	SPTTsp.PR
Bloomberg	SPTT CP

www.telecom.cz

Market Cap	€ 6.1 bn
Shares	322m
Volume	€ 7.7m
Free float	31%

Next corporate event

FY05 results 24 February 2006

Performance over	1m	3m	12m
Absolute	2,6%	7,7%	38,3%
Rel. PX-50	-1.7%	-4.6%	-4.0%

12-m Hi/Lo CZK 546/385

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Cesky Telecom operates telephone and telecommunications networks throughout the Czech Republic. The Company offers telephone, telegraph, telex, voice, data transmission, and Internet access services. Cesky Telecom also offers wireless telephone services and provides international telecommunications services.

- **We maintain our Sell rating and CZK 480 fair value.** CT shares are now overvalued in our view. At a 2006F EV/EBITDA of 6.8x and 2006F P/E of 22.0x, we see no catalysts to push valuations further. We see nothing in CT's fundamentals to warrant the 20% premium that the shares are trading on relative to its regional peers, given its lower growth prospects and return profile.
- **Our estimates are below consensus.** Our revenue forecast is below consensus by 1.8% for 2005 and by 3.3% for 2006, whilst our earnings expectations are lower by 2.5% and 3.5% respectively. Our forecasts are underpinned by the view that CT's fixed-line revenues are declining more rapidly than at MT or at TP, whilst with a 112% penetration rate, the contribution of mobile growth is substantially more muted. Furthermore, we believe that CT's margins are unsustainable, forecasting EBITDA margins to contract from 47% in 2004 to 44% in 2007 before stabilising.
- **Dividends are likely to disappoint:** The single biggest driver of the share price in recent months, dividends, is on hold until middle of this year, when the new management will propose a new dividend policy to the board. Whilst gearing up the balance sheet would help, in our opinion, the potential gain offers insufficient incentive for investors to hold onto the shares at this level.
- **Cashflows are no better than peers':** Although revenue deterioration has turned the focus to CT's strong cashflows, as another driver of the company's valuation premium, we estimate that CT will yield 9.2% in normalised free cash in 2006, in line with our estimates for MT and TP at 8.8% and 10.0% respectively.

KBC Securities

SELL CT – Premium unwarranted

We see nothing to support CT's valuation premium as dividends and earnings are likely to disappoint

At a 2006F EV/EBITDA of 6.8x, we believe CT is overvalued. The 20% valuation premium to its peers has been driven almost exclusively by speculation over dividends, which are likely to disappoint, in our view. The current valuation implies a much higher dividend increase than our forecast CZK 48 per share, which is already a 183% increase from the 2004 level (dividends were suspended in 2005 post the TEF acquisition). As we discuss below, we believe this is highly unlikely given Czech dividend restrictions.

Furthermore, we believe that current and long-term fixed and mobile fundamentals are more challenging in the Czech Republic than in Poland or Hungary, as reflected in our 0.3% 2006-2011F CAGR for group revenues for CT, versus 0.7% and 1.4% for MT and TP respectively. We forecast a flat 2006-2011F revenue evolution in CT's mobile arm, ET, compared to 1.0% for TMH in Hungary, and 7.4% for Centertal in Poland. Therefore, we believe that the risk to the consensus EBITDA estimate for 2006 is skewed to the downside, as margins in both fixed-line and mobile operations are set to contract on higher competition. Finally, we argue that CT's strong cashflow generation does not deserve a premium, given that it is increasingly the norm, rather than the exception, in mature telcos, and its 9.2% normalised free cash yield is in line with TP (10.0%) and MT (8.8%).

Dividends are likely to disappoint

CT is unlikely to gear-up its balance sheet to pay windfall dividends

Dividends at CT are likely, in our view, to fall short of investor expectations. Although CT has the capacity to increase its gearing by EUR 2bn in debt, in the absence of any attractive M&A opportunities, we see no catalyst for it to do so. Alternatively, CT could also embark on a share buyback to divert the cash in its balance sheet. Until management gives clearer indications, with regards to the use of the cash pile on its balance sheet, CT shares are likely to languish and be driven by news that may signal the direction of cash usage. Note that Czech law limits a company's dividend payout to 100% of its mother company's retained earnings. Taking our 2005 net profit forecast, CT will have a maximum CZK 16bn dividend capacity in 2006, or roughly CZK 48-49 DPS. Current valuations imply a much higher dividend expectation, which in our view is very unlikely.

Faster deterioration in fundamentals not yet priced-in

We believe that the faster rate of deterioration in CT's drivers are not yet priced-in

The Czech telecom market is more competitive than in Poland or Hungary, and we believe that the faster rate of deterioration in CT's drivers are not yet priced-in, which is likely to lead to a re-rating going forward. Regulatory restrictions make it more challenging to counter traffic migration to IP-based platforms and continuing F2M substitution in the fixed-line business, and competition continues to intensify in the highly-penetrated mobile market. We are forecasting -3.5% fixed-line and 0.8% mobile growth at CT in 2006, compared to -2.7% and 2.4% fixed-line and mobile growth for MT in Hungary. Furthermore, we are forecasting group EBITDA margin contraction at CT of 40 bps in 2006 and 120 bps in 2007, versus our margin expansion forecast for MT of 90 bps in 2006 and 130 bps and 2007.

Consensus revenue and EBITDA estimates are too high

We forecast a 1.4% revenue decline, versus consensus estimate of flat growth in 2006

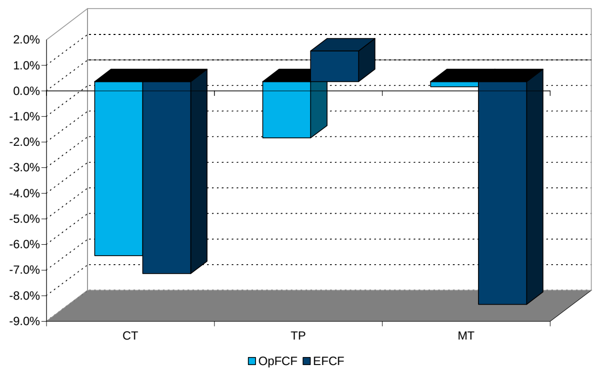
In our view, the risk to the consensus revenue and EBITDA expectations for 2006 lies on the downside. The consensus estimate calls for a 1.8% EBITDA decline on flat revenues. In our model, we estimate a 1.4% revenue decline in 2006 and a 2.2% EBITDA decline. Our more conservative assumption is underpinned by what we believe to be more realistic assumptions on fixed-line pressure, as traffic continues to post high double-digit declines (we forecast 25% traffic revenue decline in 2006), and slowing mobile subscription and revenue growth.

CT does not deserve a cashflow premium

Higher capex on lower revenues and EBITDA will pull operating free cash down in 2006 by 6.8%

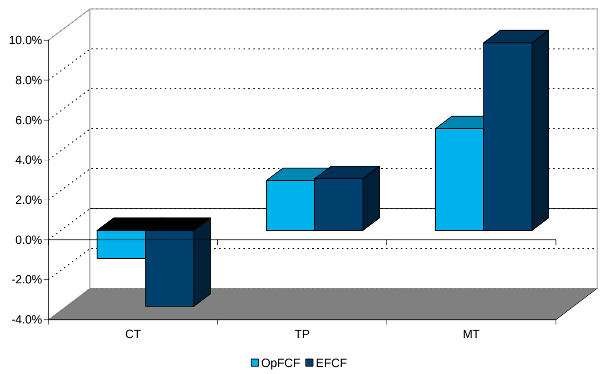
While CT yields an attractive 9.2% on current valuations, we argue that CT's cashflow profile is less attractive compared to TP and MT. CT, in line with its regional telco peers, is set to increase its capital expenditures in 2006 to 12.5% of sales from the current 11%, as it accelerates fixed-line broadband deployment and UMTS network roll-out. Hence, we estimate that higher capital expenditures on lower revenues and EBITDA will pull operating free cash down in 2006 by 6.8%. We would expect cashflows to accelerate again after 2007, when the bulk of UMTS and broadband-related capex is done, and we forecast a 2006-2011F CAGR of -1.4% and -3.8% in OpFCF and EFCF respectively. In comparison, we are forecasting -2.2% and -0.2% OpFCF for TP and MT respectively in 2006.

Cashflow growth 2006



Source: KBC Securities

Cashflow growth 5Yr CAGR



Source: KBC Securities

Outlook

Fixed margin contraction likely to come sooner

Risk to EBITDA margins are skewed to the downside

The risk to our, and market fixed EBITDA margin assumptions, lie on the downside. We are forecasting fixed margins to hold up at the 47% level this year, and to start contracting in 2007. However, Tele2 appears to be intensifying its marketing and CPS take-up could accelerate. Additionally, GTS' increased market power following its acquisition of Aliatel and Nextra could start putting more pressure on CT's fixed margins.

We are forecasting a 15% decline in fixed core revenues

CT's high fixed margins are set to go under pressure as revenues continue to deteriorate. As we discussed in previous reports, we are concerned about CT's strategy of lower subscriptions, lower per-minute tariff, but no free minutes, as we are not convinced that lower tariffs would stimulate enough incremental traffic. We believe that the most effective strategy of countering traffic migration, price declines and overall fixed line deterioration is to migrate from traffic-based to access-based revenues. We are therefore forecasting a 15% decline in fixed core revenues (traffic and subscriptions) in 2006 on a 25% and 12% drop in traffic and subscription revenues respectively.

On the other hand, pressure on core fixed-line services is offset by better data and broadband prospects, which we are forecasting to grow by 34% in 2006, driven mainly by a doubling in DSL installations to 700k lines. In our view, broadband, specifically DSL, could be the future growth engine for CT. We believe it is not migrating CT's subscribers to higher-priced services that matter in their broadband roll-out in the near-term, but rather locking-in the subscribers to their fixed lines with DSL connections. Given that DSL is also a higher-margin product, CT will do well to ramp-up connections, to halt not only fixed-line revenue erosion, but margin contraction as well. CT could benefit from TEF's expertise in broadband deployment, looking at its parent's success in Spain with its bundled offerings, including Imagenio, its IPTV platform.

Oskar VOD and MNP bode market share erosion for ET

Mobile market saturation is pulling back mobile growth

At 112% penetration rate, mobile revenue growth is decelerating and we are forecasting just 1% revenue growth at ET in 2006. The recent introduction of Mobile Number Portability is set to exacerbate the already cut-throat competition in the Czech mobile space and with Oskar VOD as the third sub-scale operator, we believe that the risk to our mobile forecasts and mobile expectations are skewed to the downside.

MNP, entry of MVNOs and high penetration rate puts downside risk to our ET forecasts

We are forecasting 4.8m subscribers on a market share of 42.8% for ET in 2006. We believe that Oskar VOD could decide to accelerate its market share uptake by competing aggressively in price following the launch of MNP. Therefore, given that T-MobCR is also unlikely to sit in the sidelines, tariff and market share erosion could accelerate faster than what we are currently forecasting in the Czech Republic. Further, Unient Communications has also announced that it plans to launch mobile services this year, with 100k mobile numbers it has reserved and capacity bought from existing operators.

We expect ET's margins to start contracting in 2006

Given the above, we expect ET's margins to start contracting this year. While we estimate 2005 mobile EBIDTA margin to be largely unchanged from 2004 at 44%, we are forecasting an 80bp contraction in 2006 to 43.4%, with risk firmly on the downside.

Financial data

CT: Segmental Analysis					
Fixed Business	**2004**	**2005**	**2006**	**2007**	**2008**
Access Lines (m)	3.368	3.120	2.862	2.674	2.562
DSL Lines (m)	.01	.354	.707	1.414	1.768
Fixed Core Revenues	22,022	18,405	15,539	13,056	11,431
Traffic	11,811	8,937	7,234	5,946	5,110
Subscriptions	10,149	9,409	8,247	7,054	6,267
Interconnect	3,832	4,051	4,253	4,370	4,478
Data & VAS	3,684	4,550	6,100	8,261	9,996
Other	1,651	1,635	1,620	1,593	1,579
Total Fixed Revenues	33,974	31,482	30,396	30,207	30,456
Interconnect Payments	4,869	3,681	3,108	2,611	2,286
Other selling costs	971	1,259	1,277	1,269	1,431
Staff Costs	5,892	5,509	5,319	5,437	5,787
Other SG&A	5,984	6,296	6,383	6,948	7,005
Total Opex	17,716	16,746	16,087	16,265	16,509
EBITDA	16,258	14,736	14,309	13,942	13,947
EBITDA Margin	47.9%	46.8%	47.1%	46.2%	45.8%
Depreciation & Amortization	14,320	11,818	10,132	9,062	7,309
EBIT	1,938	2,918	4,177	4,880	6,637
CAPEX	2,600	2,600	3,040	3,625	3,655

Source: Company reports, KBC Securities

CT: Segmental Analysis					
Eurotel	**2004**	**2005**	**2006**	**2007**	**2008**
Subscribers (m)	4.63	4.73	4.82	4.84	4.86
Market Share	43.2%	43.3%	42.8%	42.4%	42.1%
Service Revenues	28,034	28,142	28,338	27,834	26,999
Traffic & Subscriptions	17,062	17,165	16,498	16,441	16,253
VAS	3,832	4,568	5,858	5,687	4,983
Equipment Revenues	1,301	1,340	1,380	1,422	1,464
Other	145	152	160	168	176
Total Revenues	29,480	29,634	29,878	29,423	28,639
Interconnect Payments	5,581	5,748	5,921	6,099	6,281
Other selling costs	3,422	3,852	3,884	3,825	3,437
Staff costs	1,650	1,887	2,028	2,173	2,313
Other SG&A	4,508	5,038	5,079	5,002	4,725
Total Opex	15,161	16,526	16,912	17,099	16,757
EBITDA	13,007	13,108	12,966	12,324	11,883
EBITDA Margin	44.1%	44.2%	43.4%	41.9%	41.5%
Depreciation & Amortization	6,428	5,659	5,282	5,050	4,881
EBIT	6,579	7,449	7,684	7,275	7,002
CAPEX (ex-UMTS license)	3,720	4,149	4,482	4,413	4,010

Source : Company reports, KBC Securities

Financial data

CT: P&L (IFRS Consolidated)

Year to date (CZK m)	2004	2005	2006	2007	2008
Revenues	62,142	59,797	58,944	58,321	57,820
Operating Costs	32,877	33,272	32,999	33,364	33,266
EBITDA	29,265	26,525	25,945	24,957	24,555
EBITDA Margins	47.1%	44.4%	44.0%	42.8%	42.5%
Depreciation & Amortisation	20,748	17,477	15,414	14,112	12,190
EBIT	8,517	9,048	10,531	10,845	12,364
Net Interest Income (Expense)	-1,156	-745	-284	-274	-313
Pre-Tax Profit	8,114	8,303	10,247	10,572	12,051
Taxes	2,349	2,159	2,562	2,643	3,013
Minorities	3	-	-	-	-
NET PROFIT	5,768	6,145	7,685	7,929	9,038
No of Shares	322	322	322	322	322
EPS	18	19	24	25	28
Dividends	5,476	-	15,486	15,948	13,722
DPS	17	-	48	50	43
Retained Earnings	292	6,145	-7,800	-8,019	-4,684

Source : Company reports, KBC Securities

CT: Balance Sheet (IFRS Consolidated)

Year to date (CZK m)	2004	2005	2006	2007	2008
Fixed Assets	123,874	112,438	104,545	98,472	93,945
Current assets	10,329	19,984	25,722	24,018	23,906
Cash and cash equivalents	675	9,520	9,935	8,341	8,316
Assets	134,203	132,422	130,267	122,490	117,851
Current Liabilities	18,188	18,353	18,152	18,174	18,075
Long-term liabilities	25,816	18,433	18,809	19,028	19,174
Shareholder's Equity	32,209	32,209	32,209	32,209	32,209
Minorities	6	6	6	6	6
Shareholders and Liabilities	134,203	132,422	130,267	122,490	117,851

Source : Company reports, KBC Securities

CT: Cashflows (IFRS consolidated)

Year to date (CZK m)	2004	2005	2006	2007	2008
Net Profit	5,768	6,145	7,685	7,929	9,038
Depreciation	20,748	17,477	15,414	14,112	12,190
Changes in working capital	-930	-352	67	219	58
Operating free cash flow	26,081	23,593	23,423	22,391	21,362
Capex	6,320	6,749	7,521	8,038	7,664
Investing cashflow	-6,124	-6,749	-7,521	-8,038	-7,664
Repayment of debt	-13,497	7,988	15,173	12,366	10,727
Dividends	5,476	-	15,486	15,948	13,722
Cashflow from financing activities	-25,059	-8,000	-15,486	-15,948	-13,722
Net cash flow	-5,102	8,845	416	-1,595	-24

Source : Company reports, KBC Securities

Valuation

CT core business DCF valuation

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
EBIT	10,531	10,845	12,364	15,202	16,000	16,275	17,119	17,556	17,863	17,629
Unlevered Tax	-2,633	-2,711	-3,091	-3,800	-4,000	-4,069	-4,280	-4,389	-4,466	-4,407
Capex	-7,521	-8,038	-7,664	-7,123	-6,943	-7,011	-6,792	-6,849	-6,893	-6,926
Depreciation	15,414	14,112	12,190	9,490	8,652	7,881	6,955	6,465	6,010	6,018
Change in Working Capital	67	219	58	7	126	220	121	77	91	104
FCFF	15,858	14,426	13,858	13,776	13,835	13,296	13,123	12,859	12,605	12,418
PV	14,762	12,501	11,178	10,344	9,670	8,651	7,948	7,250	6,616	6,067

CAPM	
Rf	4.0%
Risk Premium	4.5%
Beta	1
Ke	8.5%
Cost of Debt	6.0%
Tax Rate	18.0%
Kd	4.9%
% Equity	70.0%
% Debt	30.0%
WACC	7.4%
Growth	0.5%

DCF	
Enterprise Value	179,742
Net Debt/Cash	7,962
Equity Value	171,779
DCF Value per Share	**533**

CT FAIR VALUE	
EV At 5.5x EBITDA	145.890
DCF and Peer Multiple Ave	154.854
CT Value per Share	**CZK 480**

Sensitivity

CZK 533	-1.5%	-0.5%	**0.5%**	1.5%	2.5%
9.4%	384	399	417	440	469
8.4%	423	443	468	500	542
7.4%	472	499	**533**	579	642
6.4%	532	570	619	688	790
5.4%	609	663	738	849	1.030

Source: KBC Securities

CT key ratios

	2004	2005	2006	2007	2008
Dividend Yield	3.2%	0.0%	9.2%	9.4%	8.1%
EFCF Yield	11.6%	9.9%	9.2%	8.2%	8.0%
EV/OpFCF	8.5	9.0	9.6	10.5	10.6
ROE (%)	6.4%	6.6%	8.1%	8.9%	10.9%
ROCE (%)	5.0%	5.9%	7.5%	8.3%	9.9%
EV/EBITDA	6.6	6.7	6.8	7.1	7.26
P/E	29.3	27.5	22.0	21.3	18.7

Source: KBC Securities

KBC Securities

Magyar Telekom

02 February 2006

More than just a cash machine

Telecom

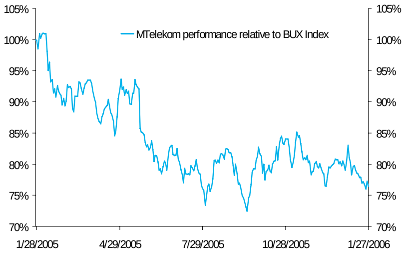
Hungary

Current price HUF 995

Target price HUF 1,150

Buy

Rating maintained



	2004	2005F	2006F	2007F
Sales (HUF m)	601,438	618,122	629,221	638,857
EBITDA (HUF m)	222,930	245,753	256,247	264,347
Pre-Tax (HUF m)	51,415	99,198	107,313	114,517
Net profit (HUF m)	34,641	79,015	86,070	91,192
EPS (HUF)	33	76	83	87
Dividend Yield (%)	7.0	7.0	7.5	8.1
EFCF (%)	7.8	9.5	8.7	10.2
EV/EBITDA (x)	6.0	5.5	5.2	5.0
P/E (x)	30.1	13.2	12.1	11.4

Source: KBC Securities

Reuters	MTEL.BU
Bloomberg	MTELEKOM HB
www.magyartelekom.hu	
Market Cap	€ 4.1 bn
Shares	1,042.8m
Volume	€ 5.4m
Free float	41%

Next corporate event

FY 05 results 13 February 2006

Performance over	1m	3m	12m
Absolute	5,4%	2,2%	16,4%
Rel. BUX	-4.8%	-8.2%	-22.2%

12-m Hi/Lo HUF 1065/859

- **We reiterate our Buy recommendation and fair value estimate of HUF 1,150 per share.** At a 2006F EV/EBITDA of 5.2x, MT trades well below its Western European and CEE3 peers, which trade in a range of 2006F EV/EBITDA 5.5x-6.8x. Given MT's growth prospects are in line with its regional peers and its generous dividends from stable cashflows, we believe the discount is unjustified.
- **Magyar/TMH merger could provide further upside.** Although we have factored in merger-related tax benefits for 2006, further cost-savings could still provide substantial upside to margins. Management is expected to provide details of the merger benefits at the presentation of its full-year results for 2005, scheduled for 13 February.
- **Slower-than-expected mobile market share erosion.** Data for 2H05 indicate that VOD's market share uptake has been slower-than-expected. We are currently forecasting 2.4% mobile revenue growth on a 320bp mobile market share contraction from 44% to 40.8% in 2006. However, there is potential upside to revenue expectations if slower-than-expected market share erosion at TMH continues.
- **Dividends are set to increase.** Given a lack of large-scale M&A opportunities consistent with MT's guidelines, the dividend payout is likely to increase. We expect dividends to increase to HUF 75 this year from HUF 70 in 2005.

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Magyar Telekom provides telecommunications services in Hungary. The Company offers local and long-distance, mobile, data transmission, and Internet access services.

Buy MT – attractively valued

Stable cash flows, clear dividend policy and attractive valuations warrant a Buy recommendation for MT

We reiterate our Buy rating on MT. On a 2006F EV/EBITDA of 5.2x, MT trades at an unwarranted discount of 10% to the CEE sector average and 23% to CT. In our view, the discount is unwarranted, particularly to CT, given that MT offers superior growth (0.7% 2006-2011F revenue CAGR versus 0.3% at CT) and similar cash yields. Furthermore, while the market is paying a premium for CT on speculation over an increased dividend, MT has a proven, clear and stable dividend policy, which yields 8%. We also believe that MT's valuation should start reflecting the Magyar/TMH merger benefits, once management provides clearer visibility on potential cost savings. Finally, earnings could surprise on the upside, should the market share of TMH contract more slowly than our conservative assumption for 3.2% erosion in 2006. There is 15% upside to our fair value estimate of HUF 1,150 per share.

Dividends are set to increase

Lack of large acquisition candidates that satisfy MT's criteria supports our expectation of a dividend increase

We expect an 8% rise in dividends from the 2005 level to HUF 75 per share. The lack of large-scale acquisition candidates that satisfy MT's criteria supports our expectation of a dividend increase. Our dividend expectation has been lowered from our original forecast of HUF 80.5 per share, as it is unclear whether MT takes into account a year-end calculation of its net gearing or its actual position at the time of payment, when determining its dividend pay-out. The Orbitel and Dataplex acquisitions, the Romanian CPS rollout and the EDR capex are likely to take net gearing very close to the 40% threshold prior to the dividend payment.

Merger benefits are not yet priced in

Magyar/TMH merger provides upside to our EBITDA and earnings estimates

The Magyar/TMH merger should result in cost savings from elimination of overlaps, capex optimisation, and the realization of tax savings in the near- to medium-term. Specifically, the merged entity is set to realize a HUF 6.8bn tax credit in 2006, from its broadband investment. In addition, the merger will lower the tax charge for the group, given that Magyar Telecom (the parent company) currently has a negative tax base. Although we are waiting for details from management regarding the planned cost savings from the merger before including any benefit into our forecast operating costs, we estimate that savings could lead to incremental margin expansion of up to 100bp in the first full year.

Earnings could surprise on the upside

MT is the only listed operator in CEE3 that is set to post revenue growth in 2006

We believe MT's earnings have a good chance to surprise on the upside versus even our above-consensus forecast for 8.9% y/y growth. Firstly, we could start seeing some merger-related cost savings in 2H06. Secondly, VOD's market share uptake has been slower-than-expected, leaving possible upside to our mobile EBITDA margin estimates, as retention costs may come in lower. Our forecast for a substantial deceleration in mobile revenue growth (2.4% in 2006 vs. 4.2% in 2005), may prove too conservative, as we assume only a modest 1.2% mobile revenue contribution from Hungary on flat subscriber growth and ARPU.

Our conservative forecasts for 2006 are underpinned by a lower EBITDA assumption, as we believe that the company's announced plan to accelerate DSL rollout could pull margins back. Potential restructuring of MT's new Bulgarian asset, Orbitel, could also hold margins down. Furthermore, we are also conservative in our assumptions regarding mobile market competition, assuming faster market share erosion and slower EBITDA expansion. Finally, costs of consolidating the fixed-line and mobile operations could dampen margins in 1H06.

Outlook

Fixed-line deterioration is slowing

Fixed-line decline is set to decelerate from 7.0% to 2.6% in 2006

Although we forecast fixed-line revenues to continue to decline until 2008, the rate of decline decelerates from over 7% in the last two years to 2.6% in 2006, as the migration to flat-rate packages mitigates the continued slide in voice prices and traffic migration to mobile or IP-based platforms. We estimate that much of the decline in total fixed-line revenues will still come from Hungary, as we forecast a 4% decline in the fixed-line domestic market. The decline is on the back of a 10% drop in fixed-line core revenues on a 20% and 3% decline in voice traffic and subscription revenues respectively. The slowdown in the rate of decline of subscription revenues is a reflection of the company's aggressive migration from traffic to access-based revenues. As fixed-line voice traffic continues to decline, MT is aggressively pushing DSL, as a means to offset fixed-line core deterioration, and prevent churn. In 2006, the company is targeting the installation of 600k DSL lines, versus our 605k forecast.

Slower TMH market share erosion could provide upside

Mobile revenues should grow by 2.4% this year… with upside potential from slower market share upstake of VOD

We are forecasting a gradual mobile market share erosion for TMH, but growth in mobile data and other enhanced services should continue to support mobile revenues, which we are forecasting to grow by 2.4% in 2006. We are forecasting Hungarian ARPUs to remain broadly flat in 2006 as the decline in mobile voice tariffs decelerates and VAS ARPU grows by some 10%. We are also expecting flat subscriber growth this year, as market growth slows and VOD takes the lion's share of net adds. Given these conservative assumptions, we estimate modest 1.4% growth in Hungarian mobile revenues. However, TMH could surprise on the upside if slower market share erosion translates to further subscriber growth and higher mobile revenues. Furthermore, while we are conservatively forecasting market share erosion from 44.1% to 40.8% in 2006, TMH has reiterated that it intends to retain its 10% market share lead over Pannon and VOD.

EDR should provide a moderate but stable boost to mobile revenues

MT has signed a 10-year agreement with the Hungarian government to provide EDR services to public safety and security agencies. The service will use Terrestial Trunked Radio (TETRA) technology and rollout is planned for 2006. MT estimates a one-off capex requirement of some HUF 20-25bn, the bulk of which will be spent this year. The EDR project should bring in a modest revenue and profit contribution starting in 2007. On HUF 9.3bn of annual revenues and with margins in line with the mobile business (we are assuming a 35% margin in year 1, rising to 42.5% by 2010), we estimate an average group EBITDA and earnings uplift of roughly 1.5% from the project over the next 10 years.

Financial data

MTEL: Segmental analysis					
Fixed Business	**2004**	**2005**	**2006**	**2007**	**2008**
Access Lines* (m)	2.876	2.673	2.555	2.442	2.386
DSL Lines* (m)	.204	.367	.605	.907	1.179
Fixed Core Revenues	257,720	244,461	226,928	213,209	203,959
Traffic	124,686	106,936	90,300	77,037	69,443
Subscriptions	107,030	109,390	106,677	104,891	103,113
Interconnect	26,004	28,134	29,951	31,280	31,403
Data & VAS	56,686	65,404	75,196	82,454	90,453
Other	32,521	31,512	29,838	27,966	26,688
Total Fixed Revenues	346,927	341,376	331,962	323,629	321,100
Interconnect Payments	60,701	54,813	53,387	51,966	51,455
Other selling costs	4,067	4,062	3,938	3,984	3,954
Staff Costs	89,222	68,003	63,339	64,092	65,399
Other SG&A	91,187	80,939	75,786	73,834	73,231
Total Opex	245,177	207,818	196,450	193,876	194,040
EBITDA	101,750	133,558	135,512	129,753	127,060
EBITDA Margin	29.3%	39.1%	40.8%	40.1%	39.6%
Depreciation & Amortization	83,376	72,513	47,565	52,860	61,821
EBIT	18,374	61,046	87,947	76,893	65,239
CAPEX	45,136	43,866	42,858	42,398	39,546

*Source : Company reports, KBC Securities (*Access line data for Hungary only)*

MTEL: Segmental analysis					
TMH**	**2004**	**2005**	**2006**	**2007**	**2008**
Subscribers* (m)	4.13	4.12	4.12	3.99	3.93
Market Share*	47.1%	44.0%	40.8%	39.7%	39.1%
Service Revenues	269,205	280,604	287,376	289,352	291,931
Traffic & Subscriptions	236,335	241,645	244,002	242,910	242,652
VAS	31,993	38,192	42,824	46,204	49,176
Equipment Revenues	25,027	27,095	27,894	15,598	15,767
Other	2,525	1,580	1,449	10,707	10,735
Total Revenues	296,757	309,279	316,719	315,657	318,433
Interconnect Payments	60,764	67,469	69,567	70,659	72,085
Other selling costs	37,399	36,308	35,284	37,537	37,834
Staff costs	20,365	20,852	20,879	20,392	21,172
Other SG&A	57,049	57,820	59,260	52,047	52,539
Total Opex	175,577	182,450	184,990	180,635	183,629
EBITDA	121,180	126,829	131,729	135,023	134,804
EBITDA Margin	40.8%	41.0%	41.6%	42.8%	42.3%
Depreciation & Amortization	44,414	44,693	66,094	62,270	50,503
EBIT	76,766	82,136	65,635	72,753	84,302
CAPEX (ex-UMTS license)	46,983	49,887	62,010	54,288	46,370

*Source : Company reports, KBC Securities (*Subscriber data for Hungary only; **includes revenues and costs for EDR from 2007)*

Financial data

MTEL: P&L (IFRS consolidated)					
Year to date (HUF m)	**2004**	**2005**	**2006**	**2007**	**2008**
Revenues	601,438	618,122	629,221	638,857	648,833
Operating Costs	378,508	372,369	372,974	374,510	377,669
EBITDA	222,930	245,753	256,247	264,347	271,164
EBITDA Margins	37.1%	39.8%	40.7%	41.4%	41.8%
Depreciation & Amortisation	123,790	117,206	113,660	115,129	112,324
EBIT	99,140	128,547	142,587	149,218	158,841
Net Interest Income (Expense)	-33,087	-30,586	-36,533	-35,978	-35,027
Pre-Tax Profit	51,415	99,198	107,313	114,517	125,111
Taxes	-8,088	-10,912	-11,804	-13,742	-15,013
Minorities	-8,686	-9,272	-9,438	-9,583	-9,732
NET PROFIT	34,641	79,015	86,070	91,192	100,366
No of Shares	1,043	1,043	1,043	1,043	1,043
EPS	33	76	83	87	96
Dividends	72,997	72,997	78,472	84,749	84,749
DPS	70	70	75	81	81
Retained Earnings	-38,356	6,018	7,599	6,443	15,616

Source : Company reports, KBC Securities

MTEL: Balance sheet (IFRS consolidated)					
Year to date (HUF m)	**2004**	**2005**	**2006**	**2007**	**2008**
Fixed Assets	870,017	831,004	806,360	771,514	731,096
Current assets	159,541	492,742	545,786	606,839	483,796
Cash and cash equivalents	36,879	286,678	300,539	324,321	162,586
Assets	1,029,558	1,323,746	1,352,146	1,378,353	1,214,891
Current Liabilities	221,550	213,738	215,600	217,544	220,067
Long-term liabilities	231,344	513,655	513,996	514,633	313,045
Shareholder's Equity	516,567	536,622	561,092	584,407	616,896
Minorities	60,097	59,732	61,457	61,768	64,883
Shareholders and Liabilities	1,029,558	1,323,746	1,352,146	1,378,353	1,214,891
Net debt	283,729	313,322	299,461	275,679	237,414
Net gearing	35,5%	36,9%	34,8%	32,1%	27,8%

Source : Company reports, KBC Securities

MTEL: Cashflows (IFRS consolidated)					
Year to date (HUF m)	**2004**	**2005**	**2006**	**2007**	**2008**
Net Profit	34,641	79,015	86,070	91,192	100,366
Depreciation	123,790	117,206	113,660	115,129	112,324
Changes in working capital	18,848	-24,138	4,310	-1,322	-898
Operating free cash flow	176,791	173,719	205,220	205,687	211,791
Capex	-94,747	-95,023	-105,876	-97,146	-88,768
Acquisitions	-	35,250	7,000	-	-
Investing cashflow	-94,829	-130,315	-112,887	-97,155	-88,778
Dividends	72,997	72,997	78,472	84,749	84,749
Financing cashflow	-66,669	206,395	-78,472	-84,749	-284,749
Net cash flow	15,293	249,799	13,861	23,782	-161,736

Source : Company reports, KBC Securities

Valuation

MTEL business DCF valuation

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
EBIT	142,587	149,218	158,841	160,657	173,825	178,801	189,247	189,044	185,379	182,787
Unlevered Tax	-23,527	-24,621	-26,209	-26,508	-28,681	-29,502	-31,226	-31,192	-30,588	-30,160
Capex	-105,876	-97,146	-88,768	-86,261	-78,877	-79,300	-79,670	-79,815	-79,881	-79,991
Depreciation	113,660	115,129	112,324	110,146	99,537	93,006	86,973	84,821	85,634	85,541
Change in Working Capital	4,310	-1,322	-898	312	-307	1,202	-977	821	904	889
FCFF	131,154	141,258	155,290	158,346	165,496	164,206	164,348	163,679	161,448	159,067
PV	120,931	118,390	118,300	109,644	104,162	93,940	85,460	77,363	69,361	62,116

CAPM	
Rf	6.9%
Risk Premium	4.5%
Beta	1
Ke	11.4%
Cost of Debt	8.0%
Tax Rate	16.0%
Kd	6.7%
% Equity	70.0%
% Debt	30.0%
WACC	10.0%
Growth	0.5%

DCF		**MTEL FAIR VALUE**	
Enterprise Value	1,615,612	EV At 5,5x EBITDA	1,409,357
Net Debt/Cash	313,322	DCF and Peer Multiple Ave	1,199,162
Equity Value	1,302,290		
DCF Value per Share	**1,249**	MTEL Value per Share	**HUF 1,150**

Sensitivity

HUF 1,249	-1.5%	-0.5%	**0.5%**	1.5%	2.5%
12.0%	909	942	981	1,027	1,083
11.0%	1,010	1,052	1,102	1,163	1,237
10.0%	1,129	1,183	**1,249**	1,330	1,432
9.0%	1,271	1,342	1,430	1,541	1,686
8.0%	1,443	1,539	1,659	1,816	2,031

Source: KBC Securities

MT key ratios

	2004	2005	2006	2007	2008
Dividend Yield	7.0%	7.0%	7.5%	8.1%	8.1%
EFCF Yield	7.8%	9.5%	8.7%	10.2%	11.6%
EV/OpFCF	10.3	9.0	8.9	7.9	7.0
ROE (%)	6.4%	15.0%	15.7%	15.9%	16.7%
ROCE (%)	4.8%	10.2%	11.0%	11.6%	12.9%
EV/EBITDA	6.0	5.5	5.2	5.0	4.7
P/E	30.1	13.2	12.1	11.4	10.4

Source: KBC Securities

Netia

02 February 2006

Roll of the Dice

Telecom

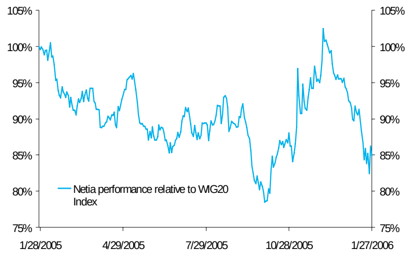
Poland

Current price PLN 5.5

Fair Value PLN 4.7

Sell

Fair value revised



	2004	2005F	2006F	2007F
Sales (PLN '000)	897,162	919,941	918,759	923,208
EBITDA (PLN '000)	324,908	356,036	354,257	345,715
Pre-Tax (PLN '000)	113,668	126,665	139,419	121,357
Net profit (PLN '000)	159,153	101,674	112,005	97,371
EPS (PLN)	0.42	0.25	0.28	0.24
Dividend Yield (%)	0.0	1.8	1.8	1.8
EFCF (%)	NM	7.3	7.2	7.1
EV/EBITDA (x)	5.9	5.8	5.9	5.7
P/E (x)	13.2	21.9	19.8	22.8

Source: KBC Securities *NM: Not meaningful*

Reuters	NTIA.WA
Bloomberg	NET PW
www.netia.pl	

Market Cap	€ 585 m
Shares	404m
Volume	€ 2.5m
Free float	74%

Next corporate event

FY05 results 01 March 2006

Performance over	1m	3m	12m
Absolute	-0.9%	23.9%	35.7%
Rel. WIG20	-10.3%	-0.1%	-15.5%

12-m Hi/Lo PLN 5.9/PLN 4.2

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Netia is the leading alternative fixed-line telecommunications operator in Poland. It operates on the basis of its own, state-of-the-art fiber-optic backbone network that connects the largest Polish cities as well as its local access networks. Netia provides a broad range of telecommunications services, including voice, data and network wholesale services.

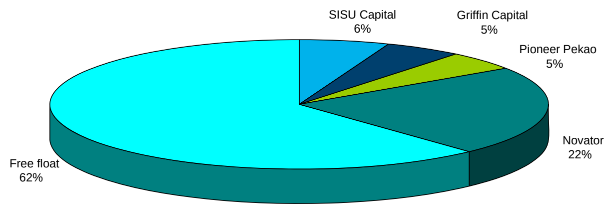
- We maintain our Sell recommendation on Netia. At 5.9x 2006F EV/EBITDA, Netia's shares are overvalued, trading at a premium of 7% to TP and 13% to MT. Our revised fair value estimate of PLN 4.7 per share implies 15% downside . Given a lack of growth in its fixed-line business and no mobile exposure, Netia should trade at a discount to integrated operators' valuations.
- M&A catalyst has diminished. Whilst we do not expect it to disappear entirely, M&A should dissipate, given Novator's increasing stake in the company, now 22% with 33% targeted within 12 months (purchases likely to be made on the open market) and the absence of any competing buyer.
- Netia offers zero growth. We are forecasting flat revenue growth in 2006, and a 0% 2006F-2011F revenue CAGR, as fast-growing wholesale and interconnect businesses fail to offset direct voice revenue declines. Note that our estimates for revenues and earnings are even slightly ahead of consensus for 2006.
- Mobile prospects are challenging. P4 will be launching services as an MVNO, which should be valued at a lower level than network operators. Given the presence of operational and execution risk, as well as Netia's limited equity participation, this foray into the mobile market does not justify an uplift to Netia's value

Sell Netia – M&A premium overdone

Reduced potential M&A upside, stretched valuations and deteriorating fundamentals warrant a Sell

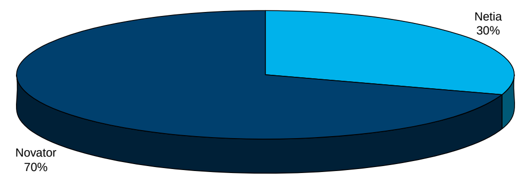
We retain our Sell rating on Netia, especially since the primary share price driver in recent months, M&A speculation, has been vastly diminished by Novator's increasing stake in the company. Netia's fundamentals warrant a discount to integrated operators', in our opinion, but at 5.9x 2006F EV/EBITDA, the shares trade at a premium of 4% to the average multiple of CEE3 operators and of 7% to TPSA. Despite our forecasts being slightly ahead of consensus, we are expecting flat revenues in 2006 compared to 2005, and are forecasting a 2006F-2011F revenue CAGR of 0% for Netia versus 1.4% growth at TPSA. Furthermore, given less flexibility in the business model, margins are more vulnerable to revenue deterioration, and we forecast EBITDA to decline by 1% in 2006. P4, which has been widely expected to drive future growth, is unlikely to make any meaningful contribution in the foreseeable future, and as an MVNO, its prospects are even less attractive.

Netia Ownership Structure



Source: Company reports

P4 Ownership Structure



Source: Company reports, KBC Securities

M&A prospects have diminished

Novator is likely to augment its stake opportunistically in the open market

Novator's recent acquisition of a 23% stake in Netia, and announced plans to take it up to 33% minus 1 share in the next 12 months (most probably in the open market) removes an M&A catalyst and reduces speculative upside. Novator's increasing stake in the company has actually started further speculation that it is positioning itself as a blocking minority for a future buyout. Polish law calls for a tender offer for at least another 33%, taking the stake to 66% of the company, once the 33% threshold is breached. It appears that Novator is unwilling to breach the threshold, indicating that it is perfectly happy to remain as a minority shareholder. In our view, an imminent buyout from another party is unlikely, given a) the timeline for Novator's planned stake increase; b) Netia's shares are already trading at a significant premium to the sector average; c) any interested investor is likely to wait for visibility in regulatory changes; and d) the mobile business plan hasn't yet been executed. Our base case scenario is that Novator is the most likely contender for a controlling stake and that it will achieve so opportunistically in the open market (otherwise they could have also called for a tender offer for the remaining 10% of their 33% -1 share planned stake). Therefore, we see no further catalysts to drive the shares substantially upwards.

Therefore, we do not see further catalysts to drive the shares substantially upwards over the next 6-12 months

M&A Metrics: Premium/Discount Drivers

Centertel (7x EBITDA)	TDC (7.5x EBITDA)			Netia	
Mobile	**TDC Group**	**Fixed**	**Mobile**	**Fixed**	**Mobile**
9.5m subscribers	28.6% 3Q05 EBITDA Margin	81% of total fixed lines	41% domestic mobile market share	25% of fixed business segment	30% ownership of P4
1/3 of a 75% penetrated market	65% dividend pay-out ratio;	63% of domestic traffic	39% domestic outgoing traffic market share	Less than 7% of total fixed market	To start operations 2H06-1H07
2005E EBITDA margin 35%; long-term margin 45%	3.3% dividend yield on current price of DKK 375, DPS 12,5	72% of ADSL customers	31.8% 3Q05 domestic mobile EBITDA margin	40% EBITDA margins	sub-scale operator margins likely to be below 30%
2005E TPSA ROCE 8.9%	ROCE 10.1%	30.4% 3Q05 EBITDA margin		2005E ROCE 4.9%	

Additionally, Netia is unlikely to command a premium similar to those implied in recent transactions for reasons set out in the table above. Applying a 25% discount to the average implied multiple of 7.0x from recent transactions in the sector would yield a potential take-out equity value of PLN 2.4bn, or PLN 5.9 per share. However, we assign a low probability for an imminent take-over and would not recommend factoring in such a scenario at this time.

M&A-driven valuation

	EV	Equity Value	Value per share
At 35.0% premium	3,347,732	3,878,978	9.6
At 25.0% premium	3,099,752	3,630,998	9.0
7.0x Average sector execution	2,479,802	3,011,047	7.5
At 25.0% discount	1,859,851	2,391,097	5.9
At 35.0% discount	1,611,871	2,143,117	5.3

Source: KBC Securities

Weak fundamentals warrant a discount

Netia's existing business is not immune to the declining trends in the fixed-line market

The perception that Netia is a growth story is inaccurate, as we see revenue growth slowing down and EBITDA margins starting to contract. We are forecasting revenues in 2006 to remain flat y/y versus a consensus expectation for a 1% contraction, reflecting the fact that Netia's existing business is not immune to the declining trends in the fixed-line market. We expect EBITDA margin to contract by 270bps to 35.8% in 2006 from 38.5% in 2005, as the rise in costs does not match the revenue slowdown. Additionally, we estimate a negative contribution of PLN 2.6m from P4. However, lower depreciation and amortization charges should help earnings to expand by 10% in 2006. Furthermore, a lower capex requirement (19% of sales, versus 20% in 2005) raises operating free cash marginally by 4% in 2006. In 2007, we expect further revenue growth deceleration, margin contraction and negative earnings impact from P4 to push earnings down by 13%.

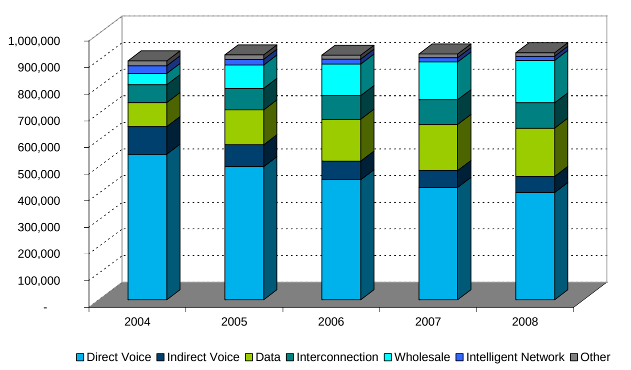
In our view, growth from interconnect revenues will be muted going forward after the substantial expansion in the last 18 months, following the El-Net acquisition. Moreover, Netia benefits from current favourable interconnect arrangements with TPSA, and we believe that this is likely to be revised going forward, leaving up to 10% of Netia's revenues at risk.

Further downside risk to our estimates, and consensus expectations could be in Netia's wholesale revenues. We are forecasting another 35% revenue growth from the wholesale business in 2006, after the strong growth in 2005. Our wholesale revenue expansion forecast is underpinned by the incoming regulator's pronouncements of opening up the fixed-line market, which in our view will accelerate unbundling and tariff rebalancing; which should translate to increased take-up of wholesale lines and capacity. However, TPSA could also decide to compete in pricing, which could limit the attractiveness of Netia's offering.

Netia continues to benefit from rapid expansion in fixed-line data services, which we estimate will grow by another 20% in 2006, to form 17% of total revenues. We believe that data will remain an important growth engine for telecom operators, and the one segment where they can differentiate their product offering to raise ARPU and offset price declines in the increasingly commoditised voice and bandwidth segments. Data growth offsets the rapid decline in Netia's traditional core business, direct voice services, which we forecast to decline by 10% this year.

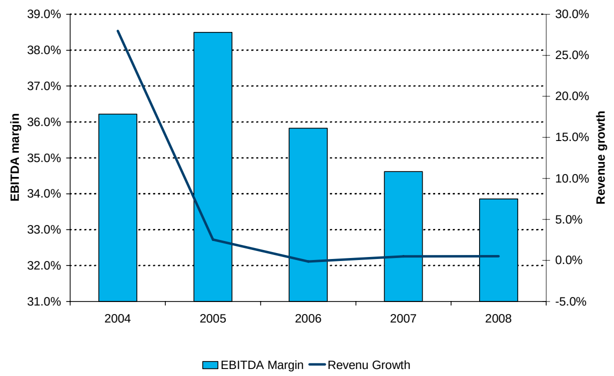
In our view, Netia will have to diversify its revenue base to remain in the game. We believe that consolidating the alternative carriers would be the optimal way to strengthen its foothold in the fixed-line market by posting a more viable competition to the incumbent. However, GTS appears increasingly a strong contender for the consolidator role having recently snapped-up Energis Polska. We would view an acquisition of the one remaining operator, Telefonia Dialog, positively. However, visibility on timing and pricing issues for such a deal remains very low.

Netia Revenue Composition



Source: Company reports, KBC Securities

Forecast Revenue and EBITDA Evolution



Source: KBC Securities

Changes to our Numbers

We have revised our forecasts to bring both our revenue and margin forecasts in-line with the reported trends. We have taken down our revenue assumptions for the core voice business, and increased our estimates for wholesale and interconnect revenues for 2005-2008. We then adjusted our EBITDA margin estimate for 2005, in line with management's guidance for 40%. Finally, we have had to adjust our estimates for Netia's tax charges, as we had previously assumed a higher tax benefit from their network investments. The result was a 6% reduction in our previous fair value estimate of PLN 4.6 per share. However, we have now also accounted for Netia's investment in P4 of PLN 360m. Furthermore, we have also adjusted our cashflow estimates for share buybacks and various investments on license fees (mostly for the 3.8 Ghz license). Following these adjustments, our fair value estimate for Netia's core [existing] business rises by 2% to PLN 4.7 per share.

Adjustment summary:

- **Revenues** were lowered by 9.9% on average over 2005-2010. Direct voice revenue forecasts were cut by 14.5% on average, while data revenue estimates are up by nearly 30% over the period.
- **EBITDA margins** have been adjusted upwards by 300bp on average over 2005-2010, from an average of 35% to 38%, as we trimmed our cost estimates in salaries and legal services. We have also included PLN 20m for license fees.
- **Taxes:** We no longer assume a longer tax holiday and higher tax breaks, and are now assuming tax charges in line with Polish corporate tax rate of 19%.
- **Share capital:** The number of shares was adjusted for warrants exercised from 390m to 404m. We have also included a PLN 120m cash outflow in 2005 for share buybacks.
- **P4:** We have factored in the PLN 360m investment in P4. Our estimates were still slightly ahead of consensus estimates prior to this. We have incorporated loss and income contribution from P4, in the associate line, taking into account Netia's 30% stake in the mobile venture. Associate losses push net profit down by 2% and 7% in 2006 and 2007 respectively (assuming first full year of operations in 2007), but lifts earnings by 3% on average by 2010.

Note that in our blended DCF and peer group valuation for Netia, we use a 5.0x 2006 EV/EBITDA multiple, versus the 5.5x multiple we have used for the integrated operators (CT, MT and TP). This is to reflect our conviction that Netia should trade at a discount to incumbents, given its limited business model and much smaller scale operations. Further, the absence of a potential future growth driver such as mobile operations warrants a discount, in our view.

Financial data

NETIA: P&L (IFRS Consolidated)					
Year to date (PLN '000)	**2004**	**2005**	**2006**	**2007**	**2008**
Monthly fees	144,248	143,474	134,050	125,502	117,956
Calling charges	398,152	352,006	312,744	292,381	280,687
Local calls	134,842	107,874	86,299	73,354	66,019
DLD	82,223	65,778	55,912	53,116	51,788
ILD	35,685	36,577	35,846	35,129	34,777
F2M	121,506	119,076	113,122	110,294	108,640
Other	23,896	22,701	21,566	20,488	19,463
Payphones	3,949	4,146	4,188	4,272	4,272
Direct Voice	546,989	499,582	450,926	422,133	402,884
Indirect Voice	103,445	82,756	70,343	63,308	60,143
Data	90,288	130,918	157,101	172,811	181,452
Interconnection	67,256	80,707	88,778	93,217	95,081
Wholesale	41,921	87,772	118,308	141,449	159,661
Intelligent Network	28,869	21,652	18,404	16,564	15,735
Other	7,826	16,555	14,899	13,726	13,040
TOTAL Revenues	897,162	919,941	918,759	923,208	927,996
YoY Revenue Growth	28.0%	2.5%	-0.1%	0.5%	0.5%
Previous Forecasts	*897,162*	*958,112*	*1,011,002*	*1,051,030*	*1,094,184*
Other Operating Income	4,634	4,866	4,963	5,013	4,963
Interconnection charges	158,733	182,543	200,797	210,837	216,108
Salaries & benefits	113,952	119,581	125,560	130,583	134,500
Professional services	13,840	10,119	10,106	10,155	10,208
Insurance	6,505	6,440	6,431	6,462	6,496
Taxes & fees	44,239	50,597	41,344	41,544	41,760
Advertising & promotion	24,523	27,598	18,375	18,464	18,560
Cost of rented lines & maintenance	73,618	80,980	85,029	86,729	88,464
Other operating expenses	121,217	90,913	81,821	77,730	75,787
EBITDA	324,908	356,036	354,257	345,715	341,076
EBITDA Margin	36%	38%	36%	35%	34%
Depreciation	188,891	173,165	155,168	147,713	148,479
Amortization	49,938	43,291	38,792	36,928	37,120
EBIT	85,794	115,663	135,185	134,956	128,576
Net financial income	27,874	12,002	6,826	4,773	10,410
Associates		-1,000	-2,592	-18,371	3,561
Profit Before Tax	113,668	126,665	139,419	121,357	142,548
Tax Charge	46,343	-24,066	-26,490	-23,058	-27,084
Share in minorities	-858	-925	-924	-928	-933
Net Profit	159,153	101,674	112,005	97,371	114,531
EPS	0.42	0.25	0.28	0.24	0.28

Source : Company reports, KBC Securities

Financial data

NETIA: Balance sheet (IFRS consolidated)					
Year to date (PLN '000)	**2004**	**2005**	**2006**	**2007**	**2008**
Cash and cash equivalents	301,863	172,462	121,137	262,079	420,105
Accounts receivables	122,763	128,895	128,730	129,353	130,024
Current Assets	437,546	314,605	263,098	404,727	563,493
Fixed Assets	1,817,156	1,871,270	1,929,458	1,984,851	2,031,251
Intangibles	307,473	280,691	289,419	297,728	304,688
Licenses	222,783	196,483	196,805	193,523	191,953
Software	84,690	84,207	92,614	104,205	112,734
Deferred income tax assets	46,843	2,533	2,788	2,427	2,851
Other long-term assets	1,149	1,178	1,177	1,182	1,188
Non-current assets	2,095,015	2,155,723	2,222,893	2,286,239	2,340,029
Total Assets	2,532,561	2,470,328	2,485,991	2,690,966	2,903,522
Accounts payable and accruals	150,234	152,357	152,161	152,898	153,691
Deferred income	10,589	9,199	9,188	9,232	9,280
Current liabilities	176,744	165,606	165,398	166,179	167,020
Other longterm liabilities	1,216	1,216	1,216	1,216	1,216
Non-current liabilities	55,304	55,304	55,304	55,304	55,304
Total liabilities & provisions	241,943	230,109	229,890	230,715	231,604
Share capital	366,956	366,956	366,956	366,956	366,956
Share premium	1,605,357	1,605,357	1,605,357	1,605,357	1,605,357
Treasury shares	-2,812	-2,812	-2,812	-2,812	-2,812
Other supplemental capital	203,565	183,209	164,888	148,399	133,559
Retained earnings	112,366	61,274	71,605	56,971	74,131
SHE	2,285,432	2,213,983	2,205,994	2,174,871	2,177,191
Total SHE & Liabilities	2,532,561	2,470,328	2,485,991	2,690,966	2,903,522

Source : Company reports, KBC Securities

NETIA: Cashflows (IFRS consolidated)					
Year to date (PLN '000)	**2004**	**2005**	**2006**	**2007**	**2008**
Net Profit	159,153	101,674	112,005	97,371	114,531
Depreciation & Amortization	238,829	216,457	193,960	184,642	185,599
Minority share in profits	858	925	924	928	933
Increase in longterm assets	457	60,708	67,170	63,346	53,790
Changes in working capital	-27,213	8,496	-347	1,306	1,405
Net Cash provided by operating activities	**315,691**	**388,260**	**373,712**	**347,593**	**356,258**
CAPEX	-191,397	-183,988	-174,564	-166,177	-157,759
Change in restricted cash & equivalents	-95,608	-	-	-	-
Chage in investments	-	-150,000	-210,000	-	-
Payments for licenses	-	-20,000	-	-	-
Net cash from investing activities	**-292,299**	**-357,188**	**-384,564**	**-166,177**	**-157,759**
Redemption of notes	-	-120,000	-	-	-
Dividends	-	-40,400	-40,400	-40,400	-40,400
Net Cash from financing activities	**54,915**	**-160,473**	**-40,473**	**-40,473**	**-40,473**
Net change in cash & cash equivalents	**73,862**	**-129,401**	**-51,325**	**140,942**	**158,026**
Cash at start of year	228,001	301,863	172,462	121,137	262,079
Cash at end of year	301,863	172,462	121,137	262,079	420,105

Source : Company reports, KBC Securities

Valuation

Netia core business DCF valuation

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
EBIT	135,185	134,956	128,576	131,241	116,772	93,243	97,520	101,570	103,859	106,706
Unlevered Tax	-25,685	-25,642	-24,430	-24,936	-22,187	-17,716	-18,529	-19,298	-19,733	-20,274
Capex	-174,564	-166,177	-157,759	-151,115	-152,616	-152,751	-151,884	-151,059	-150,276	-149,535
Depreciation	193,960	184,642	185,599	188,893	203,488	218,216	202,511	188,823	176,795	166,150
Change in Working Capital	-347	1,306	1,405	4,834	2,754	248	-1,591	-1,513	-1,436	-1,359
FCFF	128,549	129,085	133,392	148,918	148,211	141,240	128,028	118,524	109,210	101,687
PV	120,457	112,051	107,263	110,930	102,273	90,285	75,813	65,016	55,496	47,868

CAPM	
Rf	4.6%
Risk Premium	4.5%
Beta	1
Ke	9.1%
Cost of Debt	6.5%
Tax Rate	19.0%
Kd	5.3%
% Equity	70.0%
% Debt	30.0%
WACC	7.9%
Growth	0.5%

DCF	
Enterprise Value	1,533,227
Net Debt/Cash	171,246
Financial Participation (P4)	360,000
Equity Value	2,064,473
DCF Value per Share	**5.1**

NETIA FAIR VALUE	
EV At 5.0x EBITDA	1,771,287
DCF and Peer Multiple Ave	1,917,880
NETIA Value per Share	**PLN 4.7**

Sensitivity					
PLN 5.1	-1.5%	-0.5%	**0.5%**	1.5%	2.5%
9.9%	4.2	4.3	4.4	4.5	4.7
8.9%	4.4	4.6	4.7	4.9	5.1
7.9%	4.7	4.9	**5.1**	5.4	5.7
6.9%	5.1	5.3	5.6	6.0	6.6
5.9%	5.6	5.9	6.3	7.0	7.9

Source: KBC Securities

Netia: key ratios

	2004	2005F	2006F	2007F	2008F
Dividend Yield	0.0%	1.8%	1.8%	1.8%	1.8%
EFCF Yield		7.3%	7.2%	7.1%	7.6%
EV/OpFCF	14.4	11.9	11.7	10.9	9.8
ROE (%)	7.0%	4.6%	5.1%	4.5%	5.3%
ROCE (%)	8.9%	5.5%	5.9%	5.0%	5.7%
EV/EBITDA	5.9x	5.8x	5.9x	5.7x	5.3x
P/E	13.2x	21.9x	19.8x	22.8x	19.4x

*Source: KBC Securities *N/M: Not meaningful*

P4: Poland's 4th Mobile Operator

"Due to the execution of the provisions of the Agreement, since 23 August 2005 the Company does not control P4…" (Note 9 Investments in Associates)

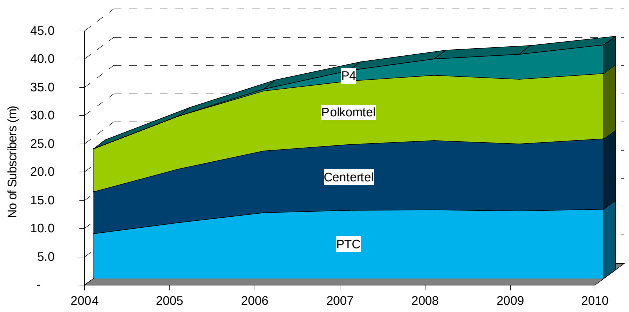
One of the issues that has pushed up Netia's valuation in recent weeks has been expectations of earnings and value enhancement from P4, its mobile venture with Novator. Although Netia only owns 30% of the mobile business, and have capped their capital exposure at some PLN 360m (EUR 90m), the market appears to be factoring in a substantial valuation uplift from the investment. We would highlight Netia's own statement in the notes to its 3Q05 release: *"Due to the execution of the provisions of the Agreement, since 23 August 2005 the Company does not control P4…"* (Note 9 Investments in Associates). Although the management has been unable thus far to provide any meaningful guidance for P4's operating and profitability metrics, we have constructed a model to show the potential incremental value it can create for Netia. Below, we set out the assumptions we have made in forecasting P4's operational and profitability prospects in the Polish mobile market.

Building blocks for P4 Model

Start of operations	2H06
Year 1 of commercial operations	2007
Forecast penetration rate at start of operations	87%
Market Share by 2010	12%
Long-term Market Share (2015)	15%
Post-Paid split	15%
5 Yr Subs CAGR	27%
5 Yr Revenue CAGR	24%
Long-term EBITDA margin	32%

Source: KBC Securities

Polish Mobile Market



Source: Company reports, KBC Securities

Lack of GSM license spells MVNO entry

A fourth operator obtaining one of the remaining GSM licenses will be negative … as it will simply exacerbate competitive pressure…

Netia has dropped out of the bidding race for one of the 3 blocks of 1800Ghz licenses being auctioned-off by the regulator, which would have enabled it to accelerate its GSM network roll-out, and offer services on its own capacity. Given management's insistence that P4 will launch mobile services later this year, we believe it will have to do so as an MVNO. Without a license to build-out a GSM network, and with negotiations for vendor financing for its UMTS still without progress, P4 would have to acquire capacity from the existing operators. However, it is still unclear whether they would have their own switches, or offer services as a pure reseller. In our view, both propositions are even less attractive than if they were to launch operations on their own network. In our previous report *(Netia: Wanted Business Model, 06 September 2005)*, we stated that an MVNO business model creates little value given long-term EBITDA margins of sub-20%.

Only TPSA, Dialog and Telekomunicakja Kolejowa remain in the bidding race for the GSM licenses. In our view, beefing up their capacity could indicate that TPSA is positioning itself to capture more traffic, and possible to be a prime capacity wholeseller. What is more interesting, in our view, is the two state-owned telcos' bid, given that they are both fixed-line operators. We believe that the state is likely to be dressing the two operators up to make them more attractive for future sale, or be positioning them as potential mobile operators, in anticipation of regulatory changes such as national roaming being introduced.

In our view, a fourth GSM operator will be negative for the sector as it will simply exacerbate competitive pressure without significant incremental benefit to subscribers. How the regulator will compensate the three existing operators (PTC, Centertel and Polkomtel) for having been charged nearly 8x what it charged Netia for the fourth UMTS license is unclear, although there have been indications that it is likely to write-off the balance that the operators have yet to pay (roughly EUR 390m for each of the operators).

P4 could disrupt status quo

Beyond sub-optimal margins, our concern is that P4 could end up disrupting the relatively rational pricing dynamic in the current status quo

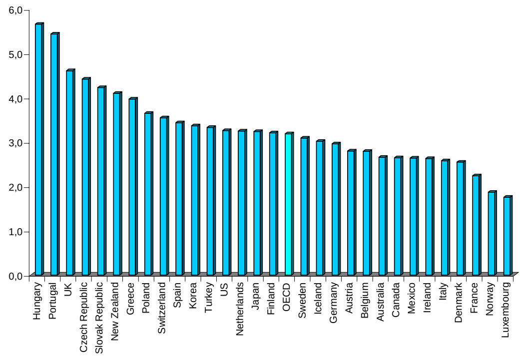
Although recent conversation with management confirmed that P4 is still in the process of talking to various equipment manufacturers, and has yet to secure vendor financing or vendor partnership for its UMTS roll-out, we have assumed that P4 will begin building-up its network in 1H06, and be able to start acquiring subscribers towards the end of 2006. In our view, P4 will likely enter the market by cut-throat pricing to acquire subscribers. Beyond sub-optimal margins, our concern is that P4 could end up disrupting the relatively rational pricing dynamic in the current status quo.

Given that Poland's telecom spending is already close to 5% of GDP, and that mobile accounts for half of that, we see slower incremental growth in revenues new entrants

We are assuming long-term EBITDA margin of 32%, but in our view, the cost of rolling out services and acquiring customers will outstrip revenues in the first 2 years. The bulk of Novator's and Netia's EUR 300m (PLN 1.2bn) capital contribution is likely to be used to finance the operational costs, while vendor financing is being lined-up for capital expenditures. Although Netia estimates that network build-up will take 12 months and the first full year of commercial operations will be in 2007, the company has yet to provide an update on negotiations progress with equipment vendors or even sites for base stations.

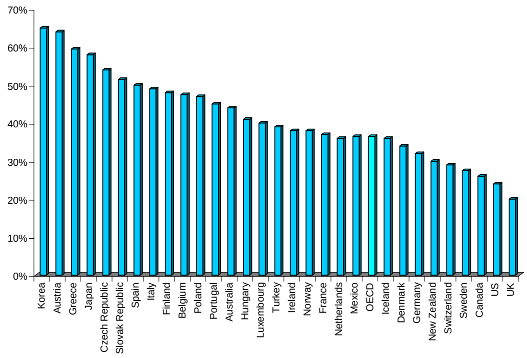
Delays in network roll-out will push-out commercial operations, increasing the risk that P4 will enter the market at a higher penetration rate, with a firmer status quo among the three operators in place, and therefore would require a more aggressive strategy to acquire subscribers, inevitably at the expense of profitability. Moreover, given that Poland's telecom spending is already close to 5% of GDP, and that mobile accounts for half of that, we see slower incremental growth in revenues for operators, making the environment even more challenging for new entrants.

Telecom revenues as % of GDP 2004



Source: OECD

Mobile share of telecom revenues 2004



Source: OECD

We estimate that P4 will be loss-making in the first 2 years of operations and will not make a meaningful income contribution to Netia until 2009. Although Netia has guided for a PLN 100m revenue contribution in year 1, we are finding it challenging to see how this will be achieved, as we expect the initial subscriber base to be made up largely by low-end, pre-paid subscribers, who will likely use mobile phones primarily for cheaper services, such as SMS. We would expect traffic to be generated only with significantly lower voice tariffs, in which case P4 would have to reach critical mass to generate the projected revenues for Netia. We have, however, factored-in P4-related interconnect and wholesale revenues going forward. On valuation, given Netia's 30% stake in P4 and the lack of visibility on how and when the business plan will be executed, we have treated Netia's investment in the company as an equity participation and valued it at cost, by adding their PLN 360m capital outlay to our DCF-based equity valuation.

P4 Operating Statistics and Profit & Loss

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Penetration Rate	87.0%	95.0%	100.0%	101.5%	105.5%	107.5%	109.5%	110.0%	110.0%	110.0%
P4 Subscribers	0.37	1.83	2.94	4.49	5.05	5.46	6.13	6.13	6.27	6.27
PostPaid	0.06	0.27	0.52	0.95	1.13	1.26	1.45	1.47	1.52	1.53
PrePaid	0.31	1.56	2.42	3.53	3.92	4.20	4.67	4.66	4.75	4.74
Market Share	1.1%	5%	8%	11%	12%	13%	14%	14%	15%	15%
Gross Adds	0.16	0.59	0.28	0.88	0.20	0.54	0.49	0.31	0.46	0.33
Net Adds	0.37	1.46	1.11	1.55	0.57	0.40	0.67	0.01	0.13	0.01
Blended Service ARPU (PLN)	44	40	34	30	29	27	25	24	23	21
Total Mobile Revenues	121	643	1,181	1,697	2,096	2,198	2,373	2,435	2,383	2,335
Service	99	538	1,042	1,560	1,993	2,153	2,325	2,407	2,377	2,330
Equipment	22	104	139	137	103	45	47	28	6	5
CoGS	76	398	658	787	952	820	863	868	832	816
SG&A	52	286	466	600	743	728	787	809	792	777
EBITDA	-7	-42	57	310	401	649	723	758	758	743
EBITDA Margin	*-6%*	*-7%*	*5%*	*18%*	*19%*	*30%*	*30%*	*31%*	*32%*	*32%*
Depreciation & Amortization		10	47	59	84	105	133	156	172	187
Operating Profit	-7,26	-51,46	9,98	250,44	317,32	543,73	589,71	602,51	586,59	556,12

Source: KBC Securities

TPSA

02 February 2006

Volatility creates opportunity

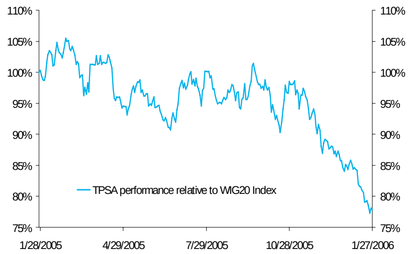
Telecom

Poland

Current pce	PLN 23.2
Fair Value	PLN 28.0

Buy

Rating maintained



	2004	2005F	2006F	2007F
Sales (PLN m)	18,564	18,346	17,905	18,074
EBITDA (PLN m)	7,931	7,961	7,698	7,728
Pre-Tax (PLN m)	3,171	3,021	2,872	3,388
Net profit (PLN m)	2,240	2,182	2,326	2,744
EPS (PLN)	1.6	1.6	1.7	2.0
Dividend Yield (%)	1.4	2.1	4.3	5.5
EFCF (%)	8.9	9.9	10.0	9.3
EV/EBITDA (x)	4.9	5.1	5.5	5.6
P/E (x)	14.5	14.9	14.0	11.8

Source: KBC Securities

Reuters	TPS PW
Bloomberg	TPSA.WA
www.tpsa.pl	
Market Cap	€ 8.2
Shares	1400
Volume	€ 10.7m
Free float	48%

Next corporate event

FY05 results 13 February 2006

Performance over	1m	3m	12m
Absolute	0,8%	1,7%	30,6%
Rel. WIG20	-8,8%	-18.0%	-18.7%

12-m Hi/Lo PLN 26.7/18.3

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TPSA owns, operates, and leases telecommunications networks throughout Poland. The Company provides local and long-distance telephone, telegraph, paging, and Internet access services. Telekomunikacja Polska also offers mobile telephone services through its mobile arm, PTK-Centertel

- We reiterate our Buy rating on TPSA. TPSA remains our top pick among C3 operators, driven by strong mobile growth, robust cash generation and attractive valuations. We recommend buying on newsflow-driven weakness. Our PLN 28 fair value presents an 18% upside from current level.
- Valuations are still attractive. At 5.5x 2006 EBITDA, TPSA trades in-line with its Western European peers, but at a discount of 19% and 7% to CT and Netia respectively. Given its superior mobile growth and cashflow prospects, the discount is unwarranted, in our view.
- Regulatory risk is priced-in. We are forecasting a revenue decline of 2.4% in 2006 versus management guidance of flat growth. Our more conservative forecast incorporates higher competition and market share loss in the fixed market.
- Growth prospects are underrated. Our 2.4% revenue decline forecast reflects a bottoming-out in 2006. Revenues are set to turn-around in 2007 as fixed-line deterioration decelerates and broadband and mobile drive topline growth. We forecast a 1.4% 5Yr revenue CAGR for TP, versus 0.7% for MT, and 0.3% for CT.

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KBC Securities

Buy TP – Downside risk fully priced-in

Regulatory risk is priced-in. Growth prospects and cash yields do not justify 19% discount to CT

TPSA remains our top pick in the CEE3 telco sector. We believe that the risk from imminent changes in regulations, that favour new entrants, are already priced-in. Our below consensus 2006 estimates incorporate aggressive assumptions on market share erosion in fixed access lines and traffic, as well as fixed-line and mobile tariff declines. Furthermore, we believe that TP's growth prospects in the mobile space are underrated. We are forecasting a 7.4% 2006F-2011F CAGR in mobile revenues and we expect a re-rating, driven by forthcoming M&A transactions in the Polish mobile sector.

Given TP's mobile growth and cashflow generation, the shares are attractively valued, in our view, offering 19% upside to our PLN 28 per share fair value estimate. At a 2006F EV/EBITDA of 5.5x and 2006F P/E of 14.0x, the shares trade at a discount to CT of 19% on an EV/EBITDA basis, and 36% on a P/E basis. Given its mobile and medium-term group revenue growth prospects (a 2006F-2011F CAGR of 1.4% versus CT's 0.3%) and slightly better cash yields (10.0% 2006 EFCF yield versus CT's 9.2%), we believe the large discount is unjustified. We see potential weakness in share price from newsflow on regulation as an opportunity to buy TP.

Sector deregulation is a given

We expect LLU acceleration and faster declines in wholesale rates, which would favour new entrants… however, this is already priced-in

At current valuations, we believe that regulatory risk is already priced into TP. In our model, we incorporate steeper fixed-line declines at TP than at CT or MT (-7.2% versus -3.5% for CT and -2.7% for MT). We expect LLU acceleration and faster declines in wholesale rates, which would favour new entrants in Poland. TP's strategy of migrating fixed-line customers to flat-rate packages pre-empts churn, as competitors could offer access lines at more competitive rates. However, unbundled lines are likely going to be used for broadband access, as voice traffic continues to migrate to mobile and IP-based platforms. On the other hand, there is a risk that the new regulator could limit such packages to encourage customers to switch to new operators. However, we also see a revision of the current interconnect agreements between TP and its competitors, which could provide modest upside. Although interconnect rates are largely asymmetric, TP estimates that the current arrangements with its biggest fixed-line competitor, Netia, are not favourable to the incumbent. A shift in the interconnect rates could translate into higher margins for TP.

We see no pressing need for further deregulation of the mobile market

In the mobile space, we do not see pressing need for further deregulation, given that market share is fairly evenly distributed amongst three operators, plus a potential MVNO.

Growth for FT, value for shareholders

FT could press for more growth from TP at the expense of margins and cashflows

In our view, FT's push towards growth and the expected regulatory changes could facilitate a balance between reasonable growth and profitability. FT, owner of a 47.5% stake, has named TP as a main reason for missing its internal targets in the past. The French telco has already called for the resignation of CFO Roger de Bazelaire late last year, after TP revised its 2005 guidance for the second time in the year during the 3Q05 earnings season. FT's recent statements and revenue targets indicate that it will have to aggressively push revenues up through investments. FT could push TP in the same direction, at the expense of margins and cashflows. However, imminent regulatory changes in Poland could restrict aggressive revenue growth initiatives, which could mean that TP would have to deliver growth on the bottom-line instead. We view earnings expansion over revenue growth more positively as revenue growth will likely have to come at the expense of margins and profitability.

Expect a re-rating driven by mobile M&A

We expect a re-rating driven by forthcoming M&A transactions in the Polish mobile sector

We are forecasting a 7.4% 2005F-2011F CAGR in mobile revenues to offset our expected 2% cumulative average decline in fixed-line revenues. We believe that TP's strong position in the fast-growing Polish mobile market warrants a premium. Additionally, we expect forthcoming M&A transactions in the sector to drive valuations up in the next 12 months.

Centertel's strong growth continues to support group revenues while fixed-line revenues should bottom-out this year. We are forecasting mobile revenues to grow at 8.1% y/y versus ET's 0.5% and TMH's 2.4%. Furthermore, we believe that there is upside to Centertel's subscriber estimates given the lack of strategic direction at its competitors, as they struggle with ownership issues (Vodafone, TDC, KGHM and PKN at Polkomtel, and TMob, Elektrim and Vivendi at PTC). Furthermore, we see the potential imminent competitive threat from a fourth operator as benign, from a timing and subscriber point of view. The earliest launch from a new operator is at the end of 2006, by which time the penetration rate is likely to be some 87%, and the status quo more firmly set.

Outlook

Revenues bottoming out in 2006

The risk to our forecast is now on the upside, having folded-in very aggressive assumptions on market competition

We are forecasting TP's group revenues to decline by 2.4% in 2006 to PLN 17.9bn, versus management's guidance for flat growth, and a consensus estimate of PLN 18.5bn. Our more conservative forecast is underpinned by pronouncements from the incoming regulator, regarding its intention to accelerate sector deregulation that could shrink TP's fixed-line market share more rapidly over the next 1-2 years, and management's track record for guidance revisions in 2005. We reiterate that the risk to our forecast is now on the upside, having factored in very aggressive assumptions on market competition.

We see revenues bottoming out this year, while management is guiding for a turnaround

Our conservative assumption on revenues bottoming-out this year as market competition intensifies also translates to our margin forecasts. We estimate that EBITDA will be pulled back by 3% as margin contracts slightly by 20bp to 42.8% on a 2.4% revenue decline. Despite lower revenues and EBITDA, lower financial costs and the elimination of minority payments for Centertel boosts earnings by 6.5%. Note that we see revenues bottoming out this year, while management is guiding for a turnaround. In our model, we assume revenues and earnings to start turning around in 2007.

We believe that there is significant upside in our cashflow estimates beyond 2007 when TPSA's capex commitments are lifted

While there is limited scope for a positive surprise in capex given that privatization-related capex commitments will not be lifted until 2007, potential revenue and margin upside could also boost cashflows. We believe that there is significant upside in our cashflow estimates beyond 2007 when TPSA's capex commitments are lifted. We are curently forecasting average capex/sales of 16% for 2006-2010. TPSA has already made significant network investments since privatization, and we believe that capex requirements will be substantially lower going forward. However, we await more details from TP regarding future investments before adjusting our forecasts.

Fixed line faces more pressure… nothing new

We are forecasting another 7.2% decline in fixed revenues as traffic continues to migrate to mobile and IP-based platforms

We are forecasting another 7.2% decline in fixed-line revenues on the back of an 11% drop in core revenues (traffic and subscriptions). Fixed-line margins are unlikely to expand significantly as voice prices remain under pressure and even prices of new DSL offerings would have to be attractively low to encourage take-up. We assume margin contraction from 44.5% in 2004 to 43.3% in 2005 and 43.0% in 2006.

Rapid deployment of DSL lines will be critical for TPSA in locking-in subscribers before full unbundling

Broadband revenues are set to rise, with DSL revenues growing 28% in 2006 on our estimates. The increase is on the back of 75% growth in DSL line installations, and a 30% drop in DSL ARPU, as we estimate that TPSA will have to keep offering lower-end DSL packages, with lower speeds (512kps or below) and lower prices. Rapid deployment of DSL lines will be critical for TPSA in locking-in subscribers before full unbundling. In our model, we assume 2% fixed-line churn per annum, starting from 2006.

The future is bright… the future is Orange

We expect mobile revenue growth to decelerate from a growth of 12.5% y/y in 2005 to 7.9% in 2006

We are forecasting 7.9% growth in mobile revenues in 2006, from an expected 12.5% y/y growth in 2005. Note that we are also assuming a more competitive mobile market as P4 enters the market in 2H06. Hence, we assume market share contraction for Centertel/Orange, as market share is redistributed among four operators. Given likely changes in the market structure (along with the introduction of mobile number portability), we are keeping our margin assumption flat from 2005 to 2006 at 35%, as operators will have to keep up spending on subscriber acquisition and retention.

Financial data

TPSA: Segmental analysis

Fixed Business	2004	2005	2006	2007	2008
Access Lines (m)	11.240	11.305	11.192	11.024	10.804
DSL Lines (m)	0.64	1.27	2.23	3.34	4.18
Fixed Core Revenues	11,071	9,859	8,777	8,013	7,374
Traffic	5,903	2,165	2,165	2,165	2,165
Subscriptions	4,122	4,077	3,986	3,838	3,733
Interconnect	759	739	734	728	719
Data & VAS	1,805	1,983	2,138	2,394	2,686
Other	900	889	899	905	907
Total Fixed Revenues	13,617	12,605	11,698	11,203	10,861
Interconnect Payments	2,053	1,938	1,810	1,740	1,691
Other selling costs	600	636	677	721	768
Staff Costs	2,260	2,034	1,871	1,795	1,723
Other SG&A	2,650	2,540	2,309	2,160	2,099
Total Opex	7,563	7,148	6,668	6,417	6,281
EBITDA	6,054	5,457	5,030	4,787	4,580
EBITDA Margin	44.5%	43.3%	43.0%	42.7%	42.2%
Depreciation & Amortization	3,566	3,361	3,190	2,499	2,172
EBIT	2,488	2,096	1,840	2,287	2,408
CAPEX	2,224	2,017	1,755	1,624	1,521

Source : Company reports, KBC Securities

TPSA: Segmental analysis

Centertel/Orange	2004	2005	2006	2007	2008
Subscribers (m)	7.4	9.5	10.9	11.7	12.2
Market Share	32%	33%	32%	32%	31%
Service Revenues	4,947	5,741	6,207	6,871	7,330
Traffic & Subscriptions	4,308	4,901	5,098	5,448	5,559
VAS	595	803	1,084	1,410	1,762
Equipment Revenues	204	193	194	196	198
Other	561	574	621	687	733
Total Revenues	5,636	6,315	6,828	7,558	8,063
Interconnect Payments	1,027	1,232	1,319	1,398	1,468
Other selling costs	1,130	1,042	1,024	1,134	1,209
Staff costs	390	442	478	529	564
Other SG&A	1,190	1,389	1,608	1,773	1,811
Total Opex	3,737	4,106	4,429	4,833	5,052
EBITDA	1,899	2,210	2,399	2,725	3,011
EBITDA Margin	33.7%	35.0%	35.1%	36.1%	37.3%
Depreciation & Amortization	830	902	1,012	972	1,015
EBIT	1,069	1,307	1,387	1,753	1,996
CAPEX (ex-UMTS license)	1,050	1,263	1,366	1,360	1,371

Source : Company reports, KBC Securities

Financial data

TPSA: P&L (IFRS consolidated)

Year to date (PLN m)	2004	2005	2006	2007	2008
Revenues	18,564	18,346	17,905	18,074	18,191
Operating Costs	10,633	10,384	10,207	10,346	10,410
EBITDA	7,931	7,961	7,698	7,728	7,782
EBITDA Margins	42.7%	43.4%	43.0%	42.8%	42.8%
Depreciation & Amortisation	4,431	4,263	4,202	3,471	3,188
EBIT	3,500	3,698	3,496	4,257	4,594
Net Interest Income (Expense)	-1,054	-727	-624	-869	-853
Pre-Tax Profit	3,171	3,021	2,872	3,388	3,741
Taxes	-679	-574	-546	-644	-711
Minorities	-252	-265	-	-	-
NET PROFIT	2,240	2,182	2,326	2,744	3,030
No of Shares	1,400	1,400	1,400	1,400	1,400
EPS	1.6	1.6	1.7	2.0	2.2
Dividends	-462	-693	-1,386	-1,802	-2,162
DPS	0.33	0.50	0.99	1.29	1.54
Retained Earnings	1,778	1,489	940	942	868

Source : Company reports, KBC Securities

TPSA: Balance sheet (IFRS consolidated)

Year to date (PLN m)	2004	2005	2006	2007	2008
Fixed Assets	28,795	27,636	26,529	25,978	25,638
Current assets	6,053	8,073	11,717	11,592	10,586
Cash and cash equivalents	3,033	4,779	8,502	8,347	7,320
Assets	34,510	39,405	45,396	47,700	47,318
Current Liabilities	5,230	4,972	5,036	4,986	4,884
Long-term liabilities	12,980	16,379	22,577	23,989	22,840
Shareholder's Equity	15,354	16,843	17,783	18,726	19,593
Minorities	946	1211	0	0	0
Shareholders and Liabilities	34,510	39,405	45,396	47,700	47,318
Net debt	6,694	8,171	9,948	11,103	10,630
Net gearing	30.4%	32.7%	35.9%	37.2%	35.2%

Source : Company reports, KBC Securities

TPSA: Cashflows (IFRS consolidated)

Year to date (PLN m)	2004	2005	2006	2007	2008
Net Profit	2,240	2,182	2,326	2,744	3,030
Depreciation	4,431	4,263	4,202	3,471	3,188
Changes in working capital	172	-194	-10	-18	-71
Operating free cash flow	-3,347	-3,280	-3,120	-2,985	-2,891
Capex	-3,274	-3,280	-3,120	-2,985	-2,891
Repayment of debt	-2,800	-1,500	-1,500	-2,500	-3,000
Dividends	-169	-462	-693	-1,386	-1,802
Net cash flow	1,167	1,794	3,723	-155	-1,027
Cash & cash equivalents BOP	1,818	2,985	4,779	8,502	8,347
Cash & cash equivalents EOP	2,985	4,779	8,502	8,347	7,320

Source : Company reports, KBC Securities

Valuation

TPSA core business DCF valuation

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
EBIT	3,496	4,257	4,594	4,926	5,243	5,525	5,561	5,414	5,298	5,404
Unlevered Tax	-699	-851	-919	-985	-1,049	-1,105	-1,112	-1,083	-1,060	-1,081
Capex	-3,120	-2,985	-2,891	-2,856	-2,813	-2,808	-2,751	-2,780	-2,813	-2,846
Depreciation	4,202	3,471	3,188	2,776	2,591	2,500	2,567	2,720	2,892	2,946
Change in Working Capital	-10	-18	-71	36	96	80	137	131	85	68
FCFF	3,868	3,873	3,901	3,896	4,068	4,192	4,402	4,403	4,403	4,491
PV	3,624	3,362	3,137	2,902	2,807	2,679	2,607	2,415	2,237	2,114

CAPM	
Rf	4.6%
Risk Premium	4.5%
Beta	1
Ke	9.1%
Cost of Debt	6.5%
Tax Rate	19.0%
Kd	5.3%
% Equity	70.0%
% Debt	30.0%
WACC	7.9%
Growth	0.5%

DCF	
Enterprise Value	53,720
Net Debt/Cash	-8,171
Equity Value	45,549
DCF Value per Share	**32.5**

TPSA FAIR VALUE	
EV At 5.5x EBITDA	42,338
DCF and Peer Multiple Ave	39,858
TPSA Value per Share	**PLN 28**

Sensitivity

PLN 32.5	-1.5%	-0.5%	**0.5%**	1.5%	2.5%
9.9%	22.2	23.3	24.5	26.1	28.1
8.9%	25.0	26.4	28.1	30.2	33.1
7.9%	28.3	30.2	**32.5**	35.6	39.8
6.9%	32.5	35.0	38.4	42.9	49.6
5.9%	37.8	41.4	46.3	53.5	64.9

Source: KBC Securities

TPSA: key ratios

	2004	2005F	2006F	2007F	2008F
Dividend Yield	1.4%	2.1%	4.3%	5.5%	6.7%
EFCF Yield	8.9%	9.9%	10.0%	9.3%	9.6%
EV/OpFCF	8.4	8.7	9.3	9.2	8.8
ROE (%)	14.6%	13.0%	13.1%	14.7%	15.5%
ROCE (%)	8.5%	8.6%	9.2%	11.1%	12.3%
EV/EBITDA	4.9	5.1	5.5	5.6	5.5
P/E	14.5	14.9	14.0	11.8	10.7

Source: KBC Securities

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