



# Ukraine / Telecommunications

## Ukrtelecom

Christmas Wrapping?

**HOLD**

18 Jul 2005

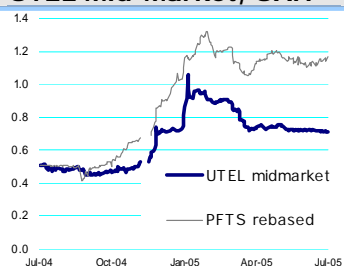
USD 0.14

12m Target

USD 0.15

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### UTEL Mid-Market, UAH



Note: 18 Jul 2005 price, as given, reflects the price of USD 100,000 block. It does not necessarily correspond to PFTS mid-market price

### Market Information

Bloomberg UTEL.UZ

Reuters UTEL.PFT

No of Shares, mln 18,726.2

Reg S GDR to Ord. 1:50

Market price 0.140

52Wk H/L, USD 0.20/ 0.08

MCap, USD mln 2,621.7

Free Float, % 2.4%

### Stock Ownership

State 92.86%

Legal entities 4.71%

Individuals 2.43%

### Ratios 2005E

EBITDA Margin 38.4%

EBIT Margin 26.1%

Net Margin 18.5%

Net Debt/ Equity 0.26

There has been a lot of positive news about UTEL the last few days. First the government approved its increased CapEx plan and upgraded its net income forecast for 2005 by 43%. Next the NCRC promised to make an "income-driving" rebalance in tariffs for UTEL. In addition, UTEL's investor-unfriendly privatization law was canceled. However, the indifference of the market suggests that investors are skeptical about the reasons for these changes and that company may be being inflated before its privatization. As the state's preferential treatment is unlikely to continue in the long-term, we think UTEL's 2005 income growth is a one off event. We upgrade our target price to USD 0.15, and maintain our **HOLD** recommendation

**UTEL's Net Income Forecast Increased By 43% To USD 314 Mln.** State Property Fund (SPF) officials announced that the government approved the increase earlier this week. We believe the main reasons for this forecast are the planned changes of fixed-to-mobile (FTM) and mobile-to-fixed (MTF) tariffs starting in August:

#### FTM Tariff Breakdown, USD/min

	UTEL	Mobile	Total Tariff
Current	0.08	0.12	0.20
Expected	0.08	0.08	0.16

The FTM tariff is split between fixed line and mobile operators. The expected decrease in the mobile component of the tariff will cause a 20% drop in the overall FTM tariff. This will stimulate FTM traffic growth, and increase Ukrtelecom's FTM proceeds

#### UTEL Tariff For Local MTF, USD/min

	UTEL	Mobile	Total Tariff
Current		0.021	0.021
Expected		0.042-0.049	

Mobile operators pay UTEL 0.021 USD per minute of every local MTF call. This tariff is expected to grow 2-2.5 times. UTEL's MTF revenue response will be limited because of an expected counteracting tariff adjustment by mobile providers causing a drop in MTF traffic

**Uncertainty About Local Fixed Tariffs.** Local fixed tariffs are expected to grow by 50%, this issue is now being discussed by the NCRC. However, increasing the local tariff is socially sensitive, and thus may be postponed.

**UTEL To Receive G3 Mobile Service License.** UTEL is expected to obtain the license in 3Q05. There is no specific evidence that telecoms receive significant benefits from G3 mobile service licenses, so we downplay this event.

**UTEL Has Corrected Its 2005 CapEx Upward By 20% To USD 530 Mln.** The SPF made this public last week. To finance its CapEx, UTEL expects to obtain a USD 418 mln loan from international banks. The probability of obtaining such loan is good, because UTEL is backed by the state. Its new CapEx level will allow the company to maintain its fixed line CapEx program of USD 430 mln, as was planned for 2005, and to spend USD 100 mln to develop its mobile segment. Also, an increasing share of long-term loans will decrease costs of capital.

**No Dilution of Minority Stake.** A week ago the Parliament cancelled the law concerning UTEL's privatization, which stipulated the possibility of an additional share issuance to the benefit of the state, while diluting other shareholder's stakes.

**The state will benefit if UTEL increases its net income: provides higher dividends, and increases its value before privatization (note that information about UTEL's net income correction was announced by the SPF, not by the company). We suspect that the state is inflating UTEL's net income before its privatization announcement, which is expected in 2006. After privatization, the government may have less incentive to give preferential treatment to UTEL. Still, UTEL will benefit from a period of special treatment, as it will be able to accumulate capital for equipment modernization and new development.**

#### KEY FINANCIAL DATA, USD mln

	Net Revenues	EBITDA	Net Income	DPS, USD
2004	1,165.8	403.3	148.9	0.0092
2005E	1,379.8	529.2	255.8	0.0076
2006E	1,540.0	610.4	286.4	0.0049

Spot Exch. Rate 5.05

#### KEY RATIOS

	EV/S	P/E	EV/EBITDA	Div. Yield
2004	2.36	17.61	6.82	6.5%
2005E	2.22	10.25	5.78	5.4%
2006E	1.98	9.15	4.99	3.5%

## Peer Comparison

## UTEL vs International Emerging Market Peers, USD mln

		Sales		Net Income		EBITDA		Fixed Lines mln	ARPL USD	Margins, 2004:	
		2004	2005E	2004	2005E	2004	2005E			Net	EBITDA
Cesky Telecom	Czech Rep	2404	2443	218	237	1172	1126	3.59	670	49%	9%
Magyar Telecom	Hungary	2955	2982	170	327	1040	1203	2.35	1259	35%	6%
Bezeq	Israel	2069	2484	139	176	871	884	3.01	687	42%	7%
Telemar	Brazil	5153	7205	303	736	2241	2961	15.20	339	43%	6%
Embratel	Brazil	2420	3104	-112	104	464	724	n/m*	n/m	19%	-5%
median									679	42%	6%
average									739	38%	5%
<b>Ukrtelecom</b>		<b>1166</b>	<b>1360</b>	<b>149</b>	<b>314</b>	<b>403</b>	<b>529</b>	<b>9.54</b>	<b>122</b>	<b>35%</b>	<b>13%</b>

Source: IBES, Bloomberg, Concorde Capital estimates

\* Embratel is a long distance operator, so number the of its fixed lines is irrelevant.

## Multiples Comparison

	Price USD	MCap	EV	EV/S		EV/EBITDA		P/E		EV/Lines USD	
				2004	2005E	2004	2005E	2004	2005E		
Cesky Telecom	18.40	5940	7046	2.9	2.9	6.0	6.3	27.2	25.0	1965	
Magyar Telecom	4.38	4510	6402	2.2	2.1	6.2	5.3	26.5	13.8	2728	
Bezeq	121.98	3190	4406	2.1	1.8	5.1	5.0	23.0	18.1	1464	
Telemar	23.61	6299	8500	1.6	1.2	3.8	2.9	20.8	8.6	559	
Embratel	2.12	1533	2504	1.0	0.8	5.4	3.5	neg	14.8	n/m	
median				2.1	1.8	5.4	5.0	24.8	14.8	1714	
average				2.0	1.8	5.3	4.6	24.4	16.1	1679	
<b>Ukrtelecom</b>		<b>0.14</b>	<b>2622</b>	<b>2750</b>	<b>2.4</b>	<b>2.0</b>	<b>6.8</b>	<b>5.2</b>	<b>17.6</b>	<b>8.3</b>	<b>288</b>
<b>Implied upside</b>				<b>-21%</b>	<b>-13%</b>	<b>-22%</b>	<b>-4%</b>	<b>41%</b>	<b>77%</b>	<b>519%</b>	
<b>Implied Target, USD</b>				<b>0.115</b>	<b>0.126</b>	<b>0.113</b>	<b>0.139</b>	<b>0.204</b>	<b>0.257</b>	<b>0.897</b>	

Source: IBES, Bloomberg, Concorde Capital estimates

EV/S and EV/EBITDA ratios imply a downside. Significant upside is implied by EV/Lines multiple; however, UTEL's ARPL is below its peers and makes us rather skeptical about using this ratio.

Though the stock currently trades at significant discount compared to its international peers by P/E, we do not suggest relying too much on signals from P/E multiples in the long term. Most probably we will see UTEL's net margin superiority over its EM peers disappear after the company's privatization (expected in mid 2006-2007), when it loses state backing. The current upside implied by P/E in our opinion is artificial, and will disappear with net margin converging to the level of international peers.

We slightly improve our 12m target for UTEL to USD 0.15, while maintaining a HOLD recommendation.

Financial statements according to Ukrainian Accounting Standards, consolidated\*

**Income Statement Summary, USD mln**

	2003	2004	2005E	2006E
<b>Net Revenues</b>	<b>963</b>	<b>1,166</b>	<b>1,380</b>	<b>1,540</b>
Cost Of Sales	(452)	(680)	(755)	(827)
Gross Profit	511	485	625	713
SG&A	(67)	(71)	(87)	(94)
<b>EBITDA</b>	<b>424.4</b>	<b>403.3</b>	<b>529.2</b>	<b>610.4</b>
EBITDA margin, %	44.1%	34.6%	38.4%	39.6%
Depreciation	(126)	(153)	(169)	(192)
<b>EBIT</b>	<b>299</b>	<b>250</b>	<b>360</b>	<b>418</b>
Interest Expense	(9)	(27.2)	(38)	(55)
Financial income/(expense)	23	39	38	38
Other income/(expense)	(55)	(31)	(19)	(19)
<b>PBT</b>	<b>257</b>	<b>231</b>	<b>341</b>	<b>382</b>
Tax	(110)	(82)	(85)	(95)
<b>Net Income</b>	<b>147.1</b>	<b>148</b>	<b>256</b>	<b>286</b>

**Balance Sheet Summary, USD mln**

	2003	2004	2005E	2006E
<b>Current Assets</b>	<b>381</b>	<b>354</b>	<b>504</b>	<b>562</b>
Cash & Equivalents	87	82	129	145
Trade Receivables	113	107	166	185
Inventories	74	81	97	108
Other current assets	106	85	112	125
<b>Fixed Assets</b>	<b>1,516</b>	<b>1,653</b>	<b>2,067</b>	<b>2,339</b>
PP&E, net	1,118	1,263	1,603	1,870
Other Fixed Assets	397	390	464	468
<b>Total Assets</b>	<b>1,897</b>	<b>2,006</b>	<b>2,571</b>	<b>2,901</b>
<b>Shareholders' Equity</b>	<b>1,503</b>	<b>1,448</b>	<b>1,691</b>	<b>1,967</b>
Share Capital	878	878	878	878
Reserves and Other	293	535	585	651
Retained Earnings	332	35	223	432
<b>Current Liabilities</b>	<b>203</b>	<b>374</b>	<b>354</b>	<b>399</b>
ST Interest Bearing Debt	35	49	67	72
Trade Payables	43	79	62	69
Accrued Wages	8	10	11	12
Accrued Taxes	20	14	17	19
Other Current Liabilities	125	394	196	226
<b>LT Liabilities</b>	<b>191</b>	<b>184</b>	<b>526</b>	<b>536</b>
LT Interest Bearing Debt	165	161	499	498
Other LT	26	22	26	38
<b>Total Liabilities &amp; Equity</b>	<b>1,896</b>	<b>2,006</b>	<b>2,571</b>	<b>2,901</b>

\* Net income 2004 is adjusted by dividends from UTEL

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