

Ukrtelecom

Privatization to unlock the triple play story

Event: Privatization to be held on December 28

Ukraine's State Property Fund will announce the bidders for the state's 92.8% stake in Ukrtelecom, the incumbent fixed-line telecom operator, tomorrow. The privatization, which has been on the table for 12 years, is scheduled for December 28, with a starting price of USD 0.076 per share. The corporate governance practices of SCM, the most likely buyer, implies little risk of minority rights violations after privatization.

Investment case: State's divestiture entails transformation

Ukrtelecom's new owner can improve inefficiency (8% EBITDA margin for 2009 vs. its peer median of 37%), primarily from overstaffing (4.1 employees per ths households vs. the European incumbent fixed-line operator average of 1.7). We estimate workforce optimization could account for up to a 19 pp increase in Ukrtelecom's EBITDA margin by 2015.

Ukrtelecom's incumbent position gives it last mile access to 10 mln customers. Key revenue catalyst is offering double (broadband + fixed voice in the short-term) or triple play services (cable/IPTV in the mid-term) based on its network. We estimate provision of these services could secure sales growth at a 8% CAGR to USD 1,327 mln in 2015E.

Valuation: TP implies 76% upside. BUY

In our DCF model for Ukrtelecom, we assumed flat development of fixed-line voice services, moderate growth in broadband, a closure in mobile services and a headcount decrease of 1/3 by 2015. We set a 2Y horizon for our target price as we see 12M as too short for the company to show restructuring positives while balance sheet clearance might entail temporary negative sentiment on the market. Our 2Y target price of USD 0.140 per share for Ukrtelecom suggests potential upside of 76%.

Risks: Minimization of personnel costs

We see the key challenge for Ukrtelecom's new owner as transforming the company from overstaffed and inefficient to modern, capable of providing a full range of telecom services with minimal personnel costs. Postponement of the privatization auction and reprivatization risks exist, but we rate these risks as low given current unity in key government branches.

Report date	20 Dec 2010
Bloomberg	UTLM UK
Reuters	UTLM=UA
Recommendation	BUY
Price (20 Dec 10), USD	0.079
2Y price target, USD	0.140
Upside, %	76%

No of shares, mln	18,726.2
Market Cap, USD mln	1,488.3
52-week performance	39%
52-week range, USD	0.113/0.054
ADT, 12M, USD mln	0.38
Free float, %	7.2%
Free float, USD mln	107.2

Prices as of Dec. 20, 2010

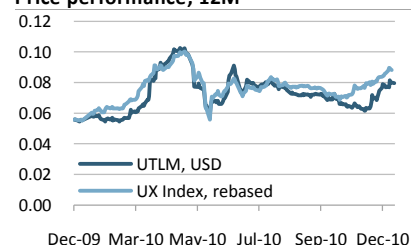
Key financials, USD mln

	2009	2010E	2011E	2012E
Sales	889	912	1,047	1,101
EBITDA	73	159	286	370
Net Income	(136)	(63)	32	98
Net Debt	416	463	380	324

Key ratios

	2009	2010E	2011E	2012E
EBITDA Margin	8.3%	17.5%	27.3%	33.6%
Net Margin	-15.3%	-6.9%	3.1%	8.9%
ROE	-20.7%	-10.0%	5.1%	14.6%
Current Ratio	0.29	0.48	0.66	0.68
Total Asset				
Turnover	0.69	0.70	0.83	0.88
D/E	70%	83%	68%	53%

Price performance, 12M



Source: Bloomberg, UX

Long-awaited privatization slated for this month

Auction to take place on December 28

The State Property Fund announced in early October it scheduled an auction to privatize the state's 92.79% stake in Ukrtelecom on December 28, 2010. Given current government unity on the issue, we expect this month to finally end 12 years of talk of privatizing Ukrtelecom.

The starting price for the stake, which is to be sold as one block, was set at USD 1.31 bln or USD 0.076 per share (5% below the current market price). Though privatization conditions published by the Cabinet of Ministers limit the list of potential bidders, we see at least one suitor, SCM, willing to pay the price for the stake.

Ukrtelecom privatization conditions

<i>Condition</i>	<i>Implication</i>
Bidder should have not have 25% or more of its shares held by any state or state-owned enterprise	A list of Telcos that have stated an interest in Emerging Market acquisitions are excluded: Deutsche Telekom (Germany), Svyazinvest (Russia), France Telecom (France), Telkom (South Africa), Telenor (Norway), TeliaSonera (Sweden)
Bidder should have less than a 25% share in value terms of the Ukrainian telecom market	Kyivstar, Ukraine's #1 mobile operator, is excluded
If the new owner decides to retire personnel within three years of privatization, it should pay 6-36 months of salary depending on tenure	Given overstaffing, we think the new owner will cut ~25% of personnel, which would result in a one-off payout of ~UAH 0.9 bln in retirement benefits, which we account in our model
New owner should build a special purpose telecommunication network for the government and transfer it to the state for free	Given that this network already exists, we think this condition will require only a limited modernization, we model UAH 200 mln in additional spending

Most likely bidder: SCM

In our view, the most likely bidder for Ukrtelecom is SCM, Ukraine's largest business group, which holds 45% of Ukraine's #3 largest mobile operator Astelit and 100% of Ukraine's #4 largest broadband provider Vega.

Another possible bidder is Sistema (LSE: SSA LI), which controls MTS, a leading CIS telecommunications group with 102 mln customers. Sistema has previously expressed its desire to buy Ukrtelecom and has more than USD 2 bln in cash accumulated on MTS' balance sheet.

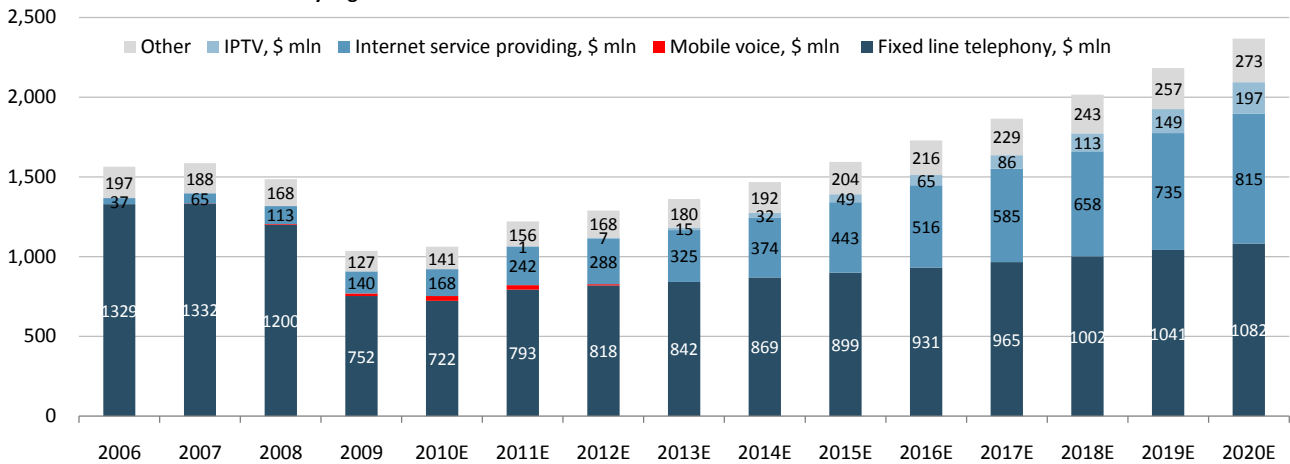
Six unnamed companies have requested applications to participate in the privatization auction from the State Property Fund, and Turkcell asked to postpone the auction in order to give them more time to make a decision.

Top line: triple play story

While global telcos have combined business models, with most providing triple play or quadruple play services, the Ukrainian telecom industry is still fragmented into separate mobile/fixed-line voice/broadband/cable TV providers. We view Ukrtelecom, Ukraine's incumbent fixed-line operator with existing last mile connectivity to 90% of households, as capable of introducing triple play services in the mid-term, which would facilitate boosting its ARPU from USD 8.4 in 2009 to USD 14 in 2015, assuming efficient management takes over.

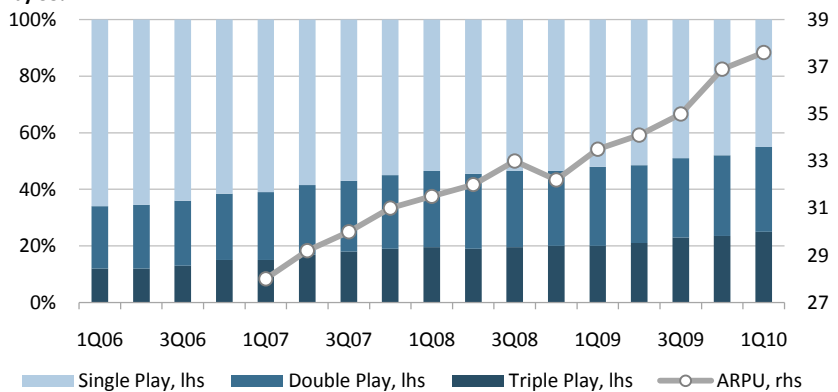
Despite its last mile advantage, Ukrtelecom earns a tiny USD 8.4 per month per customer. Due to its fixed-line voice focus, Ukrtelecom suffers from the heavily regulation of low margin local call services and cannibalization of inter-city calls by mobile operators. We see Ukrtelecom's key revenue growth potential in the provision of additional services (broadband in the short-term and cable/IPTV in the mid-term), utilizing its last mile access.

Ukrtelecom revenue breakdown by segment



Source: Company data, Concorde Capital

Case study: Telenet's increase in triple play share in services from 15% to 24%, ARPU improved by 35%



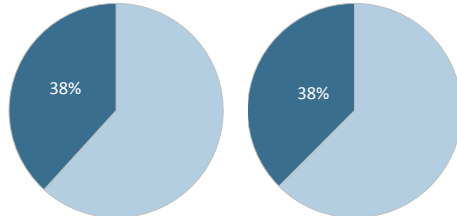
Source: Telenet (Belgian telco)

Fixed-line telephony: 73% of current revenue

Local calls: value-neutral segment

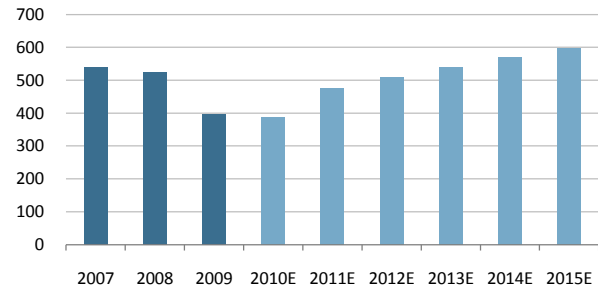
The National Telecommunications Regulatory Commission strictly controls tariffs on local calls, the most basic and cheapest telecom service. Though regulatory policy is hard to predict, we expect local call revenue to follow CPI and model this segment as value-neutral for Ukrtelecom.

Share of Ukrtelecom revenues
2009 2015E



Source: Company data, Concorde Capital

Ukrtelecom's revenue from local calls, USD mln



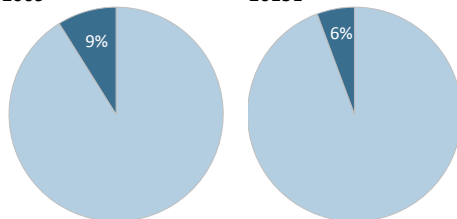
Source: Company data, Concorde Capital

Inter-regional calls: price growth driven by mobile tariff hikes

We expect Ukrtelecom's revenue from inter-regional calls (9% of total revenue) to stop declining in 2011, driven by an expected sector-wide increase in tariffs.

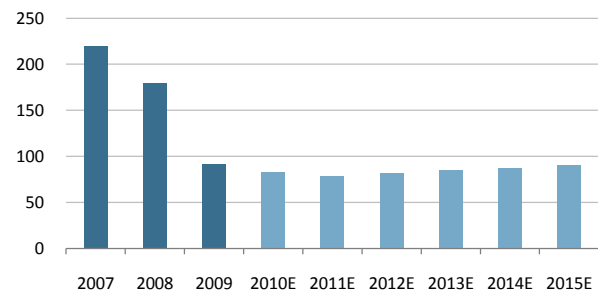
For the last ten years, Ukrtelecom's inter-regional call segment has been falling due to cannibalization from mobile telecom services, which are a natural substitution for fixed-line inter-regional calls. We think the substitution effect is close to its maximum, given that mobile penetration has been stable at about 120% for the last two years. Moreover, due to market saturation, mobile players have stopped competing by lowering tariffs and simultaneously started raising tariffs in 2010. Given our expectation of further mobile tariff hikes, we expect Ukrtelecom's inter-regional call volume to be stable and revenue to grow with CPI.

Share of Ukrtelecom revenues
2009 2015E



Source: Company data, Concorde Capital

Ukrtelecom's revenue from inter-regional calls, USD mln

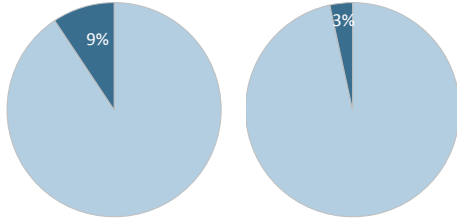


Source: Company data, Concorde Capital

International calls: downside price pressure from competitors

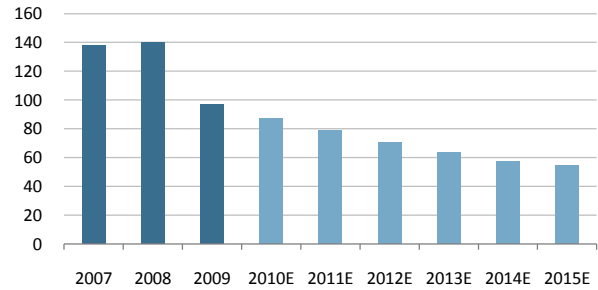
Ukrtelecom faces fierce competition for high margin international calls. We expect competition to drive prices further down, which will result in Ukrtelecom's revenue from this segment falling at a 9% CAGR over 2010-15.

Share of Ukrtelecom revenues
2009 2015E



Source: Company data, Concorde Capital

Ukrtelecom's revenue from international calls, USD mln



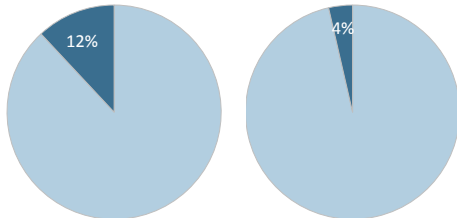
Source: Company data, Concorde Capital

Fixed-to-Mobile: positive regulation shift in interconnection

We expect Ukrtelecom's fixed-to-mobile revenues to decrease at a 9% CAGR, after a threefold decrease over 2005-2009.

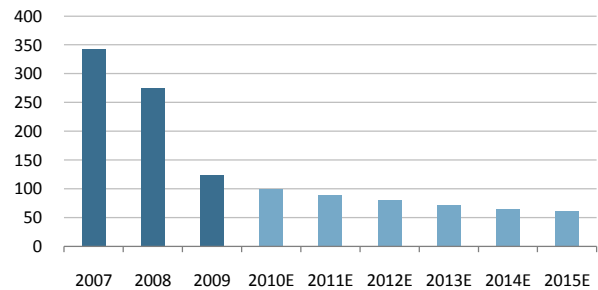
The recent review of interconnection tariffs by the National Telecommunications Regulatory Commission ended favorably for Ukrtelecom: NERC now sets tariffs (UAH 0.35 per minute for fixed-to-mobile calls, UAH 0.25 for mobile-to-fixed) versus the market (UAH 0.50/0.25 under previous agreements), an arrangement that was favorable to mobile operators. This will allow the company to lower its tariffs for fixed-to-mobile calls to the level of mobile-to-mobile calls, which should decrease fixed/mobile substitution.

Share of Ukrtelecom revenues
2009 2015E



Source: Company data, Concorde Capital

Ukrtelecom's revenue from fixed-to-mobile calls, USD mln

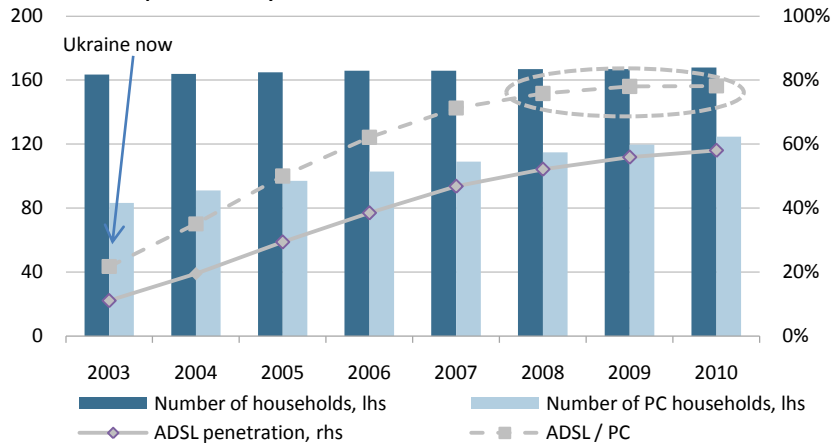


Source: Company data, Concorde Capital

Broadband internet: a key growth segment

The Ukrainian broadband market has been doubling every two years, but penetration is still only 16% as of 9M10 vs. the EU-15's average of 58% and Russia's 28%. In terms of broadband penetration, Ukraine lags the EU by seven years, and we expect Ukraine to reach 40% penetration within five years, following EU broadband penetration dynamics.

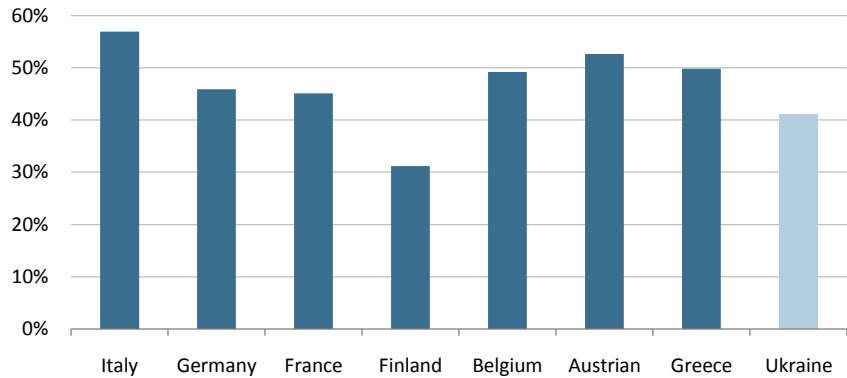
EU broadband penetration dynamics



Source: Concorde Capital

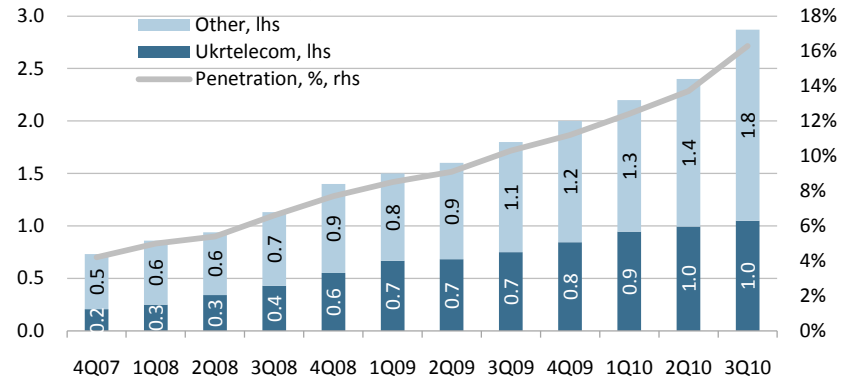
We believe Ukrtelecom, as Ukraine's incumbent telecom provider, can capture about a 50% share of the broadband market by 2012 (up 1.2x from 41% currently). Its key underlying competitive advantage is having last mile access to 10.4 mln customers (only 10% are already connected to broadband).

Market share of incumbent telcos on broadband market, 2009



Source: Concorde Capital, iKS-Consulting

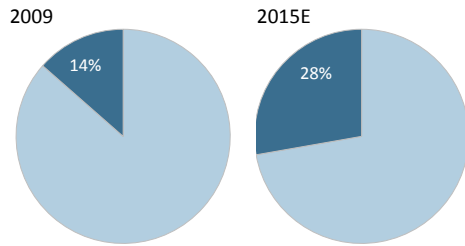
Broadband subscribers in Ukraine, mln



Source: iKS-Consulting

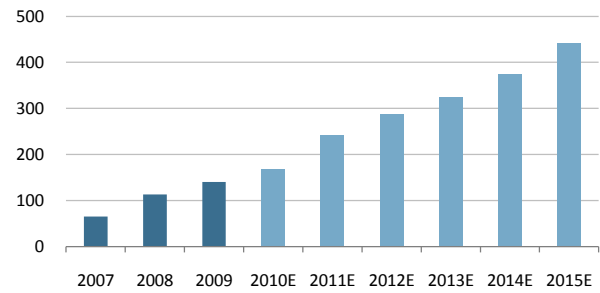
We expect Ukrtelecom's revenue from internet service provision to grow at a 21% CAGR over 2010-15, driven by increasing broadband penetration.

Share of Ukrtelecom revenues



Source: Company data, Concorde Capital

Ukrtelecom's revenue from internet services, USD mln

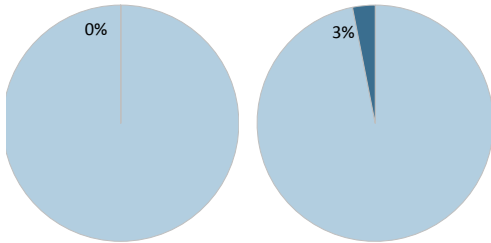


Source: Company data, Concorde Capital

Broadband TV: yet to be a revenue driver

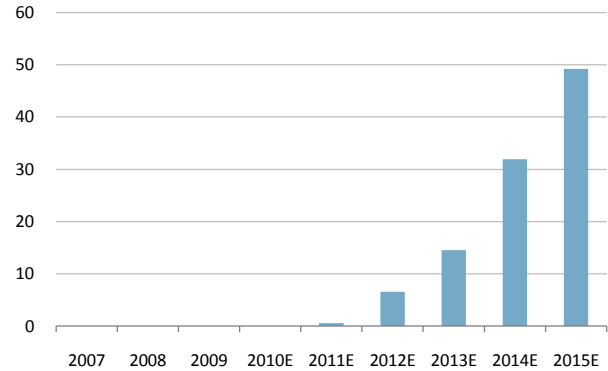
The transition to digital TV (stipulated by law by 2015) will drive pay TV penetration from 21% currently to an estimated 75% and should boost the market by fivefold to USD 1 bln in 2015, according to our forecasts. For Ukrtelecom, which is only testing pay TV services, IPTV access should be a lucrative way to leverage its customer base. We conservatively estimate the company to gain a 5% market share in 2015 and increase it to 12% in 2020.

Share of Ukrtelecom revenues
2009 2015E



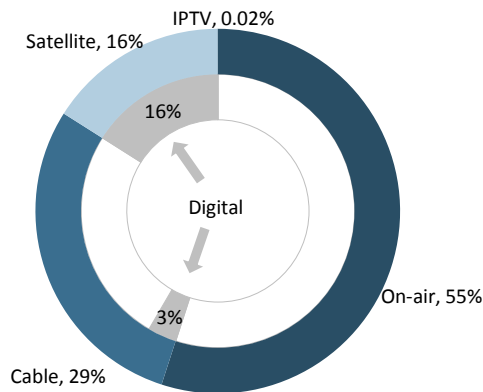
Source: Company data, Concorde Capital

Ukrtelecom's revenue from IPTV services, USD mln



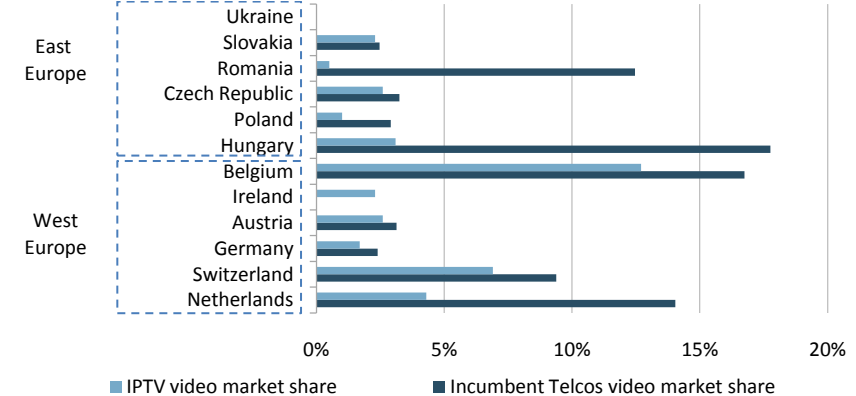
Source: Company data, Concorde Capital

TV access by technology in Ukraine, 2009



Source: GfK

Incumbent telco share in pay TV market is yet at infant stage, 2010



Source: Liberty Global

Mobile business: failed game

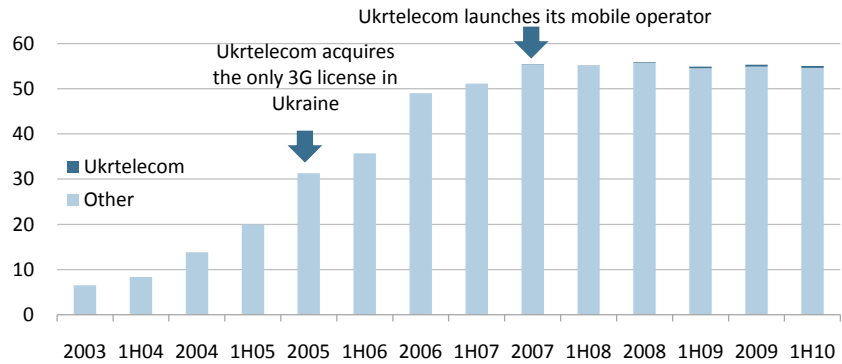
Mobile telecommunications account for 62% of the telco business in Ukraine, with a total market value of USD 3.6 bln in 2009. Ukrtelecom launched its mobile operator in 2007, but has only gained a 2% market share despite holding Ukraine’s only license for 3G mobile services.

Mobile penetration in Ukraine reached 120% as of 2009 and has remained at around that level for six quarters, which we interpret as a signal of market saturation.

Ukraine’s mobile telecom market is fairly consolidated: three players each occupy more than 10% of the market. In addition, Beeline, the #4 player (4% of domestic subscribers) announced this autumn it would merge its customer base with Kyivstar, the #1 player, in 2010-2011. Ukraine’s mobile market structure leads us to believe Ukrtelecom will not be able to gain a sufficient foothold to even cover OpEx. Thus, we expect Ukrtelecom’s new owner to either sell its base station network or merge it with its own.

However, we expect this action to be at worst value-neutral, as Ukrtelecom’s 2009 IFRS auditors already took a USD 60 mln write-down on equipment used for its mobile network due to uncertain prospects for the segment.

Mobile subscribers in Ukraine, mln



Source: Interfax

Cost side: two places to cut costs

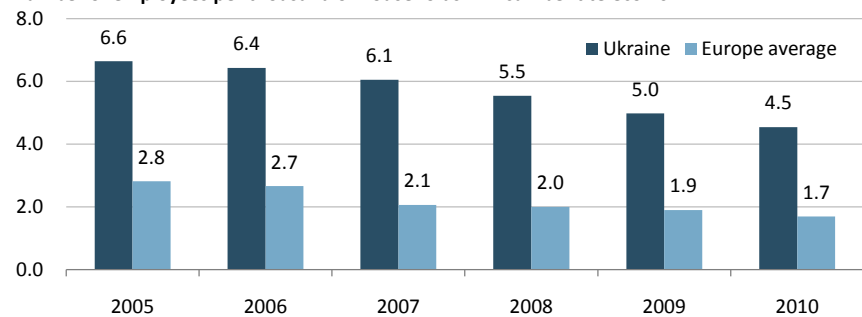
We see at least two ways for Ukrtelecom to reduce costs: workforce optimization and OpEx cutbacks. While realization will take two-three years and require about UAH 900 mln for early retirement, we estimate Ukrtelecom could more than double its EBITDA.

Workforce optimization

We estimate workforce optimization could contribute to an up to 19 pp increase in Ukrtelecom's EBITDA margin by 2015.

Costs related to payroll and social payments make up almost half of the company's revenues - workforce optimization is its main obstacle to reducing internal costs. Despite a reduction in headcount by a third over the last five years, Ukrtelecom still has room for a 30-40% reduction in personnel: there are 4.1 Ukrtelecom employees per thousand of households vs. the European incumbent fixed-line operator average of 1.7.

Number of employees per thousand of households in incumbent telecoms



Source: Company data, Concorde Capital

Even though privatization conditions require the new owner to pay generous retirement benefits to employees dismissed in 2011-13, we think the new owner will opt to cut the company's workforce by a quarter within this period. We model a conservative UAH 900 mln in additional costs affiliated with retirement benefits, the equivalent of 18 months of salary for each retired worker.

OpEx cutbacks

We anticipate Ukrtelecom can reduce costs by 10-20% due to synergy in procurement OpEx and eliminating the current inefficient government purchasing system.

Decrease in interconnection rates

The recent decrease in interconnection rates from UAH 0.50 to UAH 0.35 could save Ukrtelecom UAH 250 mln annually in costs, according to our estimates, equal to 5% of total COGS.

CapEx optimization

Following privatization, we believe Ukrtelecom can reduce CapEx by 10-20% as a result of eliminating the government's inefficient purchasing system and, if the new owner is a telco, by lowering procurement prices.

A real estate bonus

Another positive effect of workforce optimization and the transition to digital TV will be the release of office space: Ukrtelecom owns office/administrative buildings in the downtown areas in all Ukrainian cities.

The case of one of Russia's incumbent telcos, MGTS, shows that workforce optimization and digitalization freed up 0.5 mln m² of real estate. Given that Ukrtelecom is 2.2x larger than MGTS in terms of installed lines, we estimate at least approximately 1 mln square meters of real estate will be freed up after digitalization.

The effect of such restructuring is hard to estimate, but it could be surprisingly large, in our view. Our rough estimate of the total market value of Ukrtelecom's real estate is USD 0.5-1 bln (USD 500 – USD 1,000 per sq m). To partially account for this opportunity, we revise downward the company's net CapEx forecasts for 2011 onward by USD 30 mln per year.

Valuation

We base our target price for Ukrtelecom of USD 0.140 per share on DCF analysis, based on a 2Y investment horizon. Our target suggests 76% upside.

Our DCF model assumes value-neutral development of fixed-line voice (4% CAGR in 2010-2015), moderate broadband segment growth (21% CAGR in 2010-2015), the closure of inefficient mobile segment and a 5% market share of the pay TV market in 2015 thanks to the introduction of IPTV services.

To incorporate restructuring risk, we assign an abnormal 4% company-specific premium to Ukrtelecom stock, which increases the cost of equity to 19% in 2010, 18% in 2011-12 and 17% onward. We also prefer setting a 2Y investment horizon as we expect the standard 12M as too short to realize restructuring positives while balance sheet clearance might entail temporary negative sentiment from the market in 2011.

DCF model output

For forecasting purposes local currency is used

All amounts in UAH mln except otherwise stated

	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
EBITDA	1,263	2,286	2,959	3,372	3,737	4,130	4,557	4,971	5,411	5,877
EBIT	4	1,063	1,724	2,126	2,493	2,879	3,295	3,695	4,110	4,522
Tax Rate	25%	23.5%	21%	19%	16%	16%	16%	16%	16%	16%
Taxed EBIT	3	813	1,362	1,722	2,094	2,419	2,768	3,104	3,453	3,798
Plus D&A	1,259	1,223	1,234	1,246	1,244	1,250	1,261	1,276	1,301	1,355
Less CapEx	(1,200)	(721)	(1,300)	(1,300)	(1,131)	(1,237)	(1,293)	(1,340)	(1,450)	(1,816)
Less change in OWC	(208)	(126)	(92)	(40)	(29)	(28)	(42)	(40)	(43)	(45)
FCFF	-	-	1,204	1,628	2,178	2,404	2,695	3,000	3,261	3,292
WACC	15%	14%	15%	15%	15%	15%	14%	14%	14%	14%
Sum of DCF's	10,462									
Terminal Value										33,911
Discounted TV	13,158									
Firm Value	23,621									
Less Net Debt	(2,608)									
Equity Value	21,013									
										55.8%
										5.8 x
Perpetuity Growth Rate			3.0%							

WACC calculation

	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Avg. Interest Rate	13.5%	11.5%	10.0%	10.0%	9.0%	8.0%	8.0%	8.0%	8.0%	7.0%
Ukr Eurobonds YTM	8.0%	7.0%	7.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%
Equity premium	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Comp.-specif. Prem/Disc	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Cost Of Equity	19.0%	18.0%	18.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%
WACC	15.0%	14.3%	14.5%	14.8%	14.7%	14.5%	14.5%	14.4%	14.3%	13.6%

Sensitivity Analysis

WACC to perpetuity	Implied Share Price USD					Implied Share Price USD					
	Perpetuity Growth Rate					Exit Multiple (EBITDA)					
	2.0%	2.5%	3.0%	3.5%	4.0%	WACC to perpetuity	4.5 x	5.5 x	6.5 x	7.5 x	8.5 x
10.0%	0.156	0.161	0.166	0.172	0.179	10.0%	0.129	0.148	0.166	0.184	0.203
11.0%	0.147	0.057	0.057	0.057	0.057	11.0%	0.122	0.140	0.157	0.174	0.191
12.0%	0.139	0.143	0.148	0.154	0.160	12.0%	0.116	0.132	0.148	0.165	0.181
13.0%	0.132	0.136	0.140	0.145	0.151	13.0%	0.110	0.125	0.140	0.155	0.171
14.0%	0.124	0.128	0.133	0.137	0.143	14.0%	0.104	0.118	0.133	0.147	0.161
15.0%	0.118	0.122	0.126	0.130	0.135	15.0%	0.099	0.112	0.126	0.139	0.153
16.0%	0.112	0.115	0.119	0.123	0.128	16.0%	0.094	0.106	0.119	0.132	0.144

DCF model assumptions

	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
TOTAL GROSS REVENUE, USD mln	1,563	1,586	1,485	1,035	1,062	1,219	1,288	1,361	1,468	1,594	1,728	1,865	2,016	2,182
<i>y-o-y</i>		1%	-6%	-30%	3%	15%	6%	6%	8%	9%	8%	8%	8%	8%
Subscribers, mln	10.1	10.3	10.4	10.3	10.1	9.9	9.8	9.7	9.6	9.5	9.4	9.3	9.2	9.1
ARPU, \$	12.9	12.8	11.9	8.4	8.8	10.3	11.0	11.7	12.8	14.0	15.3	16.7	18.3	20.0
Fixed line telephony, \$ mln	1,329	1,332	1,200	752	722	793	818	842	869	899	931	965	1,002	1,041
<i>y-o-y</i>		1%	0%	-10%	-37%	-4%	10%	3%	3%	3%	3%	4%	4%	4%
Subscribers, mln	10.1	10.3	10.4	10.3	10.1	9.9	9.8	9.7	9.6	9.5	9.4	9.3	9.2	9.1
<i>y-o-y</i>			2%	1%	-1%	-2%	-2%	-1%	-1%	-1%	-1%	-1%	-1%	-1%
Fixed line ARPU, USD	11.0	10.8	9.6	6.1	6.0	6.7	7.0	7.2	7.6	7.9	8.3	8.7	9.1	9.5
<i>y-o-y</i>		-2%	-2%	-11%	-36%	-2%	12%	4%	4%	5%	5%	5%	5%	5%
Fixed voice local, \$ mln	444	540.0	525.7	395.7	387.8	475.0	507.9	538.0	569.9	598.1	627.6	658.6	691.1	725.3
<i>y-o-y</i>		17%	22%	-3%	-25%	-2%	23%	7%	6%	6%	5%	5%	5%	5%
ARPU, \$	3.7	4.4	4.2	3.2	3.2	4.0	4.3	4.6	5.0	5.3	5.6	5.9	6.3	6.6
<i>y-o-y</i>			19%	-4%	-24%	0%	25%	8%	7%	7%	6%	6%	6%	6%
Fixed voice long distance, \$ mln	390.7	357.6	320.0	188.9	170.0	157.2	152.5	148.3	144.9	144.7	144.7	144.9	145.3	146.0
<i>y-o-y</i>			-8%	-11%	-41%	-10%	-8%	-3%	-3%	-2%	0%	0%	0%	0%
Fixed voice intercity, \$ mln	254.3	219.6	179.9	92.2	82.9	78.8	81.9	84.8	87.8	90.4	93.1	95.9	98.8	101.8
<i>y-o-y</i>			-14%	-14%	-18%	-49%	-10%	-5%	4%	4%	4%	3%	3%	3%
Fixed voice international, \$ mln	136	138.0	140.1	96.8	87.1	78.4	70.5	63.5	57.1	54.3	51.6	49.0	46.5	44.2
<i>y-o-y</i>			1%	1%	-31%	-10%	-10%	-10%	-10%	-10%	-5%	-5%	-5%	-5%
Fixed-To-Mobile, \$ mln	398.2	342.8	275.0	123.7	99.0	89.1	80.2	72.2	64.9	61.7	58.6	55.7	52.9	50.2
<i>y-o-y</i>			3%	-14%	-20%	-55%	-20%	-10%	-10%	-10%	-5%	-5%	-5%	-5%
Fee for network access, \$ mln	96.8	91.9	79.3	43.6	65.5	72.0	77.8	83.2	89.0	94.4	100.0	106.0	112.4	119.1
<i>y-o-y</i>			-12%	-5%	-14%	-45%	50%	10%	8%	7%	7%	6%	6%	6%
Mobile voice, \$ mln	0.0	0.2	4.6	15.9	30.2	27.6	7.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>y-o-y</i>				2175%	249%	90%	-9%	-71%	-100%					
Internet service providing, \$ mln	36.7	65.4	113.0	140.0	167.7	242.2	287.6	324.9	374.5	442.6	516.2	585.5	658.3	734.7
<i>y-o-y</i>			22%	78%	73%	24%	20%	44%	19%	13%	15%	18%	17%	13%
Other internet, \$ mln	17.6	20.9	21.1	25.8	29.7	34.2	39.3	44.0	48.4	53.3	58.6	64.5	70.9	78.0
<i>y-o-y</i>			19%	1%	22%	15%	15%	12%	10%	10%	10%	10%	10%	10%
Broadband service providing, \$ mln	19.1	44.5	91.9	114.2	138	208	248	281	326	389	458	521	587	657
<i>y-o-y</i>			133%	106%	24%	21%	51%	19%	13%	16%	19%	18%	14%	13%
Broadband ARPU, \$		37.1	19.5	12.9	11.5	11.0	9.5	9.0	9.0	9.5	9.9	10.2	10.5	10.8
Broadband abonents, mln		0.10	0.39	0.74	1.00	1.58	2.18	2.60	3.02	3.43	3.84	4.25	4.65	5.05
Market share		17%	37%	43%	38%	45%	50%	50%	50%	50%	50%	50%	50%	50%
Broadband market (ab. mln)		0.60	1.05	1.70	2.6	3.5	4.4	5.2	6.0	6.9	7.7	8.5	9.3	10.1
<i>y-o-y</i>			50%	75%	62%	55%	33%	24%	19%	16%	14%	12%	11%	9%
Broadband penetration		3%	6%	10%	15%	20%	25%	30%	35%	40%	45%	50%	55%	60%
Total households, mln		17.9	17.8	17.7	17.6	17.5	17.4	17.3	17.3	17.2	17.1	17.0	16.9	16.8
IPTV, \$ mln						0.6	6.6	14.5	31.9	49.2	64.9	85.7	113.1	149.4
<i>y-o-y</i>							1000%	120%	120%	54%	32%	32%	32%	32%
IPTV ARPU, \$						5.0	5.5	6.1	6.7	7.3	8.1	8.9	9.7	10.7
Abonents, mln						0.01	0.10	0.20	0.40	0.56	0.67	0.81	0.97	1.16
Other	197.2	188.0	167.5	126.8	141.4	155.5	168.0	179.7	192.3	203.9	216.1	229.1	242.8	257.4
<i>y-o-y</i>			11%	-5%	-11%	-24%	12%	10%	8%	7%	7%	6%	6%	6%
Costs, USD mln	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
labor operating	295	307	366	255	256	252	246	238	242	253	263	274	285	297
<i>y-o-y</i>			4%	19%	-30%	0%	-1%	-2%	-3%	2%	4%	4%	4%	4%
material	110	112	128	91	95	99	93	100	109	120	132	144	157	171
<i>y-o-y</i>			2%	15%	-29%	5%	4%	-6%	8%	9%	10%	10%	9%	9%
other operating costs	387	397	404	243	249	259	245	255	270	288	307	325	345	365
<i>y-o-y</i>			3%	2%	-40%	3%	4%	-5%	4%	6%	7%	7%	6%	6%
SG&A	197	205	234	152	153	151	147	142	145	151	157	164	171	178
<i>y-o-y</i>			4%	14%	-35%	0%	-1%	-2%	-3%	2%	4%	4%	4%	4%

Source: Company data, Concorde Capital projections

Key risks

Reorganization: high

We see the key challenge for Ukrtelecom's new owner as transforming the company from over-staffed and inefficient to modern, capable of providing a full range of telecom services with minimal personnel costs. We account for this risk in abnormal 4% company-specific risk premium in cost of equity calculation.

Transfer pricing and value transfer: low

Though we see the corporate governance profiles of the main potential buyers, Sistema and SCM, as relatively good, we note that any merger entails opportunities for transfer pricing.

Local loop unbundling: low

Ukrtelecom's key advantage is its last mile reach to 10 mln customers, its inheritance as Ukraine's incumbent operator. A number of countries have demonopolized the last mile by obliging incumbent telcos to allow access to the local loop for a regulated fee. We note, however, that there has been no talk about local loop unbundling in Ukraine, and that there was very limited harm to incumbent telcos' market share in Europe from this shift.

Privatization postponement: low

There have been several attempts to privatize Ukrtelecom within the last 12 years but all have been blocked by different issues. Given historical political interest in Ukrtelecom and that Ukrtelecom is likely to be the second-biggest asset sold by the independent Ukrainian state, we do anticipate political opposition to the privatization. However, we note that Ukrtelecom is closer to privatization than it ever has been before and that current unity in the government (including the Presidential Administration, Cabinet of Ministers, State Property Fund and Verkhovna Rada) is conducive to privatization this year.

Appendix 1. Financial statements

Income statement summary, USD mln

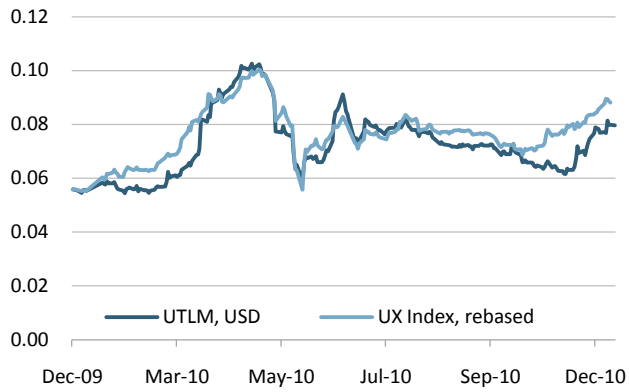
	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Net Revenues	1,295	889	912	1,047	1,101	1,156	1,233	1,327	1,429	1,529	1,634	1,746
<i>Change y-o-y</i>		-31.3%	2.6%	14.8%	5.2%	5.0%	6.6%	7.6%	7.6%	7.0%	6.9%	6.8%
Cost Of Sales	(863)	(669)	(600)	(610)	(584)	(593)	(621)	(660)	(702)	(744)	(787)	(834)
Gross Profit	431	220	312	437	517	564	612	667	727	785	847	912
Other Operating Income/Costs net	5	5	-	-	-	-	-	-	-	-	-	-
SG&A	(234)	(152)	(153)	(151)	(147)	(142)	(145)	(151)	(157)	(164)	(171)	(178)
EBITDA	202	73	159	286	370	421	467	516	570	621	676	735
<i>EBITDA Margin %</i>	15.6%	8.3%	17.5%	27.3%	33.6%	36.4%	37.9%	38.9%	39.9%	40.6%	41.4%	42.1%
Depreciation	(229)	(162)	(159)	(153)	(154)	(156)	(155)	(156)	(158)	(160)	(163)	(169)
EBIT	(27)	(88)	0	133	216	266	312	360	412	462	514	565
<i>EBIT Margin %</i>	-2.1%	-9.9%	0.1%	12.7%	19.6%	23.0%	25.3%	27.1%	28.8%	30.2%	31.4%	32.4%
Interest Expense	(42)	(40)	(58)	(55)	(40)	(29)	(24)	(21)	(21)	(22)	(23)	(23)
Financial Income	14	5	(6)	(6)	(7)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
Other Income/(Expense)	(211)	(13)	-	(30)	(45)	(40)	-	-	-	-	-	-
PBT	(266)	(136)	(63)	42	125	189	280	330	381	429	479	529
Tax	(13)	0	-	(10)	(26)	(36)	(45)	(53)	(61)	(69)	(77)	(85)
<i>Effective Tax Rate</i>	-5%	0%	25%	24%	21%	19%	16%	16%	16%	16%	16%	16%
Net Income	(279)	(136)	(63)	32	98	153	235	277	320	361	402	444
<i>Net Margin %</i>	-21.5%	-15.3%	-6.9%	3.1%	8.9%	13.2%	19.0%	20.9%	22.4%	23.6%	24.6%	25.4%

Balance sheet summary, USD mln

	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Current Assets	211	175	191	216	222	230	242	256	273	289	306	323
Cash & Equivalents	68	42	45	50	51	51	52	53	54	55	56	56
Trade Receivables	94	93	100	115	121	127	136	146	157	168	180	192
Inventories	17	11	15	16	14	14	14	13	14	15	16	17
Other Current Assets	32	29	30	35	36	38	41	44	47	51	54	58
Fixed Assets	1,299	1,122	1,100	1,030	1,039	1,045	1,031	1,030	1,034	1,042	1,061	1,119
PP&E net	1,260	1,101	1,098	1,029	1,037	1,044	1,030	1,028	1,032	1,040	1,058	1,116
Other Fixed Assets	39	21	1	2	2	2	2	2	2	2	2	3
Total Assets	1,511	1,297	1,291	1,246	1,261	1,276	1,273	1,286	1,307	1,331	1,367	1,442
Shareholder Equity	818	656	612	637	711	825	825	825	825	825	825	825
Share Capital	999	999	999	999	999	999	999	999	999	999	999	999
Reserves and Other	(181)	(343)	(387)	(362)	(288)	(174)	(174)	(174)	(174)	(174)	(174)	(174)
Current Liabilities	658	605	399	326	328	414	409	419	437	458	490	561
ST Interest Bearing Debt	529	450	257	180	187	271	259	259	266	277	298	359
Trade Payables	118	145	132	134	129	130	137	145	154	164	173	183
Accrued Wages	-	-	-	-	-	-	-	-	-	-	-	-
Accrued Taxes	-	-	-	-	-	-	-	-	-	-	-	-
Other Current Liabilities	11	10	10	12	12	13	14	15	16	17	18	19
LT Liabilities	34	35	280	283	222	36	39	42	45	48	51	55
LT Interest Bearing Debt	7	8	252	250	188	-	-	-	-	-	-	-
Other LT	28	27	29	33	35	36	39	42	45	48	51	55
Total Liabilities & Equity	1,511	1,297	1,291	1,246	1,261	1,276	1,273	1,286	1,307	1,331	1,367	1,442
Net Debt	468.0	415.9	463.0	380.0	324.3	220	207	206	212	222	243	303

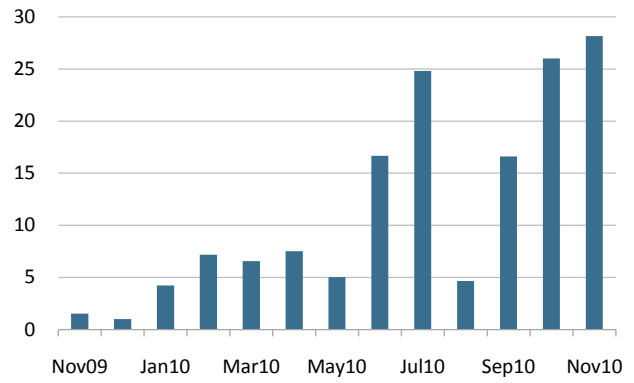
Appendix 2. Stock market

Ukrtelecom price performance, USD



Source: UX

Monthly trading volume, USD mln



Source: UX

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I, Yegor Samusenko, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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