

Wednesday, June 19, 2019 | update

Orange Polska: hold (downgraded)

OPL PW; OPL.WA | Telecommunications, Poland

Catalysts for growth finally noticed by the market

In spite of the market consensus, Orange Polska's share price has increased by 48.5% since the issue of our November recommendation, surpassing the broad-based index by > 43 pp. The company has been executing its business transformation plan announced in September 2017, which results in lower indirect costs (including headcount reduced to 13.4 thousand, i.e. by >15% in two years), a greater number of convergent B2C clients (1,276 thousand as at the end of Q1 2019), and a falling churn rate. Additionally, as we pointed out in our last recommendation, the company has generated FCFE again after a long break (our assumption for 2019 is PLN 450 million). Recently, Orange has also raised its service prices, which induced euphoria among investors. However, we believe that given the current share price, there is little chance of its further strengthening. Following an update of forecasts (also taking into account the first effects of the price raises) and of indices for the peer group (increase of 2019 EV/EBITDA median to 5.6x), we set a new target price at PLN 7.50, which implies a 2.9% growth potential. Thus, we downgraded our investment recommendation from "buy" to "hold". Additionally, we would like to stress that we expect Q2 2019 results to be poor. Our EBITDAL estimate is PLN 693 million. The result is flat YoY, however, it is lower by nearly 6% net of real estate sale profits. The company struggles to put a stop to the fall in high-margin legacy business turnover, and the higher B2C prices will be reflected in the company's results with a delay. In our opinion, the release of weak readings will lead to a sentiment cool-down. Therefore, we think now is a good time to cash in on your investment.

Relatively weak Q2 2019 results

Our estimate of Q2 2019 sales revenues is PLN 2,757 million, i.e. +2.0% YoY. Turnover on mobile services alone is expected to reach PLN 638 million (-6.2% YoY). The forecast turnover on convergent services is PLN 382 million, whereas fixed-line services alone are expected to generate PLN 555 million. When raising prices, Orange paid particular attention to an attractive equipment offer (we assume equipment sales to reach PLN 367 million, i.e. +PLN 60 million YoY). Still, high equipment sales will lead to sales costs going up to PLN 587 million (+6.6% YoY). The fall in the costs of employee benefits will be too insignificant to offset this effect. We assume that the sale of assets will generate PLN 45 million. In the end, EBITDAL is expected to amount to PLN 693 million (+0.3% YoY). Net of real estate profits, it would be lower by as much as 5.8% YoY. Additionally, we expect that the growth in FTTX customers will be lower YoY for another quarter in a row.

Delayed impact of higher prices

As we expected, Play raised prices in response to the new price list released by Orange. However, this positive development will have a delayed effect on Play's financial performance due to the fact that a subscription agreement covers 2 years on average. The impact of higher prices on the EBITDA generated by Polish MVNO will be limited in 2019 and Poland still is a market of four operators. That is why we recommend investors to remain cautiously optimistic about the fact that Plus and T-Mobile are likely to follow suit and increase their prices as well.

(PLN m)	2017*	2018*	2019E	2020E	2021E
Revenue	11,381.0	11,087.0	11,259.6	11,428.4	11,625.3
EBITDA	2,807.0	2,886.0	3,210.7	3,309.7	3,402.8
EBITDA margin	24.7%	26.0%	28.5%	29.0%	29.3%
EBIT	229.0	345.0	597.7	743.3	882.2
Net profit	-60.0	10.0	202.8	323.2	452.9
P/E	-	-	47.2	29.6	21.1
P/CE	3.8	3.7	3.4	3.3	3.2
P/BV	0.9	0.9	0.9	0.9	0.9
EV/EBITDA	5.7	5.7	5.3	5.1	4.8
DPS	0.00	0.00	0.00	0.00	0.25
DYield	0.0%	0.0%	0.0%	0.0%	3.4%

* Financial data for 2017-18 in IAS 17, from 2019 under IFRS 16.

Current Price	PLN 7.29
Target Price	PLN 7.50
Market Cap	PLN 9,564m
Free Float	PLN 4,846m
ADTV (3M)	PLN 23.8m

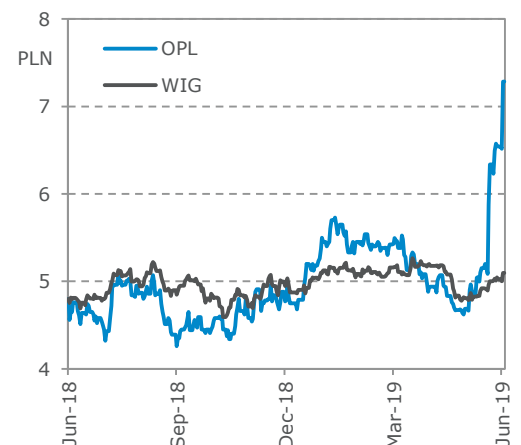
Ownership

Orange S.A. (f. France Telecom S.A.)	50.67%
Others	49.33%

Business Profile

Orange Polska is a leading telecommunications provider in Poland. It had 14.8 million mobile users, 2.6 million broadband users, and 3.4 million voice users at the end of 2018. This was equivalent to respective market shares of 28% in mobile and 49% in fixed line. Orange controls 28% of Poland's broadband Internet market. It has the most extensive network infrastructure and is currently building an FTTx network.

OPL vs. WIG



Company	Target Price		Rating	
	new	old	new	old
Orange Polska	7.50	6.40	hold	buy

Company	Current Price	Target Price	Upside/Downside
Orange Polska	7.29	7.50	+2.9%

Forecast revision since last update	2019E	2020E	2021E
	Sales	+1.5%	+1.9%
EBITDA**	+11.1%	+8.1%	+8.9%

** material effect of IFRS16 introduction from 2019.

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List of abbreviations and ratios contained in the report:

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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BUY – we expect that the rate of return from an investment will be at least 15%
ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
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NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

mBank issued the following investment recommendations for Orange Polska in the 12 months prior to this publication

Rating	buy
Rating date	2018-11-26
Target price (PLN)	6.40
Price on rating day	4.91

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