



Telecoms

Poland

TPSA

TPS PW; TPSA.WA

Hold

(Reiterated)

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TPSA announces Q3 2012 results

Current price: PLN 13.79; Target price: PLN 16.80

TPSA has released its earnings estimates for the third quarter of 2012 ahead of the originally scheduled date. Profits are more or less in line with expectations, but cash flow came as a huge disappointment at just PLN 324m, showing a drop of a whopping 44% from the same period a year ago. However, the main factor that caused TPS shares to plummet were downward revisions to FY2012 guidance, and in particular the cut in next year's dividend from PLN 1.5 to PLN 1 a share. In our opinion, such a sharp reduction in dividend cannot be justified given TPSA's cash flow prospects. Even considering the planned investment in LTE infrastructure and frequencies, and assuming temporary downward pressure on working capital, the Company should be able to generate free cash flow to the tune of at least PLN 1.8 billion (i.e. ca. PLN 1.35 a share) a year over the next three years. Even if we leave some room between FCF and dividends to allow TPSA to address debt obligations, we believe the Company would be able to pay dividends of PLN 1.20 a share during the period. Given the 8.5%-9% dividend yield typically expected of telecoms, this would imply a valuation of PLN 13.3-14.1 per share. We are working on a new valuation of TPSA, incorporating the revised guidance, and we will have the updated report for you in a few days.

TPSA announces preliminary Q3 figures, lowers FY2012 guidance and dividend

TPSA generated revenue of PLN 3473m in Q3 2012 (-5.5% y/y), with EBITDA at PLN 1323m (-5.7% y/y), EBIT at PLN 523m (+4.2% y/y), and net profit at PLN 307m (down 18.6% y/y or up 14.1% not including last year's tax breaks). EBITDA in the fixed-line segment fell to PLN 732m from PLN 739m a year earlier, and EBITDA in the mobile segment dropped to PLN 591m from PLN 663m in Q3 2011. The consolidated EBITDA margin remained flat at the year-ago level of 38.1%. Free cash flow amounted to a disappointing PLN 324m in Q3 2012 vs. PLN 579m in Q3 2011 after a 44% year-on-year drop.

The number of phone lines fell by 131,000 from the second quarter, and monthly ARPU came in at PLN 46.0 (down PLN 1.3 y/y). The rate of fixed-line voice attrition in Q3 displayed a slowdown from the H1 2012 average quarterly rate of 184,000 lines. Fixed-line broadband lines decreased by 6000 thousand to 2338 thousand, and the TV service saw 18 thousand subscriber additions (with total subscribers at 695 thousand at the end of the quarter) relative to Q2. TV and broadband ARPU increased to PLN 54.9 from PLN 54.1 the year before.

TPSA reported disappointing performance in the mobile segment. The number of active cards increased by 1000 q/q after a 43,000 drop in post-paid users combined with a 45,000 increase in pre-paid users. Given that the number of mobile broadband users increased by 59 thousand from the previous quarter, the quarterly shrinkage in the overall voice user base amounted to a whopping 58,000 lines. Mobile ARPU plunged to PLN 38, i.e. by PLN 2.7 from the year-ago level and PLN 2.0 from the quarter before. Part of the reason behind this drop was another cut in MTR rates, but retail ARPU also shrunk to PLN 31.4 from PLN 33.3 in Q3'11 and PLN 32.3 in Q2'12. The strongest ARPU contraction was recorded in post paid.

To reflect the weak third quarter and what is expected to be an equally weak fourth quarter, TPSA has cut its FY2012 guidance. Annual revenues are expected to contract at a rate of 5% to 4% rather than the 3% anticipated earlier. The EBITDA margin is estimated at 34-36% (down from 35%-37%). The CAPEX-to-sales ratio range was left unchanged at 15-17%. Free cash flow was revised downwards to PLN 1.5-1.6bn from PLN 2bn. The guidance does not take into account compensation payable to DPTG or the possible costs of 800 MHz, 180 MHz, and 2600 MHz LTE frequency auctions that are expected to be held by the regulator. Finally, TPSA has slashed next year's dividend payout from PLN 1.5 to PLN 1 per share.

Is the lower dividend just for now or forever?

We attribute the beating that TPS shares have been taking since its Q3 and guidance announcement to the slashed dividend. TPSA's Management during yesterday's conference call dodged questions about whether the 1 zloty dividend was the new medium-term distribution policy, or rather a one-time deviation necessitated by the need to make a number of cash outlays (DPTG compensation, frequency purchases). According to our calculations, even assuming downward earnings pressure from increasing competition in the mobile market, free cash flow per share should remain well over 1 zloty.

TPSA generated accumulated adjusted EBITDA of ca. PLN 5050m in the last four quarters. In 2013, even with heated competition in the mobile sector, annual EBITDA will not be less than PLN 4.7 billion in our view.

As for cash flows, they are set to improve once TPSA completes the investment in broadband infrastructure enforced by the regulator. In 2011, of a total CAPEX of PLN 2.6bn, about PLN 0.9bn went toward these projects. The remaining PLN 1.7bn is the level that we see as the maximum replacement CAPEX limit in the medium term. The frequency purchases, which can run up to a total of PLN 1.75bn, will most probably be paid for in full with debt.

Once the frequencies are secured, they will entail further expenses on expansion of LTE reach. However, these expenses should not be big, moreover, they will be shared with T-Mobile through joint LTE-ready infrastructure usage. As a result, LTE will be much less capital-intensive for TPSA than it is for the Midas / Polkomtel faction. We estimate LTE expenditure at PLN 200m max a year, adding to an annual CAPEX of PLN 1.9bn in the next few years.

Further, the financing secured to purchase LTE frequencies is expected to drive up TPSA's debt to about PLN 6.0bn, generating annual service costs of about PLN 0.5bn. Other claims on operating cash flows include taxes (ca. PLN 0.3bn not counting tax breaks) and working capital (ca. PLN 0.2bn necessitated by challenging market conditions). This would leave TPSA with free cash flow of approximately PLN 1.8 billion.

TPSA is set to experience downward pressure on EBITDA in the coming years (though the pressure is expected to ease after 2013), which, however, will be offset by decreasing downward pressure on working capital. All told, therefore, in the next three years, we believe TPSA will be able to generate annual free cash flows of at least PLN 1.8bn, or PLN 1.35 per share.

The Company may want to leave some breathing room for debt payments, but even then it should have no problem paying dividends of PLN 1.2 to its shareholders.

2013 cash flow forecast

(PLN bn)	
EBITDA	4.7
CAPEX	-1.9
Interest	-0.5
Working capital	-0.2
Tax	-0.3
Total	1.8

Source: BRE Bank Securities

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List of abbreviations and ratios contained in the report.

EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
PBA – Profit on Banking Activity
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

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