

Pilipino Telephone Corporation (PLTL)
BUY

Price	6.80
Target Price	8.80
52 week high	9.90
52 week low	5.40
Shares O/S (M)	11.71
Freefloat (M)	913.9
Market Cap (B)	80.81
Daily Turnover (M)	1.49
Dividend Yield	6.23%

Strong and Steady

Pilipino Telephone Corporation, also known as Piltel, is the third largest cellular operator in the Philippines with a subscriber base of over 13.30 million as of the end of September 2008. Piltel operates the Talk N Text brand that has seen impressive growth in the past years. With the sale of its fixed line business to PLDT, which owns 92.5% of Piltel through Smart Communications, in the early part of 2008, Piltel is currently solely in the cellular business.



Investment Considerations:

- Since its inception in 2000, Talk N Text has grown a long way. Total subscribers have grown by approximately 3.6 million in just the first nine months of 2008, bringing total subscribers to 13.3 million as of September 2008.

- In 2008, Piltel announced dividends of P0.43 per share, equal to 100% of total earnings for the first half of 2008. With the continued improvement in the company's operations, there is a great chance that they will adopt a consistent dividend policy.

- Piltel makes use of Smart's infrastructures in serving its numerous subscribers. In order to compensate Smart, a 80/20 split in favor of Piltel is applied to all of Piltel's revenues. The split was modified to 70/30, still in favor of Piltel, effective November 1, 2008.

- With the agreement between Smart and Piltel, the company has little other expenses. Piltel's margins are very impressive and so is its cash flow. Given today's current global situation, cash is certainly king, and Piltel is in a position to take advantage of that fact.

- Despite the global economic slowdown, Piltel continues to grow impressively. Talk N Text is positioned in a way to take advantage of the current crisis. Mobile phone users are limiting Value added Services (VAS) spending and focusing on the basics. The affordability of Talk N Text's numerous promos is exactly what consumers are currently looking for.

- Revenue growth is being tempered by drops in ARPU (Average Revenue per Unit). Subscriber growth is outpacing ARPU decline, leading to both top line and bottom line growth.

- Not content to rest on its laurels, Piltel is looking to the future. It has set up capital expenditures for the next five years. Its spendings will focus on improving and expanding the services rendered to its current and future subscribers.

	3 mos	6 mos	12 mos
PLTL	-6.85%	-9.33%	3.03%
SVC	-8.64%	-17.55%	-25.66%
PSEi	-9.32%	-21.25%	-36.28%

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From humble origins in the 1990's, the mobile phone has now transformed into the most ubiquitous and indispensable gadget for Filipinos. Filipinos love to stay in contact with each other. From exchanging jokes to brokering deals, the mobile phone has become an integral mode of communication. As the texting capital of the world, it is no wonder that two of the more recognizable and respected companies in the Philippines are Telecom giants PLDT and Globe.

The past few years have served as a turnaround for Piltel. Aimed at the mass market, Piltel, through its Talk N Text (TNT) brand, has found its niche. Similar to budget airlines, Piltel offers services that center on the basics of mobile communications: texting and calling. TNT offers several different promos and value packages that significantly lower the costs of texting and calling below the normal costs of P1.00 per text and P6.50 per minute.

However, things weren't always rosy in the 40 years and counting history of Piltel. Initially, Piltel culled revenue from services such as landlines, beepers, and analog celphones, which were incapable of sending text messages. The advent of new technology that enabled text messaging hurt Piltel at first, plunging the company into the red with debt increasing to more than P40 billion. In 2004, the company was back in the red and in 2006, Piltel was virtually debt-free. It has not looked back since.

Subscriber growth has been the number one driver of the increase in Piltel's top line and bottom line. At the end of 2006, TNT had slightly less than 7 million subscribers. This grew by over 39% in 2007 to 9.70 million. The growth accelerated further in 2008. As of the first 9 months of 2008, TNT had reached 13.3 million subscribers, a market share of approximately 20% (based on total subscribers of 65 million). The number of subscribers will probably be around 14.5 million at the end of 2008. Even if growth significantly decelerates to around 20% for 2009 and 2010, Piltel is on track to hit 20 million subscribers by 2010.

As technology advances, it also becomes cheaper and more prevalent. From a time when mobile phones were status symbols, they are now necessities to everyone. From CEOs to businessmen to students and even to maids and drivers, low cost handsets has put mobile phones within anyone's reach. Piltel has taken advantage of this by aligning itself as the brand for the masses. Its dominance in this market actually serves to fuel its growth as it is cheaper to text and call mobile users of the same network. As a result, the more than 14 million subscribers TNT has (at the end of 2008) will only attract more users who will be able to save more by using TNT.

Revenue growth was not as rapid as subscriber growth due to the numerous promos and packages that were launched in response to changing consumer needs. Lower ARPU (Average Revenue per Unit) has tempered revenue and income growth. From ARPUs of P194 and P184 in 2006 and 2007, ARPU has most probably dropped to around P155 for 2008. While the drop from 2006 to 2007 was more the result of Piltel's promos such as unlimited text messaging for a day for a set fee, the drop in 2008 was a combination of other similar promos and a drop in consumption by users as a result of higher inflation and the economic situation.

It bears remembering that the target market of TNT are those that are hit hardest by the current economic hardships. Although inflation has tempered in the past months, economic growth is seen to decline in 2009. Therein lies the biggest risk for Piltel, that the decline in ARPU outpaces subscriber growth. Furthermore, there have been calls by the NTC (National Telecommunications Commission) for telcos to lower interconnection rates. These are fees paid by one network to another for communications between different carriers. From the current rates of P0.35 per message and P4.00 per minute, NTC wants the charges lowered to P0.15 and P1.50 respectively.

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Continued Growth

In 2007 subscriber growth was at 39.11% while we believe it reached 49.46% in 2008. For 2009 and 2010, growth will continue albeit at a lower rate. We forecast subscribers to grow to 17.7 million in 2009. This translate to a 22.07% growth or an additional 800,000 subscribers per quarter. During 2010, growth is expected to decelerate further to 15.825. At a rate of 700,000 additional subscribers per quarter, TNT will have 20.5 million at the end of 2010. ARPU will continue to decline but at a lesser rate that the past two years. ARPU is seen to decline to P147 in 2009 and to P140 in 2010, declines of 5.16% and 4.765 respectively.

Factoring both subscriber growth and ARPU decline, Piltel's revenue are seen to increase by 10.12% and 7.53% in 2009 and 2010. Revenue growth is fueled by the increasing number of TNT subscribers while being tempered by lower ARPU. Another factor negatively affecting revenue growth is the shift in revenue sharing between Piltel and Smart. Smart and Piltel have an agreement wherein Piltel makes use of Smart's network. This gives Piltel two distinct advantages: their expenses are greatly reduced by not having to maintain their own network and it makes it cheaper for TNT subscribers to text or call Smart users. As payment for the use of Smart's network, revenues generated from TNT users are split 70-30 between Piltel and Smart. At the start of 2008, the split was 80-20. The shift in revenue sharing took effect last November 2008 and will persist until a change is warranted.

Given the uncertainty surrounding both global and local economies, a 10% top line growth is impressive. However, Piltel's bottom line will be even more impressive. Due to the cut in corporate income tax from 35% to 30%, Piltel's net income is expected grow by 16.77% in 2009 to approximately P11.5 billion. This translate to an EPS of P0.95. As shown by Piltel's performance in the past few years, its earnings are stable. With the recent reversal of its retained earnings to the positive side, Piltel is expected to distribute dividends on a regular basis similar to what PLDT, its mother company, is doing. If Piltel gives out 70% of its earnings then the current price of P6.80 (as of end of trading on January 20, 2009) would lead to a dividend yield of 9.78%.

	2006	2007	2008F	2009F	2010F
Subscribers	6.97	9.70	14.50	17.70	20.50
ARPU	194.00	184.00	155.00	147.00	140.00
Revenue	11,937.10	14,718.40	17,380.47	19,139.40	20,580.00
Expenses	5,497.40	1,811.70	2,250.77	2,734.20	2,940.00
Net Income	9,737.30	8,792.00	9,834.30	11,483.64	12,348.00
EPS	0.79	0.71	0.80	0.95	1.02
Shareholders	11,771.70	11,771.70	11,771.70	11,711.74	11,711.74

(in millions except per share data and ARPU)

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Financial Strength

A quick look at Piltel's balance sheet will reveal only positive things. Piltel has very little liabilities consisting mostly of payables and no debt. This gives Piltel the financial flexibility it needs moving forward. Also, non-current assets make up only a small portion of total assets. This is due to the fact that Piltel has no need for infrastructures to support its own network. Instead, a bulk of Piltel's assets is in cash. Piltel's cash level is enough to service all of its liabilities and still have enough left over to finance its capital expenditures for 2009.

Piltel has made it known that they are looking to deliver better services to their subscribers. As a way of achieving this goal, the company is looking to establish a data communications network that can provide multimedia content and better calls. Internet access and video calls at affordable rates may be a reality in the coming years if Piltel succeeds in its plans. For 2009, the company is expected to spend P3.4 billion and a further P4.1 billion in the years after. The stability of their earnings gives Piltel a steady stream of cash to tap, even after dividends. Furthermore, the company has the option to raise capital via debt or equity. Truly the future is looking bright.

	2006	2007	2008F
Cash	556.60	605.90	6,000.00
Assets	17,005.80	16,830.10	22,029.20
Liabilities	2,435.70	1,832.10	2,872.90
Equity	14,570.10	14,998.00	19,156.30

(in millions)

Valuation

As of January 20, 2009, PLDT (TEL) and Globe (GLO) were trading at an average 2009 P/E of 9.25. In comparison, at the price of P6.80 and expected 2009 EPS of P0.95, Piltel was trading at a 2009 P/E of 7.16. The stock is also trading at a lower P/E than it historically has. The average end of the year P/E for 2006-2008 is 9.22. While GLO and TEL are trading at an average P/BV of 2.95, Piltel is at a higher 4.18. This is expected to improve as Piltel's total equity increases as it accrues future income in its retained earnings.

Using a P/E of 9.25, which is near the historical P/E of Piltel and the current average P/E of TEL and GLO, the target price of Piltel is P8.80. The price of P8.80 represents an upside of 29.41%. The target price is consistent with a cash flow valuation of Piltel assuming yearly cash flows of P10 billion and a 10% cost of equity. This is very much within Piltel's reach as the company's net income is much higher than P10 billion starting in 2009. Even using conservative numbers and given today's lower valuations, Piltel is still undervalued. With an upside of 29.41%, an expected steady stream of dividends, strong financial strength, and earnings stability, Piltel is a buy.

	2006	2007	2008F	2009F	2010F
EPS	0.79	0.71	0.80	0.95	1.02
EPS Growth		-10.13%	12.88%	18.06%	7.80%
P/E	8.48	10.56	8.61	7.19	6.67
BV/Share	1.24	1.27	1.63	2.62	3.67
P/BV	5.41	5.89	4.24	2.60	1.85
ROE	66.83%	60.34%	65.57%	59.95%	40.30%