



Phil. Long Distance Tel. Co. (TEL)

Hold

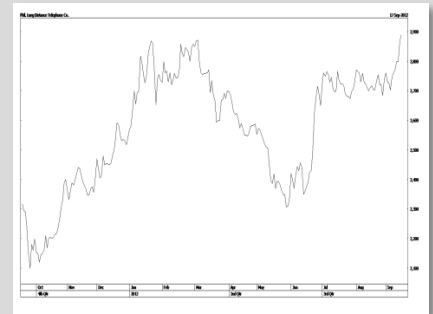
TUESDAY, 18 SEPTEMBER 2012

Company Snapshot

Price (P)	2,890
Price Target (P)	3,000
Shares O/S (million)	216.056
Market Cap (P million)	624,401
52-week High (P)	2,940
Low (P)	2,096
12-mo Avg. Value T/O (P'm)	369.669
Shareholders	
First Pacific Group	26.0%
Free float	50.0%

Price Performance

	1m	6m	12m
TEL	+6.9%	+5.7%	+25.7%
PSEi	+2.8%	+4.0%	+24.7%



The Long and Winding Turn

- **Blockbuster Transaction.** TEL acquired DGTL in a landmark share swap transaction valued at P69.2B. As payment for the acquisition, TEL issued ~27.7M of its own shares to JGS and other shareholders of DGTL. On the one hand, some market observers noted that TEL paid a hefty premium for the acquisition, considering that DGTL only earned P15.7M for 9M2012. On the other hand, the deal provided some excitement, as it brought back the telco market to a virtual duopoly.
- **Can't Beat 'Em? Buy 'Em!** In the past, the profitability of TEL and GLO was clearly affected by the price wars initiated by DGTL, primarily through its unlimited offers. Therefore, the merger of TEL and DGTL is expected to bring back more rational pricing and less intense competition between TEL and GLO. The hope is that these will all eventually lead to higher revenues, better margins and higher bottomline figures for the duopolists. Moreover, TEL expects to realize certain synergies from its merger with DGTL, which have so far translated into cost savings and capex avoidance.
- **Battle for Position.** Despite the TEL-DGTL merger, the battle for market share in the telco industry has continued to be intense. This battle has proven to be more difficult for TEL. Although TEL, on a solo basis, was able to grow its Subscriber Base to 67.4M as of 2Q2012, its Subscriber Market Share dipped to 51.9% as of 2Q2012 from 54.8% in YE2009.

Financial & Valuation Highlights

in P'million	2010A	2011A	2012E	2013E	2014E
Revenues	158,387	156,603	173,134	184,936	187,124
EBITDA	83,717	79,959	79,705	86,488	89,379
NIBT	53,685	42,677	49,147	54,991	58,345
Net Income	40,259	31,637	36,369	40,418	42,592
EBITDA Margin	54.0%	52.0%	46.0%	46.8%	47.8%
ROE	41.0%	25.3%	23.7%	26.0%	27.3%
DPS	219.0	222.0	168.0	187.0	197.0
EPS	212.9	163.1	168.3	187.1	197.1
Dividend Yield	7.6%	7.7%	5.8%	6.5%	6.8%
PE (x)	13.58	17.72	17.17	15.45	14.66

Sources: Company Data, Wealth Securities

A = Actual calendar/fiscal year results; C = Bloomberg consensus; I = Annualized interim results; E = Wealth Securities estimates

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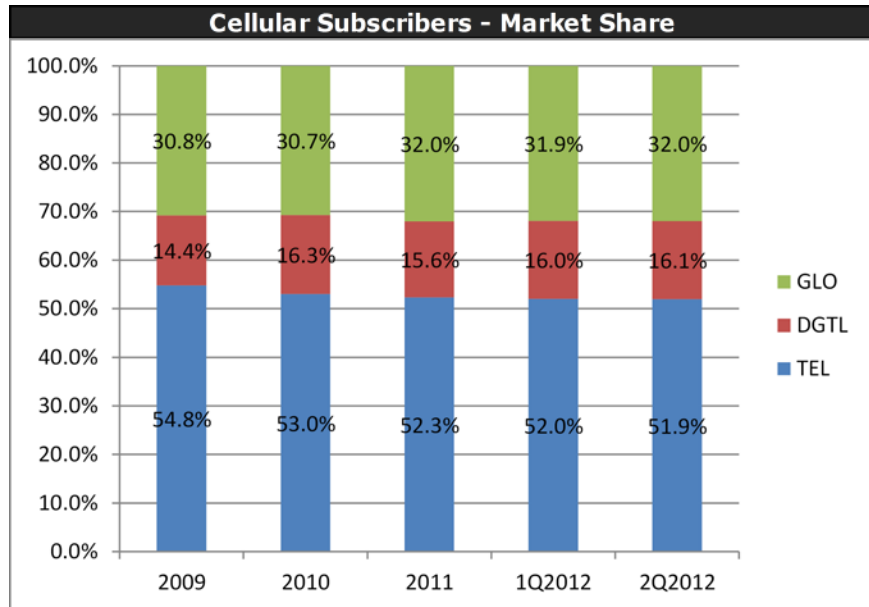
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Cellular Subscribers	2009	2010	2011	1Q2012	2Q2012
TEL	41.329	45.636	49.029	50.530	51.485
DGTL	10.860	14.040	14.667	15.579	15.944
GLO	23.245	26.471	30.040	31.025	31.726

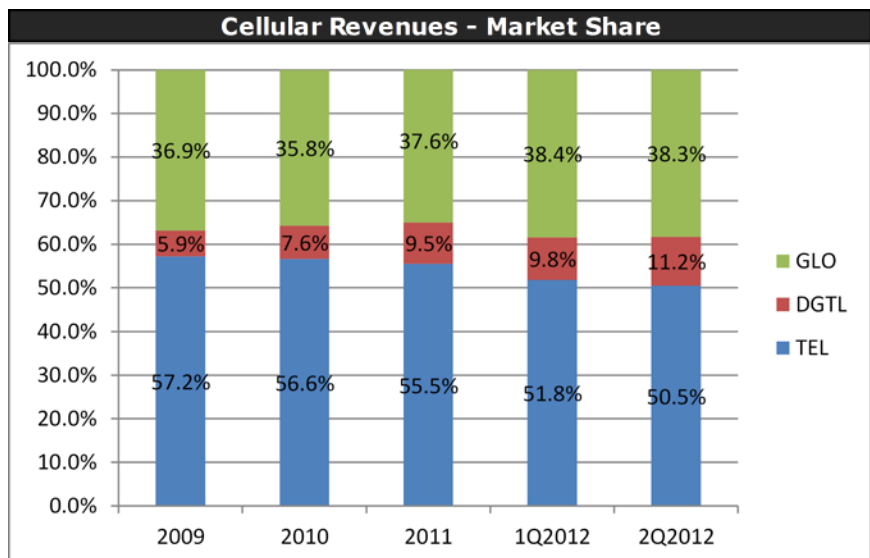
Subscriber Count in millions

Sources: Company Data, Wealth Securities



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The decline in TEL's market share is more visible if viewed in terms of revenues, as TEL's Revenue Market Share dropped sharply to 50.5% as of 2Q2012 from 57.2% in YE2009.



Sources: Company Data, Wealth Securities

Aside from this, there are other signs that competition has continued to intensify despite the completion of the TEL-DGTL merger. As seen in the table below, TEL's Advertising & Promotions (A&P) Expense was up 61.8% YOY for 1H2012 while GLO's A&P Expense was up 45.8% also for 1H2012.

A&P Expense	1H2011	1H2012	YOY
TEL	2,690	4,353	61.8%
GLO	2,022	2,949	45.8%

Sources: Company Data, Wealth Securities

- **A Visible Dent.** TEL's 1H2012 Revenues, which already included DGTL's Revenues, delivered a slight year-on-year increase.

	1H2011	1H2012*	YOY
Total Revenues	75,618	84,725	12.0%
EBITDA	41,512	39,300	-5.3%
EBITDA Margin	54.9%	46.4%	-850 bps

*1H2012 results including DGTL's contributions

Sources: Company Data, Wealth Securities

However, excluding DGTL's contributions, TEL's Revenues showed a slight drop year-on-year. What is more concerning is the sharp drop in TEL's 1H2012 EBITDA if DGTL's contributions are excluded.

	1H2011	1H2012**	YOY
Total Revenues	75,618	73,014	-3.4%
EBITDA	41,512	36,067	-13.1%
EBITDA Margin	54.9%	49.4%	-550 bps

**1H2012 results excluding DGTL's contributions

Sources: Company Data, Wealth Securities

- **Game Theory.** As TEL and GLO are left in a virtual duopoly, each one is forced to consider the other's moves. While TEL's 1H2012 results continued to show signs of pressure, GLO's 1H2012 Revenues were up 6.2% YOY, driven by the 6.0% YOY increase in 1H2012 Wireless Revenues. Despite this, GLO also encountered the same margin pressures that TEL is suffering from.

	1H2011	1H2012	YOY
Total Revenues	38,392	40,767	6.2%
EBITDA	18,043	17,679	-2.0%
EBITDA Margin	47.0%	43.4%	-360 bps

Sources: Company Data, Wealth Securities

Barring any sharp rebound in margins, it seems that GLO will likely make its stand against its bigger competitor by continuing to be aggressive in growing its revenues. Under this scenario, margins will continue to be squeezed for TEL and GLO.

- **Network Upgrade and Synergies.** TEL expects to reap benefits from its P67.1B network modernization starting 2013. From the P38B capex budget in 2012, TEL expects capex to be lower than 20% of revenues (i.e. less than P34B) for 2013 onwards. If these benefits come into fruition, TEL will deliver higher cash flows and a stronger balance sheet, moving forward. Aside from this, TEL also estimated there will be ~P500M opex avoidance and ~P8B capex avoidance for 2012, as a result of the TEL-DGTL merger. All these would be positive catalysts for TEL to sustain its high dividend payout.
- **A Longer Turn.** Despite the quantifiable benefits from the TEL-DGTL merger, it seems that TEL's performance, along with the competitive pressures that it is encountering, has not rebounded sharply after the TEL-DGTL merger. Moreover, it is possible that GLO will be energized by its improved performance in 1H2012 at the expense of TEL. Considering these, we still think that competitive pressures will eventually subside, but it is unlikely to happen in the near-term.

Given this scenario, we forecast TEL's Net Income to be at P36.4B and P40.4B for 2012 and 2013, respectively. These are based on 10.6% revenue growth assumptions of 10.6% and 6.8% for 2012 and 2013, respectively, and EBITDA margins of 46.0% and 46.8% for 2012 and 2013, respectively.

With these, we arrive at our TP for TEL of P3,000. Our TP equates to ~16x 2013E PE, which is roughly in-line with the 2013E PE of the PSE index. Our TP also translates to ~6.25% 2013E dividend yield, which is still the highest among the constituents of the PSE Index.

- **A Longer Turn.** Upside risks to our forecasts include faster revenue growth and sharper margin rebound. This scenario would likely take place if and when GLO decides to take its foot off the gas pedal, thereby paving the way for the rational playing field that most market observers expected post TEL-DGTL merger.

Downside risks to our forecasts pertain to TEL's acquisitions of TV5 and Signal, as well as its potential acquisition of GMA7. Note that TV5 and Signal are expected to deliver Net Losses for 2012 and 2013. These segments might therefore continue to drag TEL's earnings, moving forward. Moreover, TEL's potential acquisition of GMA7 might be earnings dilutive if the acquisition is priced at a premium and is funded via another share issuance from TEL.

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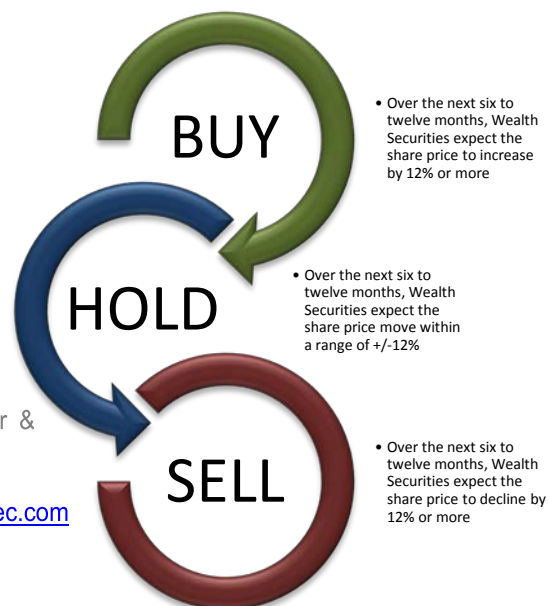
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