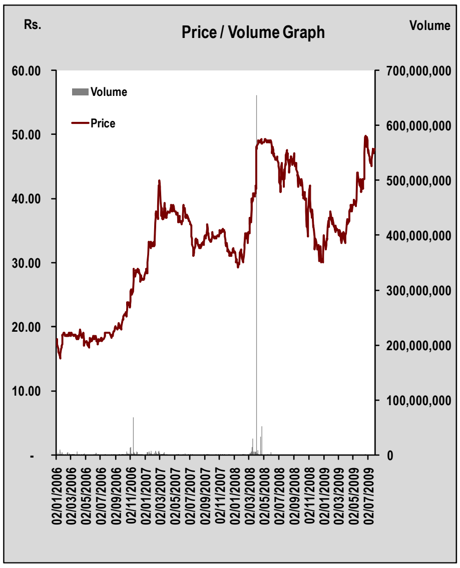
Sri Lanka Telecom PLC (SLTL)

Rs. 47.75 **BUY**

SLTL			
Reuters Code			SLTL.CM
Bloomberg Code			SLTL.SL
Share Price LKR			47.75
Issued Share Capital (Shares)			
Voting	1,804,860,000		
12 mth High/Low (Rs.)	49.75/30.00		
Average Daily Volume (Shares)	54,298		
Market Capitalisation Rs. mn			86,182
Price Performance (%)			
	1 mth	6 mth	12 mth
ASPI	3.85	39.25	1.55
SLTL	(0.52)	30.82	1.60



Fiscal Year	Turnover (Rs. mn)	NPAT (Rs.m)	EPS (Rs.m)	EPS Growth	EV/EBIDT (x)	PER (x)	Dividend Yield (%)
2005	32,515	3,093	1.7	139.3	4.6	27.9	1.6
2006	40,691	5,439	3.0	75.8	2.6	15.8	1.6
2007	43,234	5,640	3.1	3.7	2.5	15.3	2.1
2008	47,046	7,368	4.1	30.6	2.6	11.7	2.1
2009E	51,071	5,364	3.0	(27.2)	2.4	16.1	2.1
2010E	54,178	6,354	3.5	18.5	1.9	13.6	2.1

- Sri Lanka Telecom (SLT), the largest telecommunication operator in Sri Lanka, witnessed a change in its ownership structure when NTT Communications Corporation sold its 35.19% stake in the company to Global Telecommunications Holdings (GTH), a unit of Malaysia's UT Group for USD 297 million. The Government of Sri Lanka is the largest shareholder of SLTL with a stake of 49.5%. Currently, GTH owns approximately 44.98% of SLTL. The company is also the largest listed entity on the Colombo bourse with a market capitalization of Rs. 86.6 billion accounting for 10.7% of total market cap.

- Since privatization back in 1997, SLTL has being a significant contributor to the development of the telecommunication infrastructure in the country and has now become a quadruple play service provider offering fixed line, mobile, broadband and media services. The company is currently the market leader in both fixed line and data service segments while being the 2nd largest mobile provider in the country with a market share of approximately 24%.

Operational Review

Fixed Line Segment

- SLTL remains the market leader in the segment thanks to the wired connections which stood at approximately 876,000 by the end of 1Q2009. The company was the 3rd to receive CDMA licenses after Suntel and LankaBell who together managed to capture over 69% of the CDMA connections in the country by the end of March 2009. SLTL accounts for nearly 23% of total wireless lines but is seeing a decline in the fixed line market share to 46% from about 84% enjoyed in 2004, prior to the issuance of CDMA licenses.

- The wired connections have witnessed negative growth as subscribers shifted both within the segment to other CDMA operators or to mobile networks which offer cheaper rates. SLTL suffered from a 7% decline in its subscriber base during 1Q2009.

- The total CDMA subscriber base in the country too lost momentum by around 3% during 1Q2009 while SLTL suffered from an 8% decline over the same time period.

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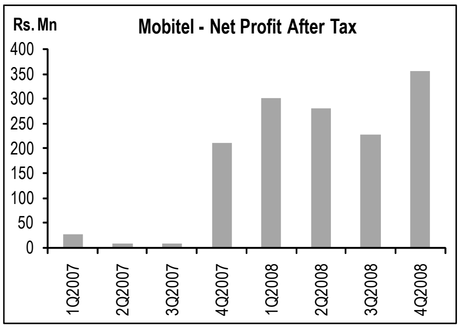
- Although the 1Q2009 figures look gloomy for SLTL, we expect the subscriber numbers, mainly in the Wireless segment to increase as economic activity in the North and East pick up. However, this growth may offset the numbers churning out of SLTL, thus no effective growth may be seen in terms of subscribers.

Mobile



- Mobitel has secured its position as the 2nd largest mobile operator in the country with a market share of approximately 24.4% and an active subscriber base of 2.8 million. With the launch of the Mobitel "Upahara" package towards the latter part of 2008, its market share rose to 24% by the end of 2008 from 18% in 2007. Mobitel's subscriber base grew by approximately 80% on average during the last 5 years when the industry witnessed an average of 51%. The unit accounted for nearly 46% of incremental connections in 2008.

- Mobitel's "Upahara" postpaid package, targeting the state sector employees and pensioners, introduced aggressive price competition within the industry with its launch. The company has remained very competitive and efficient in the industry with the expertise brought in by GTH while capitalizing on the infrastructure already put in place by SLTL.

- In FY2008, Mobitel achieved a 72% increase in revenue with a yoy subscriber growth of 92% to end the year with a pre post mix of 70 : 30. The company which turned around in FY2007 with a NPAT of Rs. 254 million, saw its NPAT increase by over fourfold to reach Rs. 1,168 million in FY2008.

- The GSM network at Mobitel currently covers nearly 70% of the country and 95% of the population. The company is rapidly expanding the number of base stations to 2,000 by mid 2009.

- Despite a high growth in the subscriber base, the company was only able to add 127,000 subscribers on to its network during 1Q2009 compared to over 400,000 in both 3Q2008 and 4Q2008, consequent to the entry of Bharti Airtel. Going forward, we expect the company to enjoy higher additions as it expands fully in to North and East through innovative tariff structures.

Data Services

- SLTL is the largest internet service provider with a market share of over 60%, whose revenue accounted for approximately 18% of group revenue in FY2008 compared to 13% a year ago. Being a dominant player, SLTL continues to enjoy higher revenue growth from increased usage and lower penetration levels in the country.

- Although the company is currently suffering from a decline in wired line services, the copper wire line network already laid across the country could be used to expand its ADSL Broadband service and capitalize on low penetration. We expect the segment to be one of the key revenue drivers for SLTL in the years to come.

Media Services

- SLTL's media services commenced operations during the 4Q2008 with the launch of IPTV, through its wholly owned subsidiary SLT Visioncom (Pvt) Ltd. This would enable SLTL to leverage on its island – wide infrastructure. The product will also allow access to e-mail, internet directory services, telephony and all other business communications through one converged IP broadband network, offering data, voice and media.

- The company has targeted its product towards a selected customer base while charging a premium price compared to that of rivals, thus enabling the unit to maintain its ARPU levels and profitability.

Network

- The company has become the largest operator in the country and one of the very few in the region to have invested in 4 submarine cable systems with the last being Dhiraagu which connects Sri Lanka and Maldives via 850 km fibre optic cable. These undersea cable networks further enable the company to pursue its global business operations.

- Total international revenues, comprising of international call revenue and international settlements, declined by 3.9% in FY2008 to Rs. 8.81 billion as a result of heavy price competition which resulted in IDD rates being lowered by 45% to 86% depending on the country.

- Further, SLT continued the transition of its existing microwave network to an island wide optical fibre infrastructure which will provide the foundation for the Next Generation Network (NGN). This will enable SLT to host multiple services on a single network. The network is configured in 11 Rings linking the entire island with approximately 4,200 km of optical fibre cabling.

- SLTL also owns a fibre optic line that runs from Mannar to Vavuniya which was damaged during the war, and is likely to be repaired as early as possible to capture the Nothern region of the country. Further, the Government has allowed another fibre optic cable to be laid along the A9 road connecting Vavuniya and Jaffna.

Valuations & Earnings

- The local telecommunication industry has witnessed increasing competition in all segments with only SLTL and Dialog Telekom PLC (DIAL) being the only operators to provide quadruple play services. The existence of aggressive competition has although been beneficial to the end consumer, has been detrimental to the industry as almost all operators have struggled to make positive earnings.

- SLTL, unlike other operators in the country, is backed by an island wide infrastructure reaching a larger subscriber base enabling SLTL to remain at the top despite competition.

- Double digit inflation that prevailed in the country during last year, hampered usage volumes in almost all segments, while new additions too slowed down despite many promotional campaigns. However, with inflation having subsided, we believe SLTL will be able to benefit from higher usage as well as greater incremental connections to its network.

- Given the current circumstances in the industry, we believe that a great deal of potential lie in the data and the mobile segments which are likely to remain as key revenue generators for SLTL. The company will undoubtedly remain as the market leader with its island wide infrastructure on the data segment while in the mobile segment, stiff competition may still be witnessed.

- We expect domestic call revenue to decline in the long term as more subscribers move out of the fixed line network, while mobile revenue is likely to grow to higher levels. The most recent addition to SLTL's product portfolio, IPTV, is likely to contribute towards higher group revenue in the long term.

- Up to the end of FY2008, SLTL has written off over Rs. 13 billion as International Telecommunication Levy (ITL), of which two thirds can be claimed due to the expansions undertaken by SLTL. In FY2008, SLTL received a refund on its ITL amounting to Rs. 2,183 million for the period between 3rd March 2003 and 31st December 2005. Although further documentation has been submitted with regard to the period after 1st January 2006, there is no indicative date for reimbursement, and therefore, have been excluded from our forecasts.

- In FY2008, earnings inclusive of the ITL refund, boosted SLTL's earnings to Rs. 7,368 million. However, excluding the refund, this represents a yoy decline of 8% in profitability given adverse economic conditions. During the year, the company also undertook the 4th Voluntary Retirement Scheme costing the company Rs. 390 million.

- With the above, we expect SLTL to post earnings amounting to Rs. 5,364 million for FY2009E, excluding any possible refunds on ITL. Earnings are expected to further increase to Rs. 6,354 million for FY2010E, representing a yoy growth of 18%. SLTL's Long Term Borrowings comprising of USD 100 million is due for repayment during the current financial year and the company has a strong Balance Sheet and a Cash flow to meet this payment.

- At a price of Rs. 47.75, the counter trades at a P/E multiple of 16 times FY2009E earnings, a 18% premium to the market. The company's NAVPS stood at Rs. 26.33 by the end of FY2008. Further, SLTL is one of the very few cash rich companies with a Cash EPS of over Rs. 8.80 expected during the next 2 years.

- With the resumption of economic activity in the North and East, we expect the need for telecommunication services to increase in the medium to long term from which SLTL can benefit vastly, therefore we recommend **BUY**.

Income Statement Year Ended 31st December	2002 Rs. 'mn	2003 Rs. 'mn	2004 Rs. 'mn	2005 Rs. 'mn	2006 Rs. 'mn	2007 Rs. 'mn	2008 Rs. 'mn	2009E Rs. 'mn	2010E Rs. 'mn
Revenue									
Domestic Revenue	14,002	15,169	18,054	18,019	22,865	21,562	16,695	15,477	12,763
International Revenue	10,379	7,638	7,429	7,928	8,286	9,501	9,775	10,292	12,816
Data & Other	999	1,670	1,270	3,005	4,216	5,600	8,512	11,066	13,058
Mobile	0	1,076	2,835	3,563	5,323	6,572	12,064	14,237	15,540
Revenue	**25,379**	**25,553**	**29,588**	**32,515**	**40,691**	**43,234**	**47,046**	**51,071**	**54,178**
Operational Costs	9,851	10,924	14,129	15,512	17,915	20,748	25,095	29,388	29,919
EBIDT	**15,528**	**14,629**	**15,459**	**17,003**	**22,776**	**22,486**	**21,951**	**21,683**	**24,258**
Depreciation	7,604	8,241	9,036	9,366	10,174	10,416	10,763	11,294	11,559
Interest Expenses	3,377	2,863	2,524	2,084	1,884	2,232	2,131	1,227	1,061
Other income	660	427	346	810	1,216	1,455	1,698	1,550	995
Profit before Exceptional Items	5,207	3,952	4,245	6,362	11,934	11,293	10,755	10,713	12,634
Int. Telecom Levy	-	710	2,804	1,550	2,282	2,851	2,987	3,050	3,355
Refund on TDC	-	-	-	-	-	-	2,183	-	-
VRS		-	-	-	425	43	390	-	-
Profit Before Tax	5,207	3,242	1,441	4,812	9,227	8,399	9,561	7,663	9,279
Tax	(2,522)	(993)	(148)	(1,719)	(3,789)	(2,759)	(2,193)	(2,299)	(2,925)
Profit After Tax	**2,685**	**2,249**	**1,293**	**3,093**	**5,439**	**5,640**	**7,368**	**5,364**	**6,354**

Balance Sheet As at 31st December	2002 Rs. 'mn	2003 Rs. 'mn	2004 Rs. 'mn	2005 Rs. 'mn	2006 Rs. 'mn	2007 Rs. 'mn	2008 Rs. 'mn	2009E Rs. 'mn	2010E Rs. 'mn
Property, Plant & Equipment	56,722	55,763	54,350	56,151	55,790	55,495	58,354	55,560	52,102
Other Non Current Assets	2,080	1,991	2,368	1,526	960	1,268	2,060	1,300	1,200
	58,802	**57,747**	**56,718**	**57,677**	**56,750**	**56,763**	**60,414**	**56,860**	**53,302**
Current Assets									
Inventories	665	785	1,312	844	1,419	1,476	1,743	2,366	2,507
Recievables	9,324	9,242	9,898	8,531	10,558	9,938	10,807	12,670	14,619
Cash and Equivalents	5,974	4,600	10,845	14,468	15,315	17,195	17,439	12,043	15,298
	15,963	**14,651**	**22,055**	**23,843**	**27,292**	**28,609**	**29,989**	**27,079**	**33,866**
Total Assets	**74,765**	**72,398**	**78,773**	**81,520**	**84,042**	**85,372**	**90,403**	**83,939**	**87,167**
Share Capital	18,049	18,049	18,049	18,049	18,049	18,049	18,049	18,049	18,049
Capital Reserves	188	188	188	188	0	0	0	0	0
Retained Earnings	11,847	13,013	13,404	15,598	19,870	23,705	29,269	32,829	37,379
Other	6,072	6,564	6,695	7,504	7,057	6,575	7,094	6,863	7,825
Shareholders Funds	**36,156**	**37,814**	**38,336**	**41,339**	**44,976**	**48,329**	**54,412**	**57,741**	**63,253**
Long-term Liabilities									
Borrowings	18,986	13,523	20,905	19,525	17,241	17,007	16,326	4,851	1,351
Retirement Benefits	429	448	520	751	942	1,329	1,500	1,750	2,000
Deferred Tax Liability	7,146	8,139	7,489	6,013	4,513	2,777	3,557	3,858	4,125
	26,561	**22,110**	**28,914**	**26,289**	**22,696**	**21,113**	**21,383**	**10,459**	**7,476**
Current Liabilities									
Trade and Other Payables	5,108	4,846	6,761	7,414	8,721	11,409	7,700	9,411	10,648
Current Tax Liability		45	297	2,777	3,732	1,896	2,335	2,685	2,147
Borrowings	6,940	7,583	4,465	3,701	3,917	2,625	4,573	3,643	3,643
	12,048	**12,474**	**11,523**	**13,892**	**16,370**	**15,930**	**14,608**	**15,739**	**16,438**
Total Liabilities	**74,765**	**72,398**	**78,773**	**81,520**	**84,042**	**85,372**	**90,403**	**83,939**	**87,167**

Cashflow Statement As at 31st December	2002 Rs. 'mn	2003 Rs. 'mn	2004 Rs. 'mn	2005 Rs. 'mn	2006 Rs. 'mn	2007 Rs. 'mn	2008 Rs. 'mn	2009E Rs. 'mn	2010E Rs. 'mn
PBIT	5,207	3,242	1,441	4,812	9,227	8,399	9,561	7,663	9,279
Tax paid	-	-	(38)	(715)	(4,334)	(6,332)	(2,193)	(2,299)	(2,925)
Depreciation	7,604	8,241	9,036	9,366	10,174	10,416	10,763	11,294	11,559
Non cash items	692	246	(84)	599	(1,370)	3,499	(1,200)	-	-
Working capital changes	(45)	(300)	47	3,138	(262)	(892)	(1,551)	(775)	(853)
Net cash generated from operations	**13,458**	**11,429**	**10,402**	**17,200**	**13,435**	**15,090**	**15,381**	**15,883**	**17,060**
Investing Activities									
Property, Plant & Equipment	(3,722)	(7,278)	(7,611)	(10,686)	(9,197)	(10,073)	(13,680)	(8,500)	(8,000)
Net cash used in investing activities	**(3,722)**	**(7,278)**	**(7,611)**	**(10,686)**	**(9,197)**	**(10,073)**	**(13,680)**	**(8,500)**	**(8,000)**
Financing Activities									
Proceeds from borrowing	944	3,400	20,970	2,041	-	2,653	3,607	-	-
Payment on borrowings	(7,580)	(7,467)	(16,379)	(3,338)	(3,739)	(3,403)	(2,321)	(11,475)	(3,500)
Dividends paid	(541)	(1,083)	(902)	(899)	(1,354)	(1,805)	(1,804)	(1,804)	(1,804)
Redemption of debentures	(375)	(375)	(375)	(375)	-	-	-	-	-
Net cash used in financing activities	**(7,552)**	**(5,525)**	**3,315**	**(2,571)**	**(5,093)**	**(2,555)**	**(518)**	**(13,279)**	**(5,304)**
Increase in cash and cash equivalents	2,184	(1,374)	6,106	3,944	(855)	2,462	1,183	(5,896)	3,756
Balance at the beginning of the year	3,790	5,974	4,600	10,706	14,649	13,794	16,256	17,439	11,543
Balance at the end of the year	**5,974**	**4,600**	**10,706**	**14,649**	**13,794**	**16,256**	**17,439**	**11,543**	**15,298**