The Moscow Times
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New Telecoms Champ Lacks Mobile Punch

By The Moscow Times

March 29, 2011



Beefed-up Rostelecom may be the country's new telecoms champion, yet uncertainty over its mobile strategy has investors fretting that it lacks sound long-term growth potential.

The state-controlled operator will have $9 billion in sales once it completes its merger with seven regional telecoms firms in early April. It will relist in Moscow at that time and is expected to list its secondary shares in London in May.

The enlarged group will be a clear leader in the fixed-line, broadband and cable television markets, with access to more than 50 percent of all Russian households.

But it will only be Russia's fifth-biggest mobile operator — a ranking that could spell trouble for future growth as customers turn increasingly to mobiles for long-distance calls.

"If you want to sell this story to international financial investors it would help to have strong

growth elements. These are most likely to come from mobile because of the anticipated wireless data boom," ING analyst Dalibor Vavruska said.

"In theory this fixed-line asset is massively valuable as an acquisition target due to its uniqueness — but I don't think a near-term sale of Rostelecom is likely," he said.

Based on analysts' estimates, Rostelecom currently trades at a discount to its international peers, while still offering higher sales growth rates than most.

But UralSib analyst Konstantin Chernyshev pointed out that, in comparison with mobile firms Mobile TeleSystems and VimpelCom, Rostelecom is trading at a 44 percent premium — unfounded given estimated 2012 growth and earnings.

"Such valuations would be justified if Rostelecom were capable of outgrowing its rivals. ... However, this is not realistic," Chernyshev said.

A Russia-focused telecoms fund manager said the stagnation of fixed-line telecoms models could pose a problem for Rostelecom.

"We don't think this is an interesting growth opportunity ... There is less and less use for fixed line as voice migrates to mobile, yet it is also a cost-intensive business. Broadband is a potential growth area, but it is very competitive in Russia with the mobile operators also involved," said the fund manager, who declined to be named in order not to reveal his investment strategy.

Market research group AC&M forecast that the consolidated Rostelecom had nearly 7 percent of the Russian mobile market at the end of 2010, while market leader MTS together with rivals VimpelCom and MegaFon held a combined 80 percent.

With revenues from mobile voice expected to remain flat as mobile data services growth surges, Rostelecom needs to fix this problem.

It may opt for an alliance or merger with one of the biggest wireless carriers to boost its mobile presence — the scenario analysts say would be the best so long as the price is right.

"I still think that a combination of Rostelecom and MegaFon is probably the most sensible solution," Vavruska said, noting that a global telecoms consolidation trend had already begun.

AT&T announced a $39 billion acquisition of Deutsche Telekom's T-Mobile USA earlier this month, after VimpelCom's deal for Orascom Telecom and Italy's Wind, as telecoms operators worldwide seek to strengthen capability to support surges in data delivery.

On the upside, analysts suggest that the company may get preferential treatment when it comes to awarding licenses for new mobile data networks, as the government remains the largest shareholder. And the fixed-line broadband market, where Rostelecom has a 40 percent share, could still help it to deliver growth.

"United Rostelecom is not a growth story as any boost in broadband could be offset by losses in voice sales. However, margins can be preserved even with no tariff growth by exploiting

significant cost-cutting potential," Aton analyst Stanislav Yudin said.

Consultants advising Rostelecom's parent company Svyazinvest estimate potential consolidation synergies at about $1 billion — a figure Yudin said looks achievable.

"We think the growth potential for the broadband and pay-TV segments is high. As for its mobile strategy, that is less straightforward, but we expect the company to reveal it shortly," Renaissance Capital analyst Ivan Kim said.

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