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Netia – Netia Acquires TK Telekom

Rating: hold | target price: PLN 5.80 | current price: PLN 6.04

NET PW; NET.WA | Telecoms, Poland

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On May 8th 2015 Netia agreed to acquire a 100% stake in TK Telekom, the telecommunications arm of the Polish Railways (PKP), for PLN 221m. The Company is financing the deal using available credit. The takeover is subject to the approval of the anti-trust office UOKiK and of PKP shareholders.

The acquisition is a good move on Nertia's part in our view. Its value is equal to 5.2x EV/EBITDA – a multiple slightly higher than Netia's excluding expected cost synergies. Netia has not quantified its synergy projections yet, nor has it provided TK Telekom's financial statements for 2014. In our opinion the main source of synergies will be payroll savings: Netia, which generates revenue of PLN 1.6bn, employs 1600 people, and TK Telekom, whose revenues approximate PLN 200m, employs ca. 400 people. Note that any potential downsizing is likely to initially entail extra costs stemming from severance pays etc. Further there is potential for synergies in SG&A (IT, office maintenance, etc.), rental costs, and network maintenance. Assuming ca. PLN 40m cost synergies the deal has a good value at <4.1x EV/EBITDA.

As for revenue generation, by acquiring TK Telekom Netia will gain access to a major customer, PKP, which accounts for about. 40% of TK's revenues (we assume the telecom has a long-term deal with its current owner). Further, TK's key contribution is 7,400 kilometers of fiber-optic network which Netia can capitalize on as an infrastructure operator and a major provider of B2B telecommunications services in Poland (Netia mentions in the press release that the acquisition has boosted its business scale by over 28% in the business clients segment). Last but not least by taking over TK Netia will become one of the leading providers of leased line services to mobile operators (especially Cyfrowy Polsat and Play), and as such it can mitigate the downward price trends in this submarket.

According to our estimates the expected cost synergies can add PLN 160m to Netia's equity value (5.0 x PLN 40m - restructuring costs), increasing the per-share value by some PLN 0.5. The other benefits of the acquisition include slower revenue erosion, as well as positioning Netia as a prime acquisition target for telecom market players like Cyfrowy Polsat.

As for the impact of the acquisition on dividends, an issue of interest to Netia's minority shareholders, given the PLN 0.42 DPS recommended by the Management Board (making for a total 2015 distribution of PLN 146m), after the acquisition and dividends Netia's pro-forma 2014 net debt/EBITDA ratio figures roughly to 0.4x – a relatively low level which should not affect dividends.

We will provide a more in-depth financial analysis for the post-merger Netia after the acquisition is finalized and after TK Telekom makes public its financial statements.

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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