

### Overview of results for 2018

6 May 2019

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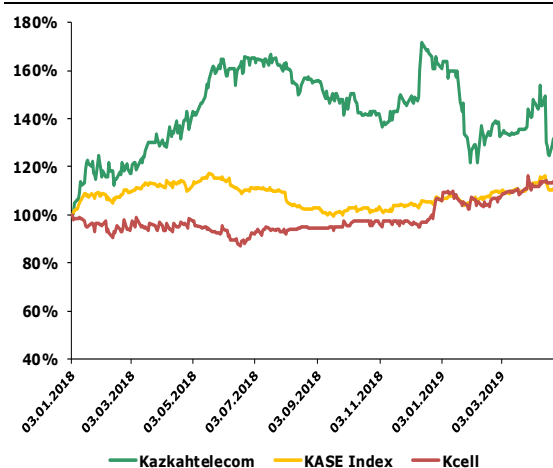
Ticker	KZTK.KZ
Recommendation	<b>Buy</b>
Current price (04.05.2019), KZT/share	25 650
12M target price, KZT/share	30 130
Expected growth potential	17,5%

Ticker	KZTKp.KZ
Recommendation	<b>Buy</b>
Current price (04.05.2019), KZT/share	12 360
12M target price, KZT/share	13 525
Expected growth potential	9,4%
Number of common shares, mn	10,9
Average trading volume fro 3M (KZTK.KZ, mn KZT)	101
Free float	14%
Market capitalization (mn KZT)	280 172
<b>Main shareholders:</b>	
Samruk-Kazyna	52%
Skyline Investment	25%

Financial indicators, mn KZT	2019F	2020F	2021F
revenue	545 824	553 318	560 442
EBITDA	168 283	161 356	155 598
Net income	44 676	45 865	47 380
Total equity	450 582	487 274	525 178
Net debt	302 986	290 199	264 708
EPS (KZT)	4 090	4 199	4 338

Price multiples	2019F	2020F	2021F
EV/Revenue	1,25	1,23	1,22
EV/EBITDA	4,05	4,22	4,38
Net debt/EBITDA	1,80	1,80	1,70
Net debt/Capital	0,67	0,60	0,50
P/E	6,27	6,11	5,91
P/B	0,62	0,57	0,53
ROE	8,2%	8,3%	8,5%

Share price dynamics	KZTK	KASE
1M	28 130	2 428
3M	27 548	2 373
12M	30 517	2 323
52 weeks maximum	35 199	2 533
52 weeks minimum	23 556	1 534



Sources: Bloomberg, Company data, Halyk Finance

We associate the volatility of Kazakhtelecom's shares in the first half of 2019 with the growth of debt burden after the acquisition of Kcell, the early realization of the put option in the Tele2-Altel joint venture and the increase in the volume of trading in shares on the market. In our opinion, corporate events related to the redemption of shares from minority shareholders and one-time expenses of Kcell for paying a fine to Kar-Tel, are temporarily reflected in the value of the Company's shares. Considering the Company's fundamentals, the extensive telecommunications infrastructure and the leading positions of Kazakhtelecom in the mobile communication, broadband access, fixed telephony and Internet segments, we believe that in the long term, the Company will be able to generate stable cash flows to cover liabilities and stabilize credit indicators. Considering the need to attract additional debt to repurchase a stake in the joint venture, on the one hand, and diversification of the Company's business portfolio, on the other, we raise our recommendation from Hold to **Buy** ordinary shares of Kazakhtelecom and lower 12M TP from 32 000 to **30 130 KZT/share**.

#### Company's financial results and opportunities for further growth.

In 2018, the Company showed revenue growth of 6% y/y mainly in the B2B segment (49% of total revenue) with an increase in total costs of ~2.7% y/y. The EBITDA margin reached 35.9% in 2018 (as opposed to 36.2% for 2017). The company identifies new business areas, such as e-commerce, M2M, cloud technologies and a platform for the development of digital services.

**Acquisition of Kcell.** The consolidation of the telecommunications segment and the acquisition of Kcell will allow the Company to expand its subscriber base, optimize the costs of integrating the infrastructure, the overall technological base and reduce the cost of providing mobile communication services. Given the high capital investment in maintaining the current infrastructure and the deployment of 5G networks, the Company, in our opinion, will be able to optimize investments in network expansion due to the synergy effect.

**Improving the performance of the JV Tele2-Altel.** We note that the main driver for improving the results of Kazakhtelecom are the financial results of JV Tele2-Altel. Following the results of 2018, JV Tele2-Altel significantly increased its subscriber base, scale of operations and integrated operational processes with Kazakhtelecom, which had a positive effect on the Company's total indicators.

**Planned SPO of Kazakhtelecom.** The proposed placement on the AIFC Stock Exchange is a key event that will enable the Company to attract investors, and to increase the transparency of its activities in accordance with international standards.

**12M TP 30 130 KZT for ordinary share and 13 525 KZT for preferred share, recommendation to Buy.** The acquisition of Kcell and the complete consolidation of JV Tele2-Altel will expand the Company's asset portfolio and the range of information and communication services. We note that with successful integration of operational processes, the Company will be able to generate enough cash flows to cover its debt obligations. Despite the volatility of the telecommunications market due to the significant investments required to maintain and build networks, we believe that by increasing its share in the telecommunications market, the Company will reduce operating/capital expenditures in the long term. According to our calculations, the Company's dividend yield for 2019 will be ~3.3% or 834KZT/share.

**Fig 1. Financial results of Kazakhtelecom for 2018, mn KZT**

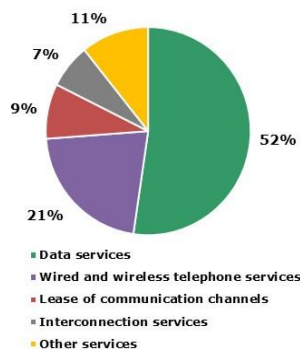
	2018	2017	y/y
Revenue	216 543	203 058	6,6%
Compensation for rendering services in rural areas	6 184	7 168	-13,7%
<b>Total revenue</b>	<b>222 726</b>	<b>210 225</b>	<b>5,9%</b>
Cost of sales	-154 016	-151 677	1,5%
<b>Gross profit</b>	<b>68 711</b>	<b>58 549</b>	<b>17,4%</b>
General and administrative expenses	-23 312	-21 452	8,7%
Selling costs	-4 388	-3 802	15,4%
Impairment losses on financial assets	-3 907	-	-
<b>Operating profit</b>	<b>37 104</b>	<b>33 294</b>	<b>11,4%</b>
Share in profit / loss of affiliated organizations	7 860	1 098	615,6%
Financing costs	-7 350	-7 826	-6,1%
Revenues from financing	3 067	4 125	-25,6%
Other income	4 359	4 428	-1,6%
Other expenses	-1 963	-1 860	5,5%
Revenues/expenses from revaluation of currency items	10 591	-634	-
Income from disposal of fixed assets	322	311	3,4%
<b>Profit before tax</b>	<b>53 991</b>	<b>32 937</b>	<b>63,9%</b>
Income tax expense	-11 108	-8 219	35,1%
<b>Net profit</b>	<b>42 883</b>	<b>24 718</b>	<b>73,5%</b>

Sources: Company data

## Review of financial results for 2018

The total income of Kazakhtelecom for 2018 increased to KZT222 726 mn tenge (+5.9% y/y), of which the income from regular activities amounted to KZT216 543 mn (+6.6% y/y) and KZT6 184 mn (-13.7% y/y) compensation for the provision of services in rural areas. Cost of sales increased to KZT154 016 mn (+1.5% y/y), providing gross profit of KZT68 711mn (+17.4% y/y). Operating profit increased by 11.4% y/y to KZT37 104 mn, due to an increase in general and administrative expenses to KZT23 312 mn (+8.7% y/y) and sales expenses to KZT4 388 mn (+15.4% y/y). According to the Company, EBITDA amounted to KZT80bn (+5.3% y/y) with EBITDA margin of 35.9% (36.2% in 2017). The share in profits of affiliates increased significantly from KZT1 098mn to KZT7 860mn (+615.6% y/y). Financing expenses fell to KZT7 350 mn (-6.1% y/y) with financial income of KZT3 067 mn (-25.6% y/y). Net income from the Company's continuing operations amounted to KZT42 883 mn for 2018 (+73.5% y/y), against the same indicator in KZT24 718 mn for 2017. The main factor in the growth of the financial results of Kazakhtelecom was the exit of JV Tele2-Altel on profit before tax and on net profit in 2018 due to the increase in revenue from contract sales with customers to KZT120 803 mn (+16% y/y) and savings in income tax of KZT4 792 mn (-50.2% y/y). Income before tax and net income attributable to the Company in the JV Tele2-Altel increased from KZT2 286 mn for 2017 up to KZT15 183 mn for 2018 (+564% y/y) and KZT1 166 mn for 2017 up to KZT7 744mn for 2018 (+564% y/y).

**Fig 2. Revenues of Kazakhtelecom in the context of the articles for 2018.**



Sources: Company data

Analysis of the Company's revenues by articles for 2018 showed that revenue from data transfer services amounted to KZT113 299 mn (+6.59% y/y), revenue from telephone services amounted to KZT46 549mn (-3.68% y/y), revenue from leased communication channels reached KZT18 543 mn (+0.67% y/y), revenue from interconnection services dropped to KZT14 949 mn (-5.84% y/y) and other income amounted to KZT23 203 mn (+ 64.1% y/y). In terms of the cost of the Company for 2018, significant changes were observed in the cost of leasing communication channels, which increased to KZT9 346 mn (+ 23% y/y), in expenses for renting premises and equipment, which amounted to KZT1 755 million (+83% y/y), as well as in payments for use of the frequency range increased to KZT 1 270 mn (+527% y/y). As of December 31, 2018, the Company received a loss of impairment of financial assets in the amount of KZT3 907 mn, including due to the accrual of the provision for impairment of the deposit placed in Eksim Bank (KZT3 399.5 mn). In 2018 due to the long currency position, the company recognized net income from the revaluation of currency items in the amount of KZT10 591 mn due to the weakening of the tenge against the US dollar and other key currencies.

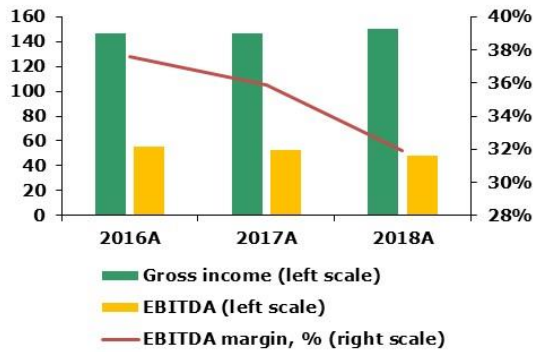
According to the data for 2018, the Company served 2.98 mn fixed telephone subscribers (-13% y/y), 1.7 mn fixed broadband subscribers (-2% y/y) and 770 thousand pay-TV subscribers (+4% y/y).

On November 26, 2018 the Board of Kazakhtelecom decided to pay dividends on preferred shares for 2018 in the amount of the guaranteed dividend per preferred share - 300 KZT, the total amount of dividends amounted to KZT96.2 mn tenge. In April 2019 the general meeting of shareholders of the Company decided to pay dividends in the amount of 20% of net profit for 2018, which corresponds to 781.06 KZT/share (KZT8 577 mn).

## Kcell acquisition and potential for synergy

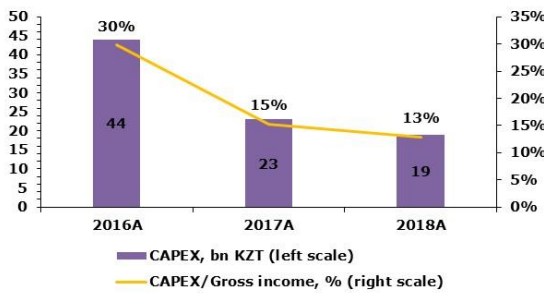
As part of the transaction, Kazakhtelecom acquired a 24% stake in Kcell from Telia Company and a 51% stake in Fintur Holdings

**Fig 3. Gross income, EBITDA, EBITDA margin Of Kcell for 2016-2018**



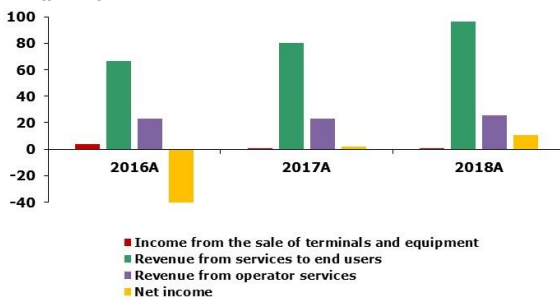
Sources: Company data

**Fig 4. CAPEX, CAPEX/gross income of Kcell for 2016-2018**



Sources: Company data

**Fig 5. Revenue of JV Tele2-Altel in the context of articles, net loss (profit) for 2016-2018, in mn KZT**



Source: Tele2 A.B.

B.V. The transaction price for the purchase of a 75% stake in Kcell Telia Company and Fintur Holdings B.V. in Kcell amounted to USD446 mn (KZT165 742 mn). As a result of the transaction, the Company recognized goodwill in the amount of KZT54 657 mn, which includes the cost of the expected synergy effect from the acquisition, which is fully attributable to the mobile telecommunications segment. Earlier, the Antimonopoly Committee of the Republic of Kazakhstan has already approved this deal, setting a number of key requirements:

- Preservation of existing tariff plans for 3 years after the closing of the transaction;
- The appearance of additional services for subscribers;
- Expansion of 4G coverage in rural areas (population above 4 thousand) until 2021;
- Implementation of the 5G service standard no later than December 31, 2021;
- Preservation of existing agreements with other market participants on the joint development of infrastructure;

Kazakhtelecom is also obliged to retain the Kcell and Activ brands. At the same time, the prerequisite is to maintain a separate business activity of Kcell, which is not dependent on the main shareholder. These conditions were key at the conclusion of the transaction.

The acquisition of Kcell will allow Kazakhtelecom to significantly expand its presence in the segment of mobile telecommunications in the GSM and LTE standard. In our opinion, Kcell will be managed as a separate business unit and the synergistic effect will come from a general reduction in operating and investment costs by eliminating duplicate costs and optimizing the base station portfolio, reducing staff, saving on regular capital costs and reducing investments in 4G networks/LTE, as well as savings from the transfer of all data transmission services and Internet services to Kazakhtelecom.

**Option valuation and results of the activities of JV**

In connection with the closing of the transaction on the acquisition of 75% of the shares of Kcell, Tele2 A.B. a decision was made on the early exercise of the put option, according to which Kazakhtelecom acquired from Tele2 A.B. at market value all shares of Khan Tengri Holding BV owned by Tele2 A.B. When exercising the option to buy back 49% of the share of Tele2 A.B. Kazakhtelecom is obliged to return the equity loan to the partner and pay the market value of the share capital. When buying Asianet shares in Khan Tengri Holding BV, Tele2 A.B. granted the selling party the right to 18% of the economic interest and the option to sell this interest with the possibility of exercising in 3 years. As of December 31, 2018, the fair value of 18% of economic interest was SEK764 mn (KZT32 866mn at exchange rate KZT/SEK as of December 31, 2018: 43,0185) versus SEK558 mn as of June 30, 2018 (KZT21 294 mn at exchange rate of KZT/SEK as of June 30, 2018: 38,1619). Based on the fair value of the economic interest presented in the accounts of Tele2 A.B. as of December 31, 2018, 51% of Kazakhtelecom’s stake in JV was KZT93 121 mn on a specified date.

We estimated the cost of JV using an EV/EBITDA multiplier. According to Bloomberg, the average indicator for 2019 for Tele2 A.B. companies is 5.67. When forecasting the results of JV, we assumed that the EBITDA margin in 2019 will be 39% against 34% in 2018. With JV revenue of KZT126 432 mn, EBITDA for 2019 will be equal to KZT48 888mn. Applying the average multiplier for similar companies (5.67), we received an EV of JV KZT277 198

**Fig 6. Calculation of value of JV Tele2-Altel, in bn KZT**

EV/EBITDA multiplier for 2019 by similar companies	5,67
EBITDA for 2019	48,90
EV	277,198
<b>Debt of JV:</b>	
Equity loan from Tele2 A.B.	-88
Interest-free debt of Tele2 A.B. owed to KZTK	12
Volume of guaranteed KZTK loans used by JV	-8,72
Value of JV	192,476
<b>Value of 49% share in JV</b>	<b>94,313</b>

Source: Tele2 A.B., Halyk Finance

mn. According to the reports of Tele2 A.B. at the end of 2018, JV loan to Tele2 A.B. amounted to KZT88bn.

According to the terms of the agreement concluded between Tele2 A.B. and Kazakhtelecom, the Company has previously provided interest-free loan to Tele2 A.B. with extension to 2031. The loan owed by Tele2 A.B. at the end of 2018, according to the statements of the Swedish company, to Kazakhtelecom was SEK279mIn (~ KZT12 002 mn at the rate of KZT/SEK as of December 31, 2018 – 43,0185). According to the data for 2018, the amount of unused credit line in DBK guaranteed by Kazakhtelecom was ~ KZT8 724 mn. We find the value of the JV by subtracting the debt from EV, receiving KZT184 054 mn. Share of Kazakhtelecom (51%) and Tele2 A.B. (49%) is KZT98 163 mn and KZT94 313 mn, respectively.

**Financial indicators of JV Tele2-Altel.** The main driver for improving the Company's financial performance is the performance of JV Tele2-Altel. For 2018 revenues amounted to KZT122 288 mn (+17% y/y), EBITDA reached KZT41 912 mn (+70% y/y), while EBITDA margin was 34%. At the end of 2018, the number of subscribers of JV amounted to 7 160 thousand subscribers (+4% y/ y).

#### One-time costs

On December 21, 2018 the Company acquired a 75% stake in Kcell, whose shares are listed on the London Stock Exchange and Kazakhstan Stock Exchange. In connection with the acquisition of Kcell by Kazakhtelecom, in April 2019 Kar-Tel has notified Kcell of the termination of the network sharing agreement in the amount of KZT14 552 mn, because Kcell has replaced the controlling shareholder, which is a violation of the terms of the agreement, giving the right to the other party to demand termination of the agreement and payment of the cancellation fee. Also, under the terms of the purchase and sale agreement, a 75% stake in Kcell, Telia company and Fintur Holding B.V. guaranteed payment of 75% of the fee for termination. In connection with the implementation of the right to terminate the agreement, the Company revised the allocation of the Kcell purchase price. The company recognized the obligation to pay a cancellation fee at its fair value and the corresponding compensating asset for reimbursement of 75% of the assessed fine receivable from Telia company and Fintur Holding B.V., and the effect of the above amounts on deferred tax liabilities and non-controlling interest. We assume that the cost of paying the fine will not significantly affect the Company's total financial performance in 2019. However, according to the published data for 1Q2019, the payment of the fine had a negative impact on the final results of Kcell's activities. The mobile operator recognized a cancellation penalty in the amount of KZT14 552 mn as a one-time expense and, as a result, received a net loss for the reporting quarter in the amount of - KZT8 751mIn (-471% y/y). We take into account in our calculations the one-time expense of Kcell to recover the fine.

#### Access to SPO and state influence on the Company's activities

According to the comprehensive privatization plan for 2016-2020, it is planned to conduct SPO of Kazakhtelecom, IPO of Air Astana and other national companies. According to Bloomberg, SPO of Kazakhtelecom on the AIFC Stock Exchange (AIX) is scheduled for the first half of 2019, which involves the sale of a certain part of the 52% of the Company's shares owned by Samruk-Kazyna.

On the part of the state, the Company's activities are regulated and controlled by the Telecommunications Committee (MIC RK Committee). In terms of protection of competition, the Company's

activities are regulated by the Committee for the Regulation of Natural Monopolies within the Ministry of National Economy of the Republic of Kazakhstan. The state regulation covers the services of the natural monopoly sphere, which include traffic transmission, connection to telephone communications and lease of dedicated channels to other operators, universal telecommunications services, as well as services provided to law enforcement agencies and the operator of the information and communication infrastructure of e-government.

According to 2018 data, about 14.5% (KZT32.3 bn) of the Company's revenues were received from the sale of services to the public sector. Kazakhtelecom participates in various government programs that involve the provision of operator access to high-speed Internet in rural areas and participation in the implementation of an e-learning system in education. We assume that Kazakhtelecom will continue to remain the main partner of the government of the Republic of Kazakhstan in the area of telecommunications and ICT services and will apply tariffs subject to government regulation. We do not include in our calculations a change in tariffs in the event of the Company's entering an SPO and a decrease in the state share.

**Trends in the telecommunications market**

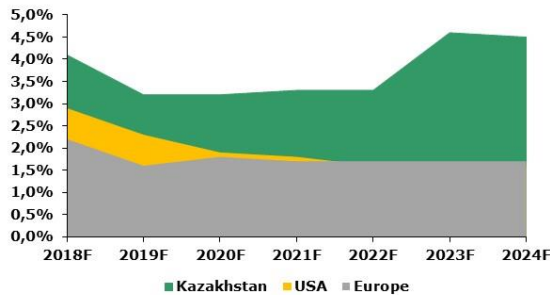
According to WCIS (World Cellular Information Service), ARPU in the mobile segment (average revenue per user) as of September 30, 2018 in Kazakhstan was ~ KZT1 125.61 (USD3.1), which is lower than the average of ~ KZT1 525.06 (USD4.2) in other countries. According to WCIS, tariffs for data transmission services in Kazakhstan are among the lowest in the CIS countries, which provides the potential for natural growth with growth in GDP and personal incomes. According to the IMF, the average long-term growth of GDP in developed countries, such as North America and Europe, will be 1.8% and 1.7%, respectively, against 3.7% in Kazakhstan in the forecast horizon 2019-2024. The demographic indicators of the Republic of Kazakhstan, which affect the main segments of the Company's activities and operational data, demonstrate a positive trend. According to the Company, EIU and Frost & Sullivan, the population of the Republic of Kazakhstan below the age of 25 years makes up about 40% of the total population of the country, while the proportion of the population aged 16–62 years is 59%, which implies a potential demand for the Company's services in mobile communication segment, fixed broadband access and data transmission.

At the end of 2018 Kazakhtelecom's share in the fixed broadband market was 69%, in the pay-TV market was 43% and in the fixed telephony market was 89%. In accordance with the state program announced in 2017, the Company aims to increase the share of fixed broadband in rural areas and develop the digital sector as a new sector of the economy. Among the significant technological trends, the Company highlights the development of digital services, cloud technologies, and M2M technologies (smart homes), the direction of Big Data and the introduction of the Internet of Things (IoT).

At the end of 2018, the Company's revenue share in the corporate segment (B2B) of total revenue was 14.9% (KZT33.1 bn), where Kazakhtelecom provides comprehensive solutions for large corporate clients and individual entrepreneurs. In the market of services provided to telecommunications operators (inter-network traffic and Internet access), the Company's revenue amounted to KZT43.1bn, which is 19.4% of total revenue for 2018.

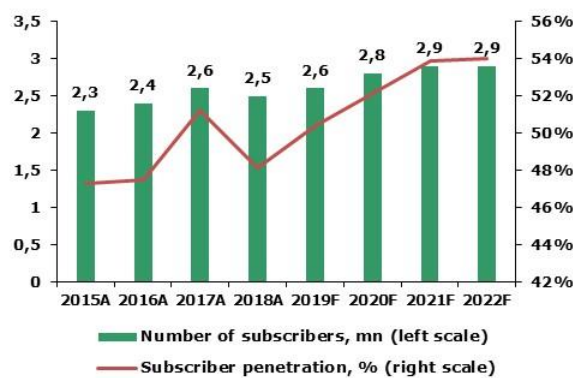
After the acquisition of Kcell and the consolidation of Tele2-Altel, Kazakhtelecom's market share in the total subscriber base in the mobile segment was 62%. According to 2018 data, Tele2-Altel and

**Fig 7. Forecast of GDP in the US, Europe and Kazakhstan for 2019-2024**



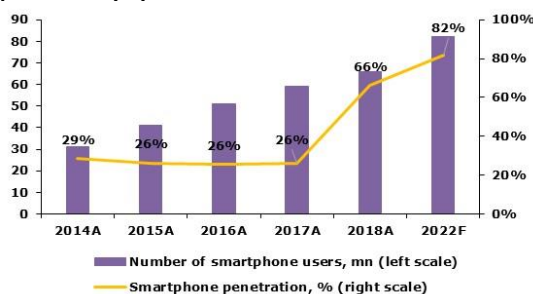
Source: IMF

**Fig 8. Forecast of the number of subscribers in the market of fixed access to Internet in Kazakhstan**



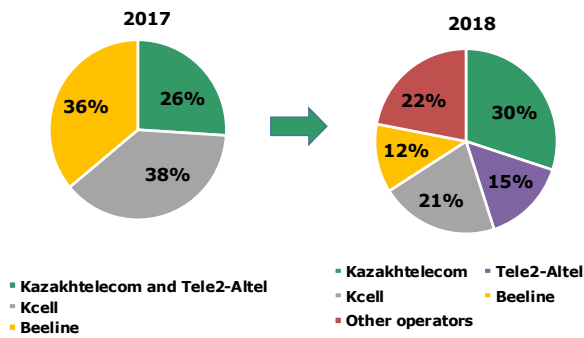
Source: Company data

**Fig 9. Number of smartphone users (mn) and smartphone penetration (%) in Kazakhstan**



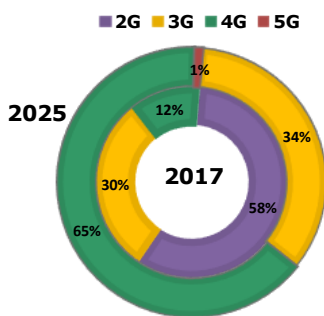
Source: Company data

Рис 10. Increase in market share of Kazakhtelecom in 2017-2018, %



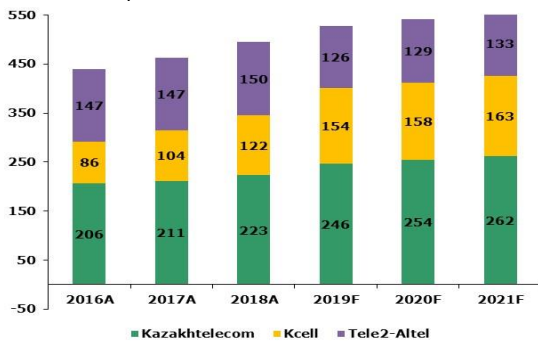
Source: Company data

Fig 11. The forecast of introduction of 4G/5G networks by 2025



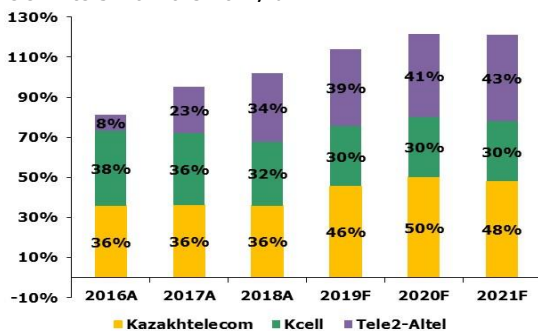
Source: GSMA, 2018

Fig 12. Kazakhtelecom, Kcell, JV Tele2-Altel revenue forecast for 2019-2021, in mn KZT



Source: Company data, Halyk Finance

Fig 13. EBITDA margin forecast by Kazakhtelecom, Kcell, Tele2-Altel JV for 2019-2021, %



Source: Company data, Halyk Finance

Kcell have made significant progress in deploying the 4G/LTE network in Kazakhstan, and now the companies cover about 75% and 62% of the country's population, respectively. The company also plans to actively deploy 5G networks. Joint cooperation with Ericsson is aimed at the development of 5G technology in Kazakhstan, which involves the pilot implementation of 5G networks in 2019-2021. It is expected that 5G will support much higher mobile broadband speeds and the transfer of large amounts of data. According to the GSMA, to meet the needs of 5G services, significant capital investments will be required in infrastructure, equipment deployment and an increase in the number of harmonized radio frequency spectrum (spectrum in the range of 1-6 GHz is the most suitable). We assume that the planned introduction of the 5G standard in the future will make it possible to efficiently use the common resources of Tele2-Altel, Kcell and Kazakhtelecom necessary for the deployment of the 5G network and include in our forecast the capital costs of launching networks.

**Update of recommendation**

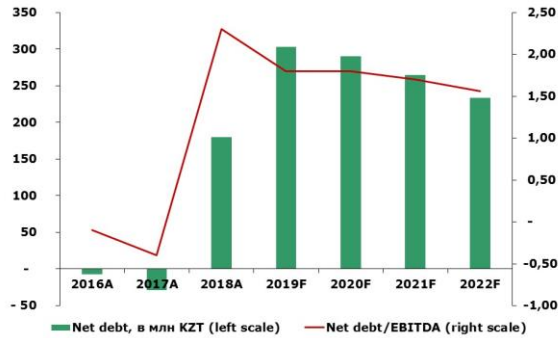
In order to calculate the fair value of the Company, we applied the discounted cash flow method (DCF). We took into account the predicted values of inflation, GDP growth, consumption growth and increase in the population of Kazakhstan. We revised the Company's operating data and the average increase in expected revenue over the forecast horizon of 2019-2025. We reviewed the cost of production, the costs of sales and general and administrative expenses due to operating synergies, savings in total capital investments and provided for investments in the launch of 5G networks.

Despite the positive macroeconomic trends, we expect the average growth rate of total revenue from the main business segments at 4%. The results of 2018 confirm our forecasts of a smooth decline in revenues from wired and wireless telephone services and a gradual transition to mobile communications and the Internet, which are becoming an alternative to landlines. Revenues from data transfer, being the main revenue item (54% of revenue in 2018), according to our calculations, will continue to grow at an average rate (+6.6% y/y). According to our data, revenues from telephone services (21% of revenues in 2018) will decline annually by 1.55% due to a declining demand for wired and wireless telephone services. Growth in revenue from interconnection and rental services is projected at 2% y/y. We predict that the annual growth rate of other income will be 5%. Revenue from the provision of services in rural areas is projected at the same level as in 2018. We predict that revenue growth will be driven by demand for the Company's services in the B2B segment (fixed services, infocommunication services, package offers) and positive trends in the digital services market.

We assume that the cost of sales of services, general administrative costs, as well as implementation costs will decrease due to the integration of infrastructure and networks, IT systems integration, optimization of staff, which will lead to a positive impact in the long run on the Company's costs. Acquisition of Kcell and consolidation of JV Tele2-Altel will allow the operator to reduce market risks during mutual transactions and make it less dependent on external macroeconomic factors (change in exchange rates). We expect that the Company will be able to maintain EBITDA margin at 38% on the forecast horizon of 2019-2025.

We expect an increase in debt burden, as well as an increase in financial expenses, taking into account the growth of interest rates on borrowing. According to Kazakhtelecom, net debt/EBITDA at the end of 2018 amounted to 2.3x (vs. -0.4x in 2017). According

Fig 14. Net debt and net debt / EBITDA forecast by Kazakhtelecom taking into account Kcell and Tele2-Altel JV



Source: Company data, Halyk Finance

to our forecasts, net debt/EBITDA will be close to 1.8x in 2019 with a net debt of ~ KZT302 986mn by attracting additional funds to repurchase shares in the joint venture Tele2-Altel.

When calculating the target price, we also updated the WACC calculation parameters. We applied a risk-free interest rate for Kazakhstan equal to 8%; beta value for Kazakhtelecom, equal to 1.06 and average market yield for the Republic of Kazakhstan (KASE Index) at 11.83%. The cost of equity and weighted average after-tax debt is 15.8% and 8.5%, respectively. According to our calculations, WACC is 11.65%. We take into account the long-term growth rate of 3% after 2025.

According to our estimates, the fair value of Kazakhtelecom is taking into account the synergy with Tele2-Altel and Kcell and attracting the debt necessary for the full consolidation of companies, and is equal to **KZT30 130 per share**. We recommend to buy common shares of Kazakhtelecom.

Fig 15. Calculation of the cost of Kazakhtelecom, taking into account Kcell and Tele2-Altel, mn KZT

	2019F	2020F	2021F	2022F	2023F	2024F	2025F
Выручка	488 325	514 106	516 967	537 247	553 667	569 862	573 477
ЕБИТ	82 940	109 190	102 575	113 457	128 387	136 204	134 542
" +Amortization"	85 344	86 943	88 371	89 506	90 248	91 507	90 145
" - Income tax"	18 015	24 023	22 977	26 504	28 780	30 337	29 810
" - Capital expenditures"	96 853	99 544	102 576	105 834	109 245	118 611	120 453
" - Changes in working capital"	-15 051	4 223	-395	2 890	3 395	686	1 659
<b>Free cash flows</b>	<b>68 466</b>	<b>68 343</b>	<b>65 788</b>	<b>67 735</b>	<b>77 215</b>	<b>78 077</b>	<b>72 764</b>
WACC	11,6%						
<b>Свободные денежные потоки (PV)</b>	<b>61 324</b>	<b>54 828</b>	<b>47 273</b>	<b>43 595</b>	<b>44 512</b>	<b>40 313</b>	<b>33 651</b>
Terminal value (PV)	355 819						
Enterprise value (EV)	681 315						
" - Net debt forecast"	302 986						
" - Market value of preferred shares"	15 292						
" - Minority interest"	33 934						
Market capitalization of Kazakhtelecom, mn KZT	329 102						
Number of shares, mn	10,923						
12M Target price < KZT	30 130						

Source: Company data, Halyk Finance

When forecasting the total capital costs, we took into account the investments in infrastructure development, the costs of implementing and deploying 4G/5G networks. In our opinion, the Company will invest in expanding the throughput capacity of the new infrastructure due to the increasing demand for bulk content and new communication services (Internet of things, electronic commerce). As a result, we believe that the ratio of capital investment to revenue (CAPEX / Revenue) will be at 23% in the forecast horizon 2019-2025.

### Valuation of preferred shares and dividends

We proceed from the assumption that the Company will continue to pay the guaranteed amount of dividends in the amount of 300 KZT/share, and also we have calculated the spread between the price of common and preferred shares at the level of 51%. We believe with a 90% probability that the price will depend more on the current spread, and with a 10% probability on calculations using the method of discounted dividends (DDM). Based on these assumptions, we recommend to buy preferred shares of Kazakhtelecom and estimate 12M CC at a rate of 13 525 KZT/share.

Announced for 2017 dividends on ordinary shares (KZT 17 087 mn) provide about 70% of the net profit of Kazakhtelecom. The company announced dividend payments in the amount of KZT8 577mln or KZT781.06/share for 2018, which is 20% of the Company's net profit. We assumed that the dividend payout ratio would be 40-50% starting from 2024-2025. As a result, the dividend on ordinary shares can reach 3 864 KZT/share in 2024.

### **Risks**

Corporate events related to the disagreement of minority shareholders with the transaction for the repurchase of Kcell shares by Kazakhtelecom may raise concerns of potential investors and, as a result, affect the value of the Company's shares. The proposed placement on the AIFC (AIX), which is due to take place in 2Q2019, is a significant event for the Company and will enable it to acquire new strategic investors, comply with international standards of corporate governance and contribute to an increase in the Company's transparency.

We separately single out the risk associated with an increase in the Company's debt burden indicators, which may adversely affect the Company's financial indicators and dividend payments. There is also a risk associated with the successful implementation of the operating and investment synergies of the Company, Kcell and Tele2-Altel JV. The deterioration of the macroeconomic environment in Kazakhstan may adversely affect the financial performance and operating data of the Company. Decreasing demand for data transmission services, the number of subscribers, deterioration in the fixed broadband access market, slowing down the introduction of 5G networks and increasing investments in the current infrastructure in order to maintain the demand for high-volume traffic can put pressure on the Company's profitability and lower quality of service.



**Appendix 1. Forecast of financial indicators of Kazakhtelecom, mIn KZT, except for data per share**

	2016A	2017A	2018A	2019F	2020F	2021F	2022F	2023F	2024F	2025F
<b>Balance sheet</b>										
Property, plant and equipment	272 176	259 022	390 309	545 824	553 318	560 442	566 642	571 300	579 247	570 619
Intangible assets	17 140	15 593	176 543	294 999	302 497	307 657	310 301	310 196	307 428	300 078
Investments in associates	67 161	69 246	77 669	0	0	0	0	0	0	0
Other long-term assets	7 626	12 055	15 002	29 786	32 723	31 996	31 502	32 073	31 857	31 811
<b>Total non-current assets</b>	<b>364 103</b>	<b>355 915</b>	<b>659 523</b>	<b>870 608</b>	<b>888 538</b>	<b>900 095</b>	<b>908 445</b>	<b>913 569</b>	<b>918 531</b>	<b>902 508</b>
Inventories	4 484	3 015	8 402	12 733	12 647	12 890	13 201	13 069	13 390	13 666
Trade receivables	24 992	32 094	52 173	82 728	85 149	87 751	91 026	93 775	95 943	98 474
Other short-term financial assets	48 133	62 134	4 685	3 675	3 757	3 823	3 871	3 919	3 942	3 948
Other current assets	2 929	2 170	12 347	32 785	31 335	28 628	30 916	30 293	29 946	30 385
Compensating asset	0	0	10 914	0	0	0	0	0	0	0
Short-term Investments	0	0	0	0	0	0	0	0	0	43 720
Cash and cash equivalents	24 321	15 986	45 350	24 416	25 705	25 848	26 862	27 683	28 493	28 674
<b>Total current assets</b>	<b>104 859</b>	<b>115 399</b>	<b>133 872</b>	<b>156 338</b>	<b>158 941</b>	<b>158 941</b>	<b>165 877</b>	<b>168 740</b>	<b>171 713</b>	<b>218 868</b>
<b>Total assets</b>	<b>468 962</b>	<b>471 314</b>	<b>793 395</b>	<b>1 026 946</b>	<b>1 047 131</b>	<b>1 059 035</b>	<b>1 074 322</b>	<b>1 082 309</b>	<b>1 090 245</b>	<b>1 121 376</b>
issued shares	12 137	12 137	12 137	12 137	12 137	12 137	12 137	12 137	12 137	12 137
Repurchased shares	-6 464	-6 464	-6 464	-6 464	-6 464	-6 464	-6 464	-6 464	-6 464	-6 464
Foreign currency translation reserve	-2	-6	-15	-15	-15	-15	-15	-15	-15	-15
Other reserves	1 820	1 820	1 820	1 820	1 820	1 820	1 820	1 820	1 820	1 820
Retained earnings	336 307	351 622	373 429	409 170	445 862	483 766	525 947	578 520	644 714	711 180
Non-controlling interest	0	0	33 934	33 934	33 934	33 934	33 934	33 934	33 934	33 934
<b>Total equity</b>	<b>343 798</b>	<b>359 108</b>	<b>414 841</b>	<b>450 582</b>	<b>487 274</b>	<b>525 178</b>	<b>567 358</b>	<b>619 932</b>	<b>686 125</b>	<b>752 592</b>
Loans: long-term part	53 795	24 968	135 838	208 995	193 880	164 619	141 664	149 329	100 990	115 990
Finance lease liabilities: long term	1 273	7 681	15 975	20 735	19 549	19 253	18 884	18 569	21 287	23 287
Deferred tax liabilities	19 624	19 041	38 897	41 912	41 445	41 127	41 495	41 356	41 326	41 392
Other long-term liabilities	12 872	18 437	23 483	28 503	27 893	27 468	27 955	27 772	27 732	27 819
<b>Total long-term liabilities</b>	<b>87 564</b>	<b>70 126</b>	<b>214 194</b>	<b>300 146</b>	<b>282 766</b>	<b>252 467</b>	<b>229 997</b>	<b>237 026</b>	<b>191 335</b>	<b>208 488</b>
Loans: short term	2 474	2 358	57 614	118 407	122 024	125 937	118 566	68 399	54 417	0
Finance lease liabilities	3 163	3 921	6 754	1 997	2 592	2 444	2 407	2 360	2 321	2 661
Trade payables	11 997	13 507	42 147	67 837	67 493	68 798	70 270	69 619	71 078	72 413
Advances received	2 835	3 033	0	0	0	0	0	0	0	0
Obligation to pay a fine for termination of the contract	0	0	14 552	0	0	0	0	0	0	0
Other current liabilities	17 132	19 262	43 292	87 977	84 982	84 211	85 723	84 972	84 969	85 221
<b>Total current liabilities</b>	<b>37 600</b>	<b>42 080</b>	<b>164 360</b>	<b>276 218</b>	<b>277 091</b>	<b>281 390</b>	<b>276 967</b>	<b>225 351</b>	<b>212 784</b>	<b>160 296</b>
<b>Total liabilities</b>	<b>125 165</b>	<b>112 206</b>	<b>378 554</b>	<b>576 364</b>	<b>559 857</b>	<b>533 857</b>	<b>506 964</b>	<b>462 377</b>	<b>404 120</b>	<b>368 784</b>
<b>Total liabilities and equity</b>	<b>468 962</b>	<b>471 314</b>	<b>793 395</b>	<b>1 026 946</b>	<b>1 047 131</b>	<b>1 059 035</b>	<b>1 074 322</b>	<b>1 082 309</b>	<b>1 090 245</b>	<b>1 121 376</b>
<b>Income statement</b>										
Revenue	205 820	210 225	222 726	488 325	514 106	516 967	537 247	553 667	569 862	573 477
Cost of sales	-138 292	-151 677	-154 016	-342 266	-343 029	-350 275	-357 458	-356 788	-363 037	-367 341
<b>Gross profit</b>	<b>67 528</b>	<b>58 549</b>	<b>68 711</b>	<b>146 059</b>	<b>171 077</b>	<b>166 692</b>	<b>179 789</b>	<b>196 879</b>	<b>206 826</b>	<b>206 136</b>
General and administrative expenses	-24 720	-25 255	-27 699	-63 119	-61 887	-64 116	-66 332	-68 492	-70 621	-71 594
Impairment losses on financial assets	0	0	-3 907	0	0	0	0	0	0	0
<b>Operating profit</b>	<b>42 808</b>	<b>33 294</b>	<b>37 104</b>	<b>82 940</b>	<b>109 190</b>	<b>102 575</b>	<b>113 457</b>	<b>128 387</b>	<b>136 204</b>	<b>134 542</b>
Net financial income/expenses	-2 837	-3 701	-4 283	-33 909	-53 071	-46 091	-48 210	-47 983	-37 258	-38 649
Non-operating income/expenses	2 522	2 245	13 309	13 660	13 769	13 873	13 982	14 093	14 132	17 001
Share in profit/loss of affiliated organizations	-18 410	1 098	7 860	0	0	0	0	0	0	0
<b>Profit before tax from continuing operations</b>	<b>24 082</b>	<b>32 937</b>	<b>53 991</b>	<b>62 691</b>	<b>69 888</b>	<b>70 357</b>	<b>79 229</b>	<b>94 496</b>	<b>113 079</b>	<b>112 893</b>
Income tax expense	-9 210	-8 219	-11 108	-18 015	-24 023	-22 977	-26 504	-28 780	-30 337	-29 810
<b>Profit from continuing operations</b>	<b>14 872</b>	<b>24 718</b>	<b>42 883</b>	<b>44 676</b>	<b>45 865</b>	<b>47 380</b>	<b>52 726</b>	<b>65 717</b>	<b>82 742</b>	<b>83 083</b>
Profit / loss after tax from discontinued operations	40 960	0	0	0	0	0	0	0	0	0
<b>Net income</b>	<b>55 832</b>	<b>24 718</b>	<b>42 883</b>	<b>44 676</b>	<b>45 865</b>	<b>47 380</b>	<b>52 726</b>	<b>65 717</b>	<b>82 742</b>	<b>83 083</b>
<b>EPS</b>	<b>5 072</b>	<b>2 250</b>	<b>3 914</b>	<b>4 090</b>	<b>4 199</b>	<b>4 338</b>	<b>4 827</b>	<b>6 016</b>	<b>7 575</b>	<b>7 606</b>
<b>Statement of cash flows</b>										
Cash flows from operating activities	60 198	66 225	66 352	172 304	139 513	156 330	161 799	143 591	218 026	161 853
Cash flows from investing activities	-42 010	-38 096	-120 277	-91 907	-94 458	-97 346	-100 456	-103 714	-112 924	-114 605
Cash flows from financing activities	-13 534	-35 472	77 277	-101 332	-43 766	-58 841	-60 329	-39 056	-104 292	-47 068
<b>Net cash change</b>	<b>4 654</b>	<b>-7 343</b>	<b>23 352</b>	<b>-20 934</b>	<b>1 289</b>	<b>1 43</b>	<b>1 014</b>	<b>821</b>	<b>810</b>	<b>181</b>
Cash and cash equivalents at the beginning of the period	19 965	24 321	15 986	45 350	24 416	25 705	25 848	26 862	27 683	28 493
Exchange Rate Effect	-298	-992	6 012	0	0	0	0	0	0	0
<b>Cash and cash equivalents at the end of the period</b>	<b>24 321</b>	<b>15 986</b>	<b>45 350</b>	<b>24 416</b>	<b>25 705</b>	<b>25 848</b>	<b>26 862</b>	<b>27 683</b>	<b>28 493</b>	<b>28 674</b>

Source: Company data, Halyk Finance forecast

**Appendix 2. Brief description of the Company.**

Kazakhtelecom is the largest telecommunications operator in Kazakhstan, providing a full range of information and communication services to private and corporate clients. The company owns 51% in the share capital of the joint venture Tele2-Altel, established jointly with the Swedish company Tele2 A.B. and leading activities in the mobile segment. On December 29, 2018 Tele2 A.B. made an early decision to exercise put option, which is implied in the agreement with Kazakhtelecom. At the end of December 2018 Kazakhtelecom has acquired a 75% stake in Kcell.

According to data as of 2018, Kazakhtelecom served 3 mn fixed telephone subscribers, 1.7 mn broadband subscribers and 800 thousand pay-TV subscribers. On December 31, 2018 the subscriber base of JV Tele2-Altel and Kcell totaled 7.2 thousand and 9 thousand of subscribers, respectively.

Common and preferred shares of the Company are traded at KASE under the tickers "KZTK" and "KZTKp", respectively. The main shareholders of Kazakhtelecom as of December 31, 2018 were Samruk Kazyna (52%) and Skyline Investment (25%).

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