AB TEO LT

2007 First Quarter Update Report

DnB NORD

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BUY

Target price LTL 2.77

FIRST QUARTER UPDATE

- Based on better than expected financial performance, significantly better than expected proposed dividend for 2007, and upgraded future dividend estimates, we reiterate our BUY recommendation for TEO LT, projecting a share price of LTL 2.77, which implies a capital gain of 18.4%.

- The company's recently released Q1 2007 results bested our revenue forecasts by +2.33%, mainly driven by faster adoption of broadband and slower than expected decline in voice services as fixed line growth trend reversed to positive figures after steadily declining for more than twenty quarters in a row. Faster than expected growth in OPEX (+6.9%) resulted in slightly lower (-0.9%) EBITDA margin, which we expect to be a one-off event however, without affecting longer term performance.

- One of the major factors for favourable valuation is the jump in dividend, with LTL 0.26 (11.1% yield) per share paid for 2006 as opposed to expected LTL 0.19 (8.1% yield). We take it as a sign that company is starting to hand out its huge excess cash reserve already in 2007 onwards, with future DPS expected to closely follow EPS plus a fraction (LTL 0.09 per share) of retained earnings. The earlier than expected cash distribution to investors provides significant contribution to its estimated current value.

- IPTV services have emerged as significant player in the main value driving factors, with estimated impact on the company's bottom line to reach up to 7% by 2011. Additional to the face value of revenue generated, the service is also expected to serve as a strong factor supporting the rest of the company's product portfolio via triple-play packaging.

- Current share price implies estimated forward P/E of 15.9 with an EV/EBITDA of 4.5, which also makes TEO LT an attractive share relative to its peers. Our target price would bring the stock to a competitive P/E of 18.8 and EV/EBITDA of 5.3.

FIRST QUARTER RESULTS AND EXPECTATIONS

Sales	2007 Q1	2007 Q1E	Deviation
Fixed Line	129,615	127,271	1.8%
Internet	48,020	45,821	4.8%
Other	8,170	8,479	-3.6%
Total Sales	**185,805**	**181,570**	**2.3%**

Income Statement	2007 Q1	2007 Q1E	Deviation
Sales	185,805	181,570	2.3%
Operating Expenses	-101,151	-94,594	6.9%
EBITDA	**86,185**	**86,976**	**-0.9%**
Depreciation	-42,439	-48,475	-12.5%
Operating Profit	**43,746**	**38,501**	**13.6%**
Profit Before Tax	**46,250**	**38,418**	**20.4%**
Income Tax	-8,372	-6,915	21.1%
Net Profit	**37,880**	**31,503**	**20.2%**

TEO LT SUMMARY STATISTICS

Share Price and Target Price				2007.05.28
Current Price	LTL			2.34
Price Target 6m	LTL			2.77
Recommendation				BUY
Previous Recommendation				BUY
Key Data				
Market Cap	LTLm			1,817.8
Shares Outstanding	mln			777
P/E	X			15.9
P/Book	X			1.8
Bloomberg	ticker			TEO1L
Share Price Performance				2007.05.28
Absolute 1 / 6 / 12m	%	-2.1	-6.0	4.0
DJ Stoxx Global 1800 Telecom	Index			276.1
Relative 1 / 6 / 12m	%	3.3	-22.7	-31.5
High / Low 12m (TEO LT)	LTL		3.1	2.1
180 Day Volatility (TEO LT)	%			24.27
Risk Level				Low Risk

TEO LT SUMMARY FINANCIALS

Income Statement (LTL000)	LTLm	06	07E	08E	09E
Revenues		735.0	752.0	789.2	804.9
Operating Costs		-391.5	-421.0	-441.6	-455.2
EBIT		151.9	128.0	157.6	168.5
EBITDA		343.5	330.9	347.6	349.7
Pre-Tax Profit		159.9	139.7	166.0	175.1
Net Profit		128.3	114.5	141.1	148.9

Year End December		06	07E	08E	09E
EPS	LTL	0.17	0.15	0.18	0.19
P/E	X	16.72	15.87	12.88	12.21
DPS	LTL	0.26	0.24	0.27	0.28
Dividend Yield	%	9.42	10.26	11.54	11.97
P/Book	X	1.94	1.78	1.87	1.99
EV/Sales	X	2.31	1.97	1.97	1.98
EV/EBITDA	X	4.93	4.48	4.47	4.55
ROE	%	11.58	11.23	14.48	16.29

Growth sustained by new services

Faster than anticipated broadband adoption rate aided by reversal of downward trend in the number of fixed line subscribers allowed TEO's 1Q revenues to beat our forecasts by +2.3%. In the mid term, increased growth in IPTV related sales allowed us to increase the revenue outlook to LTL 831M in 2011, up by +8.6% from previous estimate.

As TEO had to increase its marketing efforts due to finally introduced triple play packaging, increased levels of expenditure (+6.9% versus estimate), EBITDA margin ended up at 46.4% against the expected 47.3%. Due to increased revenue outlook in the mid term, we have also increased related expense forecast, resulting in a total of LTL 474M by 2011, up by +7.7%. EBITDA margin, however, remains unchanged throughout the forecast period.

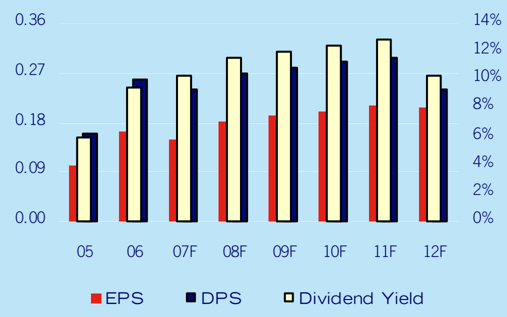
Q1 net profit bested our expectations by +20.2% due to lower depreciation and tax burden. In the mid term, however, we expect the profit growth to remain at an earlier estimated level and reach LTL 164M figure by 2011.

Dividends — market leading yield

We were pleasantly surprised by TEO's change of dividend policy, which suggests that the company has started to pay out its excess cash (TEO's net debt comprised LTL -450M (LTL 0.58 per share) at the end of 2006) even before the privatisation of TeliaSonera, which we previously assumed to be the trigger for any significant cash payout. It is likely however, that privatisation is still the driving force behind such change, as the earlier payout would increase TEO's value and hence the appeal of its owner TeliaSonera to potential investors or buyers.

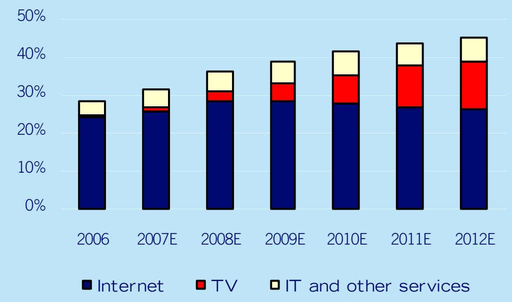
We believe that this year's dividend policy of paying out an amount equal to EPS plus additional LTL 0.09 out of retained earnings (totalling to LTL 0.26 or 11,1% yield) per share will remain unchanged until TEO would pay out most of its cash reserves and retained earning by 2012, just in time for expected TeliaSonera's privatisation, with sustainable dividend of LTL 0.24 (10.3% yield) per share after that.

TEO LT EPS vs. DPS



Source: OMX Vilnius Stock Exchange, TEO LT, DnB Nord Bankas

Growing Role of Non-Voice Services



Source: TEO LT, DnB Nord Bankas

IPTV — new growth centre

IPTV IN PERSPECTIVE

Although IPTV has been around since 1994, it has not been until recently widening adoption of broadband internet connections that it really took off, with TEO being the first company to offer the service to Lithuanian consumers in 2006. Particularly strong and growing fast in Europe and Asia, experts expect it to keep momentum in the upcoming years, possibly even replacing cable TV altogether.

Table above compares IPTV to the rest of mainstream television transmission systems, with focus being on Lithuanian market. It is evident that with the regulatory push and growing demand for digital high definition content and value added services (Video on Demand, choice of language and subtitles, internet browsing, customised content, etc), IPTV and TEO are well positioned to be the pioneers of the digital TV revolution in Lithuania. This is due to several reasons:

- While terrestrial television has traditionally been seen as the most affordable means of using TV, this role is set to change by 2012, when the switch to DVB-T will force everyone willing to watch free TV to upgrade to digital decoders or more expensive TV sets. Services offering subsidised equipment are expected to gain momentum, putting IPTV on level ground with the rest of paid proposals.
- Although cable and satellite providers are technically capable of offering the same portfolio of services as IPTV does, market situation in Lithuania provides a player like TEO with an advantage — even though subscriber base of cable TV is currently above 322K, the market is very fragmented, with more than 50 providers without sizeable market share.
- Conversion to digital and HDTV requires sizeable financial resources that small providers are unable to gather alone, while TEO's financial strength and existing network of fixed lines allows it to aim at providing the absolute majority of Lithuanian households with high-speed broadband for HDTV and other bandwidth intense applications.
- The company can push the services more effectively via recently introduced triple-play offers and reap the economies of scale at the same time, exploiting its sizeable customer base.

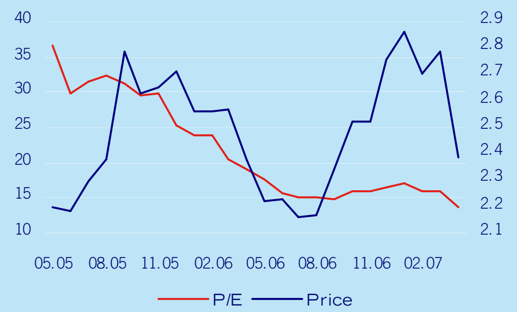
TEO is hence perfectly positioned to take on television retransmission market. The main risks for the company to succeed are the potential entry of another big player, possibly through acquisition of existing cable TV network portfolio.

IPTV IN PERSPECTIVE (CONTINUED)

	General case				Lithuanian Market			
	IPTV	Terrestrial	Cable	Satellite	Gala (TEO)	Terrestrial	Cable	Satellite
Digital ready (better quality)	+	+	+	+	+	+ (DVB-T)	-	+
Interactive (value added services)	+	-	+	+	+	-	-	-
HDTV capable	+	+	+	+	+ (bandwidth limited)	+ (DVB-T)	-	+
Reach	Urban areas	100%	Urban areas	100%	==> 100%	100%	Urban areas	100%
Need for additional equipment	+	Sometimes, for digital	Sometimes, for digital	+	+	+ (DVB-T)	-	+
Possibility for triple-play	+	-	+	+	+	-	+	-

The company has noted that due to backbone limitations and lack of specialists not all willing customers were able to subscribe to the service, resulting in IPTV subscriber turnout lagging our expectations somewhat. Driven by strong demand, however, Q1 momentum was particularly favourable, providing basis for expecting increased growth in the mid term, as well as supporting company's plans to reach 20,000 — 25,000 subscribers by the end of 2007.

TEO LT Historical P/E



Source: OMX Vilnius Stock Exchange, TEO LT, DnB Nord Bankas

We upgrade our estimates to 121K customers (28% of the DSL subscriber base) by 2011 versus a previous estimate of 116K. The resulting revenue share grows from 5.4% to more than 7% by 2011. Better sales figures are mainly driven by increased forecasted ARPU (Average Revenue Per User), reaching LTL 42 (up from previous LTL 35) in 2011, as the company lived up to its promises and started offering additional services in order to secure increasing ARPU in the future.

Based on the above factors and adjusting for the latest economic development forecasts, our valuation yields a share price of LTL 2.77, suggesting potential gain of 18.4%. Given a rather conservative approach to estimating relevant growth figures, we believe the BUY recommendation to be well deserved.

Peer comparison suggests undervaluation

Even though when comparing with DJ Stoxx Global 1800 Telecom index TEO's share performed on par after adjusting for dividends, the stock has trailed both the OMX BALTIX index (~-12% after adjusting for dividends) and the performance of its peers, outlined in the table below.

When compared to its Western European peers, TEO share still has very favourable P/E, P/B, and, notably, EV/EBITDA ratios, suggesting there is upward potential in the share price. Also, increased dividend payment outlook make it an attractive face-value investment that is expected to generate stable and low-risk return over longer time frame, and a worthy consideration for institutional investor's portfolios.

The bottom line

Based on our valuation yielding more than 18.4% higher value on TEO share than its current price, as well as the company's P/E ratio being on a steady decline to all time lows and the multiples comparison suggesting undervaluation, we reiterate BUY recommendation for TEO LT stock.

Fundamental valuation remains favourable

TEO LT and Peer Comparison

Name	Price	YTD	EPS	P/E	P/B	EV/EBITDA	D : E	Dividend Per Share	Dividend Yield
TEO LT	2.34	-15.2%	0.18	13.92	1.64	3.89	0.00	0.26	11.1%
Eesti Telekom	8.46	0.7%	0.65	13.82	4.43	8.15	0.00	0.61	7.2%
Cesky Telecom	593.00	24.6%	24.90	23.08	2.10	6.25	0.11	45.00	7.6%
Magyar Telekom Telecommunica	925.00	-12.7%	72.51	12.76	1.83	4.40	0.52	70.00	7.6%
Telekomunikacja Polska	21.10	-14.1%	1.50	13.66	1.59	4.72	0.38	1.90	9.0%
MNI	5.43	-8.6%	0.39	16.72	1.26		0.68	0.00	0.0%
Ukrtelecom	1.15	19.1%	0.03	41.51	2.73	7.76	0.44		
TeliaSonera	50.50	-2.7%	3.78	13.13	1.77	9.12	0.22	1.80	3.6%
Central and Eastern Europe Average		-0.9%		19.35	2.23	5.86	0.30		7.1%
Western Europe Average		31.2%		26.19	5.96	23.82	0.59		0.6%

Source: Bloomberg, DnB Nord Bankas

ANNUAL ESTIMATES

Income Statement (LTL000)	2005	2006	2007E	2008E	2009E	2010E	2011E
Revenues	**732,802**	**735,006**	**751,991**	**789,242**	**804,862**	**816,544**	**831,637**
Fixed Line Service Revenue	531,790	524,571	513,317	501,397	489,707	478,241	466,996
Broadband Revenue	148,787	179,218	194,005	222,992	227,933	227,478	224,380
TV, Data and IT Service Revenue	52,225	31,217	44,669	64,853	87,222	110,824	140,261
Expenses	-387,431	-391,488	-421,050	-441,644	-455,179	-464,995	-474,463
EBITDA	**345,371**	**343,518**	**330,941**	**347,599**	**349,683**	**351,549**	**357,175**
Depreciation and Amortisation Charge	-250,515	-195,849	-202,914	-189,956	-181,147	-173,738	-167,823
Operating Profit	**105,691**	**151,940**	**128,027**	**157,643**	**168,536**	**177,811**	**189,352**
Finance Costs	-163	7,957	11,652	8,354	6,593	5,102	3,593
Profit Before Tax	**105,623**	**159,938**	**139,679**	**165,997**	**175,129**	**182,913**	**192,944**
Income Tax	-24,964	-30,291	-25,142	-24,900	-26,269	-27,437	-28,942
Profit Attributable to Equity Holders of the Company	**80,097**	**128,267**	**114,537**	**141,098**	**148,859**	**155,476**	**164,003**

Balance Sheet (LTL000)	2005	2006	2007E	2008E	2009E	2010E	2011E
Cash and Cash Equivalents	304,521	457,870	343,308	272,043	233,669	200,622	167,503
Other Current Assets	188,282	108,528	120,809	126,793	129,303	131,179	133,604
Non-Current Assets	765,902	682,569	659,914	676,008	649,512	617,300	585,489
Total Assets	**1,258,705**	**1,248,967**	**1,124,032**	**1,074,844**	**1,012,484**	**949,101**	**886,596**
Equity and Minority Interest	1,105,891	1,107,363	1,019,927	974,589	913,707	851,674	790,400
Interest Bearing Debt	16,069	8,582	7,712	6,864	6,013	5,201	4,454
Non-Interest Bearing Debt	136,745	130,757	107,036	104,035	103,407	102,868	102,385
Total Liabilities and Equity	**1,258,705**	**1,246,702**	**1,134,675**	**1,085,487**	**1,023,127**	**959,744**	**897,239**

Cash Flow Statement (LTL000)	2005	2006	2007E	2008E	2009E	2010E	2011E
Cash generated from operations	378,488	333,318	295,769	340,962	346,579	349,134	354,267
Net cash from operating activities	345,646	291,925	270,627	316,063	320,309	321,697	325,325
Net cash from investing activities	-170,232	-71,070	-179,668	-197,409	-147,814	-136,218	-132,247
Net cash before financing activities	**175,414**	**220,855**	**90,959**	**118,654**	**172,495**	**185,478**	**193,078**
Net cash from financing activities	-113,376	-135,526	-205,521	-189,919	-210,869	-218,526	-226,197
Increase in cash and cash equivalents	**62,038**	**85,329**	**-114,562**	**-71,265**	**-38,374**	**-33,048**	**-33,119**
Cash at beginning of year	242,483	304,521	457,870	343,308	272,043	233,669	200,622
Cash at end of year	**304,521**	**457,870**	**343,308**	**272,043**	**233,669**	**200,622**	**167,503**

QUARTERLY EARNINGS ESTIMATES

	2006					2007				
LTL000	Q1	Q2	Q3	Q4	2006	Q1	Q2E	Q3E	Q4E	2007E
Revenues	180,409	181,750	184,440	188,212	734,811	185,805	186,149	186,272	193,765	751,991
Operating Expenses	-88,932	-92,206	-99,345	-110,303	-390,786	-101,151	-100,804	-101,828	-117,266	-421,050
Net Other Income / Expense	2,253	1,910	1,425	617	6,205	1,531	-510	-510	-510	0
EBITDA	**93,730**	**91,454**	**86,520**	**78,526**	**350,230**	**86,185**	**84,834**	**83,934**	**75,989**	**330,941**
Depreciation and Amortisation	-54,575	-51,643	-45,811	-43,350	-195,379	-42,439	-57,070	-52,429	-50,976	-202,914
Operating Profit	**39,155**	**39,811**	**40,709**	**35,176**	**154,851**	**43,746**	**27,764**	**31,505**	**25,013**	**128,027**
Net Financial Income / Expense	454	833	1,601	2,433	5,321	2,504	3,527	2,304	3,317	11,652
Profit Before Income Tax	**39,649**	**40,645**	**42,311**	**37,610**	**160,215**	**46,250**	**31,291**	**33,808**	**28,330**	**139,679**
Income Tax Expenses	-8,445	-7,377	-8,088	-6,381	-30,291	-8,372	-4,662	-7,324	-4,784	-25,142
Net Profit for the Period	**31,687**	**33,268**	**34,223**	**31,245**	**130,423**	**37,880**	**26,628**	**26,483**	**23,545**	**114,537**

ANNUAL KEY RATIOS

Key figures (LTL000)	2005	2006	2007E	2008E	2009E	2010E	2011E
Number of Shares (000)	776,818	776,818	776,818	776,818	776,818	776,818	776,819
EPS	0.10	0.17	0.15	0.18	0.19	0.20	0.21
P/E	26.3	16.7	15.9	12.9	12.2	11.7	11.1
P/Revenue	2.9	2.9	2.4	2.3	2.3	2.2	2.2
P/Book	1.9	1.9	1.8	1.9	2.0	2.1	2.3
EV/Revenue	2.5	2.3	2.0	2.0	2.0	2.0	2.0
EV/EBITDA	5.3	4.9	4.5	4.5	4.5	4.6	4.6
EV/Operating Profit	17.2	11.2	11.6	9.8	9.4	9.1	8.7
DPS	0.16	0.26	0.24	0.27	0.28	0.29	0.30
Dividend Yield	5.9%	9.4%	10.3%	11.5%	12.0%	12.4%	12.8%
Revenue Growth	1.4%	0.3%	2.3%	5.0%	2.0%	1.5%	1.8%
EBITDA Margin	47.1%	46.7%	44.0%	44.0%	43.4%	43.1%	42.9%
EBITDA Growth	4.9%	-0.5%	-3.7%	5.0%	0.6%	0.5%	1.6%
Operating Profit Margin	14.4%	20.7%	17.0%	20.0%	20.9%	21.8%	22.8%
Operating Profit Growth	138.0%	43.8%	-15.7%	23.1%	6.9%	5.5%	6.5%
Net Profit Margin	10.9%	17.5%	15.2%	17.9%	18.5%	19.0%	19.7%
Net Profit Growth	166.0%	60.1%	-10.7%	23.2%	5.5%	4.4%	5.5%
CapEx % Revenue	11.1%	14.5%	25.7%	26.1%	19.2%	17.3%	16.4%
Return on Equity	7.3%	11.6%	11.2%	14.5%	16.3%	18.3%	20.7%
Equity : Total Assets	0.88	0.89	0.91	0.91	0.90	0.90	0.89
Financial Debt : Equity	0.01	0.01	0.01	0.01	0.01	0.01	0.01
Net Interest Bearing Debt	-288,452	-449,288	-335,597	-265,179	-227,657	-195,421	-163,049

IMPORTANT INFORMATION

Company:	AB TEO LT
Analyst:	Mantas Pakėnas
Coverage Date:	2007-05-28

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RECOMMENDATION AND TARGET PRICE CHANGES FOR AB TEO LT

Date	Recommendation	Base Price (LTL)	Target Price (LTL)	Price Obtained (LTL)
2007-05-28	BUY	2.34	2.77	
2006-10-30	BUY	2.50	2.99	3.08

RECOMMENDATION STRUCTURE AND RISK CLASSIFICATION

DnB Nord Bankas recommendations are based on a six month horizon, and are based on absolute performance. Risk is based on historic six months of volatility of the security.

Buy:	indicates an expected return greater than +7.5%
Hold:	indicates an expected return between +7.5% and -7.5%
Sell:	indicates an expected return of less than -7.5%

High Risk:	volatility over 40%
Medium Risk:	volatility from 25% to 40%
Low Risk	volatility under 25%

Investing in any security is subject to substantial risk. Return on investment may vary greatly. Careful consideration for possible financial distress should be accounted for before investing in any security.

DISCLAIMER