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# How MENA Telecom Operators Will Weather the Global Financial Crisis

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Following several years of high premiums and leveraged acquisitions, Middle East telecom operators will enter into a new chapter of growth as a result of the global markets crisis. This new chapter will be characterized by more realistic prices paid for acquisitions, by mergers of equals, and by the clear success of operators that fortify existing assets and that grow the scope of their businesses beyond traditional telecommunications services.

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# HOW MENA TELECOM OPERATORS WILL WEATHER THE GLOBAL FINANCIAL CRISIS

Just weeks ago, rapid deal making at high premiums characterized the telecom industry in the Middle East. Growth was achieved through acquisition, and many of these deals were highly leveraged. Little thought was given to extracting value from acquired or built assets, and no pressing desire to innovate was evident. This is about to change.

Although we may still see some deals involving high premiums, today's acquisitions are likely to be made at lower absolute prices. Cash-rich operators will dominate. These players will be able to acquire many increasingly cash-strapped operators. Companies that do not get "eaten" in the short term are much more likely to merge with those that have complementary assets. We can also expect telecom operators to both aggressively extract value from assets and make a strong push to innovate beyond their telecommunications services to capture and retain customers.

## Who Will Be the Winners?

In the past six months, the total telecom market in the Middle East has lost around 30 percent of its stock value. Among the top 14 operators in the region, market value losses ranged between 14 percent and 55 percent, with Orascom Telecom Holding SAE losing the most. Saudi Telecom Company (STC), however, remained solid. Its market capitalization stayed relatively stable with a growth rate of about 2 percent.

This created a new landscape for the telecom industry in the Middle East. As of 15 October 2008, STC led the market, the clear number one in terms of market capitalization at US\$34 billion. Emirates Telecommunications Corporation (Etisalat) followed at \$24 billion and Zain Group at \$22 billion. STC has the highest liquidity

and profitability ratios among the top operators in the region, despite heavy investments made in the past year.

Operators with liquidity problems will have more difficulties raising capital than they did previously. Debt is likely to become more costly, if it is even available. And companies that list more shares in the market to generate cash will only serve to signal their lack of cash and further lower their share prices.

This phenomenon could result in further consolidation in the market. Deals that might not have been possible in the past may now be more likely. Market players that require significant capital expenditures in the early years of their operation will likely face cash problems, and this will make them potential targets for acquisition by bigger players.

However, the number and extent of the deals will depend on the appetite of these bigger players in the region. Little credit will be available to buy risky operations even under attractive conditions. Top operators may become more prudent in spending their own cash. Stock swaps may become more common, given the low market valuation of certain companies.

Although European players have a growing appetite to reenter the Middle East market, European operators will not be able to offer the same kinds of premiums on deals as regional operators, because their synergies will be less than those of regional players. In addition, these operators will not be able to leverage debt due to the financial crisis.

Ultimately, the winners in the region will be those that can successfully leverage their strong cash positions to execute investments within the region and grow in scale, in addition to those

companies that focus on extracting value from synergies and that innovate on service and pricing, thereby growing in scope.

### Securing Future Growth

Acquisitions lead to scale growth, whereas innovation and convergence of industries lead to scope growth. Now may be the perfect time for telecom operators that can no longer pursue large acquisitions to look into alternatives that allow them to grow the scope of their businesses and thus generate new ways to acquire and retain customers.

Joining up with media companies is one way telecom operators can grow the scope of their business. This convergence allows telecom operators to offer richer and more tailored content. Electronic commerce, particularly mobile commerce, is an emerging area of convergence between the banking sector and telecommunications that can facilitate cheaper and easier small transactions and transfers. Beyond these, there are many other innovative services and applications that can generate traffic, increase usage, and achieve advertising value for telecom operators.

Such services are successful only when telecom operators enter into partnership agreements with key players in other industries. Such relationships can be strengthened further if operators acquire or build joint ventures with these entities. These investments require just a fraction of the financing needed for major acquisitions.

Consumer spending on telecom is unlikely to deviate from the expected general downward trend we anticipated prior to the financial

crisis. Telecom services in the region have followed a steady downward path, with the exception of certain countries experiencing hyperinflation. The downward trend has been attributed predominantly to increased competition and the opening of markets. When consumer goods prices drop in the near future, as they are expected to do, telecom prices in the region will likely continue to fall.

Operators may face difficulties in any prolonged long-term price wars. If these price wars occur, it will force operators to dip into the financing that would otherwise be used for network expansion. A stabilization of price drops, combined with securing a stable usage of services, would allow operators to sustain organic revenue growth during the credit crisis.

### Clear Actions to Take Now

Despite the global economic crisis, the future for the telecom industry in the region looks bright. However, there are four action points that ought to be considered by operators that want to sustain growth and survive the crisis:

1. "Cash is king," so use it. In a situation in which attractive financing is not readily available, maintaining the ability to spend on network expansion and growth is very important. Aggressive price wars would act against this principle, and thus should be avoided.
2. Eat or be eaten. Acquiring smaller players or merging with equals and consolidating may be the best ways to avoid facing future competition from consolidated regional giants, or to avoid being acquired by one of these giants.

3. Innovate. It is time to take industry convergence seriously and start innovating beyond basic voice and SMS price reduction. Consumers in the region expect better quality and better creative services.

4. Extract value. Focus on extracting value from acquired or built assets by leveraging scale and integration at a global level, and by reducing capital and operating expenditures in the process.

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