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**Beyond License
Acquisitions**
*The Way Forward for
Telecom Investments
In the MENA Region*



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EXECUTIVE SUMMARY

Favorable economic conditions coinciding with a strong wave of telecom liberalization in the Middle East region have attracted significant investments in the telecom industry. Such investments have occurred predominantly in the form of license acquisitions by regional telecom players whose primary aim is to mitigate the potential risk of stagnation or decline from imminent liberalization and saturation in their home markets.

The scarcity of license issuances and privatization opportunities in the Middle East and North Africa (MENA) region has driven up price premiums and triggered a new wave of consolidation among the top players. A period of uncertainty is now emerging, characterized by new

challenges facing the operators that have caught the footprint expansion wave in the region and are now in the process of moving to the next phase of international development. The investors who will succeed are those who can best address the challenges of non-organic expansion.

TELECOM INVESTMENT ENVIRONMENT

In the past few years, telecom operators in the MENA region have exhibited varying levels of readiness to expand beyond their home markets. As a result, only a handful of ambitious operators have dominated the race for international expansion. These operators are often referred to as the Big Four: Etisalat (UAE), Orascom (Egypt), MTC (Kuwait), and Q-Tel (Qatar).

It is evident that the international expansion pioneers have been the operators that faced growth stagnation in their home markets as they became liberalized or reached higher maturity levels. As such, these operators' ambitious plans were truly a product of necessity.

Other operators, however—especially those that focused on realizing untapped potential in their home markets—have de-emphasized to date the adoption of an international expansion strategy. Examples of such operators include Saudi Telecom and OmanTel, the only two Gulf Cooperation Council (GCC) countries that have mobile penetration levels below 100 percent.

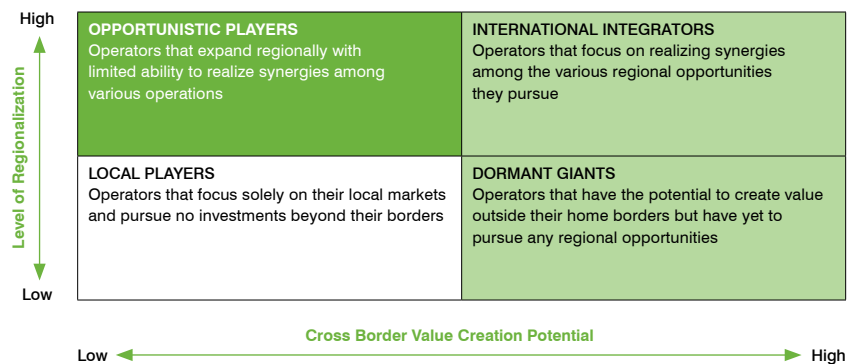
Irrespective of the breadth of their footprint, operators possess varying abilities to create value from international expansion. Cross-border value creation is a key success factor for operators because it helps to both enable transaction success and sustain long-term competitive advantage.

Classifying operators based on their level of internationalization and ability to create value provides insight into their next move (*see Exhibit 1*).

Local Players: Operators that focus solely on their local markets. Unless their home markets exhibit significant value potential, these operators face a major risk as they become increasingly threatened by regional players who could eventually take them over.

Opportunistic Players: Operators that expand regionally with limited ability to realize synergies among their various operations. They should expect to integrate and consolidate their operations or risk failure or takeover.

Exhibit 1
Emerging Breeds of Telecom Operators in the MENA Region



Source: Booz & Company

International Integrators: Operators that focus on realizing synergies among the various regional opportunities they pursue. This category of players will dominate the telecom landscape across the region as they increasingly accumulate and sustain a competitive advantage.

Dormant Giants: Operators that have the potential to create value outside their home borders but have not yet pursued any regional opportunities. These operators should expect to make major acquisitions using their untapped financial power to capture new growth opportunities.

Going forward, it is unknown whether operators that dominated the previous expansion wave will continue to do so. In fact, operators that were late to participate in expansion may be well-positioned to lead the next phase, partially because of their untapped financing potential.

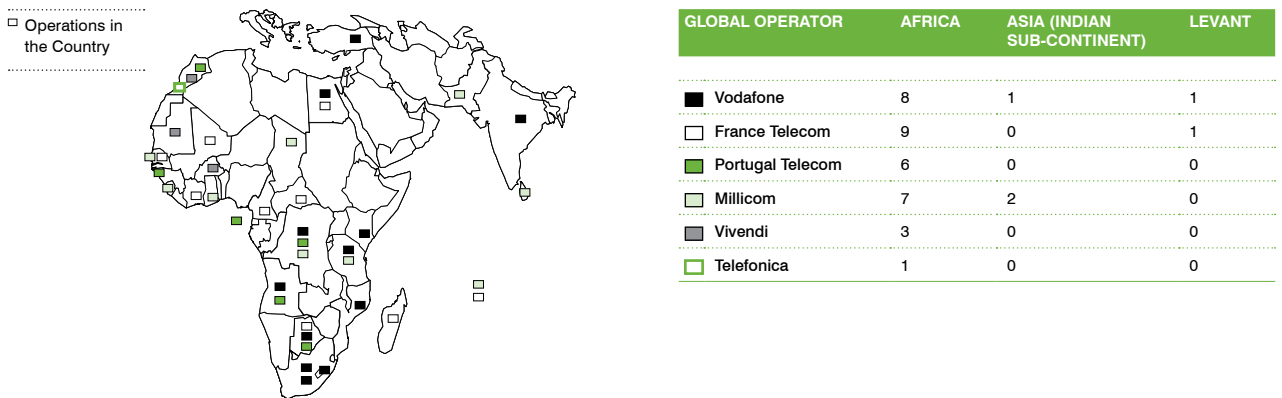
In addition, many of the original pioneers may be busy consolidating their portfolios and trying to realize the expected value of their initial investments. In the future, we may also see increasing interest by global operators in the Middle East and Africa region as their home markets mature even more. *Exhibit 2* details the current footprint of selected global operators in Africa, the Middle East, and the Indian Subcontinent.

In building their international portfolios, operators can perform three possible transaction types:

1. Greenfield expansion
2. Acquisition of existing operators
3. Merger of equals

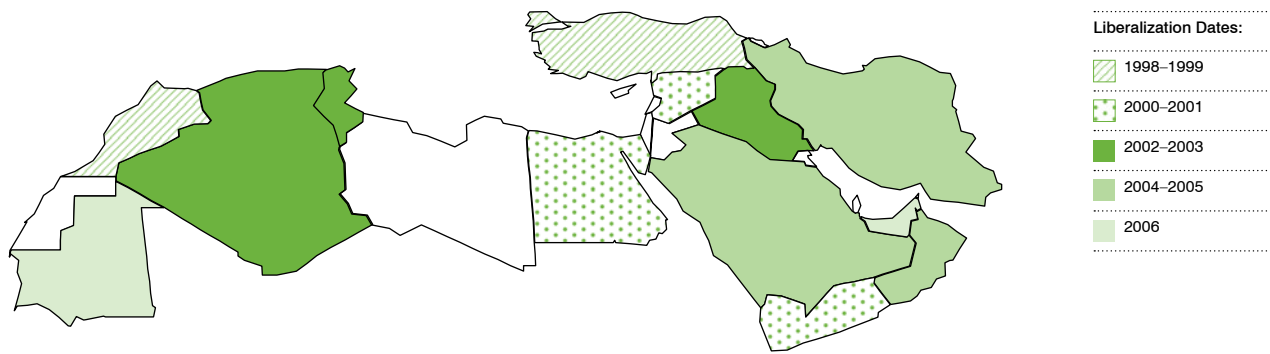
In the Middle East, we have thus far predominantly observed the first and second approaches. We have witnessed the early signs of potential mergers of equals, but no such transactions have yet occurred.

Exhibit 2
Geographic Footprint of Global Operators in the Middle East, Africa, and Southeast Asian Regions (March 2007)



Source: Operators' Web sites; Booz & Company

Exhibit 3
Mobile Market Liberalization Timeline in the MENA Region



Source: Arab Advisor Group, Regulators' Web sites; Booz & Company

Greenfield Expansion

Since the start of the liberalization wave in the late 1990s, more than 40 new mobile licenses have been issued in the MENA region. The premiums paid for these licenses have skyrocketed with the scarcity of issuance opportunities. *Exhibit 3* illustrates the timeline of liberalization in the MENA region, and *Exhibit 4* is a snapshot of the region's current competitive landscape.

Examples of the increasing premiums paid for mobile licenses include the acquisition by Etisalat of the third mobile license in Egypt for USD 2.9 billion in 2006. Another example is the third license acquired by an

MTC-led consortium in Saudi Arabia in 2007 for USD 6.1 billion—almost double the price of the second license granted to an Etisalat-led consortium in 2004 for about USD 3.2 billion.

Very few new facility-based mobile license issuances are on the horizon in the MENA region, and those that are forthcoming are mostly second or third licenses in highly saturated markets. Impending issuances include the second license in Qatar and the third licenses in Kuwait and Bahrain, all expected in the second half of 2007. Going forward, new mobile licenses are expected to be in the form of Mobile Virtual Network Operators (MVNO).

Exhibit 4
MENA Market Competitive Landscape (March 2007)

MENA COUNTRY	NUMBER OF MOBILE OPERATORS	NUMBER OF FIXED OPERATORS
Algeria	3	2
Bahrain	2	1
Egypt	3	1
Iran	3	1
Iraq	3	8
Jordan	4	1
Kuwait	2	1
Lebanon	2	1
Libya	2	1
Mauritania	2	1
Morocco	2	3
Oman	2	1
Palestine	2	1
Qatar	1	1
Saudi Arabia	3	1
Sudan	2	2
Syria	2	1
Tunisia	2	1
Turkey	3	1
UAE	2	2
Yemen	3	1

Source: Arab Advisor Group, Regulators' Web sites; Booz & Company

Acquisition of Existing Operators

Several privatization programs in the MENA region are attracting various interested operators, but the structure of these programs is limiting. They typically leave little room for investors to achieve control. This situation, combined with the scarcity of greenfield investments, has sparked a market consolidation phase. *Exhibit 5* contains an overview of M&A activity in the MENA region.

In addition, Middle East operators must expand beyond their traditional target geographies (*see Exhibit 6*).

Some are considering emerging regions, such as Africa, Central Europe, and Asia. This expansion of target geographies would help telecom operators grow internationally and avoid paying exorbitant premiums for the few remaining opportunities in the MENA region.

MENA operators' migration to nontraditional geographies and acquisition of existing operators is emerging and will likely become increasingly common. Acquisition examples include MTC's acquisition

of Celtel (Africa), Etisalat's acquisition of Atlantique Telecom (Africa), and Q-Tel's recent acquisition of a 25-percent stake in STT (Asia).

Merger of Equals

Mergers of equal-sized telecom operators have not yet taken place in the MENA region. However, this trend is inevitable, especially when ambitious operators realize the difficulty of achieving their global reach through sequential small-scale acquisitions. For example, Etisalat aspires to become one of the top 10 players globally, while MTC aims to become a truly global player in the next few years. In addition, Q-Tel, a recent active player in the region's expansion game, aims to become one of the top 20 global operators by 2020.

Exhibit 5
Selected Telecom M&A Transactions in the Middle East and Africa

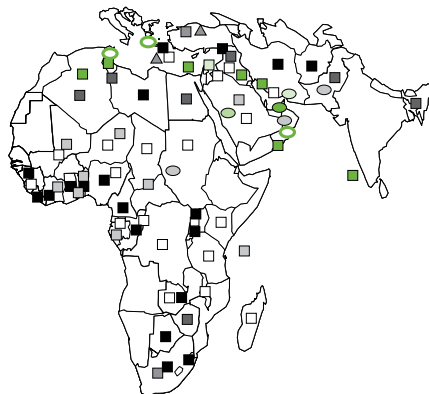
YEAR	TARGET	BUYER	PRICE PAID	PERCENT STAKE ACQUIRED
2004	Maroc Telecom	Vivendi SA	1,400	16%
2005	Turk Telecom	Oger Telecom	6,550	55%
2006	Umniah	Batelco	415	96%
2006	Investcom	MTN	5,530	100%
2006	Tunisie Telecom	TECOM	2,250	35%
2006	MobiTel	MTC	1,300	61%
2007	Wataniya	Q-Tel	3,720	51%

Source: Informa, World Cellular Information Service (WCIS); Booz & Company

The scarcity of financing possibilities will also drive mergers of equals, especially for the most active players. Unlike acquisitions, operators could possibly conduct mergers through stock-based transactions rather than cash-based transactions.

Exhibit 6
Geographic Footprint of Regional Operators (March 2007)

- Mobile Operator
- △ Fixed Operator
- Integrated Operator



REGIONAL OPERATOR	MOBILE OPERATIONS (COUNTRIES)	FIXED OPERATIONS (COUNTRIES)	INTEGRATED OPERATIONS (COUNTRIES)
■ MTN	21	0	0
□ MTC	20	0	0
■ Orascom	7	0	0
■ Etisalat	9	0	3
■ Q-Tel	7	0	1
■ TECOM	0	0	3
■ STC	0	0	1
■ Batelco	1	0	1
■ Oger Telecom	2	2	0

Source: Operators' Web sites; Booz & Company

COMPONENTS OF A SUCCESSFUL INVESTMENT STRATEGY

As the rules of the game continue to change, the winners in the consolidation phase may not be the names we have seen in the past, unless they modify their approach. At this stage, a successful expansion strategy requires a certain set of elements, such as—

- Development of a clear vision
- An optimal investment approach
- The right price
- Value capture through synergies
- Clear financial planning

- A disciplined due diligence approach
- Post-transaction planning and management

Developing a Clear Vision

Very often, telecom operators embark on an international expansion drive without clearly articulating a strategic vision. A clear investment intent is critical, and it should, at a minimum, encompass a number of critical components.

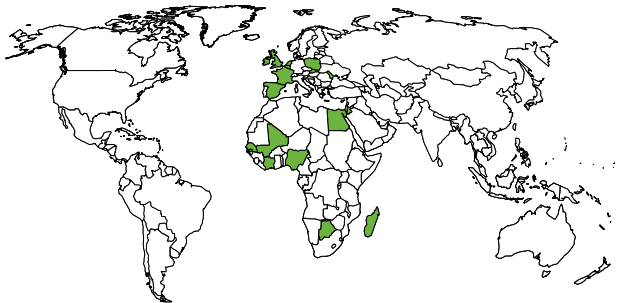
Objective for International Expansion: The ultimate objective of international expansion is shareholder value creation. At the outset, operators should determine the levels of value creation they will focus on at various stages of their investment plan. Typically, operators focus on revenue growth at early stages and seek to establish a meaningful footprint; then, they begin focusing on realizing cost savings and other synergies through integration.

Target Geographies: In selecting target markets for international expansion, operators have two key priorities: growth and synergy potential. A number of factors are used to determine growth potential, including market size, gross domestic product (GDP) per capita, addressable market, demographics, penetration rate, and level of competitive intensity. However, synergy potential considers the level of cultural and economic integration between countries.

As opposed to regional expansion, global expansion is more complex to manage and provides little or no room for synergies. Anchoring a series of operations by region ensures focus and helps operators draw on regional synergies. Most successful operators follow a regional approach rather than a global, dispersed approach. *Exhibits 7–10* illustrate the regional clustering approach of telecom operators' expansion strategies.

Exhibit 7
France Telecom Footprint (March 2007)

FRANCE TELECOM MAINLY FOCUSED ON EUROPE AND AFRICA



Source: Operator's Website; Booz & Company

Exhibit 8
Telefonica Footprint (March 2007)

TELEFONICA ESTABLISHED ITS MAIN STRONGHOLDS IN EUROPE AND THE AMERICAS



Source: Operator's Website; Booz & Company

Exhibit 9
Deutsche Telekom Footprint (March 2007)

DEUTSCHE TELEKOM'S MAIN FOCUS REGIONS REMAIN EUROPE AND THE UNITED STATES



Source: Operator's Website; Booz & Company

Exhibit 10
MTN Geographical Footprint (March 2007)

MTN HAS FOCUSED ON AFRICA AND THE MIDDLE EAST



Source: Operator's Website; Booz & Company

Target Industry Sectors: Shareholders do not favor diversifying in unrelated sectors, especially when they do not expect any synergies. As such, it is prudent to expand either strictly within the core telecom sector or into complementary Information, Communication, and Technology (ICT)-related sectors, such as content and information technology. The objective of investing in telecom-related sectors should be to enhance an operator's competitive position and to mitigate threats from upcoming industry trends, such as convergence.

Deciding on an Optimal Investment Approach

A number of key components determine an operator's acquisition approach.

Positioning: Prior to engaging in any acquisition activity, an operator should determine its positioning in terms of the level of aggressiveness with which it will pursue the upcoming transaction(s). This aggressiveness level is typically measured by the premium an operator is willing to pay. Operators' tolerance levels can vary depending on the importance of a specific opportunity and the stage of development of their expansion strategy.

Equity Stake: In most cases, telecom operators aim to exercise some level of control over the prospective acquisition. They can achieve this control through the level of equity stake or by crafting governance rights to allow the desired level of control. The more value an operator brings to the transaction, the more the operator will aspire for control. Typically, a control premium is commanded in such acquisition cases.

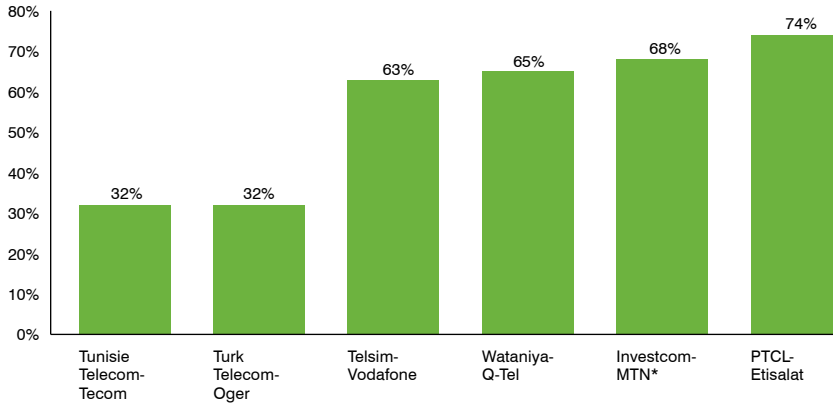
Operational Involvement: Contrary to governance control, operators do not always seek operational control. Generally, operational control is best left to the party with the most relevant execution expertise. For example, Vivendi was considerably involved in the successful turnaround of Maroc Telecom.

Partnership: Strategic partnering is very common in telecom mergers and acquisitions (M&A). In some cases, local restrictions on foreign ownership drive strategic partnering; however, in many instances, partnering is voluntary and used to extract the highest value for the merger or acquisition by leveraging complementary capabilities. Partnering is also useful for reducing risk exposure or for financing.

Paying the Right Price

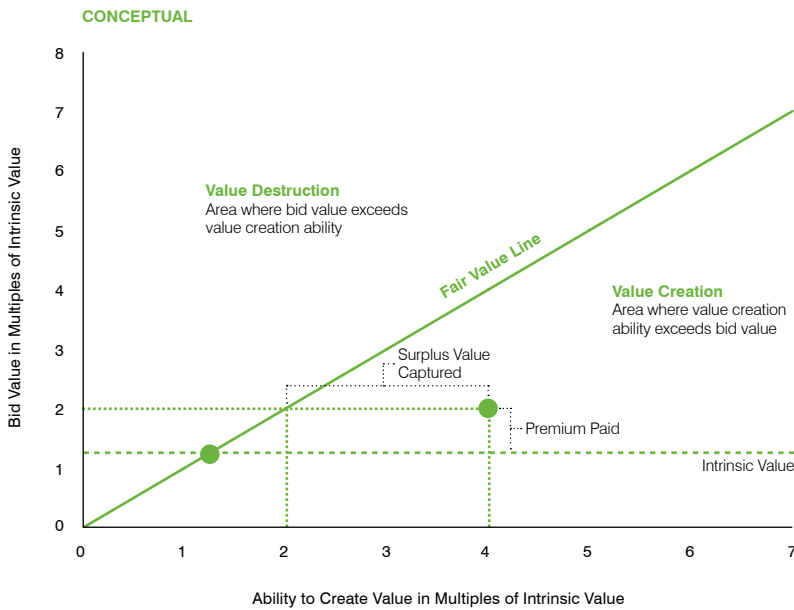
There is no such thing as a bargain or an overpriced transaction—the price of each transaction is relative to the value it can create. At first look, many M&A deals in the region seem to have been commanding unjustified premiums. However, to better assess these deals, it is important to understand the ambitions of the operators dominating the M&A scene. As mentioned earlier, most operators aspire to become global operators. They realize that doing so may not be cheap in the short term but that it will likely pay off in the long term as they continue to build a global presence. *Exhibit 11* shows the premiums paid for selected acquisitions in the Middle East and Africa. Some of these acquisitions have realized potential synergies that justify the paid price several times over. *Exhibit 12* is a conceptual illustration of the relationship between synergy potential and willingness to pay for M&A targets. However, the challenge for operators is to successfully realize these potential synergies.

Exhibit 11
Premium Over Market Price at the Time of the Transaction



*As per Economist Intelligence Unit. Not based on market price at time of transaction
 Source: Turks.us Website, Government of Tunisia, Vodafone, Zawya; Booz & Company

Exhibit 12
Bid Value Versus Ability to Create Value (in Multiples of Intrinsic Value)



Source: Booz & Company

Capturing Value Through Synergies
 Operators prefer to enter markets that exhibit a high level of integration with their existing footprint. The higher the passenger and voice traffic between countries, the higher the potential synergies to be realized. In addition, targets that share vendors with acquiring companies allow Capex and Opex synergies. Operators can also realize Opex synergies by integrating operations under a consolidated shared services model. *Exhibit 13* contains a description of potential synergy drivers in the telecom M&A sector.

Not only are synergies important for long-term value creation but also they give potential bidders a competitive advantage in the bidding process. An acquirer can pass part of its synergies to the target, hence a higher synergy potential and a higher willingness on the part of the acquirer to pay for the acquisition.

Exhibit 13
Key Synergy Drivers Sought by Telecom Operators

- | | |
|--|---|
| <p>①
 INCREASED REVENUE</p> <ul style="list-style-type: none"> - Operators could acquire additional subscribers or enhance the retention of existing ones - Operators could achieve this revenue increase if the voice traffic between the existing footprint and the target country is significant | <p>②
 ROAMING SAVINGS</p> <ul style="list-style-type: none"> - Operators could save on roaming charges in the target country by shifting all of their roamers to the acquired network - Operators could achieve a considerably high value from this type of shift when countries share high roaming traffic |
| <p>③
 OPEX SAVINGS</p> <ul style="list-style-type: none"> - Operators could leverage economies of scale in target countries by integrating their shared services, such as IT, billing, and finance - Operators could also reduce network maintenance costs through increased leverage with service provider | <p>④
 CAPEX SAVINGS</p> <ul style="list-style-type: none"> - Operators could leverage their relationships with network vendors and tap into higher discount rates as a result of increased purchasing volumes - By exercising their negotiation power, large operators could influence vendors to develop proprietary or customized equipment for them |

Source: Booz & Company

Operators prefer to enter markets that exhibit a high level of integration with their existing footprint.

Clear Financing Plans

Telecom operators in the MENA region are generally cash rich. In fact, many operators still rely on their excess cash to finance acquisitions. Others have effectively resorted to bank debt and low-interest shareholder loans. Going forward, as M&A activities further intensify, acquirers will have to tap into even more financial resources, such as high-yield bonds and equity financing. In general, operators' financing capacities remain sufficient and should not be major constraints in the future.

Exhibit 14 contains a comparison among telecom operators' debt levels across various regions.

Following a Disciplined Due-Diligence Approach

A robust due diligence process is a must for any M&A activity. Investing upfront in comprehensive due diligence helps mitigate major post-transaction risks. Notwithstanding the importance of a systematic

approach, speed is of the essence given the high level of competitiveness in the M&A landscape.

Operators can stage the due-diligence process in two key phases. A pre-due-diligence phase can serve as a guide on footprint suitability, synergy potential, and value range estimation. Then, a full, comprehensive due diligence can follow as the likelihood of the transaction's occurrence becomes clear. The due-diligence process should focus on not only financial elements but also technical, market, regulatory, and legal components, which carry considerable weight in risk identification and mitigation. Often, operators can develop a post-transaction strategy concurrently as a result of the due-diligence process.

Post-Transaction Planning and Management

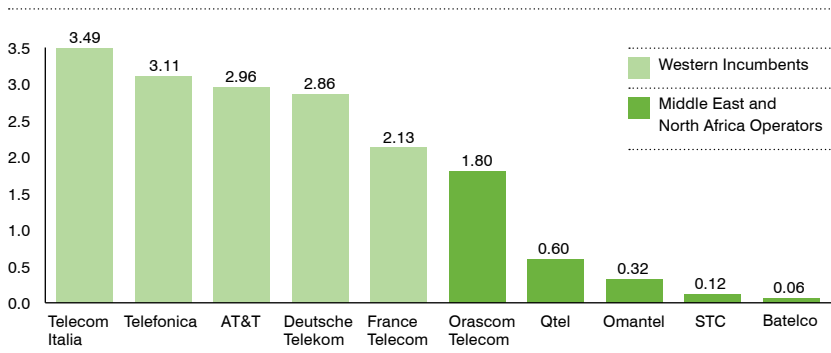
The first challenge operators face after a transaction is managing the acquired operation. A recent Booz & Company survey concluded

that more than one-third of the time, operators cite improper integration planning as a reason for M&A transaction failure. The key to success is to have a robust integration plan that is timely and does not disrupt ongoing operations. Operators should set a strict target of 100 days for integration, and a program management office should take charge of the integration effort headed by the chief executive officer (CEO).

In addition, the many actions operators must take before the transaction is complete include—

- Preparing a detailed business plan
- Appointing key management and board representatives
- Preparing integration plans
- Deploying required resources
- Implementing post-transaction performance management mechanisms.

Exhibit 14
Debt/EBITDA Ratio of Telecom Operators (2006 Year End)



Source: Bloomberg; Booz & Company

THE WAY FORWARD

A number of factors indicate that the momentum of expansion activities in the Middle East telecom landscape will continue through mergers and acquisitions.

Economic and Regulatory

Environment

- Increasing liquidity in the market will attract new breeds of investors to the regional telecom landscape, including financial investors and government entities. Examples include Almarai, a dairy products manufacturer that was among the consortium members that teamed with MTC to acquire the third license in Saudi Arabia; and the Egyptian Post Authority and the National Bank of Egypt, both of which joined Etisalat in acquiring the third mobile license in Egypt.
- Private equity players are not yet active in the regional telecom market, but they are bound to enter as more operators start exhibiting financial difficulties and require performance turnaround.
- Many telecom operators in the region are cash rich, and the level of debt on their balance sheets continues to be relatively low.
- A number of operators have not yet realized the urgency of expanding internationally because their markets are still at early stages of liberalization.

Regional Competitive Pressure

- The increasing economies of scale of regional players will pressure late players to expand so they can compete effectively.

- As regional players expand their footprint in related markets, they can leverage revenue synergies from the resulting “corridor effect,” leaving local players at a competitive disadvantage.

- As a result of their expansion, many operators will experience cross-ownership and multimarket-facing, helping them become more collaborative at the expense of local players and rivals.

Local Competitive Performance

- Markets with high levels of competition (more than four players) will exert increasing pressure on operators to deliver satisfactory financial results, prompting consolidation at the local level.
- Some players starting greenfield operations for the first time may not do so effectively and will become attractive acquisition targets.

In conclusion, the regional telecom M&A scene is set to continue thriving amid a positive economic outlook and an increased level of telecom market liberalization. As greenfield investment opportunities continue to diminish in the region, a wave of consolidation will emerge. In the upcoming phase, operators should focus on realizing cross-border synergies in the shortest possible timeframe or else risk collapse or takeover. Operators can achieve synergies through early planning and by following a highly disciplined investment execution approach that includes mastering critical activities, such as pre-deal due diligence and post-transaction integration.

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