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Opportunities Lie Ahead
MENA Telecom
Operators Reinvest
in Growth



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EXECUTIVE SUMMARY

Regional telecom operators are refocusing on growth as they move to revive the momentum that stalled during the economic crisis. That was the prevailing sentiment of more than 200 senior telecom executives, investors, investment bankers, and advisors who gathered in Doha, Qatar, on April 26 and 27, 2010, for the fourth annual TMT Finance & Investment Middle East Conference.

Telecom operators from the Middle East and North Africa (MENA) region no longer are focusing on damage control—the subject that dominated the conference a year earlier. Now, MENA operators are recalibrating initiatives to grow. They are adjusting their priorities—looking beyond mobile voice, for one, as many markets are approaching saturation levels for mobile telephony. Operators instead are looking to broadband as the next driver for organic growth, both in terms of access and as the conduit for emerging content and services.

Operators also are reviving their inorganic expansion in pursuit of the remaining mobile growth pockets and seeking opportunities to enter markets that complement their existing footprints in terms of strategies and synergies. Conference participants anticipated that mergers and acquisition activity would begin to revive in 2010 and resume its torrid pace in 2011 with the expectation that there will be multiple megadeals in the form of acquisitions or mergers of large group operators.

BRIGHT OUTLOOK FOR TELECOM

The tone at the 2010 TMT Finance & Investment Middle East Conference clearly reversed course from the 2009 gathering, when the industry was in a defensive posture waiting for the economy to emerge from its slump. This shift in attitude is a result of two factors. First, the strong showing of the industry during the previous year underscores the sector's historical

resilience. In 2009, despite the recession, MENA operators continued to increase revenue; operators such as Qtel, Zain, Batelco, Saudi Telecom Company (STC), and Etisalat all posted revenue gains of at least 5 percent (see Exhibit 1). In addition, there was a widespread belief among conference participants that the worst of the economic carnage is over. "The global economic recovery has commenced," Dr. Aasim Qureshi, associate director at QNB Capital LLC, stated, summing up the views of many others.

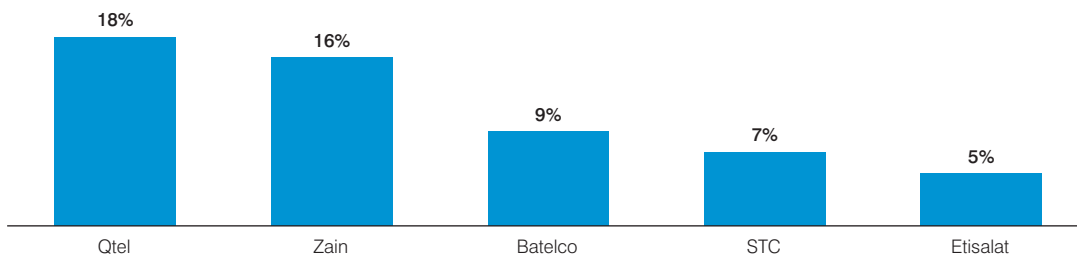
Participants looked at opportunities for growth in connecting unconnected consumers, by improving affordability and extending reach, as well as

tapping into pent-up demand for broadband and multimedia services. Other sessions were geared toward new areas of service and applications—some less proven but still tantalizing in terms of growth opportunities, such as cloud computing, mobile payments and remittances, and mobile health.

Attendees are also looking forward to a strong year in M&A, after a slowdown during the economic crisis. However, operators are likely to be very selective about which deals they pursue, focusing on those that are most likely to add value to their existing portfolios and give them points of entry into highly strategic markets.

Exhibit 1
Middle East Operators Are Showing Strong Growth

MENA GROUP OPERATOR REVENUE GROWTH (YEAR ON YEAR, 2008–2009)



Source: Operators' annual reports; Booz & Company analysis

SEEKING GROWTH

Regional industry leaders recognize that in emerging from the recession, GCC operators are standing at a critical juncture—a new era of delivery and opportunity. The big question facing all operators concerns growth. “Can the industry sustain its growth trajectory, or will another trajectory take hold?” asked Karim Sabbagh, Booz & Company partner and head of the global communications, media, and technology practice, while chairing the conference’s leadership roundtable session. Participants noted that customers want more mobility, connectivity, speed, and applications. And the industry landscape is changing swiftly, providing strong growth potential—but not for all

operators. “The industry is evolving very quickly and growth will come from different avenues. Not every operator will be as well positioned to take advantage of that growth,” said Ghassan Hasbani, CEO International at STC.

Pursuing the Remaining Mobile Voice Growth Pockets

Operators are looking to new markets for growth opportunities. “It’s extremely hard to find value in developed markets, so we have more confidence in going into frontier, more marginal markets,” said Qtel’s chief strategy officer, Jeremy Sell. There was much discussion on the promise of high-growth markets such as Africa and India (*see Exhibit 2*). Africa is a particularly enticing market to many operators: “Africa has so much potential that many operators are looking at ways to get in,” Sell added. However, participants also noted that although these markets might be a source of growth, subscribers

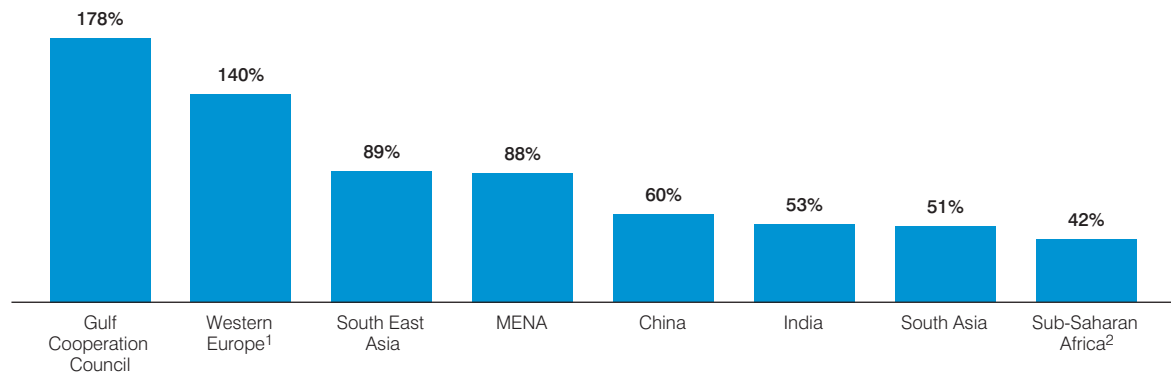
will offer a limited lifetime value; for example, average revenue per user in India is currently less than US\$2 per month. As a result, operators must master low-cost operating models.

The acquisition of Zain’s African operations by the Indian operator Bharti Airtel was a focal point for several discussions. Participants believed that this deal signals the intent of several Indian and Chinese operators to expand beyond their immediate regions into Africa and potentially the MENA region. This anticipated expansion would definitely change the competitive landscape, as these operators will bring a low-cost operating model and add pressure to already very competitive markets.

Some participants highlighted the fact that transferring the low-cost model from India to Africa is not automatic as each area represents a unique set of distinctive characteristics. For

Exhibit 2
With Relatively Low Mobile Penetration, Africa and India Are Ripe for Growth

MOBILE PENETRATION LEVELS, SELECTED REGIONS (Q2 2010)



¹ Western Europe countries are selected based on the definition provided by the United Nations Statistics Division.

² Sub-Saharan Africa includes all of Africa except North Africa (Egypt, Libya, Tunisia, Algeria, and Morocco).

Source: Informa; Global Insight; Booz & Company analysis

example, India is a single market with a population of 1.2 billion compared with 63 markets in Africa with a combined population of 980 million. The homogeneity of single-market India enables operators to realize greater economies of scale; for example, this relative advantage in scale results in an average savings of 15 to 20 percent on network rollout capital expenditures.

Another key difference is that India has a viable ecosystem of vendors, outsourcers, and suppliers, allowing operators to lower costs and boost profits. In addition, the Indian market is known for having strong cooperation among operators on infrastructure sharing, interconnection, and national roaming. Other differences include a more stable legal and regulatory environment in India, as well as a greater availability of talent. Some participants even suggested that market positioning is critical in Africa—and being first or second in African markets will prove to be a decisive advantage.

Mobile to Broadband

Conference participants also confirmed that although mobile voice services remain a lucrative business for telecom operators, it no longer is seen as providing strong growth potential. There was consensus among conference participants that broadband will be the next industry growth driver, both in widening access and in enabling more content and services. Although Internet and broadband usage has grown exponentially in recent years, the potential for growth remains significant as consumers are demanding ubiquitous access and high bandwidth to handle a growing array of services (*see Exhibit 3*).

Increased consumer demand for innovative services is coupled with increasing competition. For now, operators continue to own the relationship with the customers. However, that relationship is being threatened by the rise of both Internet companies such as Google, Yahoo, and Skype and social

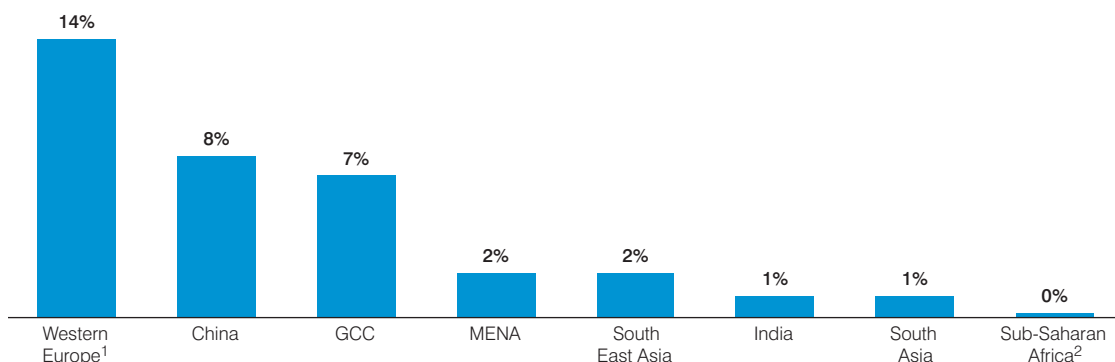
networking sites such as Facebook. “Competition is coming, and not just from traditional companies, but from Internet companies,” remarked Dr. Nasser Marafih, CEO of Qtel.

As a result, pressures are mounting on telecom companies’ operating model. Telecom operators need to find ways to become more innovative in their offerings and responsive to the continuously evolving customer demands. John Tombleton, CFO of Vodafone Qatar, suggested that telecom operators must invest to innovate across the business. “There is need for constant investment in innovation. In fact, innovations on pricing and packaging are also important,” he said. Many participants stressed that the only way for operators to compete on innovation is to partner with the Internet companies to deliver innovative services to their customers rather than compete directly against them.

Participants emphasized, too, the need for next-generation networks.

Exhibit 3
Low Broadband Penetration Offers Potential for Growth Worldwide

BROADBAND PENETRATION LEVELS, SELECTED REGIONS (Q2 2010)



¹ Western Europe countries are selected based on the definition provided by the United Nations Statistics Division.

² Sub-Saharan Africa includes all of Africa except North Africa (Egypt, Libya, Tunisia, Algeria, and Morocco).

Source: Informa; Global Insight; Booz & Company analysis

Some participants suggested that mobile broadband will receive the lion's share of telecom operators' investments as the bandwidth provided by mobile is catching up to the fixed technology. It will take more time to reap benefits from investments in fiber broadband networks and these business models are not as well defined yet.

Discussion also focused on the pricing of broadband access services. Some suggested that operators set prices according to the guaranteed quality of service provided. Current bandwidth is being consumed by few users and accordingly is affecting the quality of services for the majority of users. "About 8 percent of revenue is using up 90 percent of network capacity," said Noel Kirkaldy, director of solutions marketing at Motorola Networks.

The Role of Regulators

There was widespread agreement among conference participants regarding the need for regulatory

and even government intervention to help foster growth of next-generation technologies. The role of regulators will be to enable the building of next-generation national broadband networks, bring down the costs of infrastructure, and formulate guidelines and policies that lead to the mass adoption of e-services and the building of e-communities.

"Market competition usually is the best means to determine user needs and economic efficiencies, but next-generation networks raise challenges that mandate regulatory involvement," said William Fagan, executive director of the regulatory authority ictQATAR. Participants discussed a raft of potential models that might provide a solution to regulators' dilemma of how to spur growth of next-generation networks. Those models propose that governments provide direct subsidiaries to operators or to end users and establish rules to ensure that an incumbent's network is set

up so that all operators in the market can share it equally.

There was discussion but no consensus on a regulatory model that can be applied to the region. Fagan cited the U.S. and E.U. as ideal regulatory models. Motaz Hashem, Group SVP of strategy and planning at Etisalat, also acknowledged the role government must play. "The government must take the lead," he said. "Different countries demand different operating models. There is no one solution or one answer to many questions."

Some participants voiced fears that government intervention would be counterproductive. Direct government intervention was viewed as potentially dangerous as it could lead to re-creating monopolies.

Most participants agree that it will take input from all stakeholders—including operators, governments, and regulators—to forge the most effective guidelines to promote the development of next-generation networks.

REVIVAL OF MERGERS AND ACQUISITIONS

Mergers and acquisitions activity slowed significantly during the economic crisis as some operators struggled to continue financing their existing and future growth needs and maintain a healthy balance sheet. Even those with the ability to initiate transactions opted for a wait-and-see posture to assess the impact of the crisis.

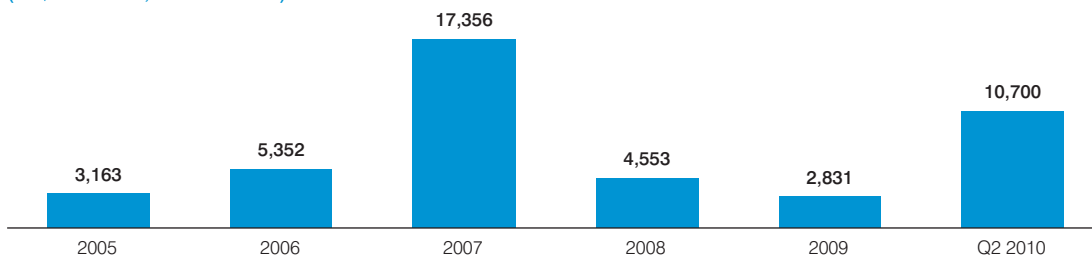
Operators now are shifting gears. “We see an uptick in CEO confidence and the financing picture is brighter,” said Valentin Pitarque, executive director of the TMT Group at Goldman Sachs International. There are clear signals of an upturn in mergers and acquisitions activity as operators look to enter new markets or augment their market share in existing markets. “The MENA telecom M&A wave is back after a temporary slowdown; already in 2010 we have seen signs of revival,” said Mohamad Mourad, a Booz & Company principal, in a keynote address (*see Exhibit 4*). Many participants expect that

regional M&A activity will continue to pick up through 2010 and really take off in 2011.

The potential for consolidation among major group operators—so-called megadeals—is significant, participants noted. Megadeals are likely to proliferate because individual entry points into new markets are becoming scarcer, and the ability to capitalize on economies of scale in the highly commoditized voice market is enticing. In addition, operators recognize that a large deal could enable them to secure entry into multiple markets through a single transaction, thus eliminating the complexity of pursuing many deals.

Exhibit 4
M&A Has Bounced Back in the MENA Region

TOTAL M&A INVESTMENTS, MENA REGION
(US\$ MILLIONS, 2005–Q2 2010)



Note: Total M&A investments also include investment/acquisitions by MENA operators outside the MENA region.
Source: Operators' annual reports; Factset; Booz & Company analysis

Nonetheless, operators are likely to be much more selective about which opportunities to pursue. Operators are building their projections more conservatively, and the premiums paid based on the synergy potential are deeply scrutinized. There also continues to be obstacles to M&A, including underdeveloped and unpredictable regulatory environments and complex legal and tax regimes.

Conference participants confirmed that bank financing continues to be readily available for Tier 1 operators with healthy balance sheets and solid business cases, which is the case for MENA operators. Participants also noted that MENA operators'

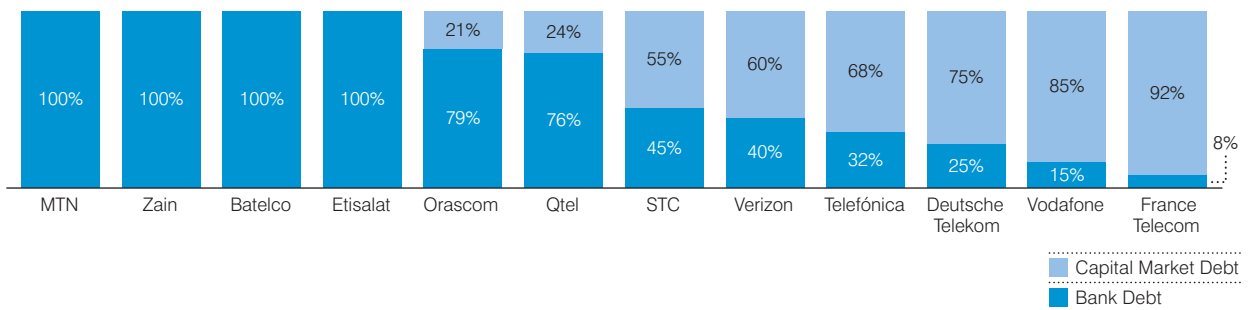
financing sources were not sufficiently diversified—in particular, debt diversification was scarce, as many regional operators opt not to tap into the bond market (*see Exhibit 5*). Another key issue: Smaller industry participants need to manage their cost structures more carefully and improve their liquidity, or they run the risk of being acquired.

Participants also suggested that companies now assessing their existing investments should scrutinize their portfolios to determine whether to divest, consolidate, invest, hold, or fortify their holdings. They can extract value, perhaps, by adopting group-wide corporate strategies,

or by assuming tighter control of the governance and business planning process of the operating companies. Operators can consider how to provide adequate support from headquarters to improve their company-wide capabilities and equip operating companies to execute better in their respective markets—for example, by institutionalizing synergy programs. Accordingly, operators need to ensure that their organization evolves a global platform to support multi-market operations to ensure better strategic alignment, more transparent governance structures, and synergy realization.

Exhibit 5
MENA Operators Rely Heavily or Entirely on Bank Debt

SELECTED OPERATOR DEBT BREAKDOWN, BY TYPE (2009)



Source: Operators' annual reports; Bloomberg; Booz & Company analysis

CONCLUSION

The participants at the TMT conference departed largely optimistic about the sector's prospects for capturing growth. The regional telecom operators that will be most successful in emerging from the economic slump are those that will leverage scale in voice and basic services, invest successfully in fixed and wireless broadband, and provide innovative services. The successful operators will strike up partnerships with Internet companies instead of competing directly with them, to better deliver innovative services to their customers. They will reinvent their business model to handle the

dichotomy of growing and saturated markets, while simultaneously capturing broadband growth. They will also expand their network coverage in nascent mobile markets, deploy next-generation broadband networks, and pursue attractive M&A opportunities.

Finally, conference participants agreed that as the industry examines all of its growth opportunities, the successful operator will ensure that its organization has evolved into a global one, able to capture the growth and, thus, value across all of its markets and businesses.

About the Authors

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