LEBANON OPPORTUNITIES

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## Scheduled for Feb 08

# Bids for mobile networks announced

That call should become cheaper after privatization

The Higher Council for Privatization (HCP) and the Telecommunications Regulatory Authority (TRA) have set a deadline of February 1 of next year for the submission of bids to acquire the subscribers and assets of the country's two mobile telephone networks. The public auction is scheduled to take place three weeks later, on February 21. The Government is expected to receive at least $6 billion from the auction.

### WHAT WILL BE ON THE BLOCK

The two mobile telephone networks in the country, Alfa and MTC Touch, have a combined total of around 1.1 million subscribers. The networks are owned by the state. Alfa is operated by Fal Dete Telecommunications, a Saudi-German consortium, and MTC Touch is operated by Kuwait's Zain Group, which was formerly known as MTC. Both Fal Dete Telecommunications and the Zain Group have four-year management contracts that are going to expire in mid-2008. The mobile telephone networks generate around $900 million per year, and they have been one of the Government's principal sources of revenue in the last few years. Local and international mobile tariffs are among the highest in the world. Telecommunications bills average $65 per month, as opposed to $40 in Saudi Arabia and even less in Europe. Pre-paid cards make up 75 percent of subscribers, with a rate of $0.44 per minute. Regular subscribers pay up to $40 in fixed charges monthly in addition to $0.14 and a tax of $0.06 per minute. Part of the fixed land-line network which currently has just 550,000 subscribers is also expected to be put on the block at some point in the near future. The state plans to sell 40 percent of its shares to an operator as a first step for Liban Telecom, a private firm which will be eventually created to run the sector.

### THE AUCTION PROCESS

The Government will be auctioning two 20-year second-generation mobile telephone licenses, along with the assets, liabilities, and subcontracts of the existing mobile telephone networks. Winners of the auction will acquire the two licenses, as well as the assets, liabilities, and subcontracts of each of the existing state-owned mobile networks. Each bid that is submitted must cover two scenarios, one that is based on a ten-percent revenue-sharing arrangement with the Government and one that is based on a zero percent revenue-sharing arrangement. The Government plans to announce the results of its technical evaluation of the bids by February 18. At the public auction, the Government will announce which of the two revenue-sharing arrangements has been selected. The auction will be broadcast live on television. Each of the two successful bidders will be required to establish a Lebanese joint-stock company and transfer one-third of its shares to the state, which will hold the shares temporarily until an initial public offering takes place. The Government has said that the initial public offering will take place within one year after the incorporation of the licensee.

### WHO WANTS TO BID?

Several companies have expressed an interest in participating in the auction. As of now, there are three prospective bidders:

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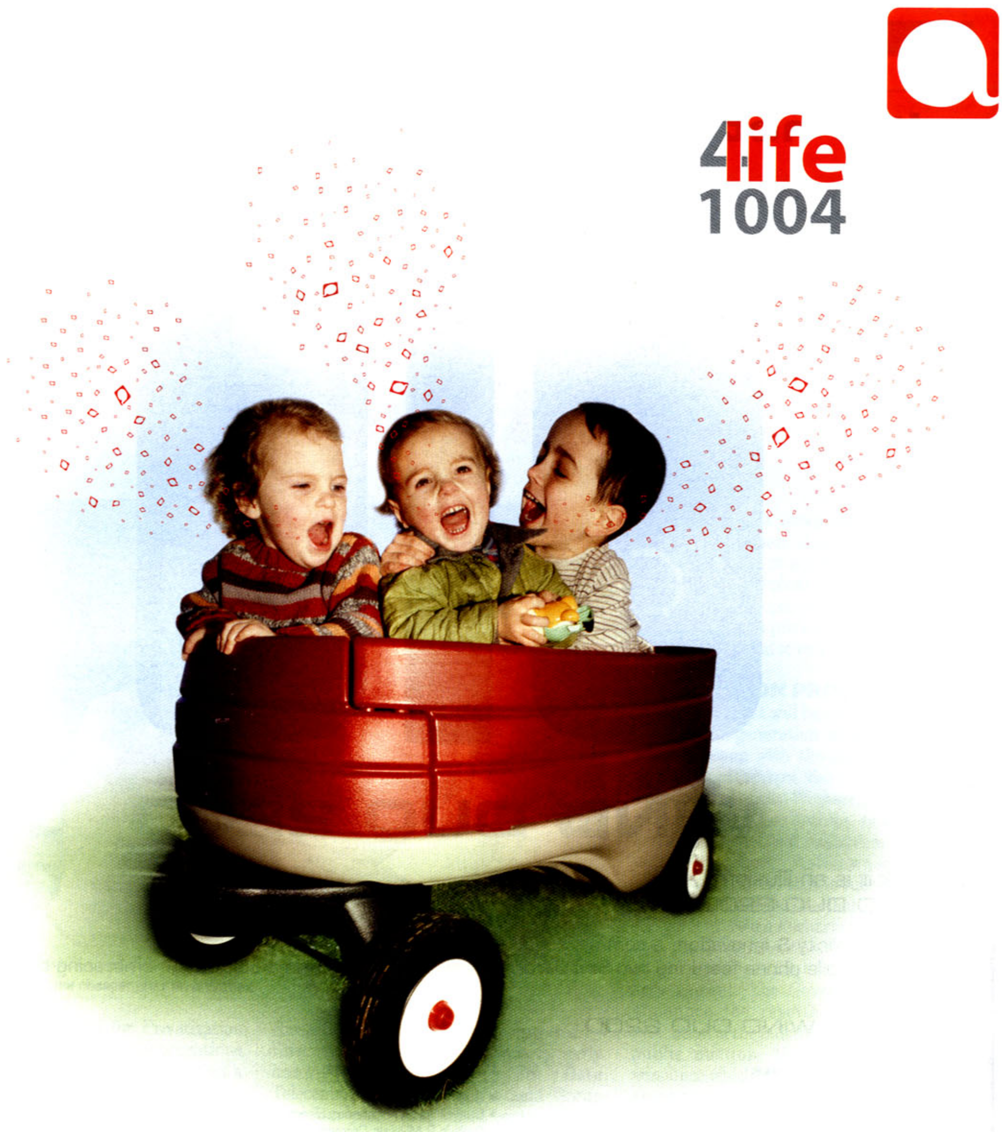

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Kuwait's Zain Group, Egypt's Orascom Telecom, and Bahrain's Batelco. Credit Suisse said: "Zain Group and Orascom Telecom have already announced that they are considering entering the tender, and we would expect strong interest in one of the few remaining mobile licenses in the region, mainly on the part of other Middle Eastern Telecom companies." The head of the TRA, *Kamal Shehadi*, who would not comment on the Credit Suisse report, noted that it came from a prestigious and neutral group. "I think that this is a report coming from a professional source," Shehadi said. According to Credit Suisse, regional mobile telephone companies have a keen interest in the privatization of this country's mobile networks. The chairman of Orascom Telecom, *Naguib Sawiris*, has said that his company is going to bid for a mobile telephone license. Orascom is the fourth largest Arab mobile telephone operator in terms of market value. Sawiris has dismissed concerns about political instability in this country. "There is no political risk," he said. Sawiris said that his company, which is involved in Iraq, Zimbabwe, and Pakistan, was accustomed to political and security risks. "For us, Beirut is like a safe haven" he said. According to Sawiris, it makes sense to compete for this country's mobile telephone market because new investment opportunities in the sector are running out. The chairman of Kuwait's Zain (now headquartered in Bahrain), *Saad Barrack*, has said that his company plans to enter the bidding. According to a source close to the Ministry of Telecommunications, companies from the Far East and Eastern Europe have also expressed an interest in participating in the bidding process, which indicates that the local telecommunications market is very attractive to investors, despite the negative political environment. Credit Suisse said that this country's mobile telephone market is attractive, despite its small size, because of several factors: The current low mobile penetration rate of around 33 percent, the high income levels of the sector, and a high average return per user (ARPU) of $72. The ARPU in this country is the highest in the Middle East. It is expected to decrease to $48 by 2010. The local Minutes of Use per month (MOU/month) of 388 minutes is the highest among comparable countries. Credit Suisse expects that the mobile penetration rate will increase to 95 percent in the next three years,

**The mobile phone market is attractive**

and reach 140 percent by 2027. In comparison, penetration levels in many GCC countries are close to 100 percent, even surpassing that level in Saudi Arabia and the UAE. According to Credit Suisse, another factor that makes the sector attractive is the assets that the successful bidders will require, which generate significant cash flow. It has valued each mobile license at around $3 billion. Sawiris said competing for the Lebanese market makes sense because new investment opportunities in the sector are rapidly running out. High prices, however, risk making such acquisitions not financially viable. He said. "Look at Saudi Arabia. The third mobile license was sold for $6 billion. At the time when the Saudi license was being sold, the market there was 80 percent saturated. What we are afraid of is that prices become so high that it would not become lucrative after that."

## WILL POLITICS INTRUDE?

Shehadi acknowledged that the political situation might affect the bidding process. He said: "Of course if we do not have presidential elections on time and a new national unity government, then there won't be any bidders." Some opposition leaders reject the idea of privatizing the mobile sector, and have threatened to block any such attempt. An opposition leader has said that the opposition would take all legal steps that are necessary if companies bid for the mobile licenses.

## EXPECTED BENEFITS OF PRIVATIZATION

The privatization of the mobile networks is an important part of the Government's economic reform program, which was announced at the Paris III Conference. In the short term, it is expected that privatization will result in a decreased in fiscal revenues from telecommunications (see news story on the budget deficit), but in the longer run privatization should prove to be beneficial. It is expected to promote the growth of the telecommunications sector and to lead to additional growth in GDP. "With privatization, we expect in the medium term an increase of at least one to 1.5 percent in economic growth every year, a decrease in debt service, and an increase in the volume of the value-added tax," Shehadi said. Government officials have said that privatization will help to create more jobs in the medium and long terms. They have predicted that mobile telephone rates will decrease by at least 30 percent after the completion of the privatization process. Credit Suisse conducted a discounted cash flow (DCF) model to value each license fee, and concluded that each fee will likely exceed $3 billion. The DCF yielded a range of $2.4 billion-$3.4 billion for each license, at an internal rate of return (IRR) of 9.3-14.3 percent. The low end of the IRR is based upon Lebanese sovereign yield, while the high end integrates a 500 basis points equity risk premium. The reason for this range, according to Credit Suisse, is that IRRs in recent license acquisitions in the Middle East, specifically Saudi Arabia and Iraq, were inclined to drop to levels close to or equal to the yield on sovereign bonds of the respective countries. In fact acquisition multiples in the region averaged ten times the 12-months forward EBITDA, which translates into $3.2 billion. Should this scenario happen in Lebanon as well, which is most probable, the valuation of each mobile license would also surpass $3 billion. According to the Ministry of Telecommunications, the auction is expected to fetch $6 billion to $7 billion. The Government has said that all of the proceeds of the privatization process will be used to reduce the size of the public debt.

*Reported by Jody Jaffe*