CAPITAL•STANDARDS
AN INDEPENDENT RATING AGENCY

Kuwait Telecom Industry

Report Contents

Analyst

Victoria Monteiro
v.monteiro@capstandards.com
+965 22258822 ext.514

Capital Standards (CSR)

Al Nassar Tower, 11th Floor,
Fahad Al-Salem St., Kuwait City
P.O.Box 26620, Safat, 13127 Kuwait
Office: +965 2225 8822
Email: services@capstandards.com
Website: www.capstandards.com

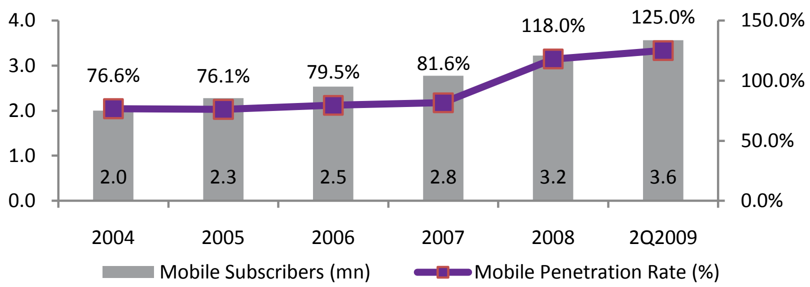
Summary

The telecom industry in Kuwait, which is highly developed[1], expanded even with a weak regulatory environment. Kuwait is still the only country that does not have an independent telecommunications regulatory authority and is the least liberalized in the Gulf region.

The fixed line sector is solely dominated by the Government of Kuwait via the Ministry of Communication (MoC). The wireless (mobile) sector is partially privatized, and was dominated by Zain and Wataniya, the two leading mobile operators in Kuwait, until the end of 2008. Their duopoly was broken when Kuwait Telecommunication Co. (Viva) was awarded the license to operate as the third mobile operator in Kuwait. The entry of Viva in December 2008, backed by Saudi Telecommunication Co. (STC), added new momentum to the telecom industry in Kuwait.

At the end of June 2009, the mobile penetration rate in Kuwait peaked 125% with the total number mobile subscribers reaching 3.56 mn, an increase of 10.7%, as compared to 3.22 mn subscribers at the end of December 2008.

Kuwait Mobile Market



Source: ITU, Other Equity Research Report, CSR Analysis

The mobile service in Kuwait is expected to grow and will continue to penetrate the market further, as the country has favorable demographics. According to the IMF, the population in 2010 will grow by 2.0% reaching 3.6 mn. In addition, more than 60% of the total population consists of expatriates and approximately 22% of the population is under the age of 15, allowing for a higher expected addressable market in the future and implying strong demand for telecom services.

[1] Kuwait ranks 5th out of 18 Arab Countries on the ICT (Information and Communication Technology) Development Index. This index compares developments in information and communication technologies over a five-year period from 2002 to 2007 and is published by the International Telecommunication Union – ITU. The ranking is based on indicators which take into account ICT access, use and skills in a particular country.

Overview of the Telecom Industry in Kuwait

Weak regulatory environment & Government dominance……

The Kuwait telecom industry was the first to open itself to competition in 1999 in the Gulf region for mobile services but still it remains the least liberalized in the region. The country does not have an independent telecom regulator and therefore, the industry lacks proper regulatory framework.

The Ministry of Communications (MoC), owned by the Government of Kuwait, which currently acts at the telecom regulator, is also the sole provider of the fixed line services. In addition, the MoC controls the international gateway, and determines all international call charges. Therefore, due to absence of an independent regulator and the government monopoly, Kuwait has the highest international calling tariffs in the region, putting both mobile service providers and their customers at a disadvantage.

………Curbing growth of mobile operators

With the MoC controlling the fixed line and the international gateway for overseas calls, the mobile operators in Kuwait are at inherent disadvantage as they cannot reap the benefits of operating as an integrated telecom player and diversifying their business risks. In addition, they cannot offer promotions and discounts on international calls. Because of the restrictive industry model in Kuwait, the mobile operators have to collect local fixed and international termination rates, which have a negative impact on their revenues.

Liberalization is needed to drive the Kuwait telecom industry

The Kuwait telecom sector, which is firmly in the hands of the government, is not only restricting growth of the mobile operators but also holding back the development of a more open and competitive market. The introduction of a regulatory body, and opening up of the fixed line and international gateway to the private sector, would allow mobile operators to diversify their business model, increase competition in telecom infrastructure, provide better grade of service quality in the country and reduce call tariffs. This would also ensure a clear structure for managing the telecom industry and eventually improve the overall telecom industry in Kuwait.

Mobile Market

List of players

Currently, the Kuwait mobile market is composed of three wireless companies, namely, Zain Group, National Mobile Telecommunications Company (Wataniya) and Kuwait Telecommunications Company (Viva).

Zain – Zain Group, formerly Mobile Telecommunications Co., was established in 1983 in Kuwait as the region's first mobile operator. Since 2003, the group has grown significantly becoming the third largest telecom operator in the world, based on its geographic presence, covering 24 countries in Middle East and Africa. With a market cap of USD 19.9 bn as of 18th March 2010, Zain is the third largest telecom operator in the Gulf Region and the largest publicly listed company on the Kuwait Stock Exchange (KSE).

Wataniya – National Mobile Telecommunications Company, operating under the brand name Wataniya, was incorporated in October 1997 and was awarded as the second licensed GSM operator in Kuwait. The telco which is listed

KSE, commenced its operations in December 1999, primarily under the flagship of Kuwait Investments Projects Company (KIPCO), ending the 14-year monopoly of the Zain Group. Qatar Telecom (Qtel) became the largest shareholder of the telco by acquiring a controlling stake of 51% in Wataniya from KIPCO in 2007 and an additional stake of 1.5% in 2008.

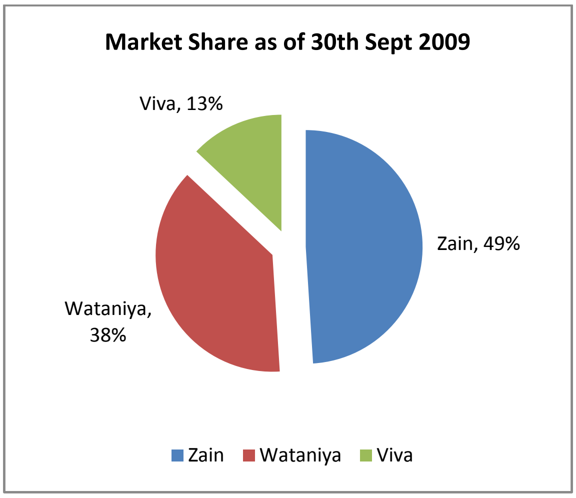
Viva - The Kuwait Telecommunication Company was established in June 2008 to operate and manage the third GSM mobile network in Kuwait. The company launched its services in December 2008 under the brand name Viva. Saudi Telecom (STC) is the largest shareholder in the company, with a stake of 26%. Viva sold a 50% stake in an initial public offering in 2008 that raised KWD 25 mn and the company has plans to list on KSE in 2010.

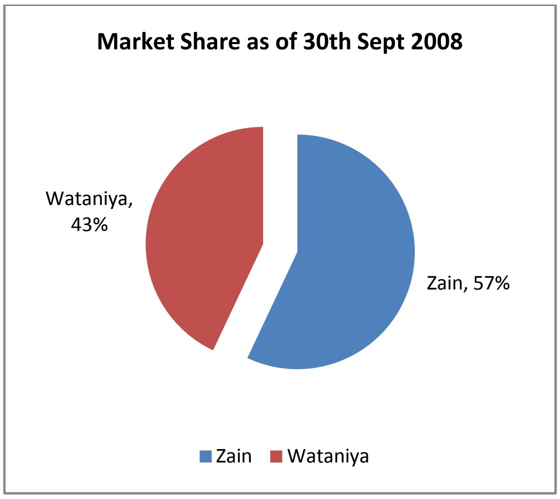
As of 30th September 2009	Zain	Wataniya	Viva
Market Share (%)	49	38	13
Total Subscribers (mn)	1.85	1.46	0.5
No. of countries with operations	24	6	1
Years of Existence	26	10	1

Source: Company reports and news

Market Share - Aggressive Competition in 2009

The entry of VIVA, backed by STC in December 2008 intensified the competition in the Kuwait mobile market. Viva rapidly established an unrivalled position, by aggressively introducing number of innovative range of products & services at a significantly lower value as compared to Zain and Wataniya. The increased competition has put a downward pressure not only on the margins of Zain and Wataniya but also impacted their respective market share. The market share of Zain and Wataniya declined from 57% and 43% in 2008 to 49% and 38%, respectively, at the end of 30th September 2009.

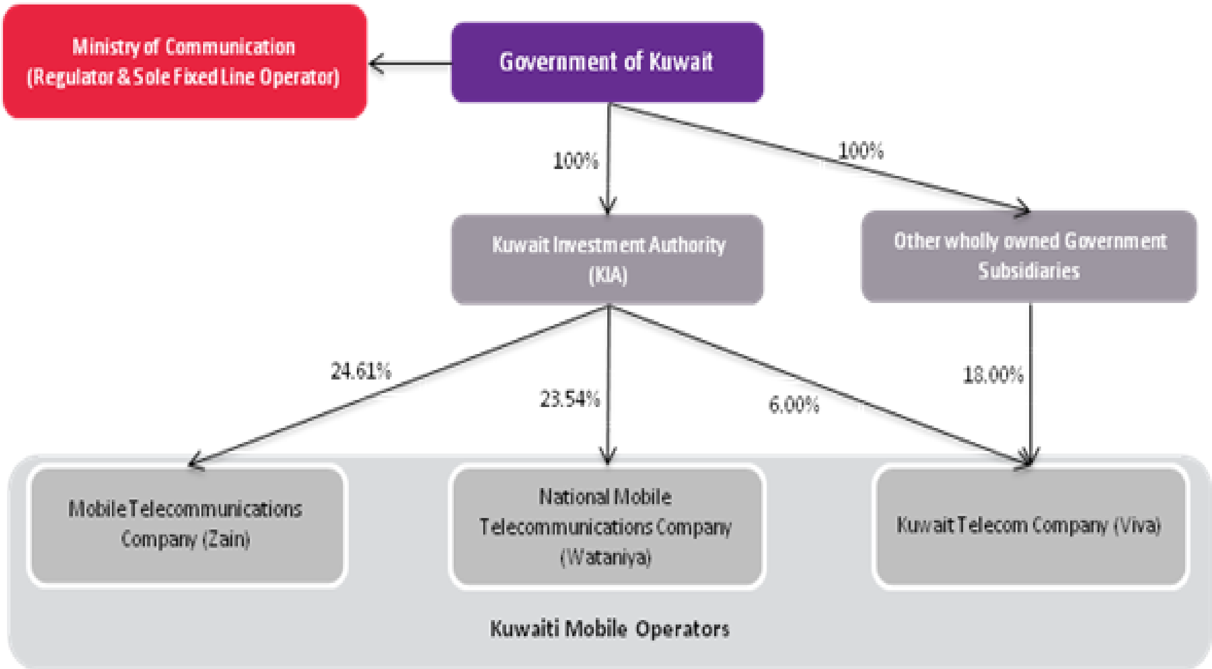




Source: Zain Quarterly Presentations (3Q08 and 3Q09)

While Zain and Wataniya will continue to maintain the market position as the top two operators in Kuwait in 2010, at the cost of ARPU's, they will lose their mobile subscribers further to Viva, bringing down their respective market shares in the industry. The fierce competition in the Kuwait mobile market will continue to benefit the customers, with reduced local call tariffs, which were among the highest in the region, and improved quality of services.

Government Influence on the Mobile Operators



Source: Zawya and CSR Analysis

The Kuwaiti Government, which already controls the fixed line sector through the MoC, also owns substantial stakes (mainly via Kuwait Investment Authority) in all the mobile operators. These strategic stake holdings not only allows the Government to retain the revenue flows from this cash generating sector but also allows the MoC to ensure that the mobile operators do not undertake value destructive price competition via its ownership influence. Thorough the stake holdings, Government can influence the operational and financial activities of these companies, and in turn can influence the mobile market in Kuwait.

Major Events in 2009 & 2010

Mobile Number Portability

In August 2009, the MoC set up a committee to follow on the execution of Mobile Number Portability (MNP) in Kuwait. This will allow mobile subscribers to switch their mobile numbers from one service provider to another at no cost. The implementation of the MNP in Kuwait, which is likely to happen in 2010, will improve the quality of services to mobile subscribers as competition will intensify further with this move. The mobile operators, especially Zain and Wataniya, will witness a higher and volatile churn rate in their mobile business. Viva, on the other hand may benefit, as introduction of MNP will help the relatively new mobile operator to grow its subscriber base and gain market share.

Zain's deal with Bharti Airtel

Other events in the Kuwaiti telecom industry that have implications for the development of the market going forward include the news on Zain's sale of its African operations. In February 2010, Zain entered into exclusive talks with India's Bharti Airtel to sell assets in 15 African countries, excluding Sudan and Morocco, in a deal valued at USD 10.7 bn. If this deal goes through, Zain's geographical presence will be primarily restricted to the Middle East, and its geographical coverage will reduce to 8 countries (namely, Bahrain, Iraq, Kuwait, Saudi Arabia, Jordan, Lebanon, Morocco and Sudan) from 24 countries, bringing an end to the company's aspirations of becoming a global player. The offloading of Zain's African assets will also have a significant impact on the company's customer base, reducing the subscribers to below 40 mn approximately, as the African subscribers (excluding Sudan and Morocco) represent 58% of Zain's total 71.8 mn active subscribers at the end of September 2009. Despite the fact that this deal will help Zain reduce its debt, provide returns to shareholders and improve liquidity to invest further in the Middle East, It also completely changes Zain profile from being an international player to a regional telecom operator. While both parties to the deal are in exclusive talk until 25th March 2010, the deal is mostly likely to go through.

Zain & Wataniya – Rank on "Most Valuable Telecom Brands"

Kuwait's Zain and Wataniya have a global ranking on 30 and 88 respectively on "The World's Most Valuable Telecom Brands" in 2008. The brand valuation and ranking is published by Intangible Business, a leading independent brand valuation consultancy, studies 500 of the world's biggest telecom operators to produce the top 100.

In the telecom industry, which is highly competitive and highly branded industry, brands can inspire loyalty, help reduce customer churn, increase ARPU, attract new customers and retain existing ones. Zain and Wataniya's ranking on the top 100 most valuable telecom brands reflects their success in building value for their shareholders and stakeholders.

Middle East (2008)				
Rank	Brand	Country	Brand Value (USD mn)	Top 100 Brand Value Rank (Global)
1	Saudi Telecom	Saudi Arabia	2,409	28
2	Zain	Bahrain	2,343	30
3	Mobily	Saudi Arabia	1,514	43
4	Qtel	Qatar	802	66
5	Wataniya	Kuwait	491	88
6	Cellcom	Israel	483	89
7	Pelephone	Israel	426	91

Source: Intangible Business

Financial Performance of Zain and Wataniya

In order to conduct an analysis on Zain and Wataniya's operating performance and financial strength, we have compared their financials and ratios to the GCC telecom industry average. The GCC telecom industry average is composed of the top telecom companies in terms of their market capitalization. These companies include:

- Bahrain Telecommunications Co. (Batelco) - Bahrain
- Oman Telecommunications Co. (Otel) – Oman
- Qatar Telecommunications Co. (Qtel) – Qatar
- Saudi Telecommunications Co. (STC) – Saudi Arabia
- Etihad Etisalat Co – Saudi Arabia
- Emirates Integrated Telecommunications Co. (EITC) – UAE
- Emirates Telecommunications Corporation (Etisalat) – UAE.

The detailed key financials for the mentioned telecom operators are included in the appendix. The analysis is based on the financial results of Q3 2009 in order to maintain consistency as the 2009 annual results were not available for all the companies.

Revenue & Profitability

Zain's large size and scalability is evident from its market capitalization and total revenues in comparison to Wataniya. Zain ranks as the third largest telecom operator in the Gulf in terms of market capitalization. Also, in terms of geographic presence, Zain has expanded into 24 countries in the MENA region whereas Wataniya is present in 6 countries in MENA region and Asia.

As of 30th September 2009		Zain	Wataniya	GCC Telecom Industry Average
Market Cap (as of 18 March 2010)	(USD mn)	19,864.8	2,763.3	10,396.1
Total Revenues	(USD mn)	6,200.7	1,225.4	5,419.5
Revenue Growth	(%)	23.6	(1.0)	13.7
EBITDA	(USD mn)	3,560.0	871.8	2,727.2
EBITDA Margin	(%)	43.1	53.4	37.4
Net Profit	(USD mn)	681.9	339.1	1,296.3
Net Margin	(%)	11.0	27.7	21.6
Return on Assets	(%)	4.1	14.8	10.4
Return on Equity	(%)	10.8	29.3	22.5
Dividend Payout (for FY 2008)	(%)	66.3	30.6	53.2

Source: Zawya, Company reports, CSR

In terms of revenue growth, Zain's revenue grew by 23.6% as of 30th September 2009, whereas Wataniya witnessed a marginal decline of 1.0%. The industry average for revenue growth was 13.7%. The decline in Wataniya's revenue is mainly due to its limited geographic diversification and concentration on its Kuwaiti operations (40.7% of its total revenues as of 30th September 2009), which was impacted due to the entry of Viva in December 2008. While Zain too witnessed a decline in revenues from its Kuwaiti operation, this was offset by its vast geographic presence. In general, looking at the high revenue growth of companies like Qtel, Zain and ETIC (refer to the appendix for individual ratios of GCC Telecom Payers), it is evident that geographic diversification does support revenue growth and offsets the pressure of competition on revenues in the local or key markets.

The EBITDA margin of both Zain and Wataniya are above the industry average and have considerably improved from the last year during the same period. As of 30th September 2008, the EBITDA margin for Zain was 38.7% and for Wataniya was 40.1%. This was due to the better cost control measures initiated by both Kuwaiti telecom operators. Such initiatives are likely to continue in 2010 to offset the revenue pressures.

In terms of profitability, Wataniya recorded higher net margin, ROA and ROE as compared to Zain and GCC industry average. For Zain, the high finance costs and unfavorable currency fluctuations in many of its African operations, coupled with reduced interest income and investment income had a negative impact on its bottom line and eventually its profitability ratios.

Going forward, Zain and Wataniya's margins are likely to remain under pressure due to the increasing competitive pressure in Kuwait.

Capital Structure

As the telecommunications industry in GCC has matured in the past five years, the leverage position of the telecom players also increased. At the end of September 2009, GCC industry average for total debt to total equity stood at 76.3%. Our capital structure analysis of the GCC telecom companies (refer to appendix), reflects that the larger telecom players have the tendency to take on high leverage (exception is Emirates Telecommunications).

As of 30th September 2009		Zain	Wataniya	GCC Telecom Industry Average
Short Term Debt	(USD mn)	1,581.0	59.4	908.8
Short Term Debt / Total Debt	(%)	21.4	11.3	32
Total Debt	(USD mn)	7,391.5	524.5	3,656.4
Current Ratio	(%)	0.6	0.9	0.8
Net Debt/EBITDA	(%)	3.0	0.4	2.7
Total Debt/Total Assets	(%)	33.5	17.2	24.1
Total Debt/Total Equity	(%)	87.4	34.0	76.3

Zain is one of the highly leveraged telecom companies, with a debt to equity ratio of 87.4% as of 30th September 2009, as compared to its peers and the industry average. This is due to the company's aggressive growth strategy, mostly funded by external financing. On the other hand, Wataniya's has low debt levels due to its conservative strategy in terms of expansion as well as sources of financing. This strategy has added strength to Wataniya's balance sheet and provides the company with the much needed financial flexibility, given the intensified competition in the GCC telecom sector.

Note: The potential sale of Zain's African assets will help Zain reduce debt and meets its short term financial obligation. As mentioned earlier, while this deal will set back Zain's aspirations to become a global player, it will nevertheless, enhance the liquidity position of the company to pay off its debt and venture into other business opportunities.

Conclusion

Zain and Wataniya, the two publicly listed Kuwaiti mobile players, have build their brands as well shown strong growth potential in the region despite the weak regulatory environment in Kuwait. In addition, the government dominance on the fixed line sector and the international gateway not only restricts the flexibility of these players to operate as an integrated telecom player but also erodes the company's top line. Further liberalization and privatization of the Kuwait telecom industry, which is the need of the hour, can boost the performance and provide further business opportunities to the Kuwaiti mobile players. The Kuwaiti Government can play major role in providing impetus to the telecom sector and in turn allowing Zain and Wataniya to outperform its regional peers.

Appendix

Key financial information of the GCC telecom players

Revenue & Profitability Indicators										
As of 30th September 2009	Market Cap (as of 18 March 2010)	Total Revenues	Revenue Growth	EBITDA	EBITDA Margin	Net Profit	Net Margin	ROA	ROE	Dividend Payout
	(USD mn)	(USD mn)	(%)	(USD mn)	(%)	(USD mn)	(%)	(%)	(%)	(%)
Batelco	2,233.9	679.6	4.4	285.4	31.5	210.8	31.0	15.6	22.6	69.1
Wataniya	2,763.3	1,225.4	(1.0)	871.8	53.4	339.1	27.7	14.8	29.3	30.6
Zain	19,864.8	6,200.7	23.6	3,560.0	43.1	681.9	11.0	4.1	10.8	66.3
Otel	2,626.8	789.2	(3.4)	616.2	58.6	274.8	34.8	21.1	35.1	63.2
Qtel	5,863.4	4,800.9	22.1	1,413.0	22.1	644.9	13.4	3.8	21.1	63.6
Etihad Etisalat	9,052.6	2,538.9	23.9	1,179.0	34.8	523.2	20.6	8.6	23.4	25.1
STC	24,104.7	10,067.0	7.4	5,632.0	42.0	2,101.5	20.9	9.8	25.9	66.4
EITC	3,082.2	1,037.0	39.8	204.9	14.8	43.4	4.2	2.4	7.9	NA
Emirates Telecommunications	23,973.0	6,018.9	6.5	2.9	36.6	1,864.0	31.0	13.1	26.6	41.5
GCC Industry Average	**10,396.1**	**3,706.4**	**13.7**	**1,529.5**	**37.4**	**742.6**	**21.6**	**10.4**	**22.5**	**53.2**

Financial Strength Indicators							
As of 30th September 2009	Short Term Debt	Short Term Debt / Total Debt	Total Debt	Current Ratio	Net Debt/EBITDA	Total Debt/Total Assets	Total Debt/Total Equity
	USD mn	%	USD mn	%	%	%	%
Batelco	194.0	95.4%	203.3	0.8	0.1	10.7	15.6
Wataniya	59.4	11.3%	524.5	0.9	0.4	17.2	34.0
Zain	1,581.0	21.4%	7,391.5	0.6	3.0	33.5	87.4
Otel	114.8	48.0%	239.4	1.0	0.4	13.8	22.9
Qtel	2,440.9	24.9%	9,802.6	0.7	9.9	42.7	241.0
Etihad Etisalat CO	867.5	35.5%	2,445.4	0.6	2.4	30.2	81.9
STC	2,224.3	25.6%	8,678.6	0.8	2.1	30.3	80.1
EITC	27.1	3.2%	843.9	0.8	3.4	34.3	115.5
Emirates Telecommunications	669.9	24.1%	2,778.8	0.9		4.0	8.1
GCC Industry Average	**908.8**	**32.2%**	**3,656.4**	**0.8**	**2.7**	**24.1**	**76.3**

Source: Zawya, Company reports, CSR

DISCLAIMER