

March 05, 2007

SICO Research

Sector: Telecom
 Market Cap: \$ 6.5 bn
 Primary Exchg: Qatar
 Other Exchg: BSE, ADSE
 Price: QR 237.10
 Target Price: Suspended
 Reuters: QTEL.QA
 Bloomberg: QTEL QD

VALUATION RATIOS[^]

	2007E	2008E
P/E x	NA	NA
P/BV x	NA	NA
EV/EBITDA x	NA	NA
Div Yld x	NA	NA

TRADING DATA

Daily Vol (6M Avg '000)	21.5
Daily T/o (6M Avg \$mn)	1.38
Issued Shares (mn)	1,200

[^]Coverage Suspended Temporarily
 Price as on 04 March 2007

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GCC Telecom: Qatar Telecom acquires 51% of NMTC

QTel -Wataniya Deal: Minority Shareholders miss the bus?

- Qatar Telecom (QTel) has entered into a binding agreement to acquire a controlling interest of 51% in National Mobile Telecommunications Company (Wataniya) from a consortium led by Kuwait Projects Company Holding (KIPCO) for a consideration of US\$ 3.72 bn. QTel will also acquire United Gulf Bank's (UGB is a listed subsidiary of KIPCO) 9% stakes in Wataniya's operations in Algeria and Iraq for an additional consideration of US\$ 100 mn taking the total value of the deal to US\$ 3.82 bn.
- The deal is very significant for QTel as it gains a controlling stake in a company whose assets stood at 1.16 times the existing asset base of QTel (as of Dec 2006). The deal values Wataniya at US\$ 7.3 bn, 5% more than the market cap of QTel as of 28 Feb 2007.
- In view of the size of the transaction and the significance of this acquisition on QTel's expected performance going forward, we temporarily suspend our coverage on the company, until a clearer understanding of the funding of the deal and the deal's impact on the company's financials is clarified.
- This transaction raises significant issues in terms of disclosure and protecting minority shareholder rights in addition to the lack of a takeover code for the Kuwaiti stock market, and regional stock markets in general. QTel's offer to buy a 51% stake in Wataniya from a consortium at a hefty 48% premium (or 87% higher than the 6 month average) leaves the balance 49% minority shareholders of Wataniya at a disadvantage as they have no mechanism to tender their shares at this price. We believe this deal is symbolic of challenges that regulators in this region will face with an inevitable rise in the levels of M&A activity in the region going forward. Hopefully regulators will look at the structures that are already in place in both developed and other emerging markets and address these concerns proactively.

Our Analysis of the Deal

- QTel will emerge as major regional player with operations in 11 countries (both MENA and Asia) as a result of this deal.
- In our opinion, QTel paid a steep premium (87% premium over six month average price of Wataniya or 48% over the last traded price) for a 51% stake in Wataniya. The financial impact on QTel will be become clearer once QTel discloses the proposed financing arrangements for the deal.
- This deal will result in a significant increase in intangible assets and goodwill (in our estimate as high as US\$ 2.8 bn) in the consolidated books of QTel, which could impact earnings negatively going forward.
- Our big operational concern for QTel is the temporary nature of Wataniya's mobile license in Iraq. We expect that the fate of this license will have a significant impact on the deal considering Iraq's contribution (27% of net profits) to Wataniya's performance.
- Financing of this deal will pose a major challenge for QTel, with our initial analysis indicating that the incremental interest expense may outweigh the benefits in the near future.

- One of our key concerns about this deal is the lack of a mechanism to protect minority shareholders of Wataniya. In most other developed or emerging markets, the minority shareholders would have been provided a mechanism to capitalise on the premium on such deals by tendering their holdings (or a proportion there-of) to the new buyer at the same share price as the exiting shareholders. We believe this deal is symbolic of challenges that regulators in this region will face with an inevitable rise in the expected levels of M&A activity in the region and earnestly hope regulatory agencies will take the necessary steps to address this concern.
- We will resume coverage of QTel once we get more clarity about the financing arrangement for the deal.

Important Note: We have used financial results of Qatar Telecom and Wataniya for the year ended Dec 2006 in our calculations. This is used for comparative purposes and for analysis of the deal. The consolidated impact may vary as the line by line consolidation of Wataniya and QTel will happen only during the current financial year (2007) and in the interim both QTel's and Wataniya's financials may change (for instance Palestine & Iraq licenses costs, if any, would be reflected in the financials for 2007 for Wataniya and the acquisition of AMH in the case of QTel).

Analysis of the deal

- QTel has entered into a binding agreement with a consortium led by KIPCO to acquire 51% stake in Kuwait based Wataniya telecom for US\$ 3.72 bn, which has operations in 8 countries in the region. In addition, QTel will also be buying United Gulf Bank's 9% stakes in Wataniya's operations in Algeria and Iraq for US\$ 100 mn. **Qatar Telecom has paid a steep premium of 48% over Wataniya's closing price of KD 3.10 on Feb 28, 2007, the day before the announcement of the deal.**

Analysis of Qatar Telecom - Wataniya Deal	
Total Value of the deal (US\$ mn)	3,818
Less Value paid for additional stakes in Iraq and Algeria (US\$ mn)*	100
Value paid for Wataniya (KIPCO consortium) @ KD 4.6 / Shr (US\$ mn)	3,718
Total Stake sold by KIPCO consortium	51%
Implied Value of Asset (US\$ mn), Wataniya	7,290
Total Number of Shares (mn)	458
Consideration paid per share (KD)	4.60
Closing Share Price (as on 28 Feb 2007) KD	3.10
Premium (Discount) Paid for Wataniya	48%

Note: *Consideration paid to UGB by Qtel, Total value based on disclosure made by UGB

Source: SICO Research, Reuters, Company disclosures

- Wataniya's share price has been buoyant over the last few months in anticipation of the stake sale by KIPCO. Our analysis shows that the premium paid by QTel is much higher when we consider the average share price of Wataniya over the last one month or six months (see table below):

Premium Paid by Qtel for Wataniya		
	KD/Share	Premium
Price paid by Qtel	4.60	
Price as on 28 Feb 2007	3.10	48.4%
Average Prices		
1 Month prior to deal	2.95	56.1%
6 Months prior to deal	2.46	87.0%

Source: SICO Research, Zawya

If we consider the 6 months average closing price of Wataniya, QTel has paid a steep 87% premium for this stake. We believe that this is a better representation of the premium attached to the deal, as Wataniya's share price has rallied recently in anticipation of a deal by KIPCO.

- The deal's implied multiples are given below. Going by recent deals such as the acquisition of Investcom by MTN (US\$ 950 per subscriber), Umniah by Batelco (US\$ 800) and Celtel by MTC (US\$ 594 per subscriber) the consideration paid by QTel at US\$ 1,325 per proportionate subscriber seems steep.

Qtel - Wataniya Deal : Implied Multiples	
Price/Sales	5.0
EV/EBITDA	11.8
Price/Earnings	28.9
EV/Subscriber based on (US\$/Sub)	
Total Subscriber base	784
Proportionate Subscriber base	1,325

Source: SICO Research, Company Reports

- QTel will have to book a large part of the consideration paid for acquiring the stake as goodwill. We estimate that QTel may recognise as much as US\$ 2.75 bn in goodwill from this deal (this represents the maximum possible goodwill based on book value of Wataniya's assets as of Dec 2006). This goodwill represents about 10.9 times the total net profit earned by Wataniya in 2006 and 5.9 times the net profit earned by QTel in 2006.

Calculation of Goodwill (\$ mn)	
Total value of the deal	3,818
Net Asset Value of Wataniya	926
Share of Assets from UGB deal	44
Total value of net assets acquired	970
Goodwill	2,848

Note: based on book value

Source: SICO Research, Company Reports

Note that QTel will be revaluing Wataniya's assets to their fair value (including licenses in various countries as intangible assets) bringing down the amount of goodwill in its consolidated books. We expect that the major part of reduction in the above estimate of goodwill will come from revaluation of licenses (as Wataniya so far has accounted for only the licenses values for its operations in Tunisia, Algeria and Maldives in its existing financials).

- **Biggest Concern : Iraq License is temporary but contribution is material**

Our biggest concern about Wataniya is the fact that their mobile license to operate in Iraq is temporary in nature. Iraq contributed around 24% of the total revenue, 32% of the EBITDA and 27% of the profits of Wataniya on a consolidated basis during 2006.

The Iraqi regulator has already stated their intention to invite bids for permanent mobile licenses in Iraq. However the unstable situation has delayed the process (benefiting Wataniya and other temporary license holders). Going by the steep bid amounts that are currently being offered for new licenses in the region, we expect Iraq will be no different.

The contribution of Iraq in Wataniya's FY 2006 performance is given below. **If we exclude the contribution of Iraq from Wataniya's consolidated results for the year 2006, the implied valuation multiples of the deal increases steeply. This makes winning a permanent license in Iraq a critical requirement for the success of this deal.** Having said that, beyond a certain threshold, paying a huge value for license may become counter productive in the long term.

Qtel - Wataniya Deal : Impact of Iraqi License		
Based on FY 2006 results	Including Iraq	Excluding Iraq
Revenue (US\$ mn)	1,470	1,107
EBITDA (US\$ mn)	661	450
Net Profit (US\$ mn)	252	183
Price/Sales	5.0	6.6
EV/EBITDA	11.8	17.4
Price/Earnings	28.9	39.8
EV/Subscriber (US\$/Sub)		
Based on Total Subscriber base	784	1,080
Based on Proportionate Subscriber base	1,325	1,627

Source: SICO Research, Company Reports

○ **Algeria Operations still to break even**

The second concern for Wataniya is their Algerian operation which is yet to break even. The company was able to acquire only a minor market share (approx 12% as of Sep 2006) in Algeria though it has been operating for almost three years. We believe that this may be one area where QTel can bring value to Wataniya's shareholders (considering its track record in rapidly building inroads into market share in its Oman operations Nawras, which started generating positive returns much faster than expected).

Comparison of Qatar Telecom and Wataniya's performance

- As a result of the deal, QTel will emerge as a regional telecom player with a footprint in nine countries across the region. QTel also has recently extended its operation to the Far East (Singapore and Indonesia) by acquiring 25% stake in Asia Mobile Holdings (AMH). QTel's total mobile subscriber base will grow by almost 7.5 times from the current 1.5 mn to about 11.5 mn. Based on its 2006 results, the revenues of the combined entity will more than double.
- However the challenge remains on the margin and ARPU front. QTel has been enjoying high ARPU levels (US\$ 960 per annum in FY 2006) and margin levels (EBITDA margin of 60% and Net Income margin of 38%) because of its strong domestic market. We will see dilutions on both these fronts as ARPU and net margins of Wataniya are much lower (EBITDA margin of 45% and Net Income margin of 17%) compared to QTel.

Comparison - Operations of QTel and Wataniya (FY 2006)			
	Wataniya	QTel	Combined**
Number of Operating Countries	7*	4	11
Total Subscriber base (mn)	10.0	1.5	11.5
Proportionate Subscriber base (mn)	5.9	1.2	7.7
Revenue (US\$ mn)	1,470	1,214	2,684
EBITDA (US\$ mn)	661	729	1,390
% Margin	45%	60%	52%
Net Profit (US\$ mn)	252	467	606
% Margin	17%	38%	23%
Average ARPU (tot sub base) US\$/month	18	83	28
Mcap (as on 28 Feb 2007)	4,913	6,931	
Enterprise Value	5,455	6,720	
EV/EBITDA	8.3	9.2	
Price/Earnings	19.5	14.8	

Note: *Includes Saudi and Palestine also, ** based on FY 2006 results

Analysis of Financing of the deal and Impact on QTel

QTel has stated that it intends to fund the acquisition using a combination of existing cash and debt facilities. **According to our estimates, QTel will require about US\$ 3 bn in new debt (at least) to finance the deal** as the combined cash available with QTel and Wataniya was US\$ 582 mn as of end Dec 2006. QTel had subsequently announced the acquisition of a 25% stake in Asia Mobile Holdings (AMH) for a consideration of US\$ 635 mn (due to which cash balances would have fallen further).

Analysis of Financing of the Deal

(Proforma - Based on Financial results for the year ended FY 2006)

all in US\$ mn		Scenario 1	Scenario 2	Scenario 3
Wataniya's net profit	252			
QTel's share of profit (51% stake)	129			
Net profit of Algeria & Iraq Operations	114			
QTel's additional share of profit (9% stake)	10			
Total incremental net profit for QTel	139			
QTel's net profit	467			
Total net profit for QTel after deal	606			
Total book value of assets after deal	5,768			
Market Cap of QTel (as on 04 March 07)	6,514			
Total debt of Wataniya (as of Dec 2006)	736			
Total debt of QTel (as of Dec 2006)	178			
Total cash available (as of Dec 2006)	582			
Additional debt to be raised		2,000	3,000	3,800
Total net debt after raising new debt		2,332	3,332	4,132
Incremental interest expense (@ 6.1%)		122	183	232
as a % of Incremental Net Profit from deal		88%	132%	167%
Debt/Total Assets (%)	16%	51%	68%	82%
Debt/Equity (Market Value)	14%	45%	60%	72%

Note: This analysis excludes the US\$ 635 mn required by QTel to buy AMH stake, Wataniya's commitment of US\$ 142 mn for the Palestinian mobile license and the cost of Iraq mobile license when it happens

Note: This analysis is based on Wataniya's and QTel's results for the year ended Dec 2006.

This analysis is provided for reference as actual consolidation will happen only after completion (Q2 07) of deal

Source: SICO Research, Company Reports

We have done a performa analysis of new debt on QTel's bottom line after considering QTel's share of profit from Wataniya and its operations in Algeria and Iraq. We have assumed an interest rate of 6.1% for the new debt which was the effective interest rate of QTel's existing debt during the year ended Dec 2006.

Taking scenario 2 as the base case, additional debt of US\$ 3 bn will increase QTel's leverage (Debt to MV of equity) from the current 14% to 60%. We feel that this higher leverage may lead to higher interest rates for QTel. For every 100 basis points change in interest rates QTel's interest expense will move by US\$ 30 mn (about 22% of the incremental net profit from the deal considering FY 2006 results).

Impact on bottom line of Qtel after considering financing (Proforma)			
All in US\$ mn	Scenario 1	Scenario 2	Scenario 3
Net profit of Qtel	467		
Incremental Net Profit for Qtel	139		
Total profit after the deal	606		
Incremental interest expense (for details see above)	122	183	232
Qtel's profit after inc. interest expense	484	423	374
% Change from current profit of Qtel	4%	-9%	-20%
% Increase required in Wataniya's profit to generate incremental return		32%	67%

Note: This analysis is based on Wataniya's and QTel's results for the year ended Dec 2006.

This analysis is provided for reference as actual consolidation will happen only after completion (Q2 07) of deal

Source: SICO Research, Company Reports

Under Scenario 2 (the base case) the incremental net profit contribution from the deal would not be sufficient to meet the incremental interest expenses. If we consider 2006 results for comparison purpose QTel's net profit would have declined by 9% as an impact of the deal. Put another way, QTel's share of profit from Wataniya has to increase by 32% (assuming full year impact of incremental interest costs) at least to meet the incremental interest expense arising out of the deal. In our view, this will be challenging task for QTel considering that **Wataniya already has made commitment of US\$ 142 mn for the Palestine mobile license**. In addition, they will have to raise additional funds to secure a permanent mobile license in Iraq. The other option will be to leverage Wataniya further – which might be a stretch given that Wataniya already has US\$ 736 mn as debt (30% total assets as on Dec 2006).

Analysis of UGB's deal

United Gulf Bank (a listed 71% subsidiary of KIPCO) also sold its direct 9% stake each in Wataniya's operations in Algeria and Iraq to QTel for a consideration of US\$ 100 mn and in addition its stake of 3.56 mn shares in Wataniya for \$57 mn. Our analysis shows that the two operations of Wataniya had combined revenue of US\$ 618 mn, EBITDA of US\$ 263 mn, Net Profit of US\$ 114 mn and a subscriber base of 5.73 mn during the year ended Dec 2006.

Comparison of KIPCO and UGB Deals		
	Kipco Deal	UGB Deal
Value of Deal (US\$ mn)	3,620	100
Stake sold	51%	9%
Implied Value of Asset (US\$ mn)	7,098	1,111
Subscribers (mn)	10.0	5.7
Revenue (US\$ mn)	1,470	618
EBITDA (US\$ mn)	661	263
Net Profit (US\$ mn)	252	114
Price/Sales	4.8	1.8
Price/EBITDA	10.7	4.2
Price/Earnings	28.2	9.8

Note: Year ended 2006

Source: SICO Research, Company reports

The US\$ 100 mn deal for 9% stake values these two operations at US\$ 1.11 bn implying valuation multiples of Price/Sales of 1.8, Price/EBITDA of 4.2 and Price to Earnings of 9.76 compared to implied multiples of Price/Sales of 4.8, Price/EBITDA of 10.74 and Price to Earnings of 28.16 that QTel paid for KIPCO's stake in Wataniya. The implied valuation multiples in the above UGB deal are at a considerable discount to those in the KIPCO deal. We feel that at these multiples, UGB deal would have easily become an attractive target for companies who are looking for acquiring interests in the telecommunications sector in the region (given the recent deals in the region).

We expect that the pricing of these deals reflect a possible sweetener to the overall deal. Though UGB made a profit of US\$ 50 mn from this deal, we question whether the sale could have fetched a higher consideration given the increasing demand for telecom assets in the region.

Concerns about minority shareholders of Wataniya

We believe this deal raises a key issue with regards to the rights and interests of minority shareholders. The majority stakeholders in Wataniya (a consortium led by KIPCO) exited their investments at KD 4.6 per share, a steep premium of 48% over its closing price of KD 3.1 on 28 Feb 2007 (or an even steeper 87% premium to the 6 month average). This leaves the balance 49% minority shareholders of Wataniya at a disadvantage as they have no means to offer their shares at this price. In the absence of the above, the only benefit of this deal to the minority shareholder of Wataniya was the spike in the company's share price and the ensuing volatility, and the possibility that the new management will generate shareholder wealth in the longer run.

We believe this deal is symbolic of challenges that regulators in this region will face with an inevitable rise in the expected levels of M&A activity in the region. We are of the opinion that going forward such M&A transactions should require an acquirer to make at the very least a proportionate tender offer to the minority shareholders (at the same price as paid to the seller) - as it the established practice in developed markets. (See *Appendix 1 for brief description of such mechanisms in other markets*).

Regulators should look at structures that are already in place in both developed and other emerging markets and address these concerns proactively.

We hope this transaction would stir a wider discussion about this issue and help put in place regulations that help protect minority stake holders.

APPENDIX -1

Applicable Takeover Clauses for Minority Shareholders in Various Countries	
Country	Applicable Clauses
European Union Directive (to be adopted by all member countries)	An Acquirer who has acquired control of a company has to make an offer to all the holders of that company's securities for all of their holdings at an equitable price. The equitable price shall be the highest price paid for the same securities by the offeror
Hong Kong	When a person acquires 30% or more of the voting rights of a company; or (currently holding not less than 30% but more than 50% of the voting rights of the company) acquires more than 2% of the voting rights of a company within a 12 month period, a general offer must be made to all other shareholders of the company at the highest price paid by the offeror
USA	The Best Price Rule requires bidders to pay any security holder the highest consideration paid to any other security holder in the tender offer.
India	Any person acquiring 15% or more of the voting capital in a public listed company should make a public offer to acquire a minimum 20% stake from the public.

Source: SICO Research, various documents

Note: The above information is indicative in nature and should not be construed comprehensive or definitive.

NOTES

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