**August 16, 2007**

**Sector**
Telecom

**CMP**
RO 1.189

**Face Value**
100 Baizas

**Equity Capital**
RO 75MN

**Market cap**
RO 892MN

**52 Week H/L**
1.750/1.043

**Bloomberg**
OTEL OM

**MSM Index**
6730

# Oman Telecommunications Co. — Accumulate

**Healthy Q2FY07 numbers** Omantel reported 6% yoy growth in service revenues to RO73.7mn for Q2FY07. The H1 service revenue of RO145.6mn is 48% of our full year estimate. Mobile revenues that ranged between RO56-58mn for the last five quarters grew strongly in Q2FY07. The Q2FY07 gross mobile revenues were at RO64.4mn up 13% yoy and 11% qoq. EBITDA grew 4% yoy for the quarter to RO45mn. A three-fold increase in net interconnection income aided total revenues that grew 13%. Profit was 13% higher at RO24.4mn. The H1 profit is 54% of our full year estimate of RO89.8.

**Net positive interconnection** charges are buoying the profit numbers for Omantel. Local interconnection income has grown faster than interconnection expense due to traffic from Nawras to Omantel due to latter's larger base. Likewise the external administration income is growing faster than expense due to higher incoming international traffic especially from the Indian subcontinent.

**ARPU's have been range bound** Average revenue per user for Oman Mobile has averaged RO15.7/month over the last six quarters ranging between RO15.9 to RO15.5. As of June 2007 on four quarter rolling basis the mobile ARPU was RO15.5/month. Blended ARPU was flat at RO15.7/month. The blended ARPUs in general have trended lower due to competition led tariff reductions in mobile business and strong growth in low usage pre paid fixed line *Sahl* that accounts for 15% of the wireline base (42,300 lines).

**Capex** The Company incurred a capex of RO57mn (20% of net revenues) in FY06. It incurred a capex of RO17.4mn for H1FY07. We expect it to scale up towards the RO50mn mark as the year progresses. With the number of mobile subscribers at 2.1mn and shrinking incremental subscriber pie the core capex is expected to plateau over the next periods. However implementation of 3G network over the next couple of years could again push up the intermediate capex.

**Stock offers value** So far we have been underweight on the stock given the modest growth prospects. Now, we opine that the stock needs a relook in the context of strong cash generation, which augurs well for dividend payouts and increasing penetration, which augur well for ARPU. Our DCF value for Omantel (under the highly conservative assumptions of zero terminal growth and zero gearing) work out to RO1.40/share, 18% higher than the current price. However, the possibility that Omantel's monopoly could end in international gateway, if TRA liberalizes the sector further, is a big risk going forward. This is especially so since this is the most profitable business for Omantel currently.

**Key Data**

| RO '000 | 2004 | 2005 | 2006 | 2007E |
|---|---|---|---|---|
| Revenues | 247,386 | 270,587 | 323,632 | 352,039 |
| EBITDA | 125,337 | 133,620 | 160,929 | 176,504 |
| PAT | 72,800 | 67,762 | 80,696 | 89,484 |
| EBIT% | 32.7% | 31.7% | 33.6% | 33.0% |
| EBITDA% | 50.7% | 49.4% | 49.7% | 50.1% |
| PAT% | 29.4% | 25.0% | 24.9% | 25.4% |
| ROE% | 50.3% | 39.6% | 41.9% | 40.5% |
| ROCE% | 38.4% | 34.0% | 38.1% | 39.5% |
| Debt Equity (X) | 0.33 | 0.58 | 0.29 | 0.05 |
| EPS (RO) | 0.097 | 0.090 | 0.108 | 0.119 |
| PE (x) | -- | 18.6 | 11.1 | 10.0 |
| BV (RO) | 0.188 | 0.209 | 0.246 | 0.284 |
| P/B | -- | 8.0 | 4.8 | 4.2 |
| EV/EBITDA | -- | 9.7 | 5.5 | 4.6 |

| Price change | OTEL | MSM30 |
|---|---|---|
| 1 month return | 1.4% | 5.1% |
| 3 month return | 4.1% | 12.9% |
| 1 Year return | -26.8% | 14.5% |

| Shareholders | Stake |
|---|---|
| Govt. of Oman | 70% |

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**Industry status** The Omani mobile market has crossed the 2.1mn mobile subscriber mark, which is close to 78% penetration on total population. A word of caution would be that, there might be dual sim card users, which may overstate the penetration levels. However, given the theoretical addressable market of 70-75% of population based on age profile even a 15-20% knock off from the current subscriber base implies a high penetration on the addressable market.

We feel the industry is maturing and Omantel has shifted focus to market share preservation from market share expansion. This is aptly reflected in its subscriber evolution. Oman Mobile that controls 63% of the mobile base captured 34% of industry's subscriber additions for the quarter. Nawras grew strongly in Q2 adding close to 116,000 subscribers.

**Competition will evolve into co-operation** We expect Nawras to continue to capture a lion's share of subscribers going forward. As a result we assume market shares between Nawras and Omantel to settle in the 45:55 ratio by 2011. We believe having achieved a critical mass with 787k subscribers, which should grow to 1mn by 2008 end; competition will evolve into co-operation with both players focusing on extracting value from the users rather than inducing customer churn.

**ARPU not at risk** OTL's wireline and wireless ARPU in 2007 is 30% and 20% lower respectively compared to 2004. The downward trend in ARPU has been characterized by competitive and customer behavior at two specific junctures. Oman's telecom industry went through the first stage of tariff rationalization wherein tariff changes were induced by competition.

In the second stage, once the penetration levels increased rapidly, attempt is being made to tap into the lower income population where marginal ARPU is lower. We have maintained that with regards to latter; the low population density in Oman may not justify the trade off between low ARPUs and subscriber additions. Going forward, we see this behavior in the forefront of companies' strategy formulation implying controlled ARPU decline for the industry as a whole. In addition the launch of 3G network could actually give a leg up to ARPU or atleast moderate the decline to a large extent. In sum, we don't see ARPU as a risk factor for the industry.

**Management is becoming proactive** After Yemen; WorldCall Pakistan, which offers WLL, long distance telephony and broadband services, is the company's serious attempt to diversify out of domestic market. OTL is looking at a 65% stake in the company. World Call is a $70mn revenue company or less than 10% of Omantel's revenues. The purpose of this update is not to analyse the impact of this foray as we await details of the transaction, which is still not finalized. In addition, OTL has also qualified for bidding for a second mobile license in Qatar in association with Belgium Telecom.

**Valuation** Our DCF analysis based on a WACC of 10.5%, puts the value per share at RO1.40/share 18% higher than the current price. Our estimates are highly conservative given a no terminal growth and zero gearing assumption. A 1% terminal growth and 20% gearing assumption results in value per share of RO1.65/share or 40% higher than the current price.

**Defensive stock** At 10x FY07E earnings and 4.6x EV/EBITDA, decent dividend yield and modest valuations, risk reward ratio is favorable. It paid out 65% of its profits in FY06, given the strong cash generation we feel this can only move higher. An 80% payout, possible given the cash generation, gives an 8% dividend yield. Long-term investors can accumulate the stock at current levels.

**DCF Output**

| RO MN | | CY2008 | CY2009 | CY2010 | CY2011 | CY2012 | CY2013 |
|---|---|---|---|---|---|---|---|
| Total subs | | 2.44 | 2.54 | 2.64 | 2.75 | 2.87 | 2.98 |
| % Penetration | | 88% | 89% | 90% | 91% | 92% | 93% |
| Nawras subs | | 952 | 1025 | 1104 | 1179 | 1252 | 1325 |
| Omantel subs | | 1428 | 1455 | 1480 | 1513 | 1552 | 1595 |
| Nawras share | | 39% | 40% | 42% | 43% | 44% | 44% |
| Omantel share | | 61% | 60% | 58% | 57% | 56% | 56% |
| **Total net revenues** | | **314.7** | **324.2** | **326.4** | **327.0** | **330.6** | **335.9** |
| Fixed | | 58.3 | 53.4 | 49.7 | 46.3 | 44.5 | 42.9 |
| Data | | 25.8 | 29.9 | 34.6 | 39.2 | 42.4 | 46.1 |
| Mobile | | 220.3 | 230.9 | 232.1 | 231.6 | 233.7 | 236.9 |
| **Subscribers** | | **1,746** | **1,796** | **1,829** | **1,860** | **1,894** | **1,938** |
| Fixed | | 264 | 259 | 254 | 249 | 244 | 241 |
| Data | | 99 | 108 | 119 | 131 | 138 | 145 |
| Mobile | | 1383 | 1428 | 1455 | 1480 | 1513 | 1552 |
| **ARPU** | | **15.0** | **15.3** | **15.0** | **14.8** | **14.7** | **14.6** |
| Fixed | | 17.9 | 17.0 | 16.2 | 15.3 | 15.0 | 14.7 |
| Data | | 13.0 | 13.4 | 13.6 | 13.9 | 13.6 | 13.4 |
| Mobile | | 14.0 | 13.7 | 13.4 | 13.1 | 13.0 | 12.9 |
| Post tax EBITDA | | 163.7 | 163.7 | 163.6 | 165.2 | 167.7 | 170.9 |
| Capex | | 58.4 | 65.3 | 65.4 | 59.5 | 53.7 | 54.6 |
| WC changes | | 2.2 | -0.2 | -0.6 | 0.0 | 0.5 | 1.0 |
| FCFF | | 103 | 99 | 99 | 106 | 113 | 115 |
| Discounted Cash Flows | | 93 | 81 | 73 | 71 | 69 | 63 |
| WACC | **10.5%** | | | | | | |
| PVs of Cash Flows | 450 | | | | **WACC** | | |
| PV Of Terminal Cash Flows | 603 | **TG** | **8.5%** | **9.5%** | **10.5%** | **11.5%** | **12.0%** |
| Enterprise Value | **1,053** | **0%** | 1.75 | 1.56 | 1.40 | 1.28 | 1.22 |
| Net Debt | 0 | **1%** | 1.91 | 1.68 | 1.50 | 1.35 | 1.29 |
| Value of Equity | **1,053** | **2%** | 2.12 | 1.83 | 1.61 | 1.44 | 1.37 |
| Value per share | **1.40** | **3%** | 2.40 | 2.03 | 1.76 | 1.55 | 1.47 |

**Few wild cards still remain**

**International Gateway** We see the liberalisation of international gateway as a major risk for Omantel and our derived value per share. International gateway accounts for a quarter of company's revenues bulk of which flows down to the bottomline. It is also the main reason for profitable wireline operations. Current mobile license terms in Oman do not permit mobile players to operate own international gateway. However it would be a key factor that can bring interest into fixed line segment if TRA decides to push the wireline liberalisation aggressively. Such a scenario could offer the second mobile player an option thus jeopardizing Omantel's interconnection revenue. Alternatively even Nawras could be allowed to operate a gateway eventually. In a different scenario, at present Omantel retains 80% (reduced from 85%) of the tariff for international traffic that originates from Nawras. An aggressive reduction can further reduce this segment revenue for OTL.

**Value capture would need triggers** The stock offers value at current price, but there are few factors that could prevent the value capture for the stock. Firstly, lack of event in terms of a presence outside Oman rather than current financial performance is bearing on the stock price. Secondly better valuation v/s growth equation of regional peers have also prevented investor interest.

**Entry of second fixed line operator** The Telecom Law provides for an entry of a second player in the fixed line business. Though it is too early to comment on this event, we feel that the Omani fixed line market given its topography and mobile to fixed ratio already at 8:1 may not be attractive per say for a new entrant purely for its local traffic exposure.

**Execution** The skills in managing multi region exposure have been untested and would have to be closely watched if any of its regional initiatives are successful.

## Regrouped quarterly numbers

| RO '000 | Q2FY05 | Q3FY05 | Q4FY05 | Q1FY06 | Q2FY06 | Q3FY06 | Q4FY06 | Q1FY07 | Q2FY07 |
|---|---|---|---|---|---|---|---|---|---|
| Service revenues | 61,736 | 60,920 | 65,165 | 69,007 | 69,456 | 69,726 | 70,311 | 71,860 | 73,777 |
| Ext admin revenue | 3,118 | 3,660 | 3,525 | 3,714 | 4,044 | 4,798 | 5,348 | 5,700 | 6,802 |
| Interconnection rev | 2,298 | 2,169 | 4,418 | 4,629 | 5,466 | 6,715 | 7,235 | 8,146 | 9,633 |
| Sale of capacity | 0 | 0 | 0 | 616 | 647 | 824 | 1,096 | 0 | 0 |
| **Total revenues** | **67,152** | **66,749** | **73,108** | **77,966** | **79,613** | **82,063** | **83,990** | **85,706** | **90,212** |
| Controllable# | 10,873 | 10,793 | 13,513 | 11,460 | 10,087 | 11,588 | 11,794 | 10,671 | 11,574 |
| % to revenues | 16.2% | 16.2% | 18.5% | 14.7% | 12.7% | 14.1% | 14.0% | 12.5% | 12.8% |
| Uncontrollable# | 20,957 | 23,421 | 23,140 | 25,791 | 26,334 | 30,209 | 30,425 | 29,695 | 33,541 |
| % to revenues | 31.2% | 35.1% | 31.7% | 33.1% | 33.1% | 36.8% | 36.2% | 34.6% | 37.2% |
| EBITDA | 35,322 | 32,535 | 36,455 | 40,715 | 43,192 | 40,266 | 41,771 | 45,340 | 45,097 |
| % to revenues | 52.6% | 48.7% | 49.9% | 52.2% | 54.3% | 49.1% | 49.7% | 52.9% | 50.0% |
| Interest | 1,129 | -650 | -1,097 | -715 | -1,147 | -242 | 111 | 480 | 538 |
| Depreciation | 13,275 | 15,684 | 14,152 | 13,954 | 14,739 | 17,958 | 20,690 | 15,681 | 15,797 |
| Operational profit | 23,176 | 16,201 | 21,206 | 26,046 | 27,306 | 22,066 | 21,192 | 30,139 | 29,838 |
| Other income | -257 | 298 | 790 | 234 | 138 | 204 | -52 | 125 | 228 |
| PBT | 22,919 | 16,499 | 21,996 | 26,280 | 27,444 | 22,270 | 21,140 | 30,264 | 30,066 |
| Provisions* | 1,426 | 1,426 | 1,426 | 1,254 | 1,254 | 1,254 | 1,254 | 2,201 | 2,201 |
| Less penalty provision | 426 | 426 | 426 | 0 | 0 | 0 | 0 | 0 | 0 |
| Tax | 1,225 | 3,339 | 2,539 | 2,987 | 2,918 | 2,678 | 2,428 | 3,670 | 3,544 |
| Less Minority int. | 190 | 49 | 93 | 120 | 113 | 89 | 90 | 104 | 136 |
| PAT | 19,653 | 11,260 | 17,513 | 21,919 | 23,159 | 18,249 | 17,368 | 24,290 | 24,186 |
| Reported PAT | 19,613 | 12,425 | 16,205 | 21,294 | 21,641 | 17,690 | 20,071 | 24,032 | 24,443 |

# Uncontrollable costs largely track traffic and subscriber growth. Controllable costs include staff, admin and mktg expenses. * Amortisation costs are controllable in terms of their timing. The total yearly provision cost has been evenly allocated over 4 quarters to smoothen the numbers.

## Reported quarterly numbers

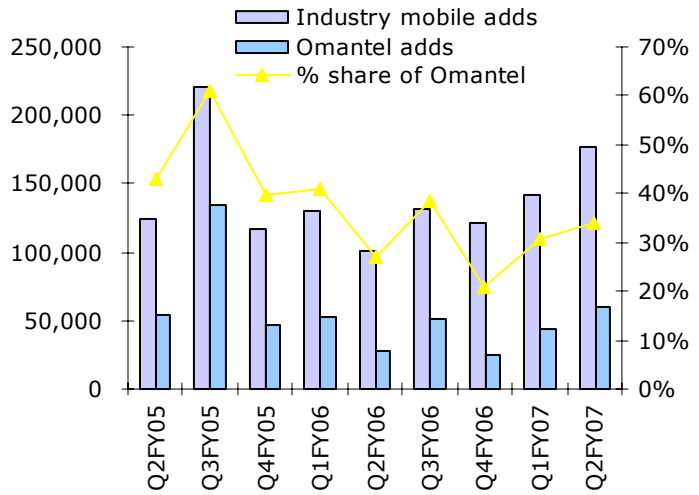
| | Q2FY05 | Q3FY05 | Q4FY05 | Q1FY06 | Q2FY06 | Q3FY06 | Q4FY06 | Q1FY07 | Q2FY07 | % chg qoq | % chg yoy |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Service revenue | 61,736 | 60,920 | 65,165 | 69,007 | 69456 | 69,726 | 70,311 | 71,860 | 73,777 | 3% | 6% |
| External admin. revenue | 3,118 | 3,660 | 3,525 | 3714 | 4044 | 4,798 | 5,348 | 5,700 | 6,802 | 19% | 68% |
| Interconnection income | 2,298 | 2,169 | 4,418 | 4629 | 5466 | 6,715 | 7,235 | 8,146 | 9,633 | 18% | 76% |
| Sale of capacity | 0 | 0 | 0 | 616 | 647 | 824 | 1,096 | 0 | 0 | | |
| **Total revenue** | **67,152** | **66,749** | **73,108** | **77,966** | **79,613** | **82,063** | **83,990** | **85,706** | **90,212** | **5%** | **13%** |
| | | | | | | | | | | | |
| Total expenses | 31,830 | 34,214 | 36,653 | 37,251 | 36,421 | 41,797 | 42,219 | 40,366 | 45,115 | 12% | 24% |
| EBITDA | 35,322 | 32,535 | 36,455 | 40,715 | 43,192 | 40,266 | 41,771 | 45,340 | 45,097 | -1% | 4% |
| EBITDA % | 52.6% | 48.7% | 49.9% | 52.2% | 54.3% | 49.1% | 49.7% | 52.9% | 50.0% | | |
| D & A | 13,275 | 15,684 | 14,152 | 13,954 | 14,739 | 17,958 | 20,690 | 15,681 | 15,797 | 1% | 7% |
| Finance income - net | 1,129 | -650 | -1,097 | -715 | -1147 | -242 | 111 | 480 | 538 | 12% | -147% |
| Op. profit | 23,176 | 16,201 | 21,206 | 26,046 | 27,306 | 22,066 | 21,192 | 30,139 | 29,838 | -1% | 9% |
| Provision for receivables | 1,891 | 686 | 3,159 | 1,879 | 2,772 | 1,813 | (1,449) | 2458 | 1943 | -21% | -30% |
| Other income | -357 | 255 | 756 | 213 | 19 | 292 | 0 | 89 | 167 | 88% | 779% |
| Share of asso. Profit | 100 | 43 | 34 | 21 | 119 | -88 | -52 | 36 | 61 | 69% | -49% |
| | | | | | | | | | | | |
| Profit before taxation | 21,028 | 15,813 | 18,837 | 24,401 | 24,672 | 20,457 | 22,589 | 27,806 | 28,123 | 1% | 14% |
| Taxation | 1,225 | 3,339 | 2,539 | 2,987 | 2,918 | 2,678 | 2,428 | 3670 | 3544 | -3% | 21% |
| Less Minority int. | 190 | 49 | 93 | 120 | 113 | 89 | 90 | 104 | 136 | 31% | 20% |
| Profit for the period | 19,613 | 12,425 | 16,205 | 21,294 | 21,641 | 17,690 | 20,071 | 24,032 | 24,443 | 2% | 13% |

## Mobile sector data

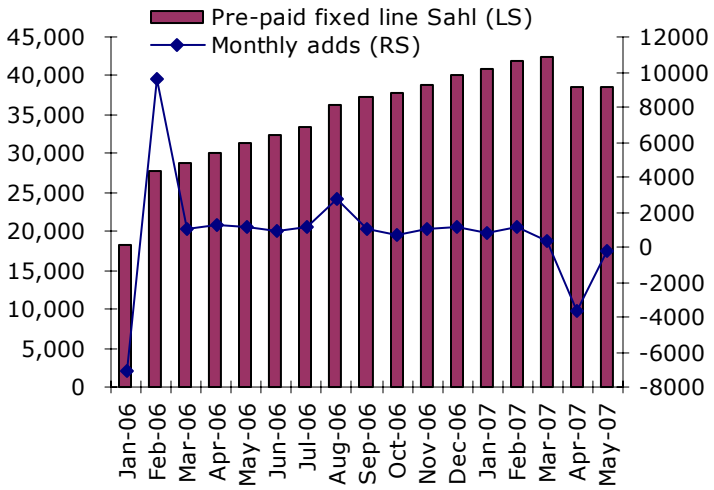
| Revenues RO '000 | Q1FY06 | Q2FY06 | Q3FY06 | Q4FY06 | Q1FY07 | Q2FY07 |
|---|---|---|---|---|---|---|
| Oman Mobile Revenue | 55,925 | 56,893 | 56,772 | 58,493 | 58,083 | 64,419 |
| Nawras Revenue | 9,481 | 11,095 | 13,440 | 15,658 | 17,981 | 21,260 |
| Total | 65,406 | 67,988 | 70,212 | 74,151 | 76,064 | 85,679 |
| Nawras' % revenue share | 14.5% | 16.3% | 19.1% | 21.1% | 23.6% | 24.8% |
| Nawras' % subscriber share | 21.9% | 25.2% | 28.0% | 31.5% | 34.2% | 36.8% |
| Total mobile subscribers | 1,462,642 | 1,563,893 | 1,696,053 | 1,818,024 | 1,960,053 | 2,137,000 |
| Industry adds | 129,417 | 101,251 | 132,160 | 121,971 | 142,029 | 176,947 |
| Omantel adds | 53,135 | 27,453 | 51,040 | 25,171 | 42,976 | 61,000 |
| Nawras adds | 76,282 | 73,798 | 81,120 | 96,800 | 99,053 | 115,947 |
| Nawras Base | 320,282 | 394,080 | 475,200 | 572,000 | 671,053 | 787,000 |
| OM Base | 1,142,360 | 1,169,813 | 1,220,853 | 1,246,024 | 1,289,000 | 1,350,000 |

Source: TRA, Qatar Telecom

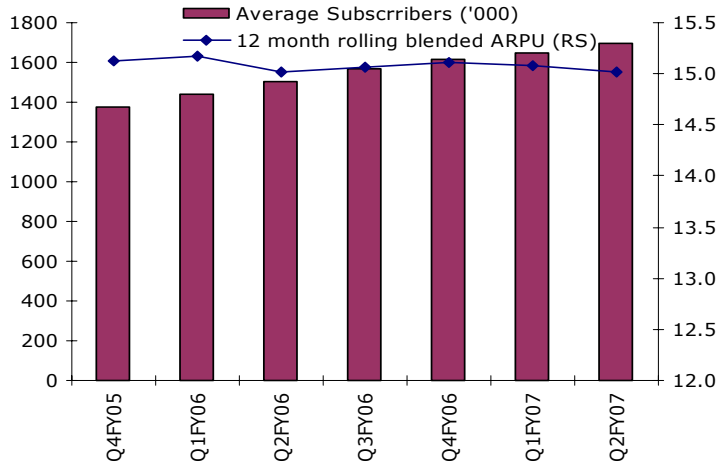
Mobile additions and share of Oman Mobile

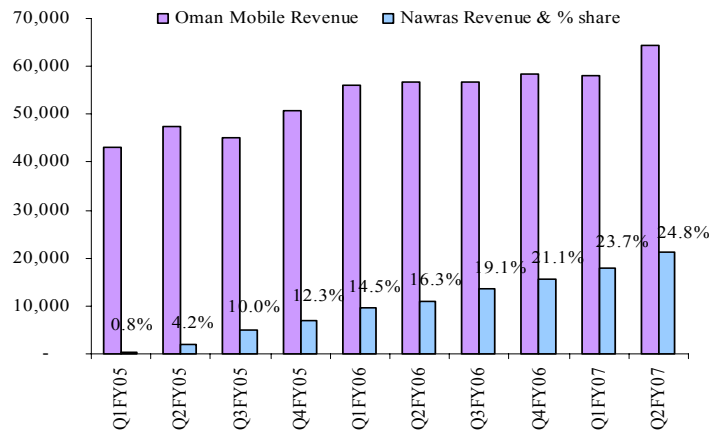



Prepaid fixed line 'Sahl' is 15% of fixed lines

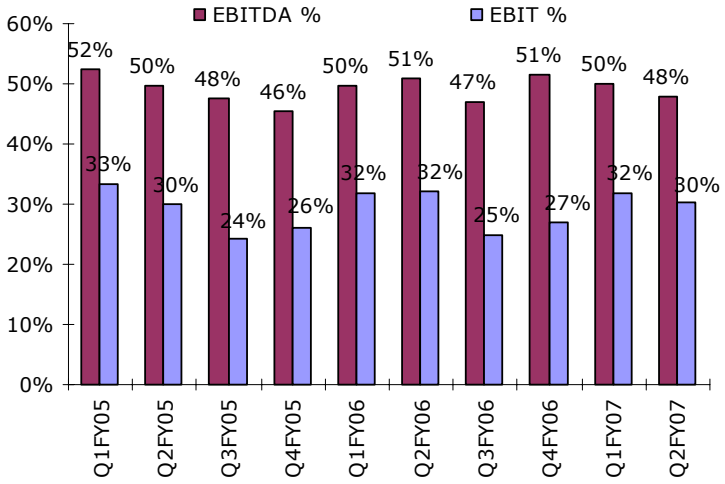



ARPUs plateauing (RO/month calculated on service revenues only)

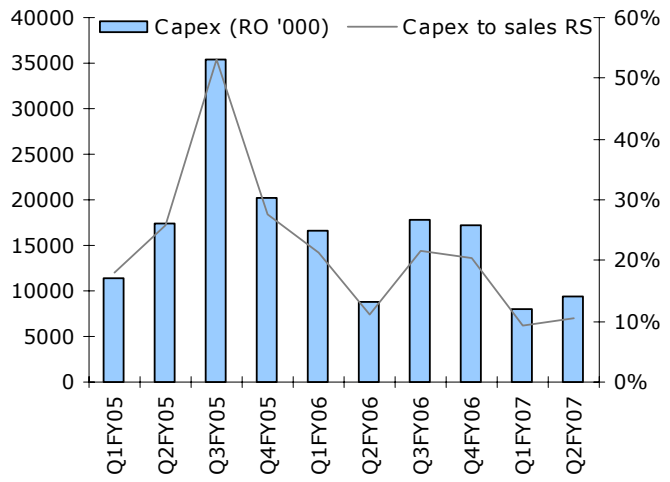



EBITDA margins are expected to stay in the 50% range.




Capex will accelerate closer to RO50mn.




Figs in RO '000

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