

15 August, 2011



## Telecom Egypt announces Q2 2011 Results

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### Presenters

Mr. Akil Beshir, Chairman

Mr. Mohamed Elnawawy, Senior Vice President & CSO

Mr. Hassan Helmy, Senior Vice President & CFO

Mr. Mahmoud Abu Taleb, Director of Investment & Investor Relations

Mr. Mohamed Kamal, General Manager of Investor Relations

### **Kunal Bajaj**

Yes, hi. Good morning and good afternoon everybody. This is Kunal Bajaj from HSBC. I'd like to welcome you all to Telecom Egypt's H1 2011 Results Conference Call.

From Telecom Egypt we have with us Akil Beshir, Chairman; Mohamed Elnawawy, Senior Vice President and Chief Strategy Officer; Hassan Helmy, Senior Vice President and Chief Financial Officer; Mahmoud Abu Taleb, Director of Investment and Investor Relations; and Mohamed Kamal, General Manager of Investor Relations and Internal Reporting.

As usual, the conference call will begin with a discussion of the key highlights of the period followed by a brief Q&A session.

I'll now hand over the call back to Mohamed Kamal for the Safe Harbor Statement. Thank you very much.

### **Mohamed Kamal**

Thank you, Kunal, for the introduction and for hosting the conference call.

Good morning and good afternoon everyone.

As a standard rule of corporate governance of Telecom Egypt, I'll first start by reading a Safe Harbor Statement.

We may make some forward-looking statements in the course of this conference call. These statements will be based on information available to us as of today and you should, therefore, not assume that in the future that we continue to hold these views. We do not commit to notify you if our views change. We refer to our public filings for some factors that may cause forward-looking statements to differ from actual future events or results.

So that was the statement. Now with the call, I will now pass you over to the Mr. Akil Beshir, Chairman of Telecom Egypt.

**Akil Beshir**

Thank you, Mohamed. Ladies and gentlemen, thank you all for joining our call today to discuss Telecom Egypt's Second Quarter 2011 Financial Results.

When we spoke to you last quarter, the events of the revolution in Egypt was fresh in our minds. The impact of these unprecedented events was felt throughout Egyptian businesses during the first three months of the year and as you know, TE was not exempted from this.

However, during the period since we last spoke to you, we have started to see the very early signs of a return to normality in Egypt. Most businesses have started to reopen and recommence trading. Furthermore, since mid-June, the curfew, which the government put in place for security reasons, has been lifted.

While we are witnessing the early signs of recovery, there is still much to be done to restore Egypt's economy. Two reasons in particular, which has a large impact remains at low level since January's events.

As you can see from today's results, TE's evolved business model has given us the resilience needed to navigate uncertain times and ultimately stabilize our business and defend our margin. I'm immensely proud of what the team has achieved and feel confident that we are well positioned for the future.

I will now pass over to Mohamed Elnawawy to give you an operational overview of TE over the past quarter.

**Mohamed Elnaway** Thank you, Mr. Beshir.

As Mr. Beshir said we continue to operate in extenuating and unprecedented circumstances. But what does this mean for Telecom Egypt?

Operationally, we have been working hard during the past three months to protect our business and stabilize our operations. Our network is one of TE's greatest assets and we are committed to ensuring we continue to deliver the highest quality of telecommunications possible. For residential enterprise and wholesale customers alike.

We have reviewed the impact of any damage and repaired it; however, an ongoing challenge has been the continued theft of our copper cable. We reported the cost of this to the market a couple of months ago, but unfortunately, it remains a recurring issue. Hassan, our CFO, will give you more on this later.

While our network is absolutely critical to TE, customers lie at the heart of our business and in a modern day, in Egypt telecommunication is fundamental to each and every one of them.

You may remember that during the first quarter, we took decisive action in the interest of public safety and security, by opening up 1.4 million subscriber lines, which had previously been suspended. In addition, we extended the payment terms for existing, active subscribers - providing them with a longer grace period for the settlement of outstanding invoices. These two actions ensured that our customers, whether active or historic, would depend on a fixed line service for their own safety.

The net effect of these free reconnections has yet fully to be worked through our subscriber base and there appears to be some confusion as to the current customer base, which I would like to clear up. What I can say is that, as security has been restored in Egypt during the second quarter. We have disconnected 1.2 million of these lines. More than 150,000 customers from this group have returned to active status.

We have reinstated our pre-revolution credit policy as a result of non-payment of January and April invoices, which have placed around two million subscribers on incoming calls only until settlement is made. For some time now, we have also offered new customers a zero-connection fee offer. Take up has contributed additional new subscribers to our network; leaving our total subscriber base as at end of June at 9 million. This means that the net effect of these actions was a minor reduction of only 300,000 subscribers. Not the 700,000 that was inaccurately reported recently in the media.

I believe that these are the right actions, which reduce our exposure to unprofitable subscribers.

Retail revenues for the second quarter were broadly in line with those seen in the first quarter of 2011 albeit with a slight decline in voice revenues.

Our broadband service, via TE Data, continues to go from strength to strength. Its subscriber base now stands at over one million ADSL subscribers, for the first time, giving it a market share of 63.4% versus 61.4% one year ago.

Many have referred to events earlier in the year as the facebook revolution and we feel confident that the combination of a young population and increasing thirst for broadband and data services will ensure a growing market for our services. In fact, broadband penetration in Egypt remains relatively low but it is growing fast - at an average rate of about 37% each year.

Additionally, internet mobile subscribers are also growing at the trend as we see greater convergence of our technology.

Throughout the last quarter, our wholesale business unit demonstrates the resilience as mobile traffic over our modern network, plus usage by other ISPs ensured that demand for capacity remained high. While some items, such as mobile to fixed traffic declined, we are beginning to see an overall pick up in our transmission business as the result of the continued growth in the mobile market. Mobile penetration rates are high: according to the Egyptian Ministry of Communications and Information Technology, there are now estimated to

be more than 70 million mobile subscribers in Egypt, which has a population of just less than 80 million people.

This is an important point for Telecom Egypt, as mobile substitution has had some impact on retail revenues; we have seen a significant increase in our wholesale business due to mobile usage of our state-of-the-art network.

At the end of last year, TE signed bilateral agreements with several other international carriers, securing greater incoming international revenues. At the same time, we have continued to work closely with the National Telecommunications Regulatory Authority to combat illegal international traffic.

You also had seen last week's press release, the launch of the first wet part of TE North, the 3600 km submarine cable reaching from Abu Talat in Egypt to Marseille in France, with the potential of further extensions across the Mediterranean.

TE-NORTH is the first Mediterranean cable network to provide commercial service using the 40G technology in the Mediterranean. It has the capacity of over 20 Terabits per second, equivalent to the transfer of over 32,000 high-definition movies in 60 seconds. The expanded design capacity enabled TE to meet the growing demand of our customers and the region.

The completion of this wet build is a major project milestone and, importantly, enabled Telecom Egypt to record revenue for TE-NORTH for the first time in our Q2 2011 results.

Finally, you have seen recently that the mobile market in Egypt has come under pressure in light of the difficult social and economic conditions. Despite this, our investment in Vodafone continues to yield value for Telecom Egypt contributing Egyptian pounds for 152 million directly to our bottom-line during first half of 2011.

Hassan will now take you through our financial performance in more detail.

Over to you Hassan.

**Hassan Helmy**

Thank you Mohamed.

As discussed, the impact of the Egyptian revolution makes comparability for Q2 2011 with Q2 2010 less enlightening than it would normally be.

Based on this, I will now talk through the key financial highlights for the quarter, but drawing comparisons with the first quarter - this should give you a sense of TE's performance in the current environment.

Total operating revenues for TE during Q2 2011 were 2.6 billion Egyptian pounds versus 2.4 billion Egyptian pounds during the first quarter of the year. Allow me to break this figure a little bit further.

Total retail revenues were 1.2 billion Egyptian pounds for the quarter versus 1.3 for the first quarter of 2011.

- Within this total access revenue were 399 million Egyptian pound for the first quarter versus 420 million pound during the first quarter. This represent a slowdown in the decline observed in the first three months of the year and would indicate that, as a result of TE's discounted promotion activities new connections are coming back.
- Total voice revenue for the quarter, were 435 million Egyptian pounds versus 473 million pound in the first quarter. There are three main points I would like to make on the retail of voice revenue.
- There has been a decline in local call revenues, partially as a result of a smaller subscriber base but also partly connected to some 750,000 customer having experience period of no service as a result of section of copper cable being stolen. In most cases the disruption of service was ten days and we are compensating customer for this disruption.
- On long distance calls we have historically been hindered by regulatory constraints, which have meant that we could not compete with the mobile operator on price. In Q2 2011, this has once again, depressed revenue from long distance. However, from July 1<sup>st</sup>, we have been able

to reduce the long distance tariff to the level of a local call and enable this capability across all phone lines. This means that the potential subscriber based on long distance call has gone from 1 million to almost 9 million at today's count. These additional potential customers are able to make long distance call via their fixed line connection and are incentivized to do so because of the low costs.

- Finally fixed to international call increased 6 % during the quarter approximately 87% of this segment is comprised of business usage so the increase is encouraging and signaling the beginning of the return to business as normal.
- Finally, internet and data revenue dropped versus Q1 where we saw surge in activity related to the revolution. The second quarter result has still been higher than Q2 2010 reflecting TE Data's larger market share and a growing market.

Our wholesale revenue, accounted for 54% of total revenue during the quarter arriving at 1.4 billion Egyptian pounds versus 1.1 billion Egyptian pound in the first quarter.

- Here the Domestic wholesale revenue, which related primarily to mobile and ISP transmission service were flat versus the same period last year but decreased slightly versus Q1 2011.
- As for international wholesale, we saw a substantial increase in revenue to reach 1.1 billion Egyptian pound versus 811 million Egyptian pound in Q1 2011. This segment was boosted by 257 million Egyptian pound of revenue recognized from our cable business and the increase in mobile to international call revenue.

TE's cost of goods increased 35% during the second quarter versus Q1 2011. This is primarily attributable to three factors.

- Firstly the increase in the repair and maintenance costs as a result of the theft of the copper cable to date the cost of replacement and repairs

stands at 85 million Egyptian pounds. This compares with just EGP 30 million over the course of the full year 2010. However this does not yet take account of any additional security that is required in the short-term. We will continue to provide updates on this issue throughout the year.

- Secondly, the cost of the cable business and booking of revenue associated with the project as you would expect we must also book the cost.
- Thirdly, you may recall us mentioning the last quarter the 15% increase in salary, which had a ceiling of 500 Egyptian pounds and a floor of 200 Egyptian pounds which came into effect from March 1<sup>st</sup> 2011. This has been implemented but the net effect had been dampened by the natural turnover of employees. Each year we experience an average of 1200 people who reach a retirement age. This is in addition to the success of our early retirement program, which has been taken up by almost 3000 employees in the second half of 2010.

Moving on to SG&A. Costs have decreased by 9% to 312 million Egyptian pounds, as a result of reversal of an accrual of 96 million Egyptian pound relating to a state supreme council's ruling on duties previously directed to a government social scheme.

Consolidated EBITDA for the period was 1.3 billion Egyptian pounds - a decline of 2.5% - primarily as a result of our increased costs during the quarter. That said EBITDA margin remains in the high 40s at 48% and I believe it's a great achievement in such an operating environment.

Income from investment in Vodafone was 233 million Egyptian pounds versus 219 million Egyptian pounds for Q1 2011, reflecting 6.4% growth in Vodafone Egypt's net profit in the first three months period in 2011.

Vodafone continued to advance its strategy of market leadership with very strong customer additions during the first three months of its financial year.

As at June 30th 2011 closing customers stood at more than 34 million subscribers. This represents new net additions of more than 1.8 million during

the first three months of the year. Total voice minutes also increased by 21% on the period ended March 31st 2011 exceeding 18 billion minutes by the end of June.

For Vodafone Egypt generated revenue of 3 billion Egyptian pounds in the three month period ending June 30 2011. A 5% increase on the previous quarter. This is in spite of a lower than average tourist level and an overall contraction in business usage of roaming and international calls. The impact of the Egyptian revolution does, however, show sign of subsiding and in spite of the increase of corporate income tax, Vodafone Egypt net profit for the period reach 518 million Egyptian pounds compared with 487 million pound for the three months ended March 31st, 2010.

So what does this mean to our bottom-line? TE consolidated net profit was 826 billion Egyptian pounds representing a net profit margin of 32%. This has been achieved in spite of the increase of corporate income tax from 20% to 25% which was announced in July 2011 but applied retroactively as of January 1st, 2011. And places us ahead of our peers in Egypt and the wider MENA region.

Capital expenditure for the second quarter of 2011 was 205 million Egyptian pounds.

Finally our cash position remains healthy at 3.2 billion Egyptian pounds.

Before opening to Q&A, I would like to add a final note on revenue. We spoke to you last quarter about our intention to change the way we report and model our revenue around our customer focus business units. While it's still our intention to do so, our immediate focus has been on restoring our business and demonstrating the stability. Therefore, we will not take you through this today, but will propose to do so in the following quarter.

This concludes our Operational and Financial Review for the second quarter. Operator, please open the line for questions.

**Christian Kern**

Thank you; it's Christian Kern from J.P. Morgan. I would like to touch on a

couple of revenue related items in terms of the latest trend on international calling revenues, potentially an update on the roaming on the mobile side, incoming roaming, and also in terms of the data load on your mobile network.

If you could comment on that and any respective CAPEX requirements going forward I would much appreciate it? Thanks.

**Mohamed Elnawawy**

So with respect to the roaming, obviously since the events in January, there is a consistent decline in the amount of visitors we're getting.

So while the inbound roaming has faced tremendous challenges due to the situation; however, we think that this is a very recoverable situation as more safety and more business as usual is - status is restored back.

On the amount of data that our network is carrying, you have to remember that Telecom Egypt provides the infrastructure that connects the mobile networks together, and this infrastructure is very abundant, and it's very large, and is capable of carrying tremendous network - tremendous traffic capability.

The fair question especially that now mobile use is - it goes beyond just voice and much of this use now data related and the need for more infrastructure is very evident.

I think this was also reflected in the fact that our pickup of transmission services and the share of the domestic wholesale in our pie has been growing significantly.

**Christian Kern**

And then

**Mohamed Elnawawy**

With respect to CAPEX we have recorded a modest 200 million Egyptian pounds for the previous quarter and looking forward we spend CAPEX on three things.

First of all the maintenance CAPEX, second previously we used to spend on our submarine cable which has now been fulfilled and perhaps some of this would be rechanneled to our access network to improving our access network and growing our access network because we have a continuously large

demand for broadband that is out there. And the third would be for our - the maintenance of our infrastructure and transmission network.

So we are continuing to spend along these lines. I believe that this is also in line with our suggestions for the previous quarter.

**Christian Kern**

Thank you for your time. Thank you.

**Madhvendra Singh**

Yes. Hi. My first question is on the data revenues. Despite the strong net additions on the area subscribers, still the revenues have declined quarter on quarter. Is there any particular reason for that? Can you please explain?

And second question is on the treatment of the new taxes regime in Egypt. I'm not - can you please explain what you have done? Have you applied the 25% rate retrospectively or what has exactly happened there? Thank you.

**Hassan Helmy**

Okay. On the data revenue, you're right. We had a strong net customer addition during Q2, however, this come at a cost because this was associated with a promotion that TE launched to subscribe for one month and get one month free.

So although that we have a decline quarter on quarter but year on year we have a 19.1% growth in data revenue.

On taxes; yes. The tax rate or the announcement of the increase in the income tax rate came in July with the government approving its budget for its fiscal year which runs from first of July to 30<sup>th</sup> of June.

However it's implemented or it's applicable on financially year that starting from first of January; accordingly, we calculated or restated our figure for Q1 to reflect the 5% increase in tax.

**Madhvendra Singh**

Okay so this quarter.

**Hassan Helmy**

Does this answer your question?

**Madhvendra Singh**

Yes, so basically second quarter 2011 taxes are calculated at 25% rate?

**Hassan Helmy**

Correct.

**Madhvendra Singh** Okay. And on data revenues, sorry. Just to follow question, is the promotion still running or it is over now?

**Hassan Helmy** No it was for a limited period.

**Madhvendra Singh** Okay. Thank you.

**Hassan Helmy** Thank you.

**Martin Mabbutt** Oh yes, hello. It's Martin Mabbutt - Nomura. Two questions please.

The first I wanted if you could just run over what you said at the beginning of the call about lines in service. I wasn't sure I caught all various movements in the ultimate 300,000 decline that you reported.

And secondly, I wondered whether on the capacity sale side, you could update us on what your thoughts were for the full year.

I think you talked about 700 million Egyptian pounds of sales for 2011 before.

Thanks.

**Mohamed Elnaway** Thank you. So the number of phone lines that were reconnected earlier this year was 1.4 million. Out of these 1.4 million, 1.2 million got disconnected because of non-payment.

So we kept on our system about 200,000 customers that were restored back into service.

Now if you couple this with the number - total number of disconnecting customers, this gives us a net effect of a minor reduction of only 300,000 subscribers.

And not 700,000 subscribers as some media has announced previously. Does this answer your question?

**Martin Mabbutt** Yes. That's fine. Thank you. And on the capacity sales?

**Mohamed Elnaway** Capacity sales on the submarine cable side?

**Martin Mabbutt** Yes. I was just a bit - you previously talked about, I think, a number of around 700 million for the full year is a likely number. Is that still a number you're happy to guide towards?

**Mohamed Elnawawy** Yes. We are confident that we are moving in this direction and very well.

**Martin Mabbutt** Okay, thank you.

**Sally Gerges** Hi. This is Sally Gerges from Beltone Financial. I just have a question regarding the submarine cables again.

I know you booked 257 million Egyptian pounds in revenues in the second quarter. Would this be, you know, would this be a sustainable second quarter or as the previous question said, would you actually, I mean, the 700 million would look attainable if you did that?

So is this a really sustainable or we're going to see some, you know, we're going to see different levels in the coming quarters?

And I also wanted to ask regarding what type of sales was booked in relation to these revenues in the second quarter, specifically?

And I also had another question on the Vodafone Egypt. What exactly was the impact of the new tax regime in Egypt on Vodafone Egypt's net profit? Thank you.

**Mohamed Elnawawy** So, regarding TE-NORTH, just take you quickly back to the guidance that was given the market in 2008 we launched this project which that we expect of total revenue of 500 million dollars over a ten year period - 500 to 600 million dollars over a ten-year period.

Now we have booked so far last year and this year, some revenues related to TE-NORTH and we are confident that this year we're going to meet or exceed the guidance that we've given the market of around 700 million pounds for the whole year.

Moving forward, yes, capacity sales are going to enjoy a different business model that will allow to have a better return.

Perhaps in the near future we'll be giving specific update for the 2008 Guidance, but there is no more information that I can give you about this right now.

**Hassan Helmy** On the increase in tax in Vodafone, it's about 90 million pounds.

**Sally Gerges** Okay, thanks.

**Hassan Helmy** Thank you.

**Delilah Heakal** Yes. Thank you for the call. Just a brief question. Can you please repeat how much the accrual reversal in SG&A was during Q2?

And also if you could remind us the total submarine cable revenues for the whole first half of 2011 versus the first half of 2010?

Thank you.

**Hassan Helmy** Okay the figure for the accrual reversal is 96 million Egyptian pounds.

**Delilah Heakal** Okay. Thank you.

**Hassan Helmy** On the sale. The figure for the sale within the submarine cable or infrastructure sale during Q2 it's 257 million.

And there are some associated revenue relating to operation and maintenance. alright?

**Delilah Heakal** Okay. What about for Q1 2011 was the figure 24 million in submarine cable revenues?

**Hassan Helmy** How much did you have?

**Delila Heakal** For the first for Q1 2011 I think it was in the range of 24 million Egyptian pounds.

**Hassan Helmy** That's correct.

**Delilah Heakal** That's correct. Okay. Thank you. Thank you very much.

**Hassan Helmy** Thank you.

**Madhvendra Singh** Just follow a question on the taxes. Can you please breakdown the tax amount in how much the impact was on the deferred taxes and how much was on the current taxes? Just because of the...

**Hassan Helmy** Okay.

**Madhvendra Singh** Just because of the change in the rates calculates the future tax liabilities.

**Hassan Helmy** On the income tax, the charge is almost 41 million. And on the reassessment of the deferred tax benefit it is about 47 million Egyptian pounds.

**Madhvendra Singh** Is it positive or negative impact on the future?

**Hassan Helmy** After year 2000 it was negative. It's a net increase of about 34 million pounds. This is if you compare 2011 H1 revenues with 2010 H1.

**Madhvendra Singh** So, even though you have deferred tax assets on your balance sheet but you actually had an increase in the deferred tax in the income tax. Is that correct?

**Hassan Helmy** Yes we have deferred tax assets unlike other operator who had different tax liabilities. So these assets we will have to be reassessed as well to reflect the 5% increase in the tax rate.

**Madhvendra Singh** So, I'm confused here. The 47 million, which you said, is it a positive impact or a negative impact on the profit? The reported profit?

**Hassan Helmy** The net it's 34 million pounds and there is a note to the financial statements it's note 20 that shows the tax and the deferred tax before and after the amendments.

**Hassan Helmy** Positive.

**Madhvendra Singh** Okay. All right. Thanks.

**Hassan Helmy** All right. Thank you.

**Akil Beshir** Thank you, Operator. I'd like to leave you with two thoughts.

First the results we have presented to you today while not largely comparable with our performance last year, it shows positive signs of improvement in Egypt.

TE has suffered some effects from the disruptions but we have managed to stabilize our business promptly, defend our margins, and continue to return a profit.

Many of our competitors do not have the same free cash flow position, revenue diversity, and strong balance sheet, and have consequently been harder hit.

Our business model has shown itself to be resilient. Telecom Egypt has always been a market leader and it will continue to strive to be one of Egypt's best performing companies.

Ladies and gentlemen this concludes our call of today. Thank you very much for your time and for participating. And of course, if you have any further questions following today's results, I encourage you to contact our investor relations team who will be happy to assist you.

Thank you very much everybody.