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Telecom Egypt Announces 9M 2010 Results

Presenters

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Marise Ananian Good morning and good afternoon, everyone. This is Marise Ananian from EFG Hermes.

I would like to welcome you all to Telecom Egypt's nine months 2010 results conference call. From Telecom Egypt, we have with us Mr. Tarek Tantawy, Chief Executive Officer and Managing Director, Hassan Helmy, Chief Financial Officer and Vice President, Mahmoud Abu Taleb, Director of Investment and Investor Relations, and Mohamed Kamal, General Manager of Investor Relations.

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 the call back to Mohamed Kamal for the Safe Harbor statement. Thank you very much.

Mohamed Kamal Thank you, Marise 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 will first start by reading a short Safe Harbor statement. We may make some forward-looking statements in the course of this conference call. These will be based on information available to us as of today and you should therefore not assume 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.

That was the statement. I will now pass you over to Tarek Tantawy, the Chief Executive Officer and Managing Director of Telecom Egypt.

Tarek Tantawy

Thank you, Mohamed, and welcome all to our nine months results call for 2010. As always, we will spend a short while discussing the market and our operational and financial performance before moving on to answers and questions. 2010 has seen a high level of competition in the Egyptian telecommunications market and we have had to take actions accordingly. During the year, most operators in the Egyptian market have felt their margins contract in the race for growth, while ours remained mostly intact and in line with management's expectations. Year-to-date, in 2010 TE has continued to demonstrate its ability to deliver sustained profitability and creating economic value for our shareholders. Our results today show a very healthy 6% increase year-on-year in net profit, equaling EGP 2.7 billion for nine months or EGP 1.6 per share basis. This translates to our nine months net margin of 35%.

When compared to the second quarter of 2010, net profit shows a quarter-on-quarter decline. And I would like to take a moment to elaborate on what is happening here. Income from investments is the largest component of this decline, but I would like to stress that operationally the contribution from Vodafone Egypt has in fact been in line with historic periods. You will recall that the second quarter of 2010 was an exceptional period because of our one-off reclassification relating to employee share in profit at Vodafone Egypt, which flattened the second quarter results and therefore distorts the quarterly comparison.

In addition, Vodafone Egypt has also incurred some one-off items this quarter, primarily relating to FX losses. Additionally, during the third quarter of 2010, we have

seen some increases in costs, primarily relating to employee costs, maintenance, and promotional activities when compared to the second quarter of the year.

Our 8% annual salary increase has been applied in July and there have been some additional increases in benefits applied to the third quarter, which will also be the case in the fourth quarter of this year. These costs have been carefully considered and our margins remain protected and at the top end of management expectations.

The model is working, but our business is not without challenges. We can never be complacent about our position and must continue to innovate across services and bundled plans. Within our traditional business, our objective has been to mitigate some of the effects coming from mobile competition on our retail business and claw back traffic through a combination of competitive pricing, quality, and service. We have taken the fight to the mobile operators by countering their aggressive pricing strategies with our own inventive and considered promotions. These promotions are already bearing fruits, but have been somewhat dampened by the timing of Ramadan this year, which coincided with the summer holiday period and has had some impact on core revenues.

Overall, though, year-on-year quarterly revenues have improved by almost 2%. Wholesale revenues accounted for EGP 1.2 billion of our total services revenue for the third quarter. You can see that we are benefiting both from the growth in mobile and Internet Service Providers' usage at home as well as the delivery of our cable projects, for which revenues are now being recognized.

Hassan will elaborate on the remaining revenue breakdown a little more in just a moment. As you know, one element of our strategy centers on newer market-leading technologies with attractive growth profiles.

Our 100% owned subsidiary TE Data, already a market leader, is a great example of this. TE Data has continued to increase its market share, which now stands at 62%. Its quarterly revenue performance has been dampened by promotion strategies, but these have in turn delivered a record quarter in subscriber acquisitions. The Demand for high-quality broadband access continues to grow and we have been able to secure 78,000 new customers this quarter alone against an average quarterly acquisition of

50,000 when taken across 2008 and 2009.

Our longstanding investment in Vodafone Egypt is another example of our investment strategy at work. We continue to reap both financial and strategic rewards from the relationship. Total income from Telecom Egypt's investment for the third quarter was dominated by income from Vodafone Egypt, which contributed EGP 292 million to net profit. I've already explained that this is broadly in line with the historic quarters and that the comparison with the second quarter is distorted by the reclassification, which took effect in the previous period.

Vodafone Egypt has continued to gain market share over the course of the year in spite of the competitive mobile market in Egypt. It has grown its customer base by a third in the past year to reach nearly 29 million customers as at 30th of September 2010. Total voice minutes increased by 53% year-on-year and extensive promotions in the quarter meant that year-to-date Vodafone Egypt's net customer addition increased by 4 million.

Finally, our cable build has been progressing well since the start of the year. We've captured revenue contribution from these initiatives over the last nine months. Another portion of revenue will be recognized in the final quarter and the rest will fall in 2011 as the projects are completed. From this, you can see that this venture is highly profitable and will continue to diversify our revenue streams further.

With that, Hassan, I'll now hand over to you.

Hassan Helmy

Thank you, Tarek, and thank you all for joining today's call. Before I start, I would like to draw your attention to a change in the presentation of our accounts. This relates to a partial aggregation line within our income statements. The EAS income statement has been changed to be in line with the presentation of the IFRS financial statements. Basically this means that there is simply an aggregation of the line items in the EAS income statements to a shorter presentation. And all details or the line items can be found in the notes to the financial statements. Also, impairment loss on financial assets is now classified as a finance cost in line with the requirement of IFRS.

Our revenue breakdown continues to reflect the evolving competitive landscape in Egypt combined with TE's commercial focus. As a result, TE's retail and the wholesale business now contribute 52% and 48% of total revenues, respectively. Revenues generated from our cable business covered by tariff are recognized under the wholesale component.

I'm going to focus my commentary on what happened this quarter rather than the nine months period. Retail revenue for the quarter was EGP 1.3 billion, a decline of 5% when compared with Q2 in 2010. The positive improvement of our promotional activities has been somewhat dampened by the impact of Ramadan falling almost entirely in August this year unlike previous year. By coinciding with the traditional holiday months this meant that the volume from long distance and the international calls were not as high in volume as previous years.

During the quarter, access revenue was effectively flat to the second quarter, reaching EGP 452 million as a result of the continuation of our pre-installation promotion. The net effect of this, however, has been a return to stability in TE's subscriber base, which currently stands at 9.4 million. Internet and data sales were again strong during the three months period, due primarily to a strong performance from TE Data.

Total wholesale revenue reached EGP 1.2 billion during the quarter showing an impressive 21% rise year-on-year. The increase was largely attributable to growth in international wholesale, particularly from the contribution of TE's cable projects, which amounts to EGP 113 million.

Cost of goods sold have shown some increases, as Tarek mentioned, as a result of our promotional strategies, maintenance costs, and an increase in employees cost. Total COGS increased 1.6% in Q2 2010. We do foresee some additional increase in cost in the fourth quarter, in particular relating to the success of our early retirement program, which will over time have a positive impact on our ability to bring down head count.

Consolidated EBITDA for the third quarter was 1.2 billion translating to an EBITDA margin of 48%, in line with management's expectation. You will note here that I'm using a single consolidated EBITDA before provision. This will be our single point of

reference for EBITDA going forward. Changes in our foreign currency position and movement of the U.S. dollar have also had a minor impact on the net result during the quarter.

Consolidated net profit for the quarter was EGP 766 million. The impact of Ramadan on retail revenue from telephony and access, lower income from investment, higher quarterly cost and a minor negative impact of foreign exchange have caused quarterly decline in net profit of 21%. Even with such items, we are still producing quarterly net profit margin of 30%, which in today's market is an excellent achievement.

As you know, we continue to exercise prudence in our approach to cash management and in maintaining a solid balance sheet. As a result, as at September 30th, we had a net cash position of EGP 3.3 billion, the highest net cash position in our history.

Finally, I would like to talk about our capital expenditure program. Our state-of-the-art infrastructure is critical in our ability to continue delivering the high quality of service to our customer. Capital expenditure during the nine months period ending September 30th was EGP 740 million. We will be revising year-end Capex guidance down to between EGP 1 to EGP 1.2 billion.

The point to note here is that we are not necessarily simply deploying less cash, but we have worked hard to become a better negotiator and are securing better terms from suppliers who are keen in the current market environment to incentivize long-term customers. Already savings of more than EGP 119 million have been achieved.

I will now hand back to Tarek Tantawy to continue today's call.

Tarek Tantawy

Thank you, Hassan. Our business and ours alone has the capacity and network to work with every single telecommunications provider in Egypt, supporting the mobile operators as they service dynamic growth, leading the field in better, faster broadband, and building new cable routes to connect different geographies, and enable the fast transfer of data. And continuing to provide the reliable and high-quality fixed line service for which we have become known.

This positions us uniquely to provide customers with a mix of telecommunication

services, which they now require in turn offering greater resilience and opportunity to our own business performance. TE is in excellent shape financially and operationally. Despite the challenges of a dynamic telecommunications landscape, we continue to prove ourselves extremely capable of constantly anticipating and responding to the market. We are managing the business for the long term.

Thank you. That concludes my comments. Operator, please open the line to questions.

Delilah Heakal

Yes, good afternoon, and thank you for the call. I'm just having a little bit of trouble reconciling the EBITDA that's reported in your earnings release presentation to the income statement. I was wondering, in the EBITDA in the earnings release do you still book impairment losses above the EBITDA line?

Hassan Helmy

Okay. Delilah, thank you for the question. It became quite easy to calculate the EBITDA. I will tell you the formula based on the income statement. You will take revenue, deduct operating expense, deduct selling and distributions, deduct admin expense, and then add back depreciation and amortization, you will arrive at the EBITDA figure. And that would be the EBITDA before provision. If you want the EBITDA after the provision, within the finance cost there is a line item called impairment losses on financial assets that will be it.

Delilah Heakal

Okay. So the one that you are reporting is before the impairment losses then for the period?

Hassan Helmy

Correct, correct.

Delilah Heakal

Okay. Okay, thank you very much.

Christian Kern

Hi there, it's Christian Kern from JPMorgan. I was just wondering if you can give us an update on the regulatory environment as well as on your strategic positioning with regards to potentially acquiring a majority in your mobile business or even venturing out into other markets. Thank you

Tarek Tantawy

Well, first in terms of the regulatory environment, there hasn't been much development; I think the situation can be described as more of a stable situation.

In terms of our ambitions to become a total communications provider, we still have the ambition. We continue to explore options and I think by Q1 of the coming year, the picture will become somewhat clearer than it is today, but the ambition is obviously still there.

Having said that, we strongly believe in our home market and I wouldn't just describe it as a home market, which adds every nine months almost 1.5 million human inhabitants. So we believe there is plenty of room and plenty of growth potential for an integrated player in addition to the huge broadband opportunity that we see in that market as well.

Christian Kern Thank you, very much.

Richard Barker Well, thank you very much. Just a quick question for you about your cable business. You may have answered a part of it, but please forgive me if that's the case. But I just wondered if you could just repeat how much revenue you have booked from your various cable activities in the third quarter. And I wonder whether you could perhaps update us on what you expect to book for the full-year, i.e., has the guidance changed from the sort of 600 to 800 million revenue that I think you mentioned in the past. And third, I just wondered whether you could give us some kind of indication as to what you expect from the business looking out over the next two to three years?

Tarek Tantawy Well, on your first question, the revenues reported in the third quarter are close to almost EGP 113 million. We still believe we should be able to recognize between EGP 600 to EGP 800 million this year and the coming year as well. What was your third question?

Richard Barker I just wondered whether you could perhaps give some kind of outlook for the next two or three years as well. It sounds as though you perhaps have given that already by saying at a similar level for 2011, is that right?

Tarek Tantawy Yes, that's what we did and the guidance was given earlier is that we expect \$500 million in revenues over the lifetime of the submarine cable system, which can extend for up to 15 years, including obviously the EGP 600 to 800 million that will be

reported this year and the next year.

Richard Barker Okay. That's very clear. Thank you.

Martin Mabbutt Yes, good afternoon. It's Martin Mabbutt at Nomura. Just a point of clarification really in thinking about Q4, obviously last year Q4 was a very weak quarter both in terms of revenues and EBITDA. And I wondered in terms of this year's fourth quarter, should we be benchmarking it against last year's Q4 or more in line with the Q3 you just reported?

Tarek Tantawy I think all that I can tell you, Martin, at this point we have given guidance at the beginning of the year in relation to our expectations for revenues and EBITDA. And we think we are on track in terms of achieving subscribers.

Martin Mabbutt Okay, just to clarify, you obviously had revenues zero to - 2% I think. On EBITDA, I'm not for sure I know what you're saying. You've given margin guidance.

Tarek Tantawy It was in – the margin in the mid-40s.

Martin Mabbutt Okay, Thank you.

Tarek Tantawy You're Welcome.

Sarah Shabayek Yes, hello. I was wondering about the nature of the revenues coming from the cable business, and my second question is about amount of Forex losses impacting Vodafone's bottom line. Can you please specify that amount?

Hassan Helmy The FX losses in the quarter is about EGP 4 million, but cumulative nine months we have EGP 47 million gains.

Sarah Shabayek Okay

Hassan Helmy All right, is this of Telecom Egypt or Vodafone?

Sarah Shabayek No, I was wondering about Vodafone's Forex losses.

Tarek Tantawy Well, Vodafone, the FX losses are of larger magnitude, so we are talking approximately something worth of EGP 30 million, possibly EGP 32 million.

Sarah Shabayek Okay, great. And about the cable business?

Tarek Tantawy And your question was...?

Sarah Shabayek I was wondering what the nature of the revenues are, because there are like the wet parts and dry parts and they have different margins.

Tarek Tantawy Well, until now, if you are talking about the third quarter alone – the revenue recognized only have to do with wet part.

Sarah Shabayek Okay, so it's basically low margin revenue?

Hassan Helmy Relatively lower, yes, than the terrestrial part.

Sarah Shabayek Okay. Thank you very much.

Hassan Helmy You're welcome

Alok Nawani Good evening, everybody. Just had two quick questions. First one relates to press reports about Telecom Egypt looking into an MVNO license, where do you stand on that currently? And the second question relates to dividends, we've seen 1.3 last year. Can we expect perhaps a similar dividend in the coming year? Thank you.

Tarek Tantawy Well, thanks for your questions. First one on the MVNO, this is definitely one of the options available for us. And we keep close monitoring to what's going on the regulatory side. The regulator has basically announced that they are currently studying issuing MVNO licenses. And we're following and we expect more clarity by Q1 of the coming year. But this is definitely one option which we would be interested in pursuing.

On the dividends question, yes, I think we today reported the highest ever net cash position. We do not foresee a huge need for cash in the coming period. So we think we should be able to maintain, if not increase, the level of dividends of the previous year.

Alok Nawani Thank you very much.

Tarek Tantawy You're welcome.

Richard Barker Yes, thanks very much. A second bite at the cherry. Thank you very much for that. I just wanted to come back on your investment plans. And particularly, I think last quarter we talked a little bit in the Q&A session about broadband investment plans and the possibility that you might be looking at a substantially higher level of investment as part of a sort of national broadband plan that maybe the government was considering. I just wondered if you could maybe talk a little bit about that, Tarek, maybe update us on where that situation is and whether you have any better feel for what sort of Capex levels you are likely to see over the next two to three years?

Tarek Tantawy Well, Richard, until now, there's been nothing new announced in terms of the national plan. So we continue to invest based on our views on the market, although we are trying to put in as much investment as possible when it comes to broadband because we see the huge potential out there. So for the time being, I would not be able to comment on such a program. However, all you can consider is that it's more of an accelerated Capex spending program if it happens sometime, and I'm sure it will. However, if it does not, for any reason, we'll end up spending the same Capex, maybe over a longer period of time. Also, just keep in mind that under any of those scenarios, I wouldn't expect any capital expenditure to be at the level whereby it basically changes the story of our ability to generate sufficient cash flows to be able to return that back to our shareholders.

Richard Barker Thanks, Tarek. I just wanted to come back to the bigger picture then, if you don't mind. You seem to be saying firstly that we shouldn't be expecting a big immediate spike up in Capex in terms of broadband investment. And equally, maybe I'm putting words in your mouth, but you also seem to be saying now, I think that an MVNO on the mobile side is perhaps the most pragmatic option for you at the moment. Neither of those two decisions would put huge pressure on your balance sheet at all.

And as you rightly said, it is extremely strong at the moment. And not only that, your

annual cash flow is also extremely strong. Can you just explain to us what it is that stops you from raising dividend payout to something say towards 80% of earnings, given how strong your balance sheet is and your cash flow are?

Tarek Tantawy

Richard, that's putting lots of word in my mouth. I didn't say all of this. So again, we said that – I did not say the MVNO is the pragmatic option, I said it's one of the available options. We never said at any point in time that we cannot go with the dividend payout to 80%. I think maybe in 2008, we even reached that level. So I think we have a very solid cash position, nothing which I currently see which will prevent us from increasing the dividend payment to the level you're referring to. At the end of the day, there's, as we said, plenty of time. Sure, we're not in the business of piling cash, so obviously if there is excess cash, we will definitely return this back to our shareholders.

Richard Barker

That's great. Thank you very much, Tarek.

Tarek Tantawy

You are welcome.

Edem Lassey

Hi. I just wanted to just clarify on your cable business, because you said it's going to be US\$500 million over the life of the cable business and you're going to do EGP 600 million to EGP 800 million this year and next year for the cable business. And then you said the rest of the revenue will be spread over the remaining life of the project. Now, in previous earnings calls, management has also said that the revenues will be recognized a lot sooner than they had previously thought. So initially management said 15 years, but how much sooner are the revenues going to get – all the revenues recognized by?

Tarek Tantawy

Well, even the guidance that we've given, we're basically saying that almost – so 300 out of the 500 will be recognized in the first two years, which is this year and the coming year. So with the rest, I would expect them to be equally split among the coming ten years. What you should keep in mind as well is that the benefits from the submarine cable are not just the revenues that we can generate from selling either physical infrastructure or capacity sales, but there is an important element in it as well

as which is a reduction in our Opex because, obviously, we need international connectivity for our broadband business. And part of the submarine cable capacity will be allocated to our home market and our retail data business.

Edem Lassey Thank you

Tarek Tantawy You're welcome.

Richard Barker Thanks again. I might as well make it a full set of three, gentlemen. Thank you very much for your patience.

Tarek Tantawy Go ahead

Richard Barker Just a couple of more sort of operational questions. I noticed, there were a couple of things that did strike me about the revenue numbers. On the broadband and data side, you obviously had an extremely strong quarter in terms of net additions and subscriber growth. The revenue goes down sequentially, I just wonder if you could talk a little bit about why that is the case and what the underlying trends that you're seeing in terms of ARPU are?

And secondly, kind of related a little bit to that, the similar kind of phenomenon on the domestic wholesale side, we've seen that the domestic wholesale revenue, which I guess is primarily from the mobile operators, is also down quarter-on-quarter. Is that just seasonality, or is there anything more to that?

Tarek Tantawy Okay. Well, first on the Internet-related revenues, yes, we definitely had a very strong quarter when it comes to subscriber additions, but at the same time, it was a very busy quarter in terms of the promotional activities which took place. So just to give you a feel for what sort of promotions were happening, we've had an offer whereby you would subscribe for one month and get another for free. There was another promotion in which you would subscribe for three months and then get two months for free. So obviously, this would have a short-term impact on the revenues, but over the long term, we believe that once we get the customer – the customer segment increases significantly and we generate revenues over the longer term. So that was the main

reason for Internet revenues not growing at the similar rate to subscriber acquisitions. So, Richard, what was your second question?

Richard Barker A similar kind of trend is on the domestic wholesale line as well, similar kind of theme, looks like it dipped down sequentially over the third quarter. I wonder if that was mainly down to seasonality affecting the mobile guys, or is there anything else you could say about that?

Tarek Tantawy That you referred to domestic wholesale.

Richard Barker Yes, that's right.

Tarek Tantawy Well. No, there is no seasonality impact. So I cannot say that there is some sort of a long-term trend. Here it's more of – in some of the cases, the mobile operator would ask for certain connectivity for a certain period of time, and they just simply cancel it later on because they wouldn't need it any more. So you should expect some variability quarter-on-quarter, but I do not see some sort of drop or a permanent drop in the level of domestic wholesale revenues.

Richard Barker Okay. That's not the question I really asked. I suppose I was asking whether there is any sort of significant re-pricing of any of your wholesale services to the mobile operators.

Tarek Tantawy No, the most recent change in pricing was at the time we signed the long-term commitment with Vodafone. And that was explained before as basically, its long-term commitment from their side in return for volume discounts. Since then – and that was in the last year, nothing happened. Obviously, Mobinil has a similar offer on the table.

If they elect to take it, then that can have some impact as well. But when you look at it from a longer-term perspective, we think the potential business generated from both mobile operators would by far outweigh the short-term negative implications, if you will.

Richard Barker Okay. Thanks very much.

Martin Mabbutt Yeah, thank you. I also want to just re-ask my guidance question in a different way, if I could. Obviously, so far this year, you've got an EBITDA margin of, I think, 51.2%. So I just wanted to ask, what is it that causes such a low margin in Q4? And I think that's true for the last few years, you've had a very low margin. What is it that creates that situation?

Hassan Helmy Are we talking of Q4 '09?

Martin Mabbutt For Q4 '09 and for the Q4 '10. Obviously, to get to a mid 40s margin, even if you exceed it.

Hassan Helmy Okay

Martin Mabbutt You're already at 51%

Hassan Helmy Right. For Q4 '09, if you recall from our conference call, there were some one-off items. This affected the bottom line in Q4 '09. For this year, as we highlighted in our discussion that we expect some increases in our cost, the salary increase which came in effect as of July 1st. This will continue in the fourth quarter. Plus, we highlighted that that impact of the early retirement program which we enhanced during the year and it applies from the 1st of July to December 31st. So we are going to have some cost there. But this, again, will bring fruit in the following year from our ability to bring the head count down.

Tarek Tantawy But just to be clear, Martin, we are not saying that there is no possibility whatsoever that wouldn't be making higher margins than our guidance. I think, yes, it's possible. But we don't think today we're in a position to update the guidance for the entire year.

Martin Mabbutt Thank you very much, I understand.

Tarek Tantawy Thank you, Operator. Ladies and gentlemen, that concludes today's call. Thank you for your time and for participating. Should 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.