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Telecom Egypt announces Q1 2011 Results

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

Stephen Pettyfer

Good morning and good afternoon everyone, this is Stephen Pettyfer of BofA Merrill Lynch. I would like to welcome you all to Telecom Egypt's Q1 2011 results conference call. From Telecom Egypt, we have with us today 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 will now hand the call back to Mohamed Kamal for the Safe Harbour Statement. Thank you very much.

Mohamed Kamal

Thank you Stephen for the introduction and for hosting this 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 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 in the future that we continue to hold these views. We do not commit to notifying 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 and now I will pass you over to Mr. Akil Beshir, Chairman of Telecom Egypt to discuss highlights from the quarter.

Akil Beshir

Thank you, Mohamed, and welcome to all of you.

First of all, those of you who are regular participants in this call you will note my presence as host.

After the period under review, as many of you know, we announced the departure of CEO Tarek Tantawy and the appointment of TE's Chief Technology Officer Mohammed Abdel Rehim Hassanein as Interim CEO, effective from 1st of May. I offer Mohammed my congratulations and full support, and I am confident he will prove himself more than capable of responding to the opportunities and challenges for TE in the coming months.

Over the years, Tarek has been a great asset to TE and, on behalf of the board, I wish him well in all future endeavors. We are committed to ensuring continuity in our operations, our commercial offering and also to transparency in our financial market communications. Mohammed's attention will be focused on our local market in the first instance, so, during the course of the rest of the year you should expect to hear more from me on earnings calls.

Undoubtedly, the first quarter of 2011 marked a momentous occasion in the history of Egypt. Much will be written about the period; in particular, the role technology had to play in the organization of the popular and largely peaceful protests which ultimately led to a change in the political regime after thirty years.

I fully expect that you will have many questions related to the business impact of the Egyptian revolution and we will answer as many as we can. I have with

me Mohamed Elnawawy and Hassan Helmy from our executive management team. They will be taking you through the discussion of our operational and financial performance. Now I will hand you over to Mohamed Elnawawy.

Mohamed Elnawawy

Thank you Mr Beshir. There are a few related points that we would like to emphasize up front:

- As a management team we take our track record of delivery very seriously. Over the past five years, we have averaged a top line growth of 2% and a net profit margin in the range of 32%.
- The Egyptian revolution marked an unprecedented period in many respects. As an environment for commercial operations, it was a period of great uncertainty for most Egyptian companies. It is understandable that therefore the comparisons with the first or the last quarter of 2010 should be regarded as a less meaningful indicator of our long-term business progress. This is distorted further because the comparative period – the first quarter of 2010 – was immensely strong.
- During the first quarter of 2011, we also took decisive action in interests of public safety and security and opened up 1.4 million subscriber lines which had previously been suspended until the first of April 2011. Customers will be exempted from any penalties, but are obliged to pay normal subscription fees and cost of calls. Since then, more than 100 thousand of these subscribers have become active, paying subscribers once again.

From the January invoice period, we have also extended payment terms for existing, active subscribers, to provide a longer grace period for the settlement of existing invoices. With the combination of protests, unrest and the Governmental curfews, our customers were simply struggling to leave home to make a payment.

These two actions ensured that our customers, whether active or historic, could depend on a quality fixed line service. However, it is difficult to predict what movement there will therefore be in the composition of our 9.3 million active

subscriber base in the short term.

Turning back to the financial results; as I have said the extenuating circumstances of the first quarter have impacted total revenues. In particular, the voice revenues derived from business customers and the international call revenues which emanate from Egypt's normally vibrant tourism industry which declined year-on-year due to inactivity. During the revolution, business in Egypt was almost entirely suspended for between three to four weeks.

In the face of such events, the diversity of our operating model has given us a degree of resilience, with the increase of more than EGP 108 million in revenues from our domestic wholesale business and broadband internet subsidiary combined, offsetting the decline in retail voice and access segments.

TE Data was the star performer and continues to set the standards of broadband Internet access in Egypt. The Internet played an important role in the protests which led to the regime change. Equally, this period has revised what we understand about how the Egyptian population interacts with the Internet. According to most commentators estimates for internet usage in Egypt are now thought to be tripled what they were pre-revolution: moving from somewhere around 8 to 9 million users to more than 23 million users. As a result, TE Data's contribution to the overall revenues also continues to increase. Revenues from retail, Internet and data services in total increased by a third when compared with the first three months of 2010, predominantly as a result of TE Data's performance.

Turning to our wholesale business, we experienced an 11.5% - or EGP 105 million - fall in international wholesale revenues as result of two factors. Firstly, as tourism effectively closed down during the first quarter. Tourist levels are estimated to have dropped by an average of 72% in the first quarter, according to the Egyptian Center for Economic Studies (ECES). While the effect was partially offset by a year-on-year increase in domestic wholesale revenues, international wholesale is typically the largest component of TE's total wholesale revenues so this effect was not mitigated in its entirety.

Secondly, delays to government permitting in-turn caused us to have to defer revenue recognition relating to our cable business. A year-on-year comparison for international wholesale revenues is also somewhat distorted due to the recognition of EGP 158 million in revenue from our cable project during the first quarter of 2010.

As I explained on the full year results call, the revenue we derived from this business will prove more difficult for you to model as the pattern of revenue is project-based rather than strictly to a quarterly schedule.

The events of the first quarter are already in the rear view mirror. As I look to the future, I am still tremendously excited by our opportunity. The demographic profile of Egypt is still highly attractive for TE as the sole fixed line network in Egypt. Under 25s account for more than half of Egypt's total population of almost 70 million. There are one million school graduates every year and more than 300K university graduates every year. Quite simply this generation expects to be connected. Mobility and internet and data services are central to their behavior. It is hard-wired into their DNA. This youth group will be a driver of both the kind of usage levels and new services that we are already seeing reflected in our new subscriber additions and our broadband revenue growth, as well as growing mobile usage from which we also derive a commercial benefit.

We are confident the groundwork we have laid in 2009 & 2010 will be invaluable. Our strategic review led us to focus on business segments centered around our customers and we have been transitioning our business behavior to this structure. The results of the cost optimization program are tangible examples of how this internal restructuring is delivering business value. From next quarter, we intend to start to break down our financial and operational performance in accordance with these segments – retail, wholesale and international customers. The IR team will be able to help you in re-modeling the historic like-for-like analysis and I would encourage you to get in touch with them.

In conclusion: the Egyptian revolution may have impacted our top line in the

short term, but firstly these effects have been mitigated by our diverse business. Secondly, our profit margin has been upheld in spite of lower revenues and, thirdly, we continue to demonstrate an unwavering commitment to supply a reliable and quality service to our customers. We have exceeded many other operators in both aspects.

I will now hand over to Hassan Helmy to take you through the financials. Over to you, Hassan.

Hassan Helmy

Thank you Mohamed. As discussed, the combined impact of the Egyptian revolution and the strength of our first quarter result in 2010 makes comparability less enlightening than it would normally be, but I will now talk through the key financial highlights for the quarter. Please note, that today's consolidated first quarter results are yet unaudited.

Total consolidated operating revenues for the first quarter to 31 March 2011 were EGP 2.4 billion a marginal decrease versus EGP 2.5 billion during the first quarter of 2010. Allow me to break that down a little further.

Firstly, our retail revenues contributed EGP 1.3 billion during this quarter.

- Total access revenues were EGP 420 million compared with EGP 455 million during the same period in 2010. While our promotional activities started the year well attracting new connections and subscriptions, this activity dried up with the period of unrest which began in January.
- Total voice revenues were EGP 473 million. All categories were affected, with local and fixed to mobile segments being somewhat cushioned by the Government imposed curfew.
- As we mentioned on our full year results call, Internet & Broadband is becoming an increasingly large contributor to our revenues mix. In Q1 2006, it contributed EGP 56 million. In Q1 2011, the contribution has increased five folds to EGP 251 million.

Secondly, our wholesale revenues accounted for 48% of total revenues during the quarter arriving at EGP 1.1 billion.

- Within this, our domestic wholesale revenues increased 16% year-on-year, reflecting increased demand from third party operators in Egypt.
- To some extent this helped offset a decline in our international wholesale revenues which were EGP 811 million versus EGP 917 million for the same period last year. Within international wholesale, in-bound calls to Egypt actually increased year-on-year as a result of the unrest, but could not fully offset the decline in the mobile-to-international call segment, which primarily comes from the notable decline in tourism during the period.
- We had expected to recognize some revenues against the cable projects during the first three months of the year; however, delays to Government permits have prevented this. This also has impacted the international revenues total booked in this quarter.

While revenues have decreased slightly, cost of sales and SG&A have declined year-on-year. When compared with the final quarter of 2010, we have managed to reduce our costs of goods sold by 27% and SG&A by 43%. This is as a result of the cost optimization programme which we started in 2010, lower maintenance costs, plus the effects of our early retirement programme.

Looking forward to how this cost will evolve in the coming year, I would like to remind you that the 15% salary increase granted in the first quarter was only in effect for one month of this period, so its full effects are not yet shown in our costs. Secondly, our salary and employee benefits restructuring programme is currently expected to take place this year. This will be done on a phased implementation basis. As a result of this, we expect some further increases to our costs over the course of the year.

Consolidated EBITDA for Q1 2011 reached EGP 1.3 billion. While there has been some pressure on our top line during the quarter, we have defended our margins resulting in an EBITDA margin of 53.5% versus 54.5% in the first three months of 2010.

Income from Investments benefitted from an EGP 219 million contribution from our investment in Vodafone Egypt as its performance relative to peers remains highly robust and only tempered by a foreign exchange effect resulting from the volatility of the Euro during the quarter.

Vodafone Egypt continues to make exceptional operational progress in spite of the continued intense competition among mobile operators. During its full year period from March 2010 to March 2011, Vodafone Egypt has added more than 7.6 million subscribers, an increase of 34% on net additions in the previous year. The result is a closing subscriber base of 32 million subscribers compared with 25 million subscriber ended in the previous year. In spite of short term service disruption, total voice minutes topped 58 billion minutes over the twelve month, a rise of 46% on the previous year. During the first three months of 2011, approximately 15 billion voice minutes were recorded.

Vodafone Egypt generated revenues of EGP 12 billion in the twelve month period ending March 31, 2011 and net profit for the period stood at EGP 2.6 billion. The lower net profit is largely the result of increased operational expenses relative to an expanded customer base and the effect of the Forex losses I discussed earlier.

As a result, TE's Consolidated Net Profit for the period was EGP 892 million, an EPS of EGP 0.52 versus EGP 0.58 in Q1 2010. The effects of the unrest on our top line were mitigated in margin terms by the cost optimization program. However, it should also be noted that Q1 2010 was flattered by the strong contribution from our cable business of EGP 158 million, which is a high margin business, and a reversal of impairment loss amounting to LE 80 million which boosted profitability.

TE's infrastructure continues to be our greatest asset and capital expenditure programme throughout the first three months of the year totaled EGP 146 million, lower than the same period in 2010 as a result of the revolution and lower levels of maintenance.

The most important point to note on our healthy balance sheet is our robust cash position. As of 31 March 2011, TE had a net cash positive position of EGP 4.8 billion.

Finally, many of you have asked us about guidance for the year. The next few months will be undoubtedly highly fluid as Egypt carves out the foundations of its long term future. It is therefore very difficult to know exactly what this will mean in operational terms and we therefore think it will be imprudent to issue guidance for the year at this point.

With that, we would like to open the call to your questions. Operator please go ahead.

Richard Barker

Thank you very much. Just a bit of a non-specific question for you gentlemen if you wouldn't mind. I just wondered if you could maybe give us some kind of idea about whether you see any major changes to the way in which regulation is viewed in the industry in Egypt after the revolution? I suppose secondly as well whether you'd think there might be any change in the way in which the government sees the industry as a potential sources of tax revenues at a time when clearly government expenditure is going up and I guess has to be financed some way. I wonder if you think there might be some risk that maybe telecoms is seen as a bit of a goose that has laid the golden egg on that one? Thank you.

Akil Beshir

Concerning the regulatory changes we don't expect any changes. We didn't see any so far and we don't expect any regulatory changes as a result of the revolution going forward. As for your second question I didn't quite get the question. You said because of the government spending they would look at telecoms as "the goose that has laid the golden egg". Did you mean imposing taxes for example or anything like that?

Richard Barker

Precisely, yes. Exactly that.

Akil Beshir

No, we don't expect anything. Of course I'm sure you've heard or read about the Minister of Finance comment about the possibility of accelerating tax rate rather than flat tax rate of 20% of which might increase by up to 5%. This has

not yet been decided and if it is decided we don't know when it will be imposed. Of course this will be cabinet decisions and changing the tax law but there's no confirmation about it, but there have been some remarks by the Minister of Finance about it.

Richard Barker

Thank you. Can I come back to you on the first part of the question on the regulation? I guess maybe to be a bit more specific I have seen some brief headlines suggesting that maybe Mobinil is reconsidering its stance in terms of pursuing an international gateway licence and there have obviously been some comments about I think possibly from the communications minister, I forget exactly talking about whether or not a fourth licence on the mobile side would be forthcoming. I wondered if you could just update us with your views on both of those and I think specifically and particularly in terms of mobile because I think I guess before the additional uncertainty of the revolution in Egypt I think we had a certain amount of uncertainty in the form of what Telecom Egypt's strategy in mobile might take going forward and I wonder if you have anything to say on that as well?

Mohamed Elnawawy

This is Mohamed Elnawawy and I am just going to answer you very briefly with respect to Mobinil and then talk about the mobile strategy. With respect to Mobinil I agree with you that recently in the newspapers some articles came up saying that they will be getting an international licence. What I don't agree is that this is different than before. This has been going on for the last I would say couple of years. The given option for them, there is a structure for the licence in terms of a payment that they have to pay for the government. It is an option that we continue to challenge. We challenge with the quality of service and also we challenge with impeccable pricing. We believe that we present a better buy option than their build option taking into account that their building option includes a licence fee to the government. This is the comment we have with respect to Mobinil. With respect to the mobile strategy, yes, you are right, Telecom Egypt's management has decided that we aspire and we plan to become a total telecoms provider, with very vibrant, very young market that

we have in Egypt and by total telecoms that means that we would be able to offer our customers in addition to fixed data and fixed voice, we would also be able to offer them mobile data. The course that we are taking right now is to implement a cooperation scenario perhaps with Vodafone of whom we have a stake in and we are discussing using part of their network in order to launch a service where we have our own numbering, our own pricing plan and we issue our own SIMs. The reason why I am getting into these things is that management sees that there is a scenario by which we are able to use the network resources for the mobile operators while maintaining operational and strategic control over our customer relationships. This is really where we are at right now. It's still under process. There is a licensing issue which is also pending here and the discussions are developing. Yes, they were curtailed by the revolution. We had reached a certain point of discussion earlier in January and things have slowed down because of the revolution. Yes, there is a challenge that the current government also had priorities that would not necessarily see that this issue is among the top items although recently the government has also made a public announcement that an MVNO for Telecom Egypt is a scenario that can be applied for 2011, so in short management is aspired to drive to make the company a total telecoms provider in time.

Akil Beshir

If I may add to what Mohamed has said, he mentioned the fourth licence, the possibility of a fourth licence, we don't see this as something that may happen in the near future, actually today or yesterday there was a comment by the Minister of ICT about the fourth license when he was asked about it and he said that in the current situation the financial situation and the business environment of Egypt, his exact words were that he was not sure that a fourth licence at this stage would be such a good idea.

Richard Barker

Thank you very much, that's very helpful.

Akil Beshir

You're welcome.

Madhvendra Singh

Hi. My question is on EBITDA. I was just wondering if there are any one-off

items during the first quarter of 2011. And Going forward do you think you will be able to maintain EBITDA margins at such high levels, at 63% plus? Thank you.

Hassan Helmy

During the first quarter of 2011, there were no one-off items but in Q4 2010. There were EGP 160 million relating to the enhanced early retirement program. As to maintaining the level of EBITDA going forward this is something difficult to judge right now. Perhaps by Q2 result we will be in a better position to talk about this. As I mentioned in my discussion, some future increases in our employee salaries and related benefits. So this is yet to be seen during the coming quarters.

Madhvendra Singh

Ok, thank you.

Hassan Helmy

Thank you.

Puneet Saxena

Hi. I had a question regarding Capex. Capex for Q1 is EGP 146 million which seems abnormally low. Any reason for that? I just wanted to clarify on capacity sales, you said that there's no revenue recognized in Q1 '11 whereas there was EGP 158 million in Q1 '10 – is that right?

Hassan Helmy

We didn't say that nothing at all was recognized in 2011. We said what we recognized in 2011 is much less than what we recognized in 2010. In 2011, you have almost EGP 24 million as compared to EGP 158 in 2010.

Puneet Saxena

I'm sorry, could you tell me the capacity sales number for Q1 2011 again please?

Hassan Helmy

It's almost EGP 24 million. What was the first question, Capex?

Puneet Saxena

The Capex figure, yes.

Hassan Helmy

You are right, this is again because of the effect of the events in Egypt and business closure for almost two weeks, and some delay on the part of our suppliers to deliver. This is not our normal Capex for Q1 but you may see in the future an accelerating level of Capex coming through.

Puneet Saxena Ok, thank you

Hassan Helmy Thank you.

Madhvendra Singh Just another follow-up question on the cost side again, can you please tell me the major areas where you saw cost optimization efforts coming through very well and apart from employee expenses going forward which areas you can see pressure on? Thank you.

Hassan Helmy Ok, On the major saving that you have in the wholesale, it's almost EGP 25 million lower as compared to the Q4 2010 and in maintenance cost there is a big amount and if you recall that in previous year's conference calls we were talking about the negotiations with service providers longer term, lower cost and this is materializing in 2011. Also advertising spending went down by almost EGP 30 million and something of the like. On the cost increases we mentioned that we have given our staff 15% effective of March 1st and this has not yet has its full effect on costs. You would see the full impact going forward starting from Q2.

Madhvendra Singh Apart from that, normally that area you see any other cost pressures like?

Hassan Helmy Sorry

Madhvendra Singh Apart from employee expenses you don't see any other major areas of cost pressure?

Hassan Helmy No.

Madhvendra Singh What was the second amount you said? The line went quite disturbed when you said the amount of the cost savings you got.

Hassan Helmy I was talking about EGP 30 million in advertising, almost EGP 80 million in maintenance and EGP 25 million in call costs.

Madhvendra Singh Call cost?

Hassan Helmy Yes. Ok

Madhvendra Singh What is call cost sorry?

Hassan Helmy Call costs, this is the interconnect.

Madhvendra Singh Call costs, sorry. Just one question on the CEO, the current CEO is the acting CEO, right?

Akil Beshir No, the current CEO was acting when the board accepted the resignation of Tarek Tantawy on the 26th April. The board has in the same, immediately had Mohammed Abdel Rahim Hasanein as acting CEO but then yesterday actually we had a board meeting which appointed Mohammed Abdel Rahim Ali Hasanein as the CEO but for an interim period. Mohammed Abdel Rahim is retiring in January of next year so you can call him an interim CEO for this period during which the board will decide on the permanent CEO.

Madhvendra Singh Ok, so the CEO will be appointed next year, not this year?

Akil Beshir Yes, January next year.

Madhvendra Singh Alright, thank you.

Akil Beshir You're welcome.

Akil Beshir Thank you. Ladies and gentlemen, there's a great deal for Telecom Egypt to feel secure about. We have delivered relative stability in a time of great uncertainty. The diversity of our revenue base insulated us from the worst effects of the unrest unlike many of our peers. We have protected profitability and continued work on medium and longer term projects which we believe will deliver economic value in the years to come. We have an exceptionally strong balance sheet and we have the highest cash position in the history of our company. However Egypt is in a transitional period. We have always to remember that. I firmly believe that the biggest impact is behind us. While we

expect to see some continued effects on our top line in the near term, we look to the future with great confidence.

Ladies and gentlemen this concludes our call for today. I would like to thank you all very much for your time and for your participation and 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. Thank you very much. Thanks everyone.