21 November 2010

KATS WTCL
Reuters WTCL KA
Bloomberg WTCL PA

Wateen - Geared for Tomorrow

PKR 3.78; Target 14.2; Upside Potential 275%

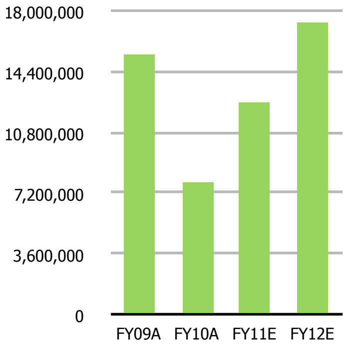
Telcos are transforming their businesses to deal with new competitive challenges, market saturation, changing technologies and evolving models. All telcos need to become more efficient, more customer centric and more competitive, and to expand the scope of the services they offer to customers. This requires a top-to-bottom rethinking of the business models, company culture, organizational structure and identities of telcos. Emerging market telco players are gearing towards a more strategic phase with the advent of 3G licenses even though Pakistan still remains a 2G license domain.

Listed exposure to telcos is limited in Pakistan, as most cellular operators remain unlisted with the exception of Ufone a wholly owned subsidiary of Pakistan Telecommunications (KSE: PTCL). Part of this neglect stems from their inability to turn themselves profitable while the remainder is their magnanimous appetite for funding. Mobile technologies have witnessed abnormally high rates of growth on account of lower tele-density and rising income levels adjusted against declining ARPU's. Now the focus has shifted to VAS and opportunities in data services as voice which accounts for 70-90% of domestic market revenues has witnessed rising competition and declining ARPU's. The current environment has prompted cellular operators to create single delivery platforms creating synergies for all market players with a reduction in redundancies. Although cellular services are the face of the telco revolution but a suite of other services such as LDI, WLL, Broadband, WiMax and integrated solutions exist with higher ARPU's and somewhat lower tele-density in contrast to cellular telephony. A solutions provider that firmly establishes itself as the carriers carrier with its presence felt in all segments of the telco dimension is "**Wateen Telecom**".

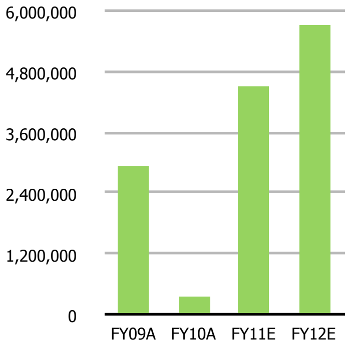
Wateen Telecom (KSE: WTCL) is an Abu Dhabi group venture which has recently been listed on all three stock exchanges. The company over the preceding years has rolled out a 10,000 KM fibre optic network the backbone of its operations. WTCL's dynamic business model covering retail and wholesale segments ensures its future viability.

FINANCIALS

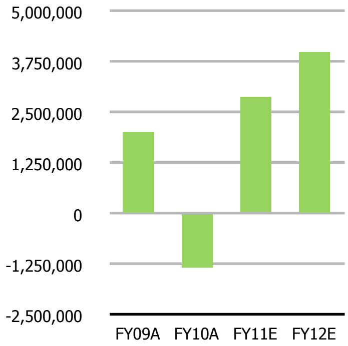
Revenue



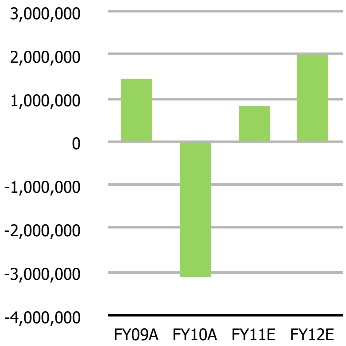
EBITDA



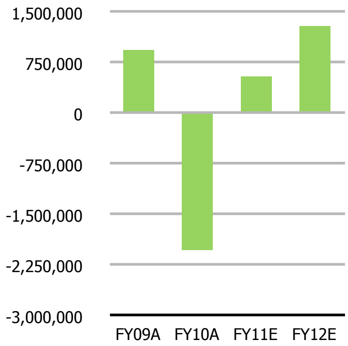
EBIT



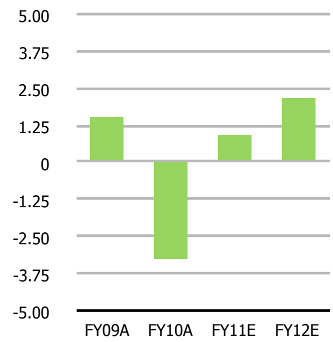
PBT



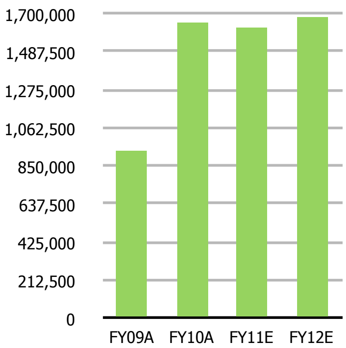
PAT



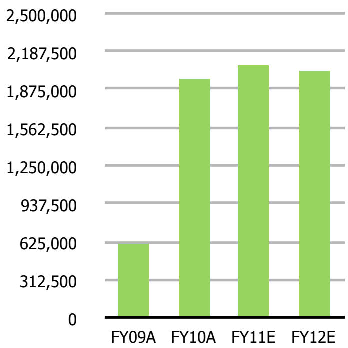
EPS



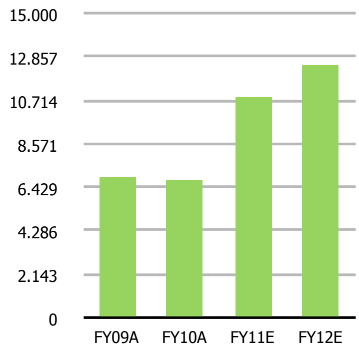
Depreciation & Amortization



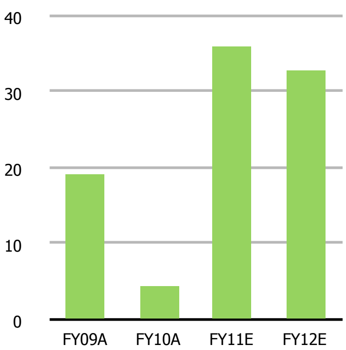
Cost of Leverage



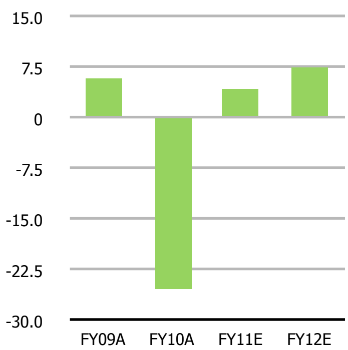
Book Value/Share



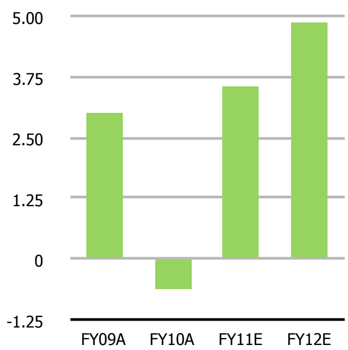
EBITDA Margin



NP Margin



Cash Earnings



Source: SAAO Research & WTCL Financials

Table of Contents

Telecoms - South East Asia & Sub Saharan Africa

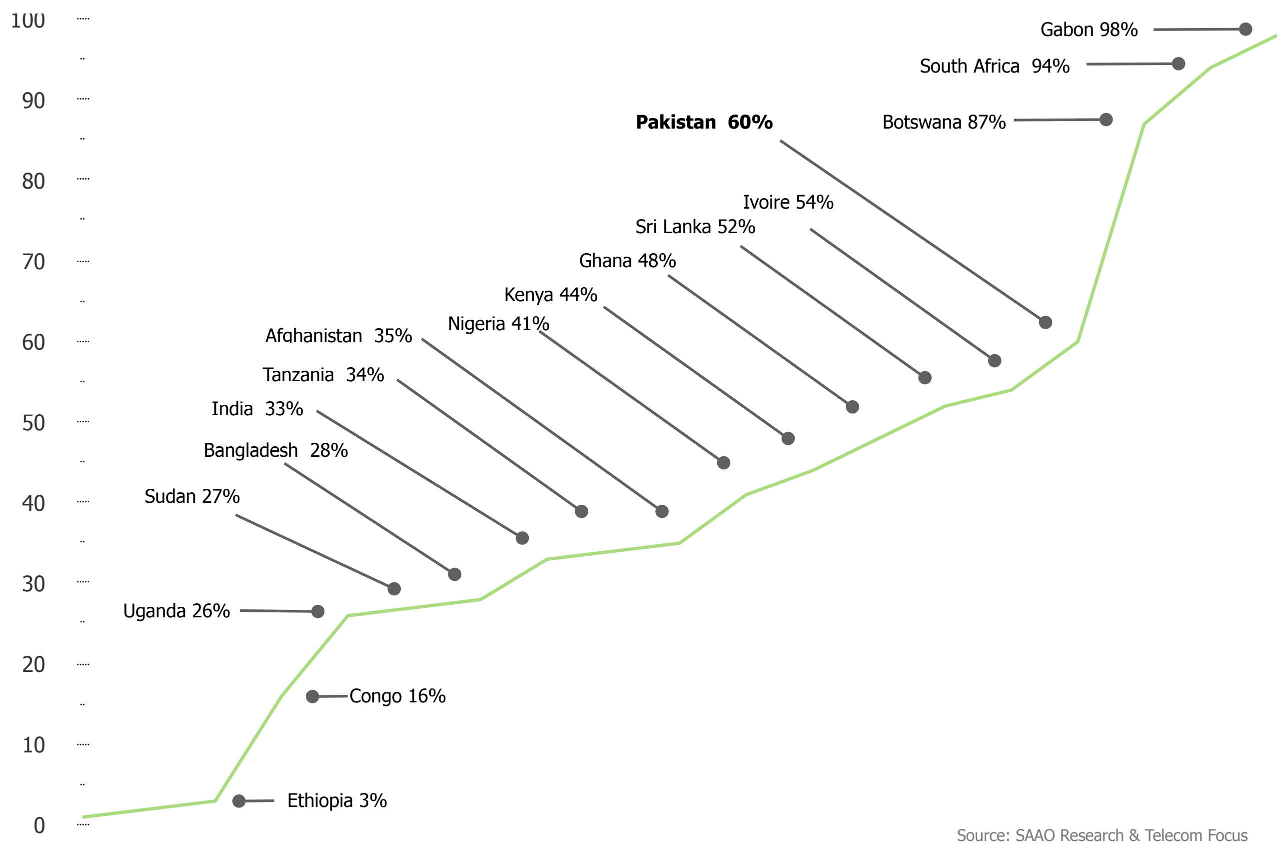
Emerging markets have attracted significant investment from international mobile operators with many players rewarded with healthy growth in subscribers and revenue streams. Now, however, emerging markets are maturing, posing a different set of challenges. Average revenue per user (ARPU) levels, remain low and are expected to fall significantly for three reasons:

- The next wave of customers will primarily be low income.
- Operator competition will continue to increase.
- Consumers will face higher budget constraints given the global economic contraction.

Telecoms - Global Hotspots

Mobile communications passed a key milestone by the end of 2007 when it achieved 50% penetration worldwide. Much of this penetration was felt in developed markets with high disposable incomes and availability of modern telecom infrastructure. Saturation in developed markets led to telco's shift in focus to geographic zones with lower tele-density. South East Asia and Africa emerged as global hotspots with large populations and relatively low rates of penetration. Their combined 3.3 billion inhabitants represent 45% of the world's population. In 2008, India and sub-Saharan Africa accounted for 32% of all mobile subscriber net additions. For the years 2009 through 2012, they are expected to contribute 44% of total net additions. Below is an illustration of mobile penetration in countries within these regions.

Fig 1. Mobile Penetration at the end of FY10



Source: SAAO Research & Telecom Focus

Telecoms - Future Drivers & ARPU's

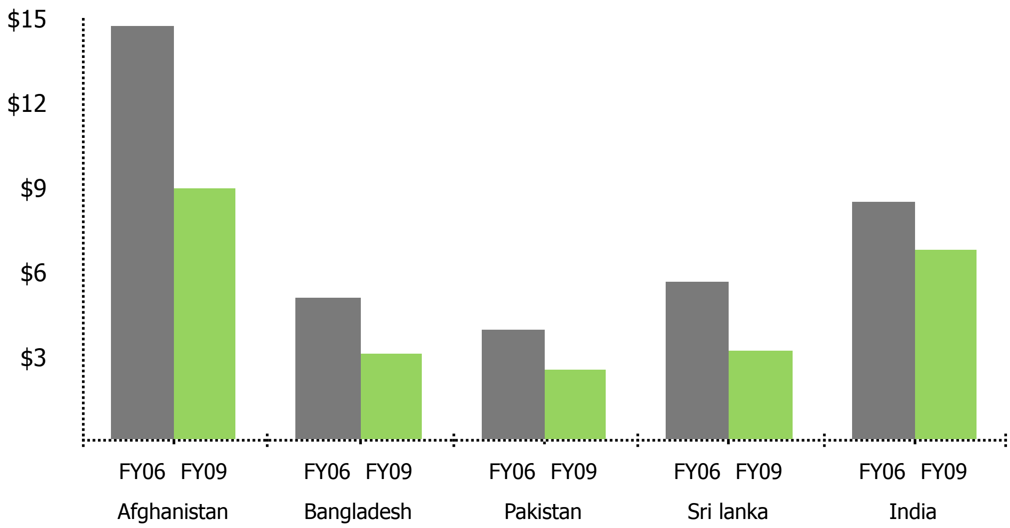
ARPU levels in emerging markets have been dramatically decreasing because of increasing competition, price reductions, and a second wave of customer acquisition from predominantly lower income segments. Still, the bottom has yet to be reached. Three factors that will lead to a second wave of ARPU reductions in the near to mid-term are as follows:

Prepaid Customers; these represent the most sensitive case for cellular operators, any budgetary constraints have a direct impact on their consumptions. under current market conditions any price pressures would adversely impact on sales.

Price Pressure; competition and price wars are another hurdle to keep ARPU's capped going forward, some countries like Pakistan and congo have five or more players placing them in the cut throat competition category coupled with WLL services also ever present.

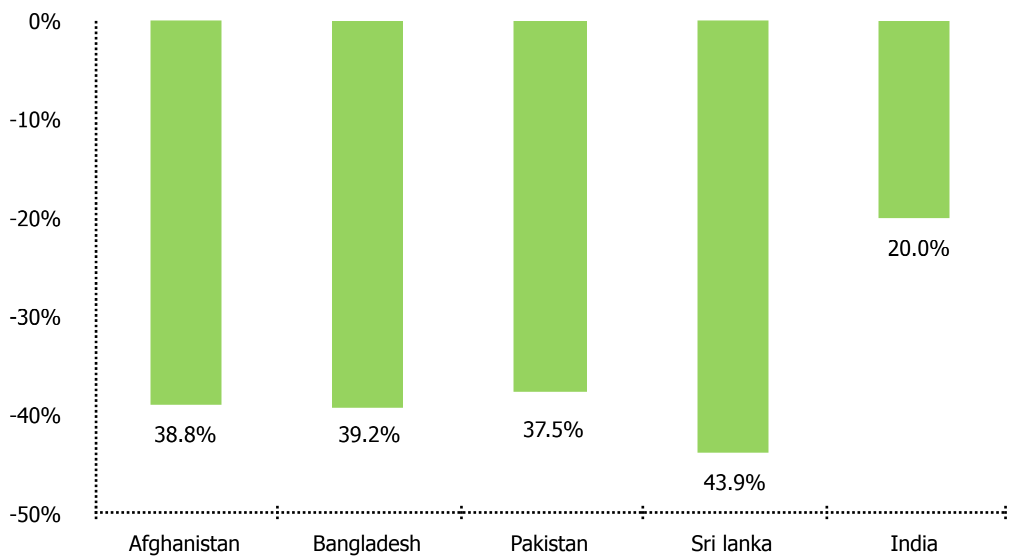
Customer Mix; to increase breadth and coverage and also to crowd out of urban centers that have experienced somewhat saturation, cellular firms would now eye rural residents that present 40% of the world population and live under $2 a day. The ideal target ARPU for this market would be US$ 1 a month.

Fig 2. Comparative Analysis of ARPU's FY06 & FY09



Source: SAAO Research & Telecom Review 09

Fig 3. Average drop in ARPU's



Source: SAAO Research & Telecom Review 09

Revenue - South East Asia & Sub Saharan Africa

To grow revenues without forsaking profits, cellular operators need to radically revamp their business model, focusing on numerous priorities and most importantly making network sharing and common gateway platforms a reality.

Despite large potential cost savings, network sharing remains limited: Fewer than 2% of towers are shared. Thus, the business case for sharing is less straightforward than in South East Asia. Faced with the obligation to decrease their price per minute to fuel top-line growth, operators will no longer be in a position to "afford" relatively high per-minute operating costs. Recent moves indicate that operators may be changing their mindset about network sharing. MTN and Neotel recently signed a $200 million deal to build a jointly owned fiber backbone in South Africa which currently has the highest penetration in South East Asia and Africa.

Two factors will further push South East Asian operators towards implementing network sharing. First, the global financial crisis increases the cost of financing network expansion. Secondly consumers will demand cost effective solutions as their top priority with weakening economic conditions.

Shift - Focus

Success stories of 2G in emerging markets were built on the backdrop of cheap licenses and small scale initial roll-out, allowing operators to limit the upfront investment and risk. Provided that governments and regulators ensure the same combination of reasonable license cost and limited coverage obligations, the next decade may well see another mobile revolution in sub-Saharan Africa and South Asia, with operators and populations leapfrogging to 4G.

Differentiating - Front End and Back End

While the next wave of subscriber growth raises many challenges for operators in sub-Saharan Africa and South Asia, operators have the ability to sustain profitability over the coming years provided that they engage now in an overhaul of their business model. Scale will increasingly become an important component in its business model. As such, the current spree of greenfield operators in these markets is bound to be followed by consolidation and creating synergies on the back end whilst competing on the front end.

Wateen - Step in the Right Direction

Pakistan's telco's have taken a step in the right direction, courtesy of Wateen's core focus on branding itself as the carriers carrier and deploying the infrastructure to allow multiple cellular players to compete on the front end as in the case of Warid and CM Pak competing against each other for subscribers and market share while sharing long haul back end channels to substantially reduce costs and improve efficiencies.

Pak Telecoms - Timeline

Pakistan's telecom operations were run under Government control with a single player PTCL dominating the telecom landscape in a monopolistic environment that lacked focus over, with minimal infrastructure development and end user serviceability. During the period between 1962 and 1991 little or no progress took place, it was the enactment of the Pakistan Telecommunication Corporation act of 91' which prompted competitive policy initiatives that resulted in award of pay-phone licenses.

Year	Milestones Accomplished
1947	14000 Operational telephone lines at independence
1947	Pakistan Posts and Telegraph Department, Ministry of Communications
1962	Pakistan Telegraph and Telephone Department, Ministry of Communications
1990	1st Private Pay-phone License
1990	Pakistan Telecommunication Corporation
1991	1st Mobile License to M/s PakTel
1992	1st Card Pay phone License
1994	1st GSM Mobile License to M/s Mobilink (Pakistan Mobile Limited): 2nd Mobile Operator
1995	3rd Mobile License to M/s InstaPhone
1995	Pakistan Telecommunication (Re-Organization) Ordinance
1996	Pakistan Telecommunication (Re-Organization) Act
1996	PTCL, FAB, PTA, NTC
1998	Paknet (1st Internet Service Provider)
1998	First Card Pay phone License
2000	Pakistan Telecommunications Rules
2000	Pakistan Telecommunications Authority Regulations
2000	Calling Party Pays Regime (CPP) for Mobile
2001	Internet over Cable Regulation
2001	M/s PTML (2nd GSM Mobile Operator): 4th mobile operator in Pakistan
2002	Ministry of Information Technology & Telecommunications
2003	End of PTCL Monopoly
2003	Telecommunications Deregulation Policy (Draft)
2003	Cable Television Rules
2003	Telecommunication Numbering Plan
2003	Telecommunication Tariff Regulations (Draft)
2004	End of PTCL Exclusivity on Cross border connection
2005	License Issued to Telenor, Pakistan
2005	License Issued to Warid, Pakistan
2005	LDI License issued to Wateen Telecom

Source: SAAO Research, PTA & Yousuf Haroon

Telecoms - Pakistan

Pakistan's telecom sector has seen an exponential growth in all segments of the revolution with cellular telephony outpacing all other forms of communication. Telco's have seen abnormal growth patterns primarily on account of over US$ 13 billion of investment in the sector.

Post de-regulation coupled with liberalization policies have resulted in the lowest ARPU (Average Revenue Per User) in not only the region but the world as a whole. Cut throat competition and bundling of VAS have remained the key drivers of sustainable profitability going forward for all telco's in Pakistan.

This has inadvertently led to exponential growth witnessed in cellular growth combined with an enormous appetite for internet services and commercial networking solutions for interconnectivity.

The current trend is to achieve economies of scope resulting in a strong case for adaptive economies of scale for telco's, resulting in lower pricing for the end-consumer (retail and commercial). Currently more and more telco's are offering there triple play and quad play solutions thus increasing breadth and coverage with the aim to penetrate further and reap the advantages of service mobilization specifically in data and content services wherein ARPU's remain high.

The mobile operators in Pakistan have seen declining ARPUs over the last few years and have probably the lowest ARPU in the world and that is because all of them are still using old technology which does not allow them to offer compelling applications and services that boost operators' revenues. They can only compete on "voice" and the only way to differentiate themselves is on the basis of tariffs. To acquire more subscribers they keep lowering their tariffs and have reached a point where it has become very difficult for them to sustain business and maintain profit margins.

There is a very high demand for broadband data connectivity in Pakistan. The data usage in GB / month on a per subscriber basis in Pakistan is more than double than in any other country globally inclusive of developed markets. The users are willing to pay much more for broadband data connectivity than they are for voice. The wireless data plans offered in Pakistan range anywhere from US$10 per month to US$35 per month. In comparison, voice ARPU's have slipped to $2.50.

With very high data demand and availability of 3G devices with affordable prices even by domestic standards, 3G and 4G technologies will certainly increase data penetration rates in Pakistan. Given the affordability, the 3G technology, in all flavors, remains poised and most suitable for providing wireless broadband access as well as rich content and value-added-services to users in Pakistan.

Telecoms - Future Outlook

The future of telephony in Pakistan from a service providers perspective would be to create synergies, single platform delivery channels and an increased market share combined with a reduction in overheads. This pressure is likely going to brace the industry into the next phase of this telco revolution, i.e. **Consolidation**.

In a high tech paced environment with the ever changing business models consolidation is likely to follow two routes: through Mergers and Acquisitions or divestment and rolling back of an existing operator. With stiff competition, expensive licensing fees involved and extensive capex the likely route is through merging and combining resources to evolve increased market share, reduce redundancies on human resource and networking infrastructure.

The battle between price and cost is going to see ramifications being done at the cost angle as telco players do not hold the pricing power. Reduction of costs and sharing one common medium is where the Wateen story commences. Wateen's business model encapsulates the bulk of the telecommunications from long haul - metro networks. Calling cards to pay-phone's, Wireless broadband services to dedicated VPN's. Corporate Solutions encompassing VPN's to VSAT services. Its presence in WLL safeguards its semi-fixed line services and LDI operations guarantee international traffic proceeds.

Envisaging technology as a product, it is clearly visible that the industry is transiting from a phase of overheating to consolidation, with high base effects in penetration reaching a peak, we are likely to move onto the next phase of the cellular telephony's life cycle. We believe the next and final destination for telephony in Pakistan is going to be the mergers and acquisition route, wherein firms will witness the creation of horizontal integration channels creating synergies and consequentially reducing redundancies. This would result in economies of scale and scope with the added advantage of increased market share and revenue streams.

Process re-engineering would be the single most important priority forcing telco's both in the cellular market and WLL to bode to the concept of service bundling.

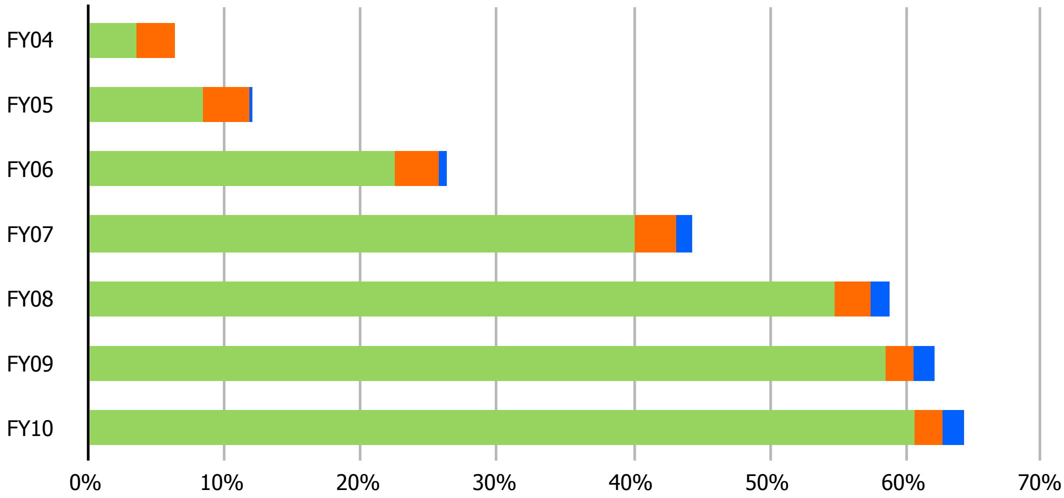
Telecoms - Cellular Landscape

Pakistan's cellular industry has witnessed a period of abnormal growth commencing from 2005. This has led to the emergence of foreign players from the region as well as from other continents to invest in this untapped under developed market that has gone through a transition from a single monopolistic state owned telecom giant to a de-regulated market flourishing with cellular operators, WLL operators and fixed line specialists.

Telecoms - Cellular History

Although cellular operators were in operations since the early 90's, but the distinction remained with affordability and only a few consumers could afford this ease of communication with concentration on voice networks. The total number of GSM subscribers witnessed a quantum jump from 68,000 in 1996 to 3.3 million subscribers by the end of 2003. From their onwards the number of subscribers grew exponentially with latest data showing Pakistan's total cellular subscribers clocking in at 99.5 million with cellular tele-density peaking at 60.4%.

Fig 4. Pakistan's Tele-density



Source: SAAO Research & PTA

Just a decade ago it was unimaginable to think that Pakistan's cellular industry would grow by 30 times to reach 60.4% in comparison to a meagre 2.16% for fixed line telephony and 1.6% for WLL operators.

Telecoms - Foreign Direct Investment

This revolution although may be a consequence of domestic policy initiatives but its implementation was a foreign affair altogether. During the period between FY04-FY10 Pakistan attracted an enormous US$ 13.9 billion in the telecom sector which is the largest chunk of FDI for any industry segment in Pakistan's history. The cellular segment attracted the highest amount of FDI recorded at 72% followed by LDI at 13% and WLL at 12%.

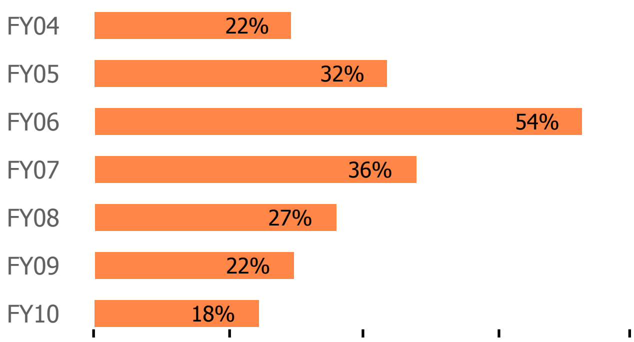


Fig 5. FDI as % of Total FDI

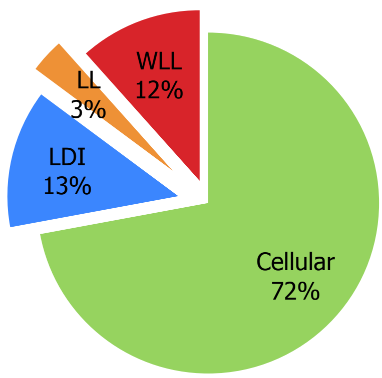


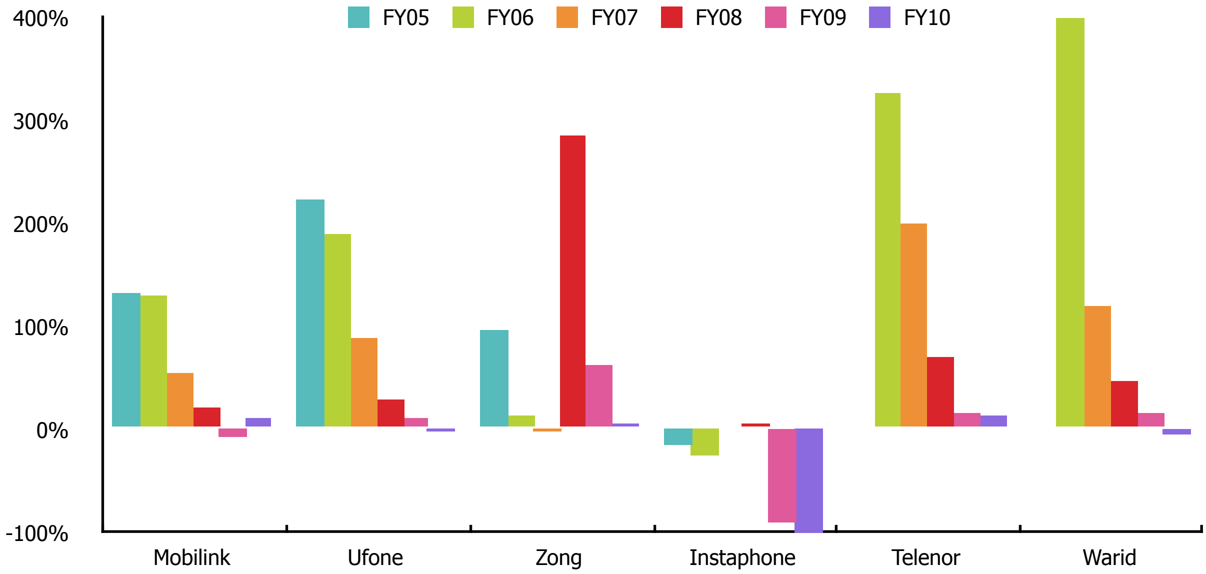
Fig 6. FDI Concentration Pie

Source: SAAO Research & PTA

Telecoms - Cellular Market Share

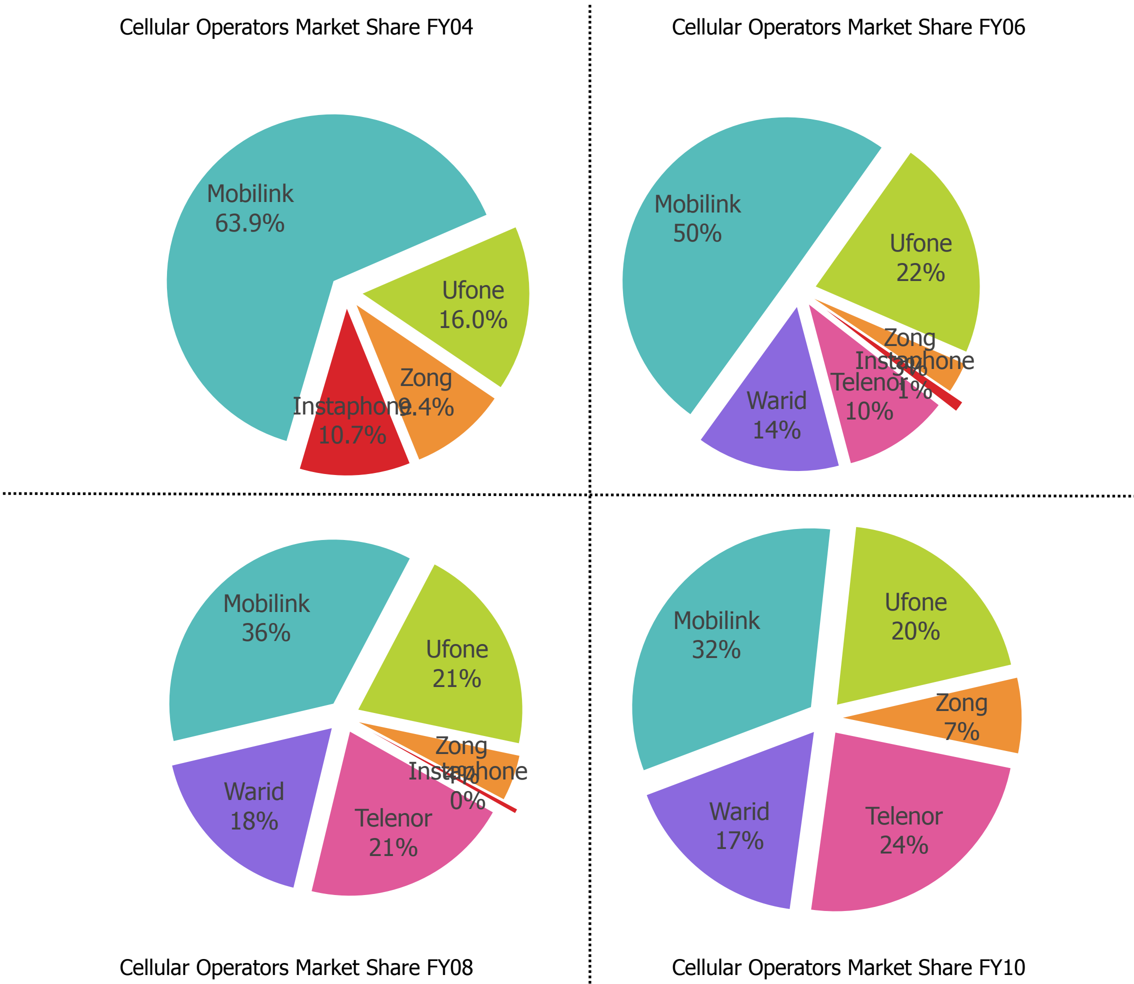
Pakistan's cellular boom has its intrinsic distinction with the GoP issuing five GSM licenses with a CDMA operator, eventually creating an environment boasting perfect competition. This led to lower pricing and better quality for the end consumer. Over the last three years focus has shifted from acquisition to retention with the introduction of MNP (Mobile Network Portability).

Fig 7. Growth in Cellular Subscribers



Source: SAAO Research & PTA

Fig 8. Market Share Analytics



Source: SAAO Research & PTA

Wateen Telecom - Abu Dhabi Group

In 1997, several commercial businesses from different backgrounds merged to create the Abu Dhabi Group, a conglomerate having interests in telecoms, financial services and real estate development. The group boasts off multi faceted business interests ranging from Africa to South East Asia with its presence countries like Pakistan, Bangladesh, Congo, Uganda and Iran. The group's consortium portfolio is estimated in excess of US$ 10 billion.

Pakistan has witnessed the bulk of this investment flow from interests in Banking (Bank Alfalah Limited: 60%, United Bank Limited 30%), Telecommunication (Warid Telecom Pakistan 70%, Wateen Telecom 68%), Real estate Development (Taavun), Healthcare (Al Razi Healthcare and Financial Services (AlfalahGHP, Alfalah Securities and Alfalah Insurance. The flagship entity for the group remains Bank Alfalah the country's fifth largest bank that currently holds a 14% stake in Wateen Telecom.

Wateen Telecom - Background

WTCL was formed on 4 March, 2005 in Pakistan with a Private Limited status primarily for providing LDI and WLL services in Pakistan. On commencement of its operations the focus was on offering wholesale telco products with an emphasis on becoming the "carriers carrier", this aim was reflective of their strategic future outlook which was to become a network service provider creating a channel for multiple uses from cellular to VSAT and everything in between them.

Wateen has been a recent addition to the local equity markets with its presence in all three stock exchanges, its IPO was offered at PKR10 a share with 110 million shares in the offing with an additional 90 million shares as a green shoe option.

Wateen Telecom - Future Strategy

WTCL aims to reap the benefits emanating from the consolidation of the telecom sector in the country with emphasis on cellular operators that seek to minimize costs due to stiff competition and low ARPU's while increasing coverage. Economies of scale likely to be achieved through the 10,000Km nationwide optical fibre infrastructure that would yield returns over the next 20 years. The management also sees the WiMax spin off to yield dividends as Wateen currently holds a 67% market share in this segment with an edge as it was the first mover in this segment. The retail suite of its products are likely to see the highest growth trajectory on account of low penetration, high ARPU's in contrast to cellular players. Cellular growth is likely to translate into Wateen's top line as its wholesale products base is likely to impact positively as its provides carrier services to sister firm Warid Pakistan, China Mobile Pak (Zong) and Telenor.

Wateen - Business Model

Wateen is a network service provider which provides communication solutions to cellular operators and carriers, corporate customers and households thus providing a full 360 degree spectrum of serviceability.

The company's product portfolio has services ranging from advanced telephony (voice and data) , calling cards tapping the international traffic of outgoing minutes. WTCL also offers broadband connectivity, video conferencing, cable Internet, DSL connections and wireless connectivity through its largest WiMax network.

Wateen also caters to the broadcast market for TV both in the form of analogue and digital channels with interactive TV, online gaming and in house infotainment and entertainment channels. Through this medium the firm also offers surveillance facilities based on managed IP.

It also provides virtual PBX, voice conferencing, virtual private networks, hosted IP contact center services, hosted data centers, professional and managed services, domestic private leased lines, international private leased circuits, IP bandwidth, and fiber optic network with secondary/tertiary routing.

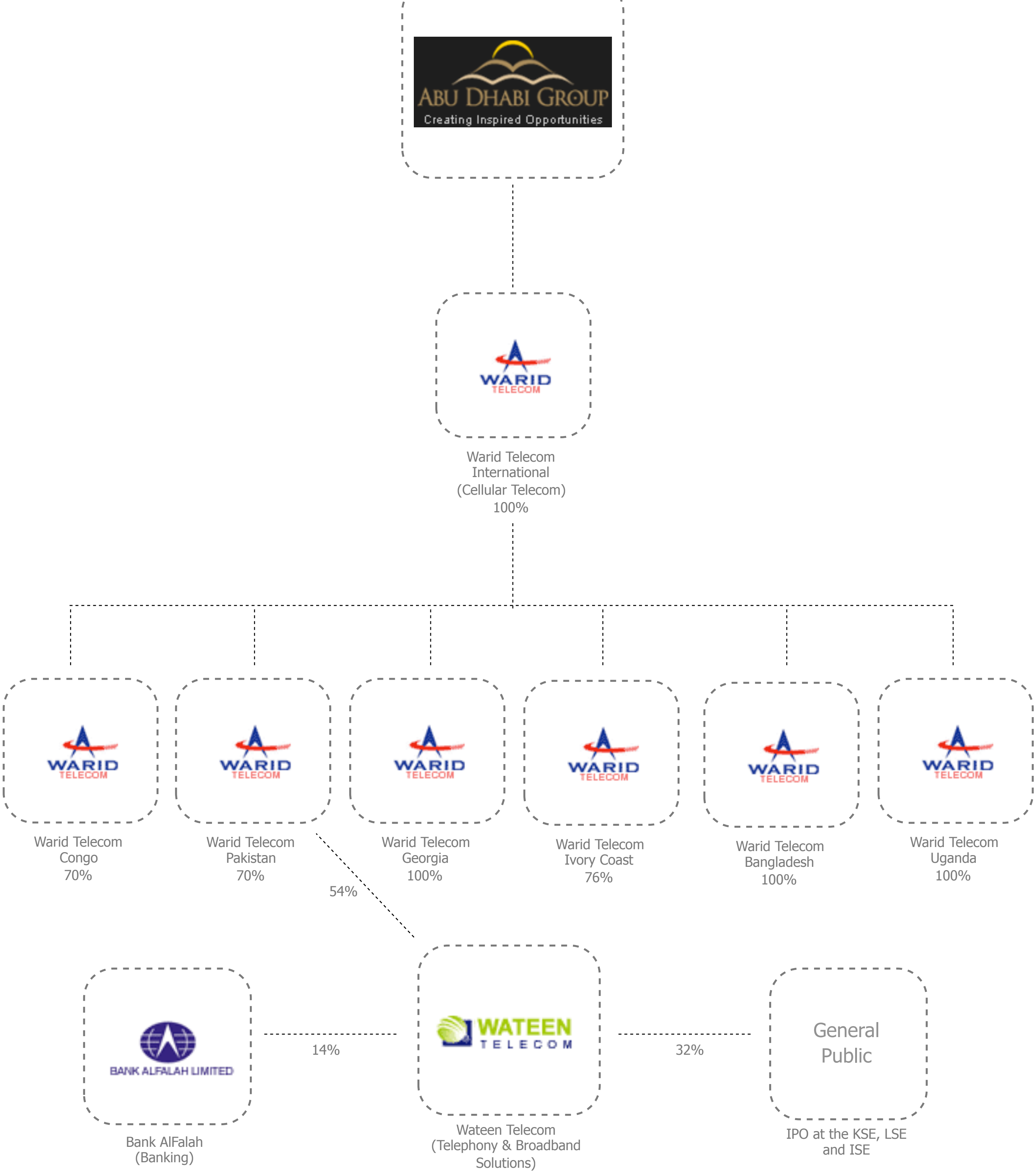
Wateen - Milestones

Wateen has established itself as the largest alternative LDI operator in the country
The largest commercial 3.5 GHz Wimax network roll out spanning 22 cities
Largest operator of satellite services in the country
Second largest optical fibre network spanning over 10,000Km
Serves all major cellular operators
Wateen's venture into FTT(x) for cable television and infotainment products

Wateen - Ownership Structure

Wateen experienced a transition in its status from a private limited company to public limited company in late 2009, before which its primary sponsors were Warid Telecom International with a majority interest at 79.6% whilst BAFL owned the remaining 20%. After its successful IPO in April of this year the shareholding pattern has seen a dilution of Warid Telecom International LLC to 54% and BAFL stake at 14% with 32% held with the general public mostly local financial institutions.

Fig 9. Shareholding Structure of Abu Dhabi Group



Source: SAAO Research & Financials

Product - Portfolio

WTCL's product portfolio is a NGN (Next Generation Network) model with its complicated architecture and varied product lines. The product portfolio currently has a bias towards the wholesale segment but with increased penetration, awareness and bundling of services the retail segment is likely to spin off exponentially. Wateen acts as a complete solutions suite offering all segments of the current telco technology ranging from broadband services to managed solutions and carrier telephony for other cellular operators.

The network offers a wide range of services that may quantify economies of scale with the second largest fibre network in the country and bundling services that bring down the cost of production as well as consumption boasting off brand loyalty.

Wholesale	Products & Services geared towards GSM Operators, Corporate Customers, SME's and Governmental Agencies
LDI	The LDI market witnessed a high churn on traffic registering impressive historical growth but is now going through the maturity cycle. As per 2009, the LDI industry registered an overall growth in revenue of 119% with Wateen growing at 145% in contrast to its peers average of 73%. Current LDI performance was a result of the APC regime and grey traffic, moving forward the volumes for international traffic are likely to pick up as the industry moves towards a one country one rate policy initiative this will also ensure the reduction in grey traffic and improve profits for the industry.
Managed Capacity OFC	During the preceding year Wateen was able to double its optical fibre network from 5,000 km to 10,000 km, making it the second largest network in the country. This capex had its impact on profitability and debt profiling of the the firm, but its long term benefits are guaranteed with dark fibre sales locally and internationally. The roll out coverage along national highways will make it an ideal alternative for back hauling by GSM operators from existing microwave media which has reliability issues. Growth is likely to be witnessed from IP transit and IPLC as wateen makes terrestrial connects with neighboring countries like India, Iran and Afghanistan.
Managed Capacity VSAT	On the VSAT services potential, Wateen is likely to reap benefits from its largest satellite network in Pakistan. With bandwidth rates witnessing an increase, Wateen will have a cost advantage over others making it in a better bargaining position. This back hauling method would have its positive implications from a regional perspective.
System Integration	Wateen also holds the distinction of being the largest system integrator in the country. the company holds technical expertise in creating networks of all breadth's and coverage. With 2000+ service providers and enterprises and 350,000+ SME's the potential for growth is huge. Margins in this business segment remain high and offer recurring payments in the form of warranties and service agreements.
Retail	Products & Services geared towards SME's and households.
VAS	Wateen's model has price advantages over other GSM operators because of asymmetric termination rates on voice, SMS services are likely to add to revenues. The company also boasts off a gaming portal with over 12,000 active members. Another revenue stream is Wateen's website which ranks amongst the top 20 websites in the country, advertising income from this segment is also going to impact the topline with little or low cost of sales and high EBITDA margins.
WiMax	The broadband market in Pakistan has seen an exponential boom in subscribers, as of 2009 the market expanded by 146% while Wateen grew its subscribers by 346% attaining market share of 67%. The PTA acknowledges this growth trajectory and predicts that broadband subscribers will reach 5 million by 2014.

Risks to Valuation

Interest Rate Sensitivity

Wateen's business model is very sensitive to interest rates with a high debt to equity ratio and interest bearing liabilities of PKR 19,081 million 1QFY11 from PKR 17,450 million on FY2010. With the financing available reaching the upper threshold, the company may face certain restrictions on their future capex.

With local interest rates witnessing a recent hike of 50bps and further monetary tightening in the pipeline to curb inflationary pressures in recent months, any upward movement in local interest rates as well as LIBOR linked rates is likely to raise financing cost and adversely affect future cash flows denting NP margins. In our model we have assumed a financing cost factor 15.5% keeping in view the monetary outlook for FY11.

Wateen's Interest Rate Calculator

Loan Classification

Long Term Liability	**1Q FY11**	**FY10**	**FY09**	**Mode**	**Financing Available**	**Bearing Interest**
Syndicate of banks	4766000	4766000	2800000	Syndicate	5000000	6 mth KIBOR +2.75%
Export Credit Guarantee Dep.	2467479	2450304	1455003	Term	3612000	6 mth LIBOR + 1.5%
Standard Chartered Bank	40500	54000	67500	Term		6 mth KIBOR + 1.25%
Dubai Islamic Bank	477000	477000	530000	Ijarah	530000	6 mth KIBOR +1.50%
Bank Al-Habib Limited	-	-	450000	Conv to Syn	450000	
Motorola Credit Corporation	4998613	4963819	2319395	Term		6 mth LIBOR + 1.7%
Term finance facility	508830	-	-			
Liability from Associates						
Term Facility from Taavun	550000	-	-	Term	600000	6 mth KIBOR +2.5%
Loan from Sponsors	1206800	-	-	Stand By	1200000	6 mth LIBOR +2.5%
Short Term Liabilities						
Short term borrowings						
Habib Bank Limited	NA	1680165	-	Credit Line	2000000	1 mth KIBOR +1.2%
Atlas Bank Limited	NA	134750	-	Credit Line	180000	12 mth KIBOR +5.25%
Short term running finance						
Bank Al Falah	NA	1498657	1292861	Credit Line	1800000	3 mth KIBOR +3%
Standard Chartered Bank	NA	1226783	1365680	Credit Line	1500000	3 mth KIBOR +2%
Soneri Bank	NA	198741	-	Credit Line	200000	3 mth KIBOR +2.25%
Total Short Term Liabilities	**4066123**	**4473456**	**2658541**			
Total Liabilities Bearing Interest	**19081345**	**17450219**	**10280439**			

Foreign Exchange Risk

As highlighted in the table above, Wateen has foreign currency denominated loans that may witness a drag in case of the rupee depreciating further. Although predicting currency shocks remains difficult, we feel that a slight depreciation trend may follow but erratic shocks to the Pak Rupee remain outlived.

Currently WTCL has a natural hedge against these loan payments as almost 50% of its revenues are driven from LDI operations and VSAT managed capacity which are dollar denominated. Going forward the share of LDI and VSAT will likely shrink as a percentage of total revenue which would dent the cash flows of the company and thus impact on profitability.

Competition Risk

With the arrival of Qtel and Orascom in the broadband segment the competition status has been elevated. Strong competition in the LDI market also remains a key challenge, and PTCL's bundling of services in its "Quad Play" suite will lead to stiffer competition and may have a drag on ARPU's going forward.

FY10 - What went Wrong?

WTCL saw heavy battering in its share price, after its initial days on the provisional counter, this was at first a result of arbitrageurs taking advantage the the difference between the counter price and IPO price, with 200mn shares in the offing, short sellers had a sure chance of a successful application.

FY10 being a tough year for the company, with its rescheduling of contracts, lower managed capacity and LDI revenues saw a 50% decline in the revenue stream coupled with high costs associated with the WiMax segment in equipment acquisition and related expenditure. WTCL also witnessed an incline on its finance cost as borrowing costs witnessed an increase during this period. Other factors included a sluggish economy and time required to deploy its network.

WTCL - Equity Markets

The market weighs Wateen's story as that of Worldcall (KSE: WTL) and Telecard (KSE: Tele) ignoring numerous services that Wateen offers that other telco's do not offer. Wateen's difference is in its dynamic network which offers retail services such as WLL telephony and high speed internet over its wireless network but offering a variety of wholesale services such as hosted solutions, system integration the bundling of services in its Triple Play suite and lastly its core strength in becoming the carriers carrier allowing cellular operators, corporates and other to use its network. Another advantage with WTCL's network is its coverage throughout Pakistan which does not limit it to province or urban center.

Below is a tabular illustration comparing Wateen's NGN services with other telcos with focus on listed companies.

	Triple Play	WiMax	Dark Fibre	OFC VSAT	System Integration	Solutions
Wateen	Available	Available	Available	Available	Available	Available
WorldCall	Not Available	Available	Not Available	Not Available	Not Available	Not Available
Telecard	Not Available	Not Available	Not Available	Not Available	Not Available	Not Available
MultiNet	Not Available	Not Available	Available	Available	Not Available	Not Available
PTCL	Available	Available	Available	Not Available	Not Available	Not Available

Wateen's dynamic network acts as a deterrent against tougher market conditions in the future, its ability to adopt and serve a variety of businesses irrespective of geographic zoning and preferences allows it to better gauge the growth in telecoms which ever segment the may be witnessed in.

Key Triggers

Changing Cellular Landscape

The convergence in the cellular circles to increase efficiency and reduce redundancies, is going to accelerate the Wateen business case in becoming the carriers carrier with its OFC network coverage and first mover advantage in the providing dark fiber and lambda services. Consequentially, this edge is going to transform the industry into a win-win platform for all telco's and Wateen. In simplistic terms Wateen would act as a highway for connectivity and bandwidth available to all for a much lower fees in comparison to laying such a network.

The second wave of growth would encompass around the increase in cellular subscribers which would result in higher margins as in the case of Warid, CM Pak and Telenor. Currently, Wateen's centralized topological architecture means that it currently provides carrier services to Warid and China Mobile in the dark fibre segment, provides for managed capacity and VSAT solutions to Telenor, Pakistan and Mobilink for OFC for joint preventive measures.

Corporate Customers; What Next?

Corporate customers would include 90% of banking institutions for connectivity and managed solutions, eight media houses and over 2700 links in other corporate institutions. The revenue from these giants is likely to continue with positive price adjustments creating a long term revenue stream. Further revenue augmentation would come from the following areas:

Educational Institutions (Schools & Universities)
Hospitals & Laboratories
Military and Defence Agencies
Government Institutions & Networks
SME's
Law Enforcement Agencies
Research Institutions

Long term Contracts

Bulk of the service agreements that WTCL get into are for long durations with some ranging as long as 20 years with a price escalations of 10-15%, thus warranting on a long term sustainable growth model.

Afghan Edge

A key trigger of growth propensity for WTCL lies in its plans to cater to the Afghanistan market which remains an under tapped market especially in the data segment. Additionally, a great potential still lies in provision of International connectivity to large industry giants with service centers across Pakistan. Managed Capacity from both OFC and VSAT will eventually be key growth drivers as WTCL makes terrestrial interconnects with neighboring countries like Afghanistan, Iran and India. Currently, a few telcos are using Wateen's Satellite services.

Halted Dilution

During the pre-IPO presentations, a key takeaway was WTCL's requirement for additional funding to the tune of PKR 1.5bn-2bn by issuing rights to its shareholders. With the circulation of 1QFY11 accounts it is clearly evident that the company has the strong support of its affluent sponsors that have injected a SBA of PKR 1.2bn and additional funding from group company Taavun to the tune of PKR 600mn of which PKR 550mn has been utilized raising an aggregate of PKR1.8bn.

Key Triggers

Advances in Technological Architecture

The future also holds the advent of new business opportunities in areas such as data warehousing, telehousing, powering 3G networks (Pakistan still remains a 2G network) extension in fibre optic coverage to include neighboring countries in the region.

Bundle Pack Offers

With Wateen's topological architecture and varied services through one platform the firm is geared to take full advantage of bundling services and achieving economies of scope. Wateen has already launched its triple play suite in DHA lahore with over 30,000 homes using this service. The launch is a pilot project, before the launch of this service throughout the country. The aim is to provide VDV (voice, data and video) all through a single platform at an affordable price. Bundling of services is the way forward as witnessed in developed economies. PTCL has also launched its Quad Play Services throughout the country offering voice, data, video and surveillance.

Reduced Capex Ahead

The last two years have seen Wateen roll out its optical fibre network from 5,000 km to 10,000 km, this coupled with its long term affiliations with leading telecom equipment manufacturers means that going forward the company will benefit from its expansion in previous years resulting in higher profitability moving ahead.

Cash Earnings Component

An important ratio used for valuations of firms that have undertaken huge capex to gauge the earnings potential over a given specified period of time. This ratio is computed by adding back the depreciation and amortization to the Profit after Tax. This measure highlights on the cash earnings that are retained within the business.

Wateen's has undertaken a vast amount of network outlay in the preceding years, this is reflected in its depreciation cost of PKR 1,648 million for FY10 in comparison to PKR 946 million in FY09. Accordingly, in FY11E the company is expected to bear PKR 1,632 million in depreciation cost. This cost is likely to repeat itself as most of the infrastructure's depreciation cycle is spread out on 20-25 years. A key take-away from using this metric is the availability of cash-flow within the firm that may be used to for other purposes for e.g. financing cost. WTCL's expected EPS for FY11 is PKR 0.9 whilst it's cash earnings for the same period would be PKR 3.5.

Wateen - Valuation

We have forecasted FCF of WTCL for the next four years on a consolidated basis with low capex as most of the capex has been achieved by the end of FY10. Moving forward the cash flows would be a function of promotion rather than capacity building.

Using DCF methodology we have arrived at a fair value for Wateen Telecom at **PKR 14.2** based on current outstanding shares of 617 million. In determining this value we have used the following metrics:

Terminal Growth Rate: 3.0%

WACC (Weighted Average Cost of Capital)

Cost of Equity	:	18%
Cost of Debt after tax	:	10%
Risk Free Rate	:	12%
Equity Risk Premium	:	6%
Beta	:	1.00 (As Wateen remains a new listing)
WACC	:	14%

Wateen - Model Assumptions

The model assumes that WiMax spin off would be the key trigger in the retail segment while dark fibre sales and back hauling by cellular operators and other corporates and government agencies would substantiate topline growth with high EBITDA.

Interest rate sensitivity has also been incorporated in forecasting FCF and therefore a prudent 100bps increase in interest payments has been predicted keeping in view a tighter monetary policy ahead.

"ARCH-e'-decon a leading evaluator in the telecom industry estimated current value of Wateen's key strategic assets at PKR 17,289 million translating into intrinsic value of PKR 52.5 per share (pre-IPO)"

WTCL - Financials

PROFIT OR LOSS ACCOUNT

PKR 000'	FY09A	FY10A	FY11E	FY12E
Revenue	**15410115**	**7961103**	**12567234**	**17342782.9**
Cost of sales	10607011	5917801	6409289.34	9191674.9
General and administration expenses	1810317	1531948	1382395.74	2081134
Advertisement and marketing expenses	198632	183146	213642.98	329512.9
Selling and distribution expenses	17307	20486	25134.47	34685.6
Other charges	-	28936	22876	29695
Other income	-189656	-75822	-30234	-45347
Earnings before interest, taxation, depreciation and amortization (EBITDA)	**2966504**	**354608**	**4544129.4**	**5721427.6**
Depreciation and amortization	946810	1648499	1632467	1680032
Earnings before interest and taxation (EBIT)	**2019694**	**-1293891**	**2911662.4**	**4041395.58**
Finance cost	614851	1974257	2072969.85	2031510.5
Finance income	-41981	-176602	14174	18238
Profit Before Tax (PBT)	**1446824**	**-3091546**	**852866.62**	**2028123.13**
Tax Charge	-519061	1071033	298503.32	709843.09
Profit After Tax (PAT)	**927763**	**-2020513**	**554363.3**	**1318280.03**
EPS @ 617mn shares	**1.5**	**-3.27**	**0.9**	**2.13**

Source: SAAO Research & WTCL Financials

WTCL - Financials

KEY RATIOS

PKR	FY09A	FY10A	FY11E	FY12E
Key Reflectors				
Price	3.78	3.78	3.78	3.78
Outstanding Shares	617474	617474	617474	617474
EPS	1.5	-3.3	0.9	2.1
Dividend	NM	NM	NM	NM
Book Value	6.98	6.82	10.9	12.51
Cash Earnings	3.04	-0.6	3.54	4.86
EBIT	2019694	-1293891	2911662	4041396
EBITDA	2966504	354608	4544129	5721428
PAT	927763	-2020513	554363	1318280
EBITDA Margin	19.30%	4.50%	36.20%	33%
NP Margin	6%	-25.40%	4.40%	7.60%
Value Indicators				
PER (x) times	2.5	NM	4.2	1.8
P/B (x) times	0.54	0.55	0.35	0.3
Div Yield	NM	NM	NM	NM
P/Cash Earnings	1.25	NM	1.07	0.78
Earnings Yield	39.68%	NM	23.75%	56.48%

Source: SAAO Research & WTCL Financials

Equity Sales Desk

Mohammad Ali Saeed	+(92)-21-2430724	ali@saaocapital.com
Mohammad Omer Saeed	+(92)-21-2467412	omer@saaocapital.com
Navaid Kamani	+(92)-21-2467159	navaid@saaocapital.com
Muhammad Shahid	+(92)-21-2467160	

Research Desk

Mohammad Ali Saeed	+(92)-21-2430724	ali@saaocapital.com
Muhammad Hasan	+(92)-21-2467418	hasan@saaocapital.com
Muhammad Yaseen	+(92)-21-2436062	yaseen@saacapital.com

SAAO CAPITAL PRIVATE LIMITED

Address:	610-611 Business & Finance Center I.I. Chundrigar Road Karachi 74000 Pakistan
PABX	+(92)-21-2436062-62
Dealing Room	+(92)-21-2467412-13
Settlement	+(92)-21-2467159-60
Research	+(92)-21-2436062-62
Fax	+(92)-21-2435597
Email	research@saaocapital.com
Web	www.saaocapital.com