

Zain In Talks With Bharti To Sell African Assets

Flash Note

Tuesday February 16, 2010

Mobile Telecommunications Company (Zain) (ZAIN.KW) in talks with Bharti Airtel (BRTI.BO) to sell African assets for USD 10.7 billion.

The Potential Deal

- Bharti Airtel (BRTI.BO) has begun exclusive talks to buy Zain's (ZAIN.KW) African assets, excluding Sudan and Morocco, for USD 10.7 billion. It is the Indian firm's third attempt to expand its operations into Africa.
- Bharti, controlled by billionaire Chairman Sunil Mittal, said on Monday that the company had entered into exclusive negotiations with Zain until March 25th, 2010 and that any deal achieved was subject to due diligence and the required regulatory approvals.
- The move by Bharti, which is 30% owned by Singapore Telecommunications Ltd (STEL.SI) follows two failed attempts to agree to a USD 24.0 billion deal with South Africa's MTN Group (MTN.J).
- Bharti has been seeking to acquire emerging market assets for some time, given that the telecommunications market in India has become very fragmented with increasing levels of competition. Over the past few years, the Indian telecommunications market has attracted a number of new entrants, triggering aggressive price competition and leading to some call charges being slashed to a fraction of a US cent.
- Mohamed Al Kharafi, Chairman of Kuwait's Kharafi Group, which owns 11.43% of Zain and is the largest private shareholder, told Indian television he was confident a deal would go through and that a full cash transaction was planned.
- If the deal goes through, Bharti would pay USD 10 billion by April 2010 for the African assets of Zain, which has USD 2 billion of debt on its books, and the remaining USD 700 million by the end of the year, according to Mohamed Al Kharafi.
- Zain Group Chairman, Asaad al-Banwan, announced that Zain intends to use the proceeds to repay debt and distribute cash dividends to shareholders. Additionally, according to Al Qubas, a Kuwaiti-based newspaper, there is also a possibility of Zain reducing its paid-in-capital.

Background

- In September 2009, Al-Kharafi Group, the largest private shareholder of the company with a stake of 11.43%, said it was confident of selling a 46% stake in Zain. It had agreed to sell this stake to a consortium, including India's Vavasi Group and Malaysian billionaire Sayed Mokhtar Al-Bukhary for USD 13.7 billion, in a deal that did not involve Zain's management. India's Bharat Sanchar Nigam Ltd and Mahanagar Telephone Nigam Ltd were also interested in the deal, at the time, but negotiations dragged on. Zain also rejected an offer from France's Vivendi for its African assets.
- Zain's African operations, targeted to be sold by Al-Kharafi Group, are spread across fifteen countries spanning west and central Africa, including Burkina Faso, Chad, Malawi, Madagascar, Uganda, Congo, Gabon, Ghana, Niger, Kenya, Zambia, Nigeria, Sierra Leone, DRC and Tanzania.



Recommendation

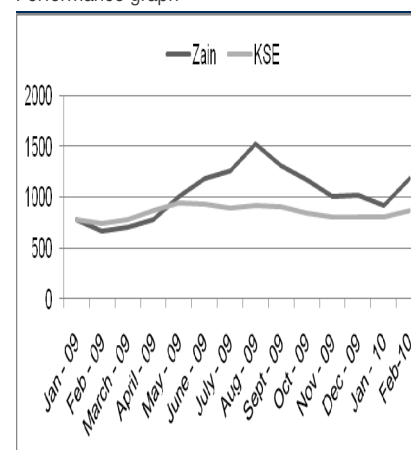
Not rated

Stock Data

Price (as of Feb 16 2010) (KWD)	1.18
Target Price (KWD)	N/A
Upside / Downside	N/A
Market Cap (KWD mn)	5,041.4
Market Cap (USD mn)	17,414.3
Number of Shares (mn)	4,297.0
52 Wk Av. value traded (USD mn)	44.2
Reuters / Bloomberg	ZAIN.KW / ZAIN KK
Exchange Rate (KWD/ USD)	3.47

Source: Reuters, Rasmala Research

Performance graph



Source: Reuters, Rasmala Research

12m High / Low (KWD) 1.6 / 0.6

	1M	3M	12M
Zain	19.2%	15.7%	57.3%
KSE Index	6.5%	6.6%	13.1%

Source: Reuters, Rasmala Research

Major Shareholders

	(%)
Kuwait Investment Authority	24.61
Al-Kharafi and Sons Company	11.43
Free Float	63.96

Source: Company data

Analyst Comment

- The mobile phone market in developed countries has become saturated, and even in some developing countries opportunities for growth are diminishing. That noted, given the wave of consolidation in the industry, mobile operators, including those from emerging economies, are looking for growth wherever possible. In our view the deal is likely to succeed as both parties will benefit.
- Zain's African assets (excluding Sudan and Morocco) represent approximately 58% of Zain's 71.8 million customer base, while revenues from the African arm (excluding Sudan and Morocco) constituted 44.3% of total consolidated revenue and only 10.4% of total consolidated net profit, at the end of 9M 09. Additionally, Zain's African operations accounted for the majority of Zain's capital expenditures (CAPEX) amounting to 66.9% of the group's total CAPEX at the end of 9M 09.
- Zain intends to use the proceeds from the sale to reduce the group's outstanding debts, given that its African arm has approximately USD 2 billion of debt on its books, while Zain's entire debt stands at KWD 1.79 billion (USD 6.19 billion), implying a net debt/EBITDA of 2.4x, which is considered highly leveraged compared to its MENA peers average net debt/EBITDA of 0.8x at the end of December 2008.
- Zain would also benefit from being able to focus more on its Middle East market, which is characterized by high ARPUs and more importantly, less capital expenditure requirements. The African markets, which are characterized by lower income per capita and low mobile penetration rates, have scattered populations. These markets require high capital expenditure particularly as the infrastructure in these nations is not as developed as in the Middle East.
- Bharti Airtel, the largest Indian operator in terms of subscribers (23% market share), experienced its slowest profit growth in more than three years in Q4 09. The Indian market has become very competitive with the entrance of many new mobile operators, such as Norway's Telenor and Tata Teleservices, part owned by Japan's NTT DoCoMo. This has led to aggressive pricing, which saw ARPU's nose-diving. With 119 million mobile users in India in December 2009, mobile penetration reached approximately 50% compared with 40% in much of Africa.
- In an effort to pursue an inorganic expansion opportunity, Bharti tried to move into Africa. Two previous efforts made by Bharti to merge with South Africa's MTN fell through, the latest in September last year. The deal was blocked by the South African government, which was unwilling to approve the deal.
- If the deal with Zain succeeds, Bharti could have the opportunity to expand its operations and subscriber base. Bharti has significant experience in deriving profits in developing countries where competition is growing as conditions are similar to its domestic market. Bharti should have the capability of running a low-cost operation in markets where consumers have very low incomes, through infrastructure sharing and outsourcing.
- On the other hand, Bharti may face high costs in Africa, either in terms of network rollout or the potential for political instability.
- According to our estimates, the deal is valued at a trailing EV/EBITDA multiple of slightly over 7.0x, which is slightly lower than the average EV/EBITDA multiple of 8.3x on M&A deals that took place during 2009 in the telecom industry. However, given the sharp 9% drop in Bharti's share price following the announcement of its discussions with Zain, we believe that investors are concerned that Bharti may have over-bid for Zain's African businesses.
- Zain's total outstanding shares stand at 4.3 billion, of which 46% is equivalent to approximately 1.98 billion shares. The announced transaction value was USD 10.7 billion, implying a price of KWD 1.54 per share (USD 5.4/share) compared to a current price of KWD 1.18 per share (USD 3.8/share), a potential upside of 30.5%.

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