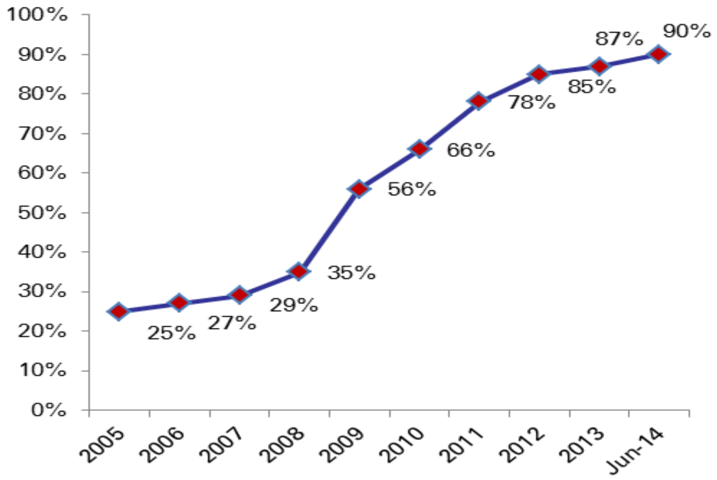
The Lebanese Mobile Market: Strident Steps in 2014 to revitalize the Sector

BLOMINVEST BANK

Mobile Penetration Rate Evolution



Source: World Bank, BMI, TRA

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In an era of unprecedented technology evolution, mobile technologies are gaining the spotlight. Shopping at ease, getting medical assistance, settling bank bills, streaming a movie or receiving breaking news alerts from around the world is now possible through one device. Consumers have no choice but to embrace mobile broadband given the enormous facilities that can be available on their smartphones as well as keeping up with the mobile technological boom .

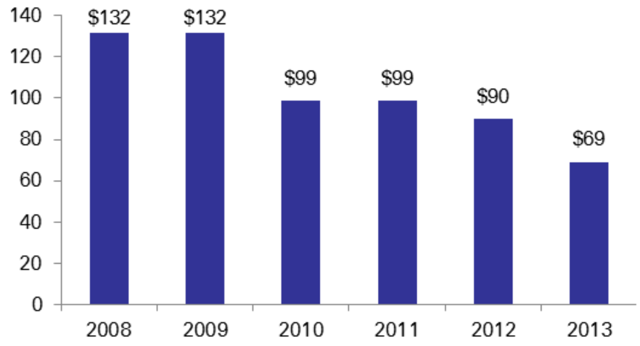
Driven by dynamic progress and rapid adoption, mobile technologies easily navigated through the Lebanese market since 1993. This was revealed by the rising number of mobile subscriptions over the past 5 years when the CAGR grew by 10.9% compared to the 8.1% growth in the World's CAGR over the same period. The following allowed Lebanon to stand as the fastest growing country in terms of ICT Development Index (IDI) (a 0.75 points increase) in 2012 to 5.37, ranking 55th out of 157 countries .

Still, the mobile market in Lebanon remains underdeveloped and not performing at full capacity. The poor conditions of the industry comprises the quality of network coverage, the quality of connection, the quality of data and internet services, the customer service, and the speed of technical repairs .

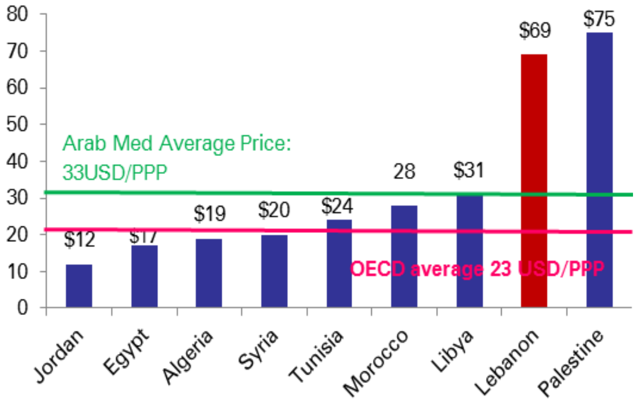
The weak structure of the sector placed Lebanon as the least competitive cellular market amongst the Arab countries in 2013. In details, the Cellular Competition Intensity Index for Lebanon stood at 41% similar to that of Syria and close to the respective 49% and 48% indices of Qatar and Libya. As for the top performers, Saudi Arabia ranked first with 77% and was followed by Jordan (76%), Palestine (72%) and Egypt (68%). In fact, Lebanon's mobile penetration rate remains relatively low. Standing at 87% in 2013, the country's penetration rate is still below the regional average that hovers around 119% .

Lebanon's mobile sector is one of the most expensive markets in the Arab World despite the downward trend in the price of mobile calls that started in 2012. In fact, the price of the cheapest mobile basket for 100 calls /month in Lebanon shed by 9% y-o-y in 2012 to $90 and by a considerable 23% in 2013 to $69. According to the Telecommunications Regulatory Authority (TRA), the Lebanese mobile basket for 100 calls /month ranks second after Palestine's basket that amounted for $75 as of November 2013. Despite 2013's substantial drop in prices, the Lebanese mobile basket's value remained higher than the $33 Arab Med average price and the $23 average price in the OECD countries .

Evolution of Mobile Basket Prices in Lebanon for 100 calls /month



Mobile Basket Prices for 100 calls /month (As of November 2013)



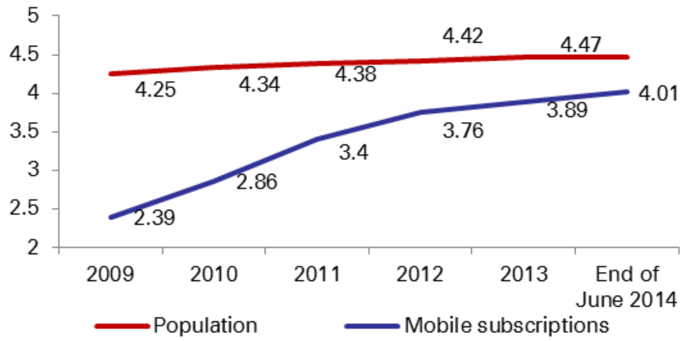
Source: TRA

The mobile market in Lebanon is state-owned but operates through 2 private mobile operators, Touch and Alfa. Both of these companies are controlled by the Lebanese Ministry of Telecommunications (MoT) and privately managed by Orascom Telecom of Egypt operating as Alfa and Zain of Kuwait known as Touch, in return for a management fee. By the end of June 2014, Touch and Alfa respectively grasped 53% and 47% of total market share.

One of the major obstacles to the sector's reaching its full potential relies in the government's policy of short-term license extensions. In fact, management contracts of operators Alfa and Touch handled by Global Telecom Holding and Zain are carried out on a three-month basis, a short-time frame that stands in the way of long term investment strategies. This has reduced both companies' motivation for expansion that can also be well perceived through the lack of adequate investment and the poor infrastructure that do not permit the provision of advanced and innovative mobile services. It was the case of the 3G services when mobile operators weren't motivated to launch the new internet service and lacked in time to follow technological evolution that was already present in almost all Arab countries since 2007 .

In addition, the government ownership of both mobile operators has kept tariffs inexplicably high, repressing growth within the sector. The mandated prices also can restrain the incentive for investment as well as tempering competition and services offered in the mobile market. In details, network managers, do not have control over retail prices which are set by the government, leaving the sector with an uncompetitive environment and a narrow freedom margin that prevent Alfa and Touch from providing better offerings in terms of services and prices .

Lebanese Population and Mobile Subscriptions Evolution (In M)



Source: World Bank, TRA

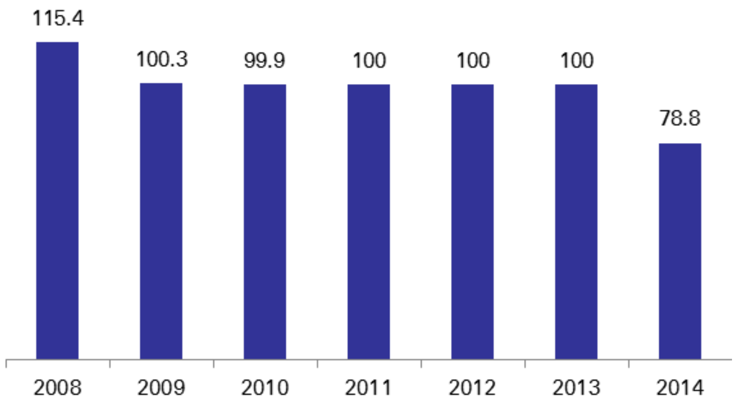
Yet, mobile subscriptions maintained the upward trend in 2013 to almost touch the level of residents. Mobile subscriptions stood at 3.89 M in 2013 and hit the 4M mark by the end of June this year . Accordingly, 93% of total inhabitants in Lebanon will mostly become subscribed on a mobile phone line by the end of 2014 .

Greater public attention is given to the development of the industry which is well perceived through the increasing investments and the maintenance of the infrastructure. Mobile operators are facing the increasing pressure from the MoT as the latter warned them over the quality of their networks. Both companies risk the termination of their contracts with the government if their networks' quality was not improved .

Because believing that a reduction in prices would boost subscriptions and raise usage, the government decided to lower tariffs for telecom services again with postpaid mobile subscribers receiving, starting the 1st of June, an additional 60 minutes of calls to compensate for the $15 monthly subscription fee. Prepaid call tariffs dropped to $0.25/min from a previous $0.36/min and 1 SMS costs 5 cents instead of 9 cents previously. As for Internet data plans, a 2 megabits per second data plan embraced a 40 gigabytes quota at a monthly $19 compared to the previous rate of $50 per 20 gigabytes. The cost of the HDSL service was reduced from $150 to $83, while the quota doubled from 40 GB to 80 GB.

Telecom revenues are one of the largest sources of income for the government and are used to service the state's debt. In fact, proceeds to the government from the telecommunications' sector amounted $1.43B in 2013, almost 15% of total fiscal revenues. With subsequent reduction in mobile prices, the government will certainly lose a part of its fiscal revenues. Yet, the Cabinet is expecting higher mobile penetration in the coming period. The MoT explained that the rates' cut will be offset by a rising number of subscriptions and the telecoms revenues' decline will only be temporary .

Communication CPI in June



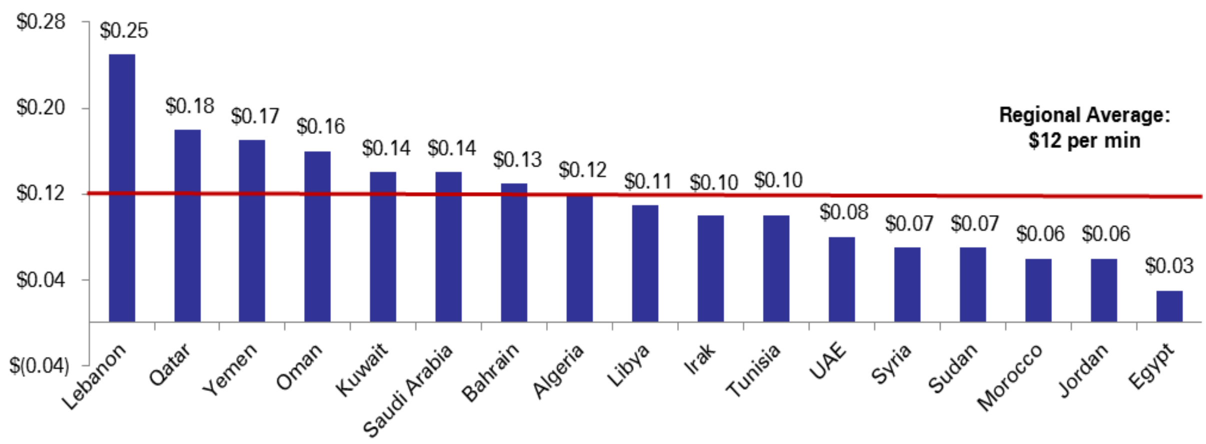
Source: CAS

The government's decision directly impacted the Consumer Price Index (CPI) level in June. Even though communication is not a heavy-weighted sub-index (a 4.6% weight of the CPI), it managed to trigger down the monthly inflation rate in June 2014. Communication prices shed by 21% from May's level tightening the monthly inflation in June by 0.7% from the previous month. Hence, the year-to-date inflation rate stood at 0.6% .

Consumers welcomed the Ministry's move as they endured the unjustifiably high prices for a long time. In contrast, mobile operators were afraid of seeing their revenues decline due to the low tariffs. In fact, the BMI highlighted that Alfa recorded by the end of June a 30% rise in data consumption on its network. Another report also forecasted that cellular mobile phone subscribers are expected to reach 4.55M by the end of 2014, up by 4.3% y-o-y from 2013.

The MoT's move is promising but offers little improvement on the regional scale. The Lebanese consumer is still paying more for prepaid services than any other Arab country . Lebanon ranked as the most expensive country in term of average prepaid price at $0.25 per min and was followed by Qatar and Yemen with respective $0.18 per min and $0.16. Egypt stood as the cheapest country in the Arab World for an individual to make a 1 minute call from a prepaid line at $0.03. Some of low tariffs can be also found in Jordan ($0.06 per min), Morocco ($0.06 per min), Sudan ($0.07 per min), Syria ($0.07 per min) and UAE ($0.08 per min.(

Average Basic Prepaid Price per Minute across the Arab World



Source: BLOMINVEST Research Department compilation

Technology revolution and new consumer trends have been a double edged-sword for both Touch and Alfa. Besides the decreasing prices, the 2 phone operators are struggling to maintain their profits along the booming of smartphones that furthered demand for mobile broadband on the expense of the SMS service and phone calls. Numerous free applications emerged allowing free text messaging, phone and video calls such as WhatsApp, Viber, Skype etc…

When 3G services were launched in November 2011, the usage of Internet in Lebanon hit new highs. The new technology was extremely appealing to the consumers sending the number of mobile broadband subscribers 158% higher in the first year only (472,000 or 14% of total mobile subscribers). In 2012, mobile broadband services saw another yearly surge in demand by 173% sending the number of subscribers to 1.29M (or 34% of total subscribers). By the end of 2013, more than 50% of mobile subscribers (2.02M) had already a mobile data plan which was facilitated by the introduction of bundles and new type of packages. At the end of June 2014, mobile network operators revealed that mobile broadband subscriptions almost rose by 16% from December 2013's level to 2.35M.

Advanced and innovative new mobile services such as the 4G LTE services were launched in May 2013. As of December 2013, there were around 400 sites (200 sites in each company) located in Central Beirut. As of December 2013, the number of 4G subscribers reached 2,000 .

However, it is worth mentioning that the MoT's measure to cut tariffs will mainly enhance data offerings' demand (3G and 4G) rather than boosting the total number of mobile subscribers. This can be confirmed by the growth of the mobile broadband subscribers in the first six months of 2014 as it rose to 59% compared to 52% by the end of 2013 .

Another reshuffling plan to bolster the sector's performance was proposed in June 2014 by Lebanon's Higher Council for Privatization (HCP). The proposal emerged from a long-dormant plan initiated in July 2002 when the Law 431 under the name of "Telecommunications Law" was issued. The plan consists on merging state-owned operator Ogero and two directorates of the MoT into a new company named Liban Telecom, to be licensed for a full range of fixed and mobile services.

The liberalization of the sector and its openness to competition are essential for its growth which is still subject to controversy. This will ensure higher customer benefits through lower prices, better quality, broader range of offers, and wider mobile broadband penetration. It will also boost the level of investments, driving up the mobile sector's contribution to economic growth, and creating thousands of jobs for the highly-educated labor-force .

On the fiscal front, any short-term drop in revenues would be compensated for, as fiscal proceeds are estimated to rise for every increase of broadband penetration. The enhancement of the sector would then impact the overall economy .

Yet, and from a political perspective, privatization poses a controversial debate as the sector represents a major fiscal contributor to the government .

Potential strategies can focus on reaching a middle ground approach where the mobile sector, and hence the broad telecoms sector, can converge to a Public-Private-Partnership (PPP) whereby the public and private sectors work together for the benefit of the mobile sector. Accordingly, the government would keep on getting part of the revenues through profit sharing agreement with the operators. This will free the mobile operators partly, while boosting their investment appetite as well as bolstering competition in the market.

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