

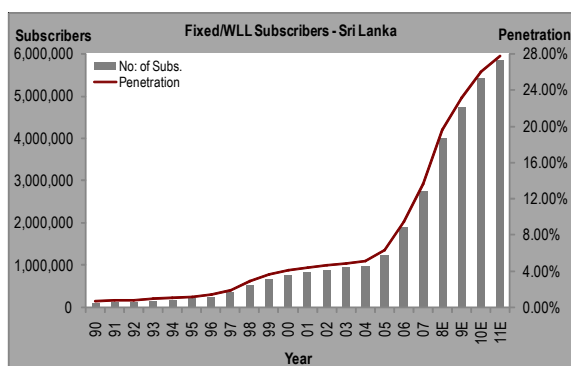
Sri Lanka : Telecommunication Sector

Fixed Line Segment	Mobile Segment
Sri Lanka Telecom Ltd (SLT)	Dialog Telekom Ltd (Subsidiary of Telekom Malaysia)
Suntel (Pvt) Ltd	Hutchison Telecommunications Lanka (Pvt) Ltd
Lanka Bell (Pvt) Ltd	Tigo (Pte) Ltd
MTT Network (Pvt) Ltd	(A fully owned subsidiary of Millicom International Cellular S.A.)
(Acquired by Dialog Broadband (DBN) which is a fully owned subsidiary of Dialog Telekom)	Mobitel (Pvt) Ltd
	(A fully owned subsidiary of Sri Lanka Telecom)

	2002	2003	2004	2005	2006	2007	2Q2008
Fixed Line Subs	883,108	939,013	991,239	1,243,994	1,884,076	2,742,059	3,861,742
Growth in Fixed Line		6%	6%	25%	51%	46%	41%
SLT Market share	87%	88%	87%	77%	63%	53%	40%
Mobile Subs	931,403	1,393,403	2,211,158	3,361,775	5,412,496	7,983,489	9,473,931
Growth in Mobile		50%	59%	52%	61%	48%	19%
Dialog Market share	52%	60%	61%	63%	57%	53%	51%
Mobitel Market share	12%	10%	13%	12%	16%	18%	20%
Total Line Population	1,814,511	2,332,416	3,202,397	4,605,769	7,296,572	10,725,548	13,335,673
Growth in Line		29%	37%	44%	58%	47%	24%
SLT Market share (Fixed & Mobile)	49%	41%	36%	30%	28%	27%	25%
Fixed Line Penetration	5%	5%	5%	6%	9%	14%	19%
Mobile Penetration	5%	7%	11%	17%	27%	40%	47%
Line Penetration	10%	12%	16%	23%	37%	53%	66%

Penetration Levels are calculated on an estimated population of 20.265 million for 2Q2008

Source : Central Bank Data & Company Quarterly Results



Operator	CDMA Subscribers (as of 2007)	Non CDMA Subscribers	Total (as of 2007)	Market Share on CDMA Subscribers (%)	Market Share on Total Subscribers (%)
SLT	520,017	931,737	1,451,754	28.73	52.94
Suntel	562,138	-	562,138	31.05	20.50
Lanka Bell	700,000	-	700,000	38.67	25.53
DBN	28,167	-	28,167	1.56	1.03
Total	1,810,322	931,737	2,742,059	100.00	100.00

Jeewanthi Malagala

jeewanthi@jkstock.keells.com

John Keells Stock Brokers (Pvt) Ltd

Company No. PV 89
130, Glennie Street,
Colombo 2,
Sri Lanka.

Tel: 9411 2421 101-9 (Gen.),
9411 2326 003,
9411 2439 047/8

Fax: 9411 2326 863,
9411 2342 068

December 2008



OVERVIEW

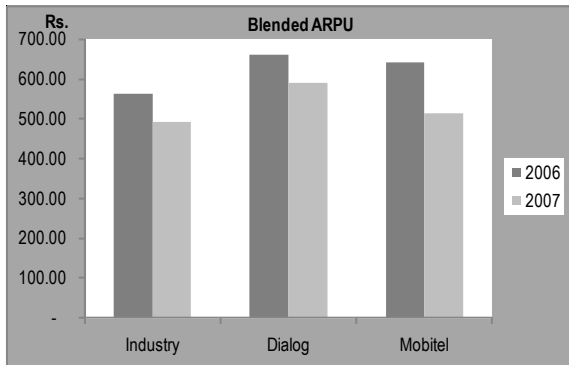
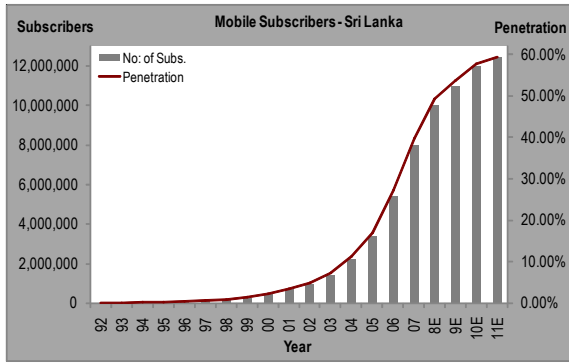
- With a CAGR in line growth of over 43%, the telecommunications sector has been a core driver of the Sri Lankan economy over the past five years. Much of the growth has come through the expansion in the mobile segment, which has increased at a CAGR of 54% over the same period. The granting of fixed CDMA licenses to the fixed line operators proved a catalyst to a significant jump in fixed line connections from 2005. The fixed line segment is dominated by Sri Lanka Telecom whilst the mobile sector is dominated by Dialog Telekom with a market share of 40% and 51% in their respective segments.

FIXED TELEPHONY

- The incumbent SLT is by far the largest fixed line operator in the island and owns licenses to provide fixed (both wired and wireless), mobile, broadband and media services in the country. Its sluggish fixed line segment has registered significant growth, with a CAGR of 23% following the launch of fixed CDMA services from 2005. However, delay in offering CDMA licenses to SLT resulted in a decline in its market share as operators such as Lanka Bell and Suntel acquired majority of the subscribers.
- By 2Q2008, approximately, 76% of fixed and fixed wireless lines were CDMA, which accounted for more than 90% of incremental connections. Currently, incremental connections are approximately 186,000 per month, and we expect momentum to improve with the clearing of rebel held areas in the North and East. Further, the only fixed wired line operator, SLT, has launched a special package offering wire line connections at cheaper rates which enable the users to enjoy a wide range of services including broadband. The segment continued to witness downward revisions in call charges as competition among operators intensified. We expect this to boost penetration levels to reach a saturation of 28% by CY2011.

MOBILE TELEPHONY

- The mobile telephony segment dominated by Dialog Telekom, witnessed a CAGR of 54% over the last 5 years which was mainly due to falling cost of handsets along with better economic conditions than those seen currently. All four operators currently run on 2-2.5G networks while Dialog and Mobitel have moved onto 3G and 3.5G networks respectively. Mobile penetration in Sri Lanka at the end of 2Q2008 was approximately 47%. Incremental connections are approximately 248,000 connections per month and we expect this to increase with the entry of Bharti Airtel.
- Similar to the fixed segment, competition has seen operators slash rates, with market leader Dialog cutting rates by approximately 30% in FY06, 50% in FY07 and another 50%



discount on call charges beyond 1 minute, applicable from 3Q2008. The most recent tariff revision was a shift towards the per second billing system applicable to both pre and post paid users from 4Q2008. The Post paid users are entitled to 1,000 free outgoing minutes per month within the network which exceeds the segment's current Minutes of Use. Despite heavy reduction in call charges ahead of entry of Bharti Airtel, it is still believed that domestic call charges are relatively higher than those in the region.

- ✓ Mobitel, a fully owned subsidiary of SLT, has recently introduced a package to the state sector employees and pensioners offering call charges below the average. The company expects this to add at least 300,000 subscribers to its network by the year end out of 1.1 million state workers which will further boost penetration levels.
- ✓ We expect penetration levels to reach 49% by CY08 after restatement of subscribers belonging to Hutch to 958,000 from 1,3 million. We also expect the curve flatten off by FY11 reaching penetration levels of approximately 59%. With competitive pricing, all operators are likely to experience high churn rates creating a possibility of industry consolidation in the long run.
- ✓ Although in the past minutes of usage have been extremely responsive to rate cuts, the series of latest price revisions have proved otherwise due to spiraling inflation in the country. Further, ARPU's have dropped significantly with the proliferation of pre-paid subscribers belonging to low income groups with lower disposable income. In addition, the recent taxes levied by the Government on mobile operators have been passed on to the users which have also led to a slow increase in minutes of use.
- ✓ Most operators have invested heavily in building up the infrastructure to increase capacity and are currently under heavy cost pressure consequent to high energy costs and heavy network related depreciation. However, a reduction in fuel costs may reduce the burden on cost significantly thereby minimizing the adverse impact on the sector earnings. Further, the Government has levied a revenue tax as Nation Building Tax of 1% which too will affect sector earnings.
- ✓ Although both Dialog and Mobitel have undertaken aggressive 3G roll out, it is unlikely that these investments will generate a return in the short or medium term mainly due to the lack of interest in subscribers for such advanced facilities. Thus, operators focus on the provision of Value Added Services (VAS) which are likely to generate revenue until such time the investments in advanced technologies such as 3G begin to provide a return. At Dialog, VAS accounted for approximately 10% of total revenue while SMS revenue continued to be the largest component of non-voice revenue accounting for 5% of total revenue.

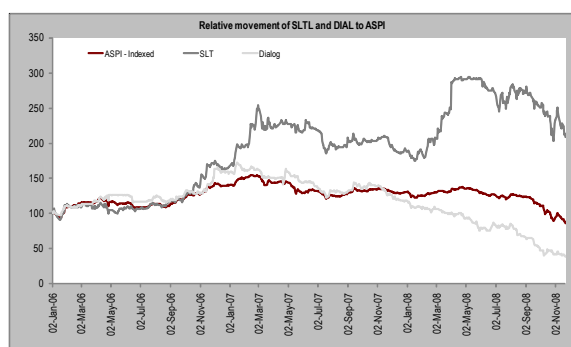
DATA SERVICES

- ✓ SLT holds majority of the market for data services and has 88,000 and 54,000 subscribers for Dial up and ADSL connections respectively. By 1Q2008, Internet and E-mail subscribers are estimated to be around 208,000 of which, the majority use dial up to access these services. The segment has experienced a CAGR of 24% over the last 5 years and with a penetration level as low as 0.97%.
- ✓ With such low levels of penetration, falling prices of PCs and its growing importance to economic development, there is a clear indication of room for growth for most of the operators in the industry.

OUTLOOK ON THE INDUSTRY

- ✓ Mobile, fixed line and data services segments have been the core drivers of the telecommunications sector with mobile segment being the largest contributor to sector earnings. We believe that there is still growth potential in the fixed line and data services segment with the clearing of rebel held areas.
- ✓ The Mobile segment is currently facing a deterioration in margins as a result of intense price competition prior to the commencement of commercial operations by Bharti Airtel. Most operators have slashed call rates with a view of improving Minutes of Use while attempting to retain the subscribers. However, this move has adversely impacted earnings of all operators as volumes failed to grow as expected.
- ✓ Bharti Airtel could be expected to offer call charges below those offered by the market leaders which could result in heavy churn rates for most operators. Consequently, we expect the earnings of operators in the industry to decline in the next 2 years with a high possibility of consolidation in the industry.
- ✓ Currently, all operators run on the “sender keeps all” regime whereby the operator from which the call generates, keeps all of the revenue. However, TRC has decided to extend this regime for a further period of 1 year with an option to review it after 6 months. If “calling party pays” regime is implemented, Dialog would enjoy a competitive advantage over the other operators although the most recent price revisions have been detrimental to the company’s earnings.

Company	Shares in Issue (Mn)	Price (Rs.)	Price / Book Value (x)	PER (x)			EPS Growth (%)		
				FY08	FY09E	FY10E	FY08	FY09E	FY10E
Sri Lanka Telecom	1,804.86	33.75	1.46	10.80	9.19	7.92	3.71	17.52	16.07
Dialog Telekom	8,143.78	6.25	0.99	5.68	39.27	76.89	(11.38)	(85.55)	(48.92)
Sector	9,948.64	11.24	1.20	7.65	14.11	13.38	(6.10)	(45.75)	5.44



EARNINGS

- ✓ Over the years, the 2 giant providers of telecommunication services in Sri Lanka have invested both in infrastructure and technology to become leaders in the provision of fully fledged quadruple play services. Dialog and SLT have already begun provision of mobile, fixed, data and media services but DIAL is yet to see the contribution from data and media services to the group’s bottom line.
- ✓ Traditional voice penetration levels show room for further improvement, though entering the late growth phase, whilst the

low data penetration provides significant opportunities. However, the industry as a whole is likely to see a reduction in their margins mainly due to lowered rates, increases in energy cost and higher finance costs with further turmoil possible with Bharti Airtel expected to begin its operations in December 2008.

- ✓ Additionally, the focus on convergence and investments in related infrastructure is unlikely to generate a return at least in the medium term but would add to the operators' cost in terms of higher depreciation. Earnings have dipped 6.1% in FY08 on the back of an 11% drop in Dialog earnings and subdued growth at SLT on account of a revenue write off on the rate rollback.

VALUATIONS

- ✓ The industry witnessed a decline in the EPS growth mainly due to pressure on profitability as most operators began to expand their networks ahead of the anticipated increase in subscribers.
- ✓ Currently, the sector P/E trades at approximately 14.2 times FY09E earnings, a 85% premium to the market. SLT stands to gain an increase in its market value given that the projected earnings or even a higher growth is achieved as contribution from its mobile arm and data services are expected to increase. Dialog on the other hand is likely to face tough conditions given its high level of dependency on mobile income which is likely to be under pressure over the next few years.
- ✓ Despite almost all operators having undertaken extensive investments in terms network expansion for convergence, it is likely that the profitability of the sector will fall as these investments are less likely to generate returns in the short run, with its main segment, voice telephony, reaching the maturity period. In addition, the existence of fierce price competition among the operators will also cause reduction of their margins. Operative economic conditions for both subscribers and operators are expected to improve with a gradual decline in inflation by FY10E, therefore, we believe that sector earnings will grow marginally by 5.4% thanks to an expected growth of 16% in SLTL's earnings.