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Telecom

Executive Summary

- ✚ We remain positive on the long-term outlook for the telecom sector.
- ✚ Merger and Acquisition (M&A) activities in the sector have risen, particularly in Asia. This will help to underpin the sector together with the rush of initial public offerings (IPOs).
- ✚ AT&T has revised downwards its earnings and sales forecast for the year, citing pricing pressures. Standard & Poor's (S&P) has warned that AT&T's ratings could be downgraded as a result.
- ✚ Virgin Mobile is planning an IPO in July while China Netcom and Hutchison will list in the fourth quarter.
- ✚ Nokia's market share in the second quarter was eroded as sales dropped 5% year-on-year (yoy). Motorola and Samsung benefited from Nokia's slide as both companies grew their market share.
- ✚ Sony Ericsson reported a profit of US\$139 million in the April-June period versus a loss of US\$126 million a year ago. Revenue surged 55% yoy to US\$1.85 billion.
- ✚ We believe the UOB Global Telecom Fund has the potential to outperform the broader market and reward long-term investors.

GLOBAL TELECOM REVIEW

16 July 2004

Outlook

Mergers and Acquisitions (M&A) in the global telecom sector have already hit US\$121.7 billion so far this year, compared with the US\$140.5 billion seen for the whole of last year, according to data provider Dealogic. Asia, including Japan and Australia, has been a hotbed for M&A activities with US\$23.5 billion worth of deals done, almost as much as the US\$24 billion in 2003. China has dominated Asian M&As, as China Telecom, China Mobile and China Unicom have spent almost US\$13 billion to buy provincial networks from their parent companies recently. US investment firm Carlyle Group and Japan's Kyocera Corp are set to purchase a 90% stake in mobile operator (DDI Pocket) from KDDI for US\$2 billion in the biggest leveraged buyout in Japan this year.

Mainstream telecom companies

AT&T, the largest long-distance telephone company in the US, has announced that it has cut its earnings and sales forecast for the year in the face of pricing pressures from **MCI** and local telephone companies. After the announcement was made, Standard & Poor's (S&P) warned that it may be forced to cut AT&T's long-term debt ratings to junk, on the back of the company's weakening revenue. AT&T currently has about US\$11.9 billion in outstanding debt, and a cut in ratings to junk status would increase the company's future borrowing costs.

Europe's two largest telecommunication companies, **Deutsche Telekom AG** and **France Telecom** have signed a memorandum of understanding for joint projects in areas of research and development. The companies said that they will aim to cooperate in the development of "future-oriented applications and services for next-generation networks and for intelligent access technology".

Britain's **Virgin Mobile** is expected to be valued at up to £713 million (US\$1.32 billion), when it lists on the London Stock Exchange on July 21. Parent company Virgin Group will sell up to 43% of Virgin Mobile in the listing. Virgin Mobile was started in 1999 with an investment of £50 million (US\$93 million), together with **Deutsche Telekom AG** as a joint venture partner. Leveraging on the Virgin brand, the company has attracted 4.1 million subscribers in less than five years. The company has earnings before interest, tax, depreciation and amortisation (EBITDA) of £78.7 million (US\$145.7 million) for the year to March 2004 on sales of £453.3 million (US\$839.5 million).

China is reportedly considering plans to merge its big 4 telephone operators into 2, merging the parents of **China Mobile** and **China Netcom**, and of **China Unicom** and **China Telecom**. All are listed on the Hong Kong Stock Exchange except for China Netcom. China Netcom, China's number two fixed line phone operator, aims to launch its US\$1.5 billion IPO in Hong Kong and New York as early as September 2004. China Netcom is expected to price its shares at a discount to its peers as Netcom is much smaller than rival fixed line operator China Telecom and its user base is concentrated in China's less affluent regions, therefore limiting its IPO pricing power. China Telecom, which went public in 2002, trades at about nine times forecast earnings per share. Cellular operators China Mobile and China Unicom both trade at forward price-earnings ratios of between 11 and 12. China Netcom plans to float 25% of its enlarged share capital and expects to be profitable in 2004 after incurring losses last year.

Hong Kong's **Hutchison Whampoa** has delayed the IPO for its telecoms business, **Hutchison Telecommunications International Ltd (HTIL)**, to October 2004. The IPO is estimated to be worth up to US\$2 billion in a dual listing in Hong Kong and New York. Hutchison also has plans to consolidate its Indian operations into a single entity, which will then be spun off and listed on the Indian stock exchange after it has completed the HTIL listing.

Indian telecoms companies are in the midst of a merger and acquisition spree as evidenced in the deals that have been done in the telecoms sector for the past 6 months. Industry experts expect the sector to trim down from the 11 companies presently to 4 or 5 major players. Analysts expect the survivors of the shakeout to include **Bharti Tele-Ventures**, which is 28% owned by SingTel, state-run **Bharat Sanchar Nigam** and soon to be listed **Hutchison Essar**, as well as the mobile divisions of **Reliance** and **Tata**. The Department of Telecom is also currently considering the possibility of merging **Mahanagar Telephone Nigam** with Baharat. Mobile phone users in India are forecast to explode from the current 37 million subscribers to over 100 million next year.

Mobile phone manufacturers

Nokia's market share fell in the first quarter of the year to its lowest in 5 years as consumers chose clamshell and camera phones made by **Motorola** and **Samsung Electronics**. The global market share of Nokia dropped to 28.9% from 34.6% a year earlier, losing ground to all its competitors according to research house Gartner. Meanwhile, Motorola's market share rose to 16.4% from 14.7% and Samsung's share reached 12.5% from 10.8%. Samsung has reported that it expects to sell up to 22 million handsets in the second quarter, up 9.5% from a record 20.1 million in the first quarter.

Nokia estimated that it had a 31% market share in handset sales in the second quarter. Nokia's second quarter net income was €135 million (US\$167 million), almost unchanged versus a year ago. Net sales in the second quarter actually declined 5% yoy to €6.64 billion (US\$8.20 billion). The decline in sales, at a time of rising unit shipments, shows the impact of lower average prices for the Nokia phones. Nokia derives around 80% of revenue from selling mobile phones. Mobile phone sales declined 13% in the second quarter to €4.17 billion (US\$5.15 billion) and Nokia's operating margin of the division slid to 19.1% from 27.2%.

Mobile phone maker **Sony Ericsson** has reported a higher than expected second quarter profit, thanks to stronger demand for its camera phones. The world's fifth largest handset maker announced a pretax profit of €113 million (US\$139 million) in the April-June period, reversing a €102 million (US\$126 million) loss in the same period last year. The company's pretax profit margin also rose to 7.5% from 7.2% in the previous quarter. Revenue grew 55% to €1.5 billion (US\$1.85 billion) from €1.1 billion (US\$1.36 billion) a year earlier amid booming global demand for Sony Ericsson's new line of mobile phones. The company shipped 10.4 million phones in the period and has revised upwards its global handset sales forecast.

LG Electronics has announced that it intends to double its exports of handphones to India from the present US\$70 million a year to US\$140 million in 2005. LG is now the largest supplier of handsets in the country with a 33.5% market share, overtaking the previous market leader Nokia, who is now in second place with 29.7%.

Lucent Technologies has signed a contract worth at least US\$5 billion to supply equipment, software and services to help **Verizon Wireless** improve its network. The contract includes a US\$525 million pact signed in March for Lucent to supply Verizon Wireless with network gear for high-speed Internet services.

Risks

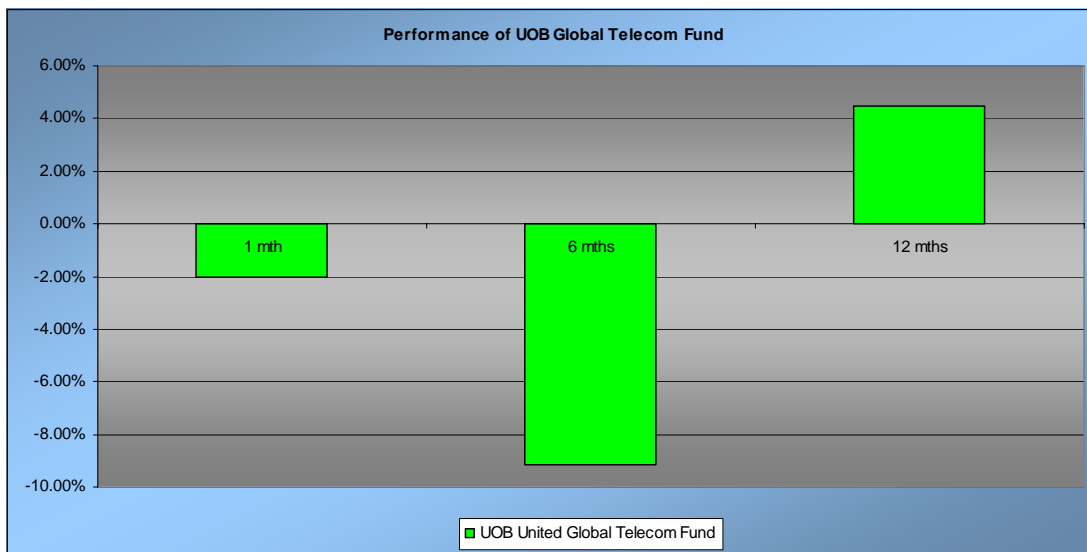
The Telecom sector is expected to be underpinned by strong mobile phone sales, M&A activities and potential IPOs. We remain positive on the long-term outlook of the sector. However, the concerns lie with the US market where pricing pressures may affect the telecom companies.

Funds Selection

We have selected the UOB Global Telecom Fund which we believe has the potential to outperform the broader market and reward long-term investors. The performance of the UOB Global Telecom Fund is shown below. The chart shows the performance of the fund in graphical form.

Return Performance	1 mth	6 mths	12 mths	3-Yr Monthly Volatility	NAV/ Bid Price
UOB United Global Telecom Fund	-2.05%	-9.14%	4.48%	5.2%	0.6269

Source: Fundsupermart as at 140704



Note: Exchange rates used (as at 160704) —
 1 Euro to 1.2344 USD
 1 Pound to 1.8519 USD

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