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***STRONG GROWTH OF
TELECOMMUNICATIONS
AND THE FUTURE OF
CANTV: TWO SIDES OF
THE SAME COIN***

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THE CLIENT

The telecommunications sector has grown steadily over the last nine years, mainly driven by mobile telephony and the Internet. In this context, the leading company in the sector CANTV, despite good results, is facing an uncertain future.

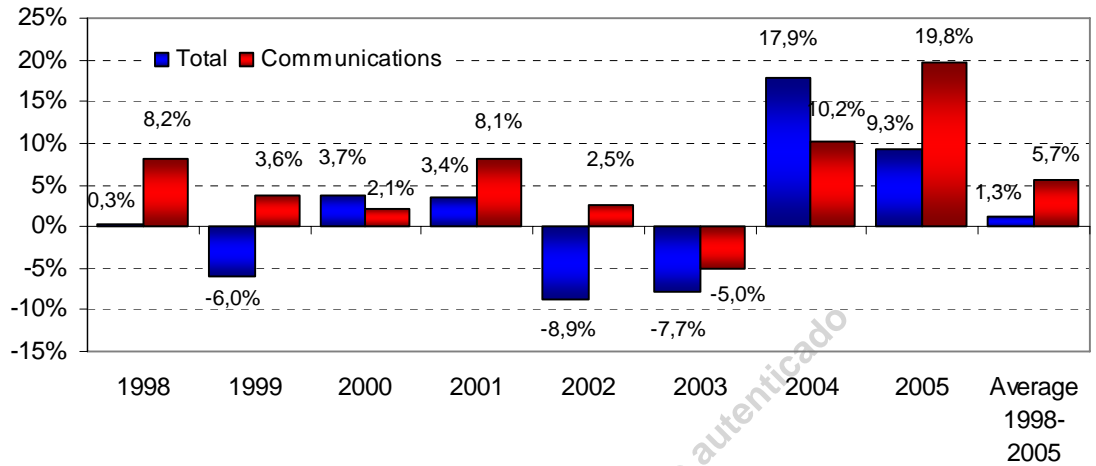
Telecommunications is one of the most dynamic sectors

Although the Venezuelan economy has been growing in the last two and half years, with acceptable growth rates in most economic sectors, telecommunications has maintained this buoyancy since the late 1990s.

In the 1998-2005 period, the average growth rate of the telecommunications sector (in terms of GDP) was 5,7% compared with only 1,3% for the overall economy, which means the sector has expanded four times more than the overall economy.

Weekly Report

GDP Communications vs GDP Total

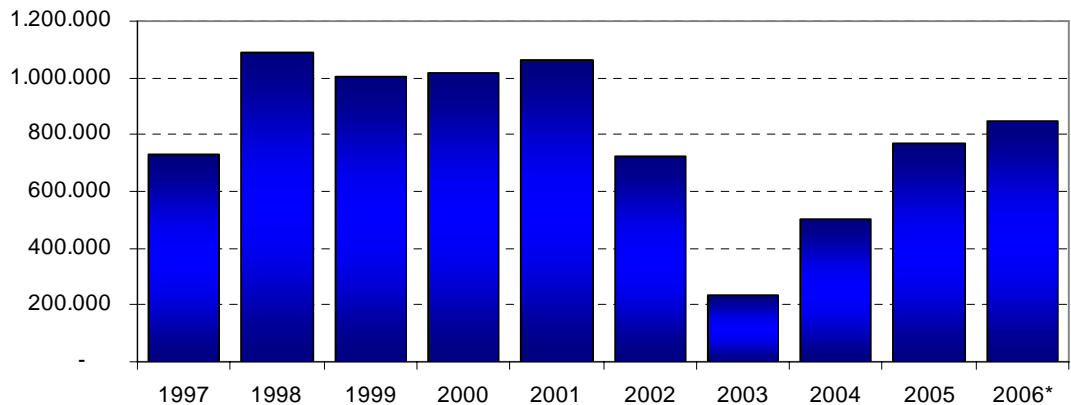


Sources: BCV and Ecoanalítica

Significant investment in the sector

One of the factors behind the excellent performance of telecommunications has to do with the investments. Between 1997-2005, investments totaled US\$7.13 billion, an annual average of US\$792 million. **Ecoanalítica** forecasts that total investments in 2006 will be around US\$900 million. The opening of telecommunications, the boom in mobile telephony and the Internet, are the factors that explain why this sector, which a few years ago had only a 3% share in the overall economy, receives such a high level of investment, especially when the general level of private investment in Venezuela is very low.

TOTAL INVESTMENTS (Thousands of \$) 1997 - 2006



Sources: CONATEL and Ecoanalítica

(*) Estimations Ecoanalítica

Despite expansion the market has not yet reached maturity

The statistics on the sector published by the National Telecommunications Commission (CONATEL) show three fundamental aspects:

1. The expansion of the sector in the last two years was fuelled by growth of mobile telephony and its related services (SMS, Internet, sale of terminals, etc). Mobile penetration leapt from 9% in 1998 to 58% in 1H06. Sources in the sector say the year could end with a penetration rate of around 70%.
2. An important expansion of Internet access with a significant increase in penetration from 3.4% in 2000 to 13.8% in 1H06.
3. A significant downturn in fixed and public telephony, explained mainly by a change in the habits of Venezuelan consumers (who prefer mobile to fixed telephones), and in the case of public telephony freezing of tariffs and the entry of informal actors.

An important factor to bear in mind is that, although the sector has grown significantly especially in relation to penetration, the market still has capacity for expansion. In mobile telephony, the experts consider that a mature market has penetration levels of around 90%. For Internet, penetration is still among the lowest in Latin America, so this service will be one of the most rapidly growing in the coming years.

Mobile telephony will continue to expand in the next few years. Venezuelan consumers are a special case. They demand sophisticated equipment because the mobile phone is seen as a status symbol. Additionally, our replacement levels (change of equipment) are the lowest in Latin America. In the first half of the year, Venezuela was leader in text and interactive messaging. The leading companies in the sector (such as Nokia and Motorola) see Venezuela as the main South American market after Brazil.

Most operating income comes from mobile telephony

A breakdown of operating income (not including the incoming interconnection) show that mobile telephony accounts for 48%, fixed only 13%, and other services 30%. A dramatic case, especially for CANTV, is public telephony which provides only 1.5% of total

Weekly Report

operating income. **Ecoanalítica** considers that mobile telephony will grow to 65% of total revenue in the next two years.

The main actor in the sector is CANTV

CANTV is the most representative company in the telecommunications sector. Through its MOVILNET subsidiary, it is second in mobile telephony, as well as leader in fixed telephony and Internet. And CANTV is responsible for about 55% of all the investments in the sector. So it is no exaggeration to say that the future of telecommunications is intimately related to what happens to CANTV.

Third quarter numbers were very positive

Last week we commented on the CANTV results for 3Q06, emphasizing the 36% increase in revenue, and an EBITDA of US\$256 million. In the January-September period, net profit grew to US\$346 million from only US\$36 million in the same period last year. In the same period, CANTV had a free cash flow of US\$395 million.

Some analysts are concerned because CANTV mobile users grew at a lower rate in 3Q06. In fact, the third quarter is always less significant in attracting users (the key quarters are the second and fourth). Even so, on a year-on-year basis, mobile telephony users increased 69%. Moreover, competition has become much fiercer, not only between MOVISTAR and MOVILNET but also with DIGITEL which now has national coverage and is very aggressive in expanding its user base.

Both EBITDA and free cash flow have been very much higher than market expectations. This year, the market has not been very optimistic about CANTV due to a series of outstanding issues, especially the litigation on the pension retroactive payments and the possible sale of the company.

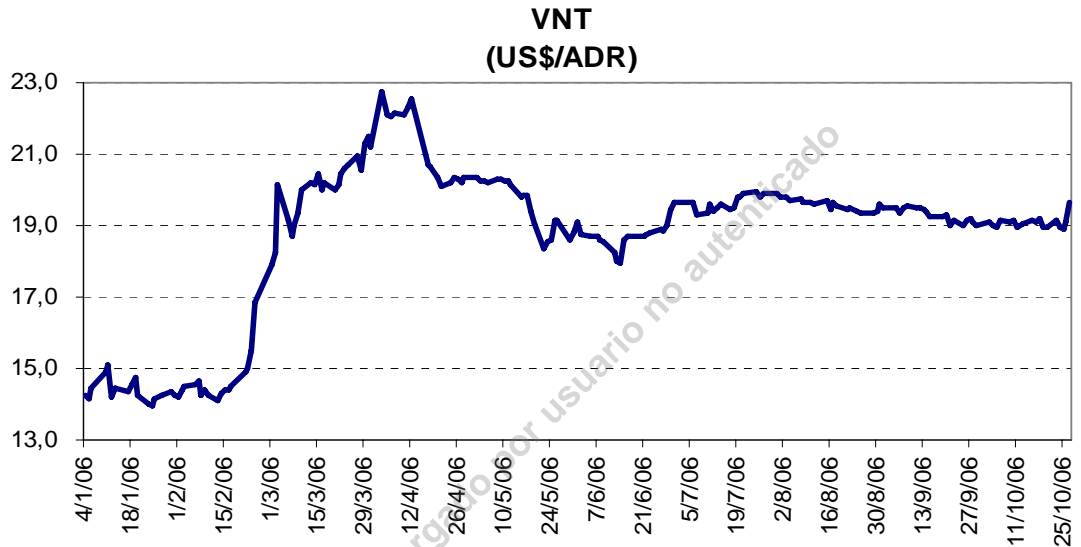
CAPEX	3Q06	3Q05	VAR (%)		3Q06	3Q05	VAR (%)
Revenues	1.742	1.285	35,5%	SUBSCRIBERS (thousands)			
EBITDA	551,1	(315,0)	N.M	Fixed	3.679	3.304	11,3%
Net Income (Loss)	465,0	(332,1)	N.M	Switched access lines	3.256	3.043	7,0%
EPADS (Bs)	4.194,0	(2.995,0)	N.M	Residential	2.527	2.340	8,0%
				Non Residential	617	602	2,3%
				Public Telephones	112	101	11,6%
				Broadband	423	261	61,6%
				ABA (ADSL) lines	406	244	65,7%
				Private Circuits	17	17	2,1%
				Mobile	6.764	4.004	68,9%
				Postpaid	314	238	31,9%
				Prepaid	6.450	3.766	71,3%
				Traffic (millions of outgoing minutes)			
				Fixed Local	3.127	3.568	-12,4%
				Fixed DLD and ILD	617	614	0,5%
				Mobile	1.528	949	61,0%

Billions of Bs	Sep-06	Sep-05	VAR (%)
Revenues	4.775,4	3.562,8	34,0%
EBITDA	1.287,8	397,8	223,7%
Net Income (Loss)	744,5	76,7	870,7%
EPADS (Bs)	6.716,0	692,0	870,7%
CAPEX	716,7	560,5	27,9%
Free Cash Flow	849,1	416,7	103,8%
Debt Payments	47,4	242,6	-80,5%

Sources: CANTV and Ecoanalítica
N.M: No Meaningful

CANTV to pay annual dividend

The Board of directors proposed a new supplementary dividend of US\$1 per ADR, continuing the dividend policy in place since 2001. The dividend needs final approved from a General Meeting in mid-November. In our opinion, it falls within the normal parameters. In fact, the shares have not moved significantly in recent days.



Sources: Reuters and Ecoanalítica

Why are we worried about CANTV?

Despite the excellent results, some factors negative factors persist:

The litigation with the pensioners and retiree:

Last year, the Supreme Court Social Division ordered CANTV to pay a group of pensioners and retirees retroactive payment for adjustment of pensions, which should be in line with the minimum wage. At the time, this news had a negative impact on company performance because it affected cash flow and future labor costs. To cover this, CANTV allocated a provision of US\$653 million.

The second part of this story is that a lower court ordered the Central Bank to calculate the retroactive amount that CANTV has to pay. However, a group of pensioners were left out of the court's decision. Due to this omission, the calculations were put in the hands of SENIAT. In the last three weeks, the CANTV pensioners have been holding street demonstrations to speed up the process. Even the National Assembly has intervened in the dispute, and President

Weekly Report

Chavez has threatened nationalization if the company does not meet its commitments.

November 8 is the deadline for the court to announce the global amount to be paid. However, **Ecoanalítica** believes this decision could be postponed, deepening the uncertainty. There is also the risk, since this is an election year, that technical criteria will give way to the politicians and their cronies. In these conditions, the amount that CANTV finally has to pay to its pensioners could be anything but on our most pessimistic calculations it should not be over US\$750 million (US\$100 million above the provision).

Delays in foreign currency deliveries

Payment of the CANTV dividend has been delayed because the company has not received the foreign currency from CADIVI. The company has suffered from this type of delay since exchange controls were put in place. One of the factors holding up the foreign currency allocation is that the company will not receive its labor clearance certificate until the dispute with the pensioners is settled. So the two decisions are linked.

The delays in the delivery of foreign currency are probably also affecting the company's investment plans and its relations with international suppliers. **Ecoanalítica** hopes this situation does not go on indefinitely.

No response from government on takeover

The entry of Carlos Slim (AMERICA MOVIL and TELMEX) into CANTV is subject to regulatory approval by CONATEL, PROCOMPETENCIA and the National Securities Commission (CNV). None of the bodies involved have pronounced so far. **Ecoanalítica** hopes that the decision will be made known early next year because it is not realistic to expect a decision of this type before the elections.

There is a lot of speculation about the content of the decision. There is talk that the government will not approve the transaction and that the State will buy CANTV because funds are no problem, whereas others think Slim will get Movilnet and sell the rest.

We repeat our opinion that Slim will be allowed to go ahead with the takeover bid for CANTV obtaining a 50% to 60% interest in the total company which would give him control. Slim is likely to spin off the fixed telephony and Internet business because the operations of

América Móvil in Latin America are focused on the mobile market. However, these businesses will not necessarily be acquired by the government, at least in the medium term.

Economic Tips

Expenditure falls in August. According to Central Bank figures, central government expenditure dropped to VEB6.2 trillion, down 5.2% from the same month last year. This expenditure is lower than the average for the last seven months (VEB8.7 trillion). However, *Ecoanalítica* expects expenditure to rebound during the last four months of the year. In August, the government reported a VEB3.3 trillion surplus, a significant figure taking into account that between January and July the government deficit totaled VEB2.2 trillion.

	Inflation August 06		14,88%		Average Inflation January-August 06		12,46%	
FISCAL BALANCE								
CENTRAL GOVERNMENT								
(VEB Billions)								
	August 2006	August 2005	Nominal Variation	January-August 2006	January-August 2005	Nominal Variation	Real Variation	
Total Revenue	9.447	7.903	19,5%	68.372	51.803	32,0%	17,4%	
Non-Oil Revenue	3.791	3.147	20,5%	31.175	22.090	41,1%	25,5%	
Oil Revenue	5.656	3.117	81,5%	36.573	24.493	49,3%	32,8%	
Central Bank Earnings	-	1.639		624	5.220	-88,1%	-89,4%	
Total Expenditure	6.175	6.508	-5,1%	67.306	42.773	57,4%	39,9%	
Primary Expenditure	5.745	5.908	-2,8%	62.297	37.193	67,5%	48,9%	
Interest Payments	430	600	-28,3%	5.009	5.580	-10,2%	-20,2%	
Domestic Debt	229	314	-27,2%	2.153	2.722	-20,9%	-29,7%	
Foreign Debt	202	286	-29,5%	2.856	2.858	-0,1%	-11,2%	
Quasifiscal Expenditure	-	-		-	-			
Fiscal Balance	3.272	1.395		1.066	9.029			
Primary Balance	3.703	1.995		6.075	14.610			
Non Oil Balance	(2.384)	(3.361)		(36.131)	(20.684)			
Debt Amortization	44	463		5.333	3.487			
Net Monetary Injection	1.042	2.988	-65,1%	37.420	13.850	170,2%	140,2%	
Financing Requirements	(3.228)	(932)		4.267	(5.542)			
Foreign Debt	66	19		226	85			
Domestic Debt	1.184	549		1.188	7.462			
Treasury Bonds	1.184	410		1.184	6.233			
Treasury Debt	-	139		4	1.229			
Others	(4.478)	(1.500)		2.853	(13.090)			

Sources: BCV and Ecoanalítica

Weekly Report

Now there is a surplus. Between January and August this year, the fiscal accounts reported a surplus of VEB1.1 trillion generated almost entirely in August in contrast to the VEB9.00 trillion surplus in the same period last year. Net monetary injection expanded 140% year on year in real terms, while the drawdown of funds from the National Treasury was VEB2.9 trillion during the first eight months. However, in August, the government accumulated a figure equivalent to VEB4.5 trillion in the Treasury accounts.

Balance of domestic debt increases Between July and August this year, domestic debt grew VEB1.3 trillion to VEB29.0 trillion (US\$13.50 billion). It is worth noting that, according to the Central Bank, there was no redemption of public paper on local markets in August.

Tax evasion squeeze. According to Tax Superintendent José Vielma, since 2003 the tax evasion rate has fallen from 67% to 43% in 2004, to 36% in 2005, and to 23% in 2006, which is reflected in the rising income tax collection figures. According to Vielma, footwear, textiles, hardware, bakeries, and jewelers are the commercial sectors with the highest rate of tax evasion.

CADIVI numbers rise. CADIVI President, Manual Barroso, said that authorizations for liquidation of foreign currency to October exceeded US\$20.00 billion, similar to the amount for all of 2005. This trend suggests that in 2006 total delivery of foreign currency will be over 25% more than all last year, which is between US\$24.00 and US\$25.00 billion, Barroso said.

Oil Tips

Oil basket falls again. The Venezuelan crude barrel fell US\$0.47 last week to US\$49.48 per barrel. In total, the Venezuela oil basket lost US\$16.34 per barrel in the last 12 weeks.

Wishful thinking According to the PDVSA president, the PDVSA associations with foreign companies in the Orinoco Oil Belt should complete their migration process to joint ventures in which PDVSA has a majority equity interest before the end of the year. In our opinion this is wishful thinking. PDVSA has still not concluded the migration process for the operating agreements which began in the first quarter of this year. Four projects are operating in the Belt (Cerro Negro, Hamaca, Petrozuata and Sincor) with Statoil, associated with the French company Total and the US companies ExxonMobil, ConocoPhillips and Chevron. The associations produce a total of 566,000 barrels a day.

Sectoral Tips

More pressure on the banks. The government could be considering a bill to grant bank preferences to industry, establishing a compulsory industrial loan portfolio on special financing conditions for the banks. The draft bill states that the executive will fix in the first month of each year the percentage that commercial and universal banks must allocate to this portfolio, which in no case will be less than 10% of total lending. Priority will be given to the SMEs and cooperatives in accessing the financing.

CVG TELECOM to offer wireless telephony. CVG Telecom will soon introduce a new wireless fixed telephony service using its approximately 36 cells in the CDMA 450 system, distributed around the country. The interconnection will provide Internet access which will improve communications in the country. At its start, the service will benefit over 800,000 people.

Important growth in electricity demand. According to the Interconnected Systems Operating Office (Opsis), in September the value of demand for power reached its highest point this year at 15,779 megawatts, up 9.91% from the same period of 2005, while power consumption grew 7.85% in the month.

Commercial sales continue rising. The Central Bank reports that the volume of commercial sales grew 31.2% in July year on year. Wholesale sales rose 38.3% and retail 28.2%. This year, the total volume of sales increased 33.2% with 40.1% expansion in the wholesale sector and 30.1% in the retail sector. The sectors with highest growth were machinery and equipment (85.3%), domestic goods (42.7%), and construction materials (24.3%).

Reactivation at Coca-Cola FEMSA. After a four-day stoppage, the soft-drink bottling operations of Coca-Cola FEMSA returned to normal last week. The blockade (which former workers imposed on the company in four plants and 32 distribution centers) was lifted after the former employees agreed with members of the National Assembly to take their claim to the Supreme Court for a review of judicial decisions on the delay in payment of their severance pay. The Mexican bottling group denied that the event would have "adverse material implications" on its financial results.

Supreme Court to investigate sale of EDC to AES Corp. The Venezuelan Supreme Court will investigate the sale of Electricidad de Caracas (EDC) to the US company AES Corporation. The litigants claim that the operation could be unconstitutional because it was not approved by parliament. The Supreme Court admitted an

Weekly Report

application filed by private individuals for the annulment of the sale of the shares. They argue that the change of ownership should have been validated by the National Assembly because it is a public service concession.

Political Tips

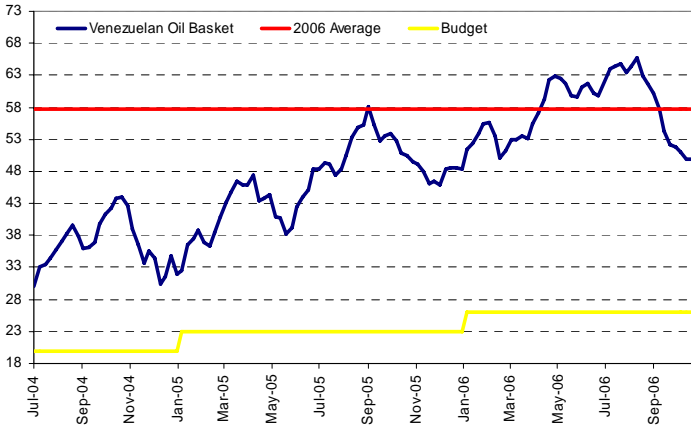
Fingerprint machines in eight states. The National Electoral Council (CNE) decided to use fingerprint machines in all voting centers in the states of Zulia, Miranda, Capital District (Libertador Municipality), Táchira, Apure, Anzoátegui, Monagas, and Carabobo. The decision means that a maximum of 6,368,489 voters (of the 15,921,223 registered voters) will be biometrically identified before voting, 40% of the total voting roll.

Important technical changes The Electoral Council has instrumented two significant changes to the voting machines and the vote counting process. First, the technicians adapted the totalization system to guarantee that the 32,331 voting machines would not receive information during the voting process. Second, the National Electoral Board changed the system of saving the votes in the equipment manufactured by Smartmatic, placing a coded 36-character name on each vote and storing them with an identical identification (time and position) so as to guarantee a secret vote.

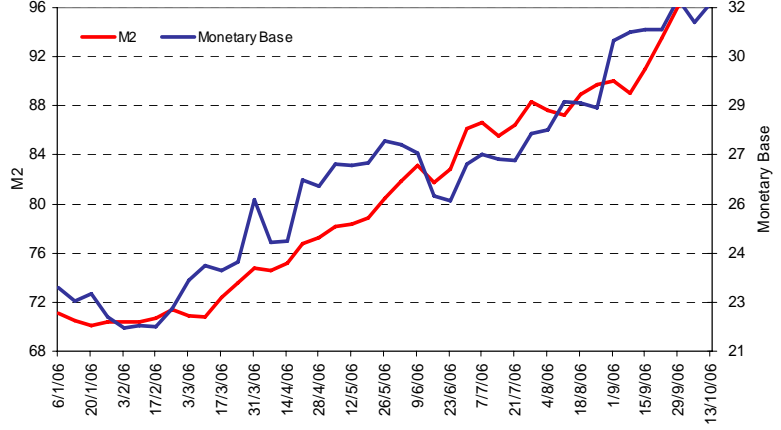
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ECONOMIC OVERVIEW

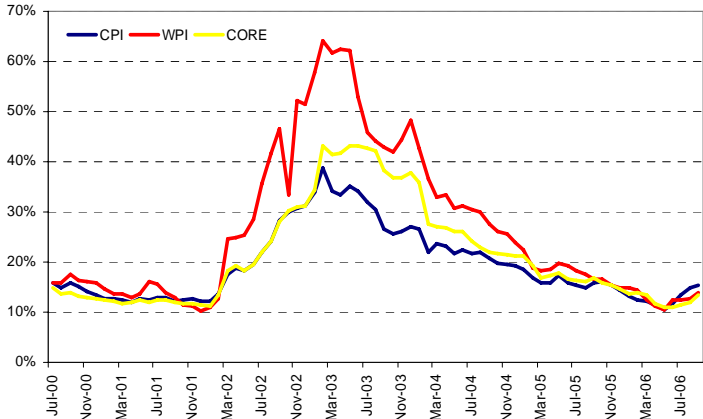
Oil Price
(Venezuelan Basket US\$/pb)



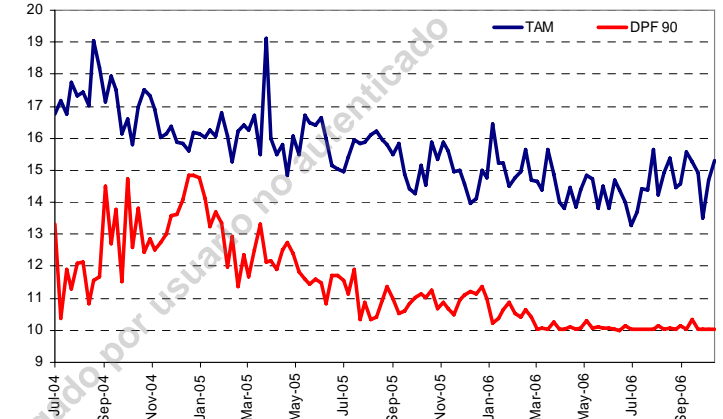
Monetary Base & M2
(VEB Billions)



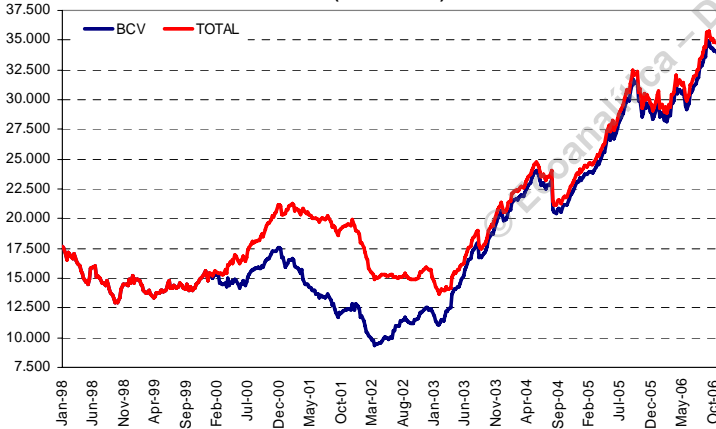
Inflation
(Last 12 Months)



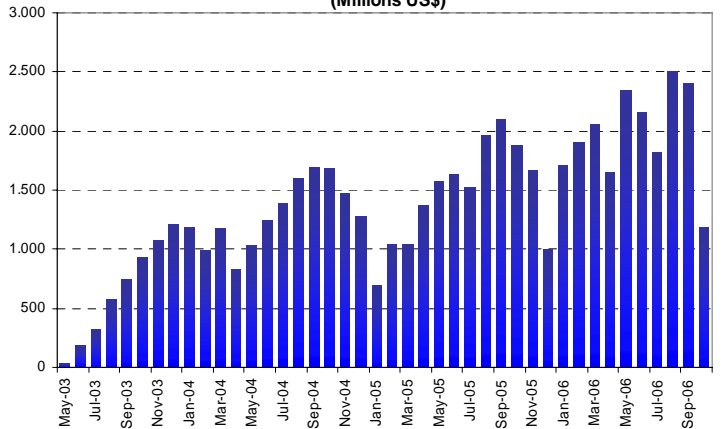
Interest Rate
(Six Principal Banks)



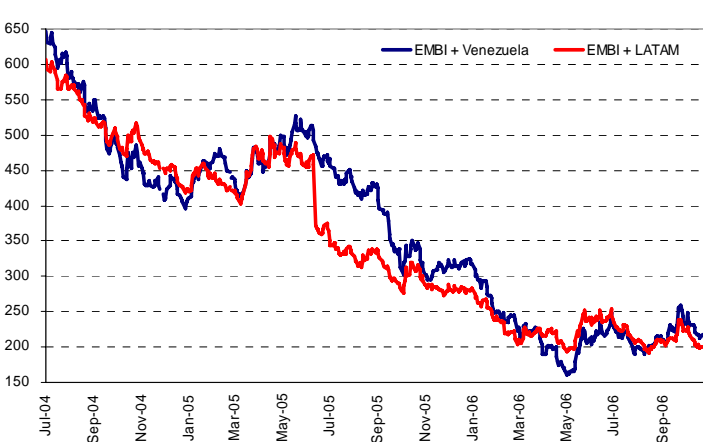
Fx Reserves
(Millions US\$)



Disbursement
(Millions US\$)



EMBI



Central Government
(VEB Billions)

