

To

Mr. David Donadze, CFO

Magticom Ltd

Dear Sir,

November 8, 2020

**Re: Our response to the GNCC's document titled "Response to the Policy Report and Expert Opinion Prepared by Consulting Companies for Magticom Ltd"**

**Preface and objective of this document**

In Oct 2020 the Georgian National Communications Commission (GNCC) has issued a document titled "Response to the Policy Report and Expert Opinion Prepared by Consulting Companies for Magticom Ltd." ("the GNCC's document"). This paper is our response to the GNCC's document.

The GNCC's document is a response to the opinion of six leading audit/consulting firms engaged by Magticom Ltd. to evaluate the GNCC's Resolution N O-20-9/156 as of December 31, 2019. We were one of the six consulting firms.

We have reviewed and analyzed the GNCC's document, its arguments, underlying data and conclusions. Our professional opinion is that some of the data, arguments and conclusions in the GNCC's document might not be accurate. Following are a few examples to demonstrate why we believe the GNCC's document can be considered disputable in terms of selecting the relevant facts as well as reaching appropriate, fair and objective conclusions.

## 1. Important factors the GNCC's document has ignored

Our paper was submitted to Magticom Ltd. in May 2020 ("the RSM's document"). It included analysis of the advantages and disadvantages of the MVNOs possible entry into the Georgian mobile market, examining whether and to what extent is the Georgian mobile market competitive, as well as assessing the risks of allowing the entrance of MVNOs.

Unfortunately, the GNCC's document has ignored some of the most important factors included in our paper. We believe that a fair and reliable document, that is supposed to represent the interests of the Georgian population, should have included a comprehensive analysis of the following factors:

- **Churn rates** - Churn rates represent the percentage of subscribers who disconnect from the mobile network in a given period. High churn rates in the mobile market, together with mobile number portability, are generally considered to be evidence of a highly competitive market. As the RSM's document clearly demonstrated, the churn rates in the Georgian mobile market are considered to be high compared with the general benchmark for competitive mobile markets, whether with or without MVNOs.
- **Switching barriers** - The Georgian mobile market is characterized by weak switching barriers, due to the following reasons:
  - **Term contracts** - contracts for mobile communications in Georgia generally include no minimum fixed term that is longer than one month. Any subscriber is allowed to disconnect from one MNO's network and transfer to another at any given moment, without any penalty.
  - **Prepaid vs. postpaid** - the vast majority of the Georgian mobile market is prepaid, rather than postpaid. Prepaid is generally considered to be more competitive, since consumers get more options to choose from, and can switch more easily among different plans and carriers. One of the most famous quotes of Marcelo Claure, the former CEO of Sprint, which used to be the fourth-largest mobile network operator in the United States, was mentioned during a conference call with investors: *"It's very, very, very competitive in prepaid out there; I would even call it crazy competitive"*

- **SIM locking Phone** - Phones are generally not locked to a specific operator in Georgia. Any subscriber can use the same phone with any MNO in the Georgian mobile market.
- **Mobile number portability** – a subscriber takes his/her mobile number to the new MNO when leaving previous MNO’s network.
- **Clear and transparent pricing plans** - when a subscriber considers whether to disconnect from an MNO’s network, he knows exactly what are the pricing plans and service packages of the competitors. No hidden fees or surprising charges are waiting for him once he switches.
- **Subscriber density** - Subscriber density is generally considered to be a measure of the level of competition in a given market, since it reflects the incentive for the carriers to offer better quality of service and competitive prices, so that a certain subscriber would not use another available alternative. Georgia’s subscriber density of 147% illustrate the fact that the Georgian mobile market is a competitive market, and there is no need for a fourth mobile operator, whether MNO or MVNO.
- **The risk of bankruptcy of an MNO and/or consolidation of MNOs** - As the RSM's document clearly demonstrated, allowing the entrance of MVNOs into the Georgian mobile market would most probably lead to the bankruptcy/market exit or consolidation of Veon with another market player, which, in turn, will decrease the level of competition and consumer welfare and increase market concentration in Georgia.

## 2. The decision to allow the entrance of MVNOs

The GNCC's document includes some important factors that should be considered before regulating the entrance of MVNOs. However, it appears that the GNCC's document has reached its conclusion to allow the entrance of MVNOs without regard to the unique facts and circumstances of the Georgian mobile market. A crucial example is the way the GNCC's document analyzed the current retail prices for mobile services in Georgia.

## **2.1 Current retail prices for mobile services in Georgia**

Following is our analysis of the response included in the GNCC's document to Question 1: "*The advisory documents allege that in terms of price, the Georgian mobile communications market is quite affordable.*"

To assess whether a certain market is competitive, the most basic approach is to start from the final result – whether current retail prices are low when compared with retail prices in similar markets. A market with low retail prices can be considered to be competitive, so no intervention or regulation is required.

The GNCC's document argues that "well-known analytical companies" prepared a study, that "*clearly demonstrated that the retail tariffs mobile services in Georgia are **higher than average** (among 37 OECD countries)... the prices of Magticom and Geocell (Silknet) for mobile and voice services in Georgia are much higher than those for the services offered by the operators in leading European countries*".

While the words "**higher than average**" were written in bold text, a simple glance at the column chart included in the GNCC's document shows that retail prices in Georgia are actually lower than the OECD's average, for both charts. For 100 calls, 0.5 GB the retail prices in Georgia (Silknet) is USD/PPP 15 per month, compared with the OECD's average of 22. For 900 calls, 2 GB the retail prices in Georgia (Magticom) is USD/PPP 30 per month, compared with the OECD's average of 34.

Moreover, even when ignoring this miscalculation of the GNCC, it appears that the underlying data in the GNCC's study is irrelevant when considering whether to allow the entrance of MVNOs into the Georgian mobile market, as follows:

- **The year** – the study is based on mobile prices in 2017, which might not be relevant under a looking-forward approach in a rapidly changing industry.
- **The players** – the study considers only Magticom and Silknet, and ignores the clearly cheaper player in the Georgian mobile market, Veon.

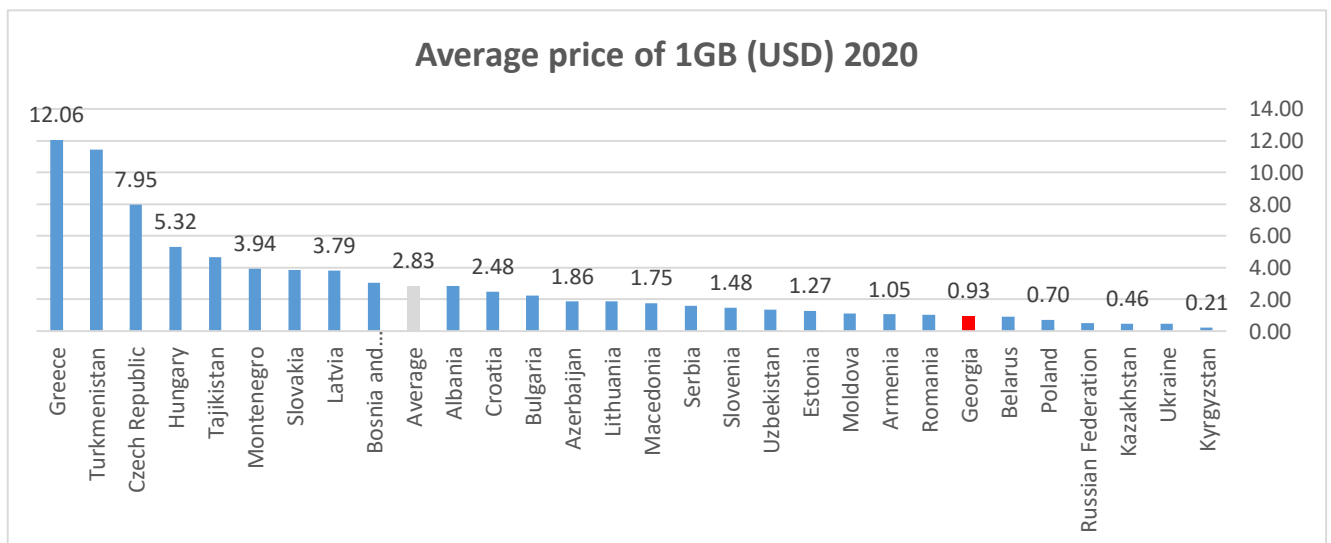
- **The plans** – the study considers only one mobile plan for each of Magticom and Silknet, and ignores many other plans available to mobile subscribers in Georgia.
- **The service** – the study includes both – calls and GB. However, current trends in the global mobile industry clearly show that calls become irrelevant, as most subscribers increasingly use the mobile internet to communicate, e.g. WhatsApp and Zoom.
- **The geography** – the study compares Georgia to the OECD countries. However, since Georgia is not a member of the OECD, prices in far-away mobile markets such as the USA, Mexico, Japan and Australia might not be relevant.

In the light of the abovementioned flaws, we believe that a fair and useful comparison of current retail prices can be found at more reliable sources, such as the British site Cable.co.uk.

Cable.co.uk gathered and analyzed data from 5,554 mobile data plans in 228 countries in February 2020. The average cost of one gigabyte (1GB) was then calculated and compared to form a worldwide mobile data pricing table, which can be found here:

<https://www.cable.co.uk/mobiles/worldwide-data-pricing/>

In our opinion, a more relevant comparison includes countries in the same region, i.e. the Baltics, the former USSR and Eastern Europe. Following is a fair and balanced comparison of the average price of 1 GB in USD:



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As mentioned above, we believe that the year 2020 is more representative when making regulatory decisions that will impact the Georgian mobile consumer. In addition, the Cable.co.uk chart above includes 27 mobile plans by all three mobile players the Georgian mobile consumer can choose from, reflecting the various packages available in terms of service and price.

As can be clearly seen in the column chart above, Georgia's average price of 1 GB (USD0.93) is actually a lot lower than the average in its geographic region (USD2.83). To be exact, 67% lower. Moreover, the prices in eight OECD members in the same geographic region (Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Slovakia and Slovenia) are higher than the price in Georgia, while only two OECD members (Poland and Russia) have a slightly lower prices.

Furthermore, the Cable.co.uk research shows that Georgia's average price of 1 GB in 2020 has decreased dramatically (72%) compared with 2019. This indicates the obvious downward trend in retail prices for mobile services due to strong competition in Georgia. This downward trend can also be seen in the following table included in the GNCC's document, where the Average Price per Gigabyte for each of the three Georgian MNOs decreased significantly between Q1 2019 and Q1 2020:

APPG <sup>®</sup>	Q1 2019			Q1 2020		
	Magti	Silknet	Veon	Magti	Silknet	Veon
Unit	17.47	29.67	63.27	16.53	39.42	65.07
Homogenous	3.00	3.77	1.45	1.01	1.37	1.16
Mixed	1.27	3.11	2.28	0.46	0.80	1.31
Average	2.79	4.38	1.91	1.01	1.58	1.43

To conclude, the Georgian mobile market is characterized by absolute as well as relative low retail prices. Therefore, this market can be considered a highly competitive one, so no intervention or regulation is required.



## 2.2 The Israeli case

Following is our analysis of the response included in the GNCC's document to Question 5: *"The advisory documents also stated that the Commission resolution fails to consider financial and market risks, operating and service quality risks as well as macro-economic factors."*

The GNCC's document has mentioned Israel as an example, demonstrating a "positive MVNO experience". The GNCC's document points out that a review prepared by the OECD states as follows: "the entry of MVNOs has significantly promoted the sector development and the market liberalization". However, this review was prepared by the OECD in 2014, based on 2013 data, so we believe it is totally irrelevant to the current mobile situation in Israel, in terms of quality of service and investment in technology.

As a firm located in Israel, we would like to clarify the following:

### Survival rates of MVNOs

Regarding MVNOs in Israel, since 2012 there were more than 10 MVNOs, but only three have survived; Rami Levi, Cellact and 019 mobile. As for Golan Telecom, it started as an MNO in Israel, **but during 2015 it disassembled its antennas and started to operate as an MVNO**. In 2017 it was purchased by another company (Electra), and in **August 2020 it was acquired by an MNO (Cellcom)**. The clear conclusion is that most MVNOs cannot survive, and they become a target for mergers and acquisitions. **Technological improvements**

Based on a study conducted by the Ministry of Communications in Israel, published in August 2020, Israel's mobile industry has declined to third-world standards. The study states: *"The data show that the current structure of the market does not provide an incentive to compete on technology. We stress that Israel's position in technological metrics was already low in 2016, when Israel was a long way behind the most advanced countries, but the past few years, particularly last year, have seen rapid deterioration in technological metrics towards those of third-world countries"*.

<https://en.globes.co.il/en/article-israels-telecoms-have-declined-to-third-world-standards-1001339855>

The main reason for the third-world mobile technology standards in Israel is the direct impact of price competition on the funds required to invest in mobile infrastructure. When MVNOs have entered into the Israeli mobile market, MNOs were left with no choice but to cut the required investments in mobile infrastructure, which in turn left the citizens of Israel behind in terms of technological advancement, compared with the rest of Europe and OECD countries.

In a healthy competitive environment, there's an incentive for the market players to improve their technology in order to raise the quality of service and charge more for a better service. In Israel, nonetheless, since the MVNOs were allowed in 2010, the MNOs struggled to survive because of the decreased prices in the market. From the perspective of the consumer, on the one hand the prices were competitive, but on the other hand there were not enough technological improvements, so the consumer in Israel was left behind in terms of technological development.

### **Conclusion**

Our professional opinion is that some of the data, arguments and conclusions in the GNCC's document might not be accurate. We believe the GNCC's document can be considered disputable in terms of selecting the relevant facts as well as reaching appropriate, fair and objective conclusions.

The GNCC's document has ignored some of the most important factors included in our paper, e.g. churn rates, switching barriers, subscriber density and the risk of bankruptcy of an MNO and/or consolidation of MNOs.

In addition, it appears that the GNCC's document has reached its conclusion to allow the entrance of MVNOs without regard to the unique facts and circumstances of the Georgian mobile market, e.g. the current retail prices for mobile services in Georgia.

**Sincerely,**

**RSM Shiff Hazenfratz & Co.**