

21st July 2010

Etisalat

2Q10 earnings miss consensus estimates...again!

Etisalat released its 2Q10 financials, showing 22% lower earnings year-on-year (YoY) and falling short of consensus estimates – for the second quarter in a row – by 7%. 2Q10 results mimicked 1Q10, with UAE revenues 7% lower on the year. This was driven in part by lower fixed-line subs, which restrained international revenues' double-digit growth (+28%). Also, margins continue to narrow due to start-up opex in new markets such as India. However, capex fell to 8% of revenues in 2Q10 (vs. 19% a quarter earlier). In the meantime, our LTFV and TP are AED22 and AED18, respectively, and our recommendation presently is Strong Buy.

Earnings lower YoY and QoQ, miss consensus by 7%: 2Q10 net income fell 22% YoY to AED1.872bn, versus an average consensus estimate (four analysts surveyed by Bloomberg) of AED2.015bn. We did not have estimates for Etisalat's 2Q10 financials, though we did forecast 7.77mn mobile subs for the UAE. The actual figure was slightly higher at 7.80mn. Fixed-line subs declined for the second straight quarter, however, continuing a trend begun in 2009. Fixed-line subs totaled 1.28mn, 2% lower than CICRe of 1.30mn. Etisalat's earnings fell despite a 28% higher international revenue of AED1.72bn (21% of total revenues).

Competition in UAE taking a toll on revenue growth: Revenue growth suffered on a 7% YoY drop in UAE revenues (79% of total revenues) to AED6.3bn, which remained largely flat quarter-on-quarter (QoQ). We believe intense competition from du continues to negatively impact Etisalat's results. Internet subs grew only 0.7% QoQ to 1.39mn (down from 2.2% in 1Q10), and we estimate EBIT margin has contracted c.15% (narrowing from 56.9% to 42.3%) as a result of opex for new start-ups such as India's **Etisalat DB Telecom**. 2Q10 EPS was AED0.24 (2Q09: AED0.31, -22%). Capex fell to 8% of revenues (AED0.65bn) in 2Q10, compared to 16% (AED1.34bn) a year ago.

Proposed interim DPS of AED0.25: According to a company statement sent to Abu Dhabi's bourse on July 20th, 2010, Etisalat intends to pay an interim dividend of AED0.25/share based on its 1H10 results. This implies a 51% payout ratio. Date of record for the dividend is July 29th, 2010, and it will be paid on August 12th, 2010.

Valuation and recommendation: Overall, Etisalat's revenues have come in line with our 2010 forecast, though we now believe it will be difficult for the company to meet our 2010 earnings estimate. We will revise our model following the release of operational KPIs in Etisalat's analyst meeting scheduled for next week. Naturally if -- as these results indicate -- we were to change our estimate, this would affect our valuation and possibly recommendation. In the meantime, our LTFV and TP are AED22 and AED18, respectively, and our recommendation presently is **Strong Buy**.

Key Performance Indicators

AED mn	2008 A	2009 A	2010 F	2011 F	2012 F
Revenues	29,360	30,831	32,027	34,456	36,800
Growth rate		5.0%	3.9%	7.6%	6.8%
EBITDA	17,228	19,504	21,998	23,124	24,476
Growth rate		13.2%	12.8%	5.1%	5.8%
EBITDA margin	58.7%	63.3%	68.7%	67.1%	66.5%
Net income	8,511	8,836	9,920	10,363	10,863
Growth rate		3.8%	12.3%	4.5%	4.8%
Net margin	29.0%	28.7%	31.0%	30.1%	29.5%
PER	NM	9.3x	8.2x	7.9x	7.5x
P/BV	2.6x	2.2x	2.6x	2.2x	1.9x
EV/EBITDA	3.8x	3.6x	3.1x	2.9x	2.7x
Net debt/EBITDA	-0.5x	-0.3x	-0.4x	-0.4x	-0.4x
Dividend yield	4.4%	5.7%	5.8%	6.1%	6.4%

Note: EV/EBITDA is proportionate; forecast does not include recently-acquired Tigo (Sri Lanka)

Source: Etisalat and CICR estimates

STRONG BUY (UNCHANGED)
LTFV | AED22 (UNCHANGED)
TP | AED18 (UNCHANGED)

COMPANY SYNOPSIS

Emirates Telecommunications Corporation (Etisalat) was established in 1976 as the UAE's sole telecommunications service provider, under UAE Federal Government Decree No. 78. Decretal Federal Code No. 3/2003 later amended this decree, requiring the liberalization of the telecom sector. Etisalat's monopoly thus came to an end in 2005, when Emirates Integrated Telecommunications Company (du) won the second integrated telecom license. Despite the end of its service monopoly, Etisalat continues to submit 50% of its earnings to the UAE's government as royalties, making it a major contributor to the UAE's budget.

Etisalat has established itself as a regional pioneer by introducing advanced technologies: mobile phone services (1982); GSM technology (1994); 3G & MMS (2003) and, most recently, BlackBerry service (2006). Driven by a vision to become one of the top 10 global telecom operators in 2010 and supported by a cash-generating, saturated telecom market in the UAE, Etisalat has expanded its service footprint to the global market. Etisalat's portfolio of assets in 18 markets in West Asian, South Asian and African markets now features an aggregate subscriber base totaling c.85mn. It is ranked 140th in the Financial Times' Top 500 Corporations in the world in terms of market capitalization whilst The Middle East magazine ranked it the 6th largest company in the Middle East in terms of capitalization and revenues.

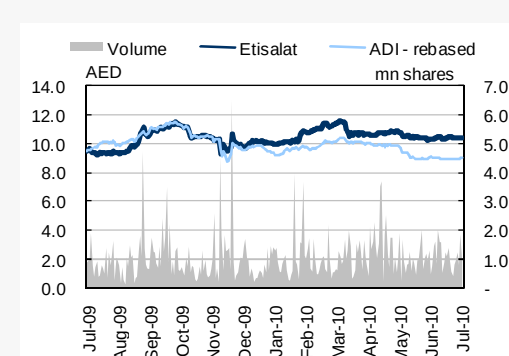
SHAREHOLDER STRUCTURE

Government of UAE	60.0%
Free float	40.0%
Total	100.0%

STOCK DATA

Reuters; Bloomberg	ETEL.AD; ETISALAT DH
Recent price as of 20-Jul-10	AED 10.35
No. of O/S shares	7,906.1 mn
Market cap	AED 81,829 mn
52-wk high / low	AED 11.59/ AED 8.64
Avg. daily volume / turnover	1.05 mn / AED 11.02 mn

STOCK PERFORMANCE | 52 WEEKS



Source: Reuters

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Figure 1 | Etisalat Major KPIs (2Q10 actual vs. 2Q09 and 1Q10, and forecasts)

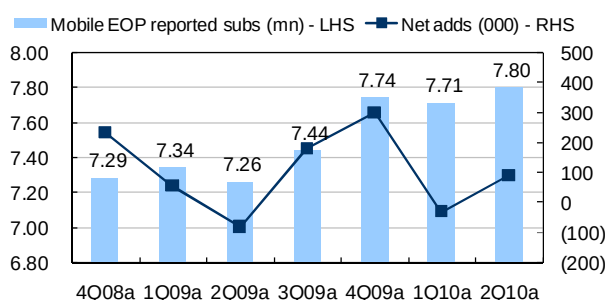
	2Q09	1Q10	2Q10				
	Actual Jun-09	Actual Mar-10	Actual Jun-10	YoY change	QoQ change	CICRe Jun-10	Var. a vs. e
(All figures in AED mn, unless otherwise noted)							
UAE subscribers (mn)							
Mobile subscribers (mn) - Reported	7.26	7.71	7.80	7%	1%	7.77	0%
Mobile subscribers (mn) - Active *	6.82	7.25	7.33	7%	1%	7.31	0%
Fixed subscribers (mn)	1.33	1.30	1.28	-4%	-2%	1.30	-2%
Internet subscribers (mn)	1.23	1.38	1.39	13%	1%		
UAE net adds (mn)							
Mobile subscribers (mn) - Reported				0.5	0.1		26
Mobile subscribers (mn) - Active *				0.5	0.1		25
Fixed subscribers (mn)				(0.1)	(0.0)		(22)
Internet subscribers (mn)				0.2	0.0		1,390

	2Q09	1Q10	2Q10					
	Actual Jun-09	Actual Mar-10	Actual Jun-10	YoY change	QoQ change	CICRe Jun-10	Var. a vs. e	No. of analysts
(All figures in AED mn, unless otherwise noted)								
Revenues	8,145	7,945	8,065	-1%	2%	7,833	3%	3
UAE	6,799	6,311	6,345	-7%	1%			
% of total revenues	83%	79%	79%					
International	1,345	1,634	1,721	28%	5%			
% of total revenues	17%	21%	21%					
Opex	(3,514)	(4,331)	(4,657)					
EBIT	4,631	3,614	3,408	-26%	-6%			
EBIT margin %	56.9%	45.5%	42.3%	-14.6pp	-3.2pp			
Income/(loss) from associates	191	98	219					
Financing income	77	282	175					
Financing cost	(132)	(10)	(151)					
Net financing income/(cost)	(55)	272	24					
Pretax income	4,767	3,984	3,651	-23%	-8%			
Income taxes	(27)	(19)	27					
Effective tax rate %	0.6%	0.5%	-0.7%					
Minority interest expense	90	24	66					
Net income (before royalty fees)	4,830	3,989	3,744	-22%	-6%			
Royalty fees	(2,415)	(1,994)	(1,872)					
Net income (after royalty fees)	2,415	1,994	1,872	-22%	-6%	2,015	-7%	4
Net margin %	29.6%	25.1%	23.2%	-6.4pp	-1.9pp	25.7%	-2.5pp	
No. of O/S shares (mn) **	7,906	7,906	7,906			7,906		
EPS **	0.31	0.25	0.24	-22%	-6%	0.25	-7%	4
Capex	1,338	1,540	653	-51%	-58%			
Capex/revenues	16%	19%	8%	-8.3pp	-11.3pp			
Cash	13,581	12,856	11,177	-18%	-13%			
Total debt	2,975	5,037	5,143	73%	2%			
Net debt / (cash)	(10,607)	(7,819)	(6,034)	-43%	-23%			

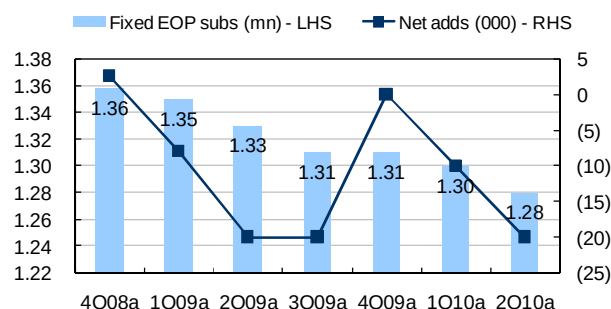
* Based on an assumed 94% activity ratio.

** 2009 number of shares and EPS are adjusted for bonus shares issued in 2010.

Source: Etisalat financials, Zawya, Bloomberg, and CICR estimates.

Figure 2 | Etisalat UAE Mobile Subs Growth – Quarterly


Source: Etisalat and CICR database

Figure 3 | Etisalat UAE Fixed-line Subs Growth – Quarterly


Source: Etisalat and CICR database

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RATING SYSTEM

In February 2009, CI Capital Research (CICR) launched a new rating system to give analysts more freedom to be market responsive. This is to make one element of our research more dynamic, namely the advertising of target prices and recommendations. What we did not change is our assessment of the Long Term Fair Value (LTFV), nor have we stopped our detailed industry and company research. What we did is changing the target price to trade in the balance of where a share should trade and where we think it will trade.

LTFV: As before we continue to estimate a fundamental valuation, largely DCF and/or NAV based.

Target Price: The target price, which is not necessarily the LTFV, is where the analyst, given all (qualitative as well as financial) information available, thinks the share price can get to within the next 3-12 months. This can be changed at any time on changing facts, and perceptions.

Recommendations: Our new rating system falls out from the total return relating to the share price performance to the target price, and including any distributions as may not be included in the target price calculation. This is shown in the table below, and to be BUY must return over 19%, an arbitrary hurdle rate we think reasonable given prevailing interest rates and risks. (Please see table below.)

Recommendation structure:

	Change to Target Price	
Strong BUY	> 30%	Strong Conviction
BUY	> 20% < 30%	
Hold	> 10% < 20%	
Underweight	> 0% < 10%	
SELL	< 0%	

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