



EFG - Hermes

Etisalat

1H2006 - Subscriber Growth Exceeds Expectations

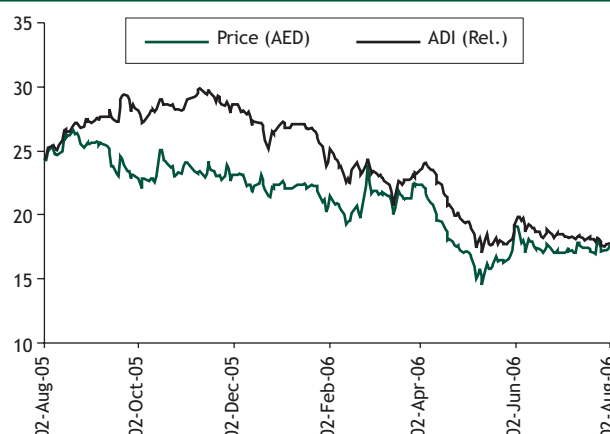
02 August 2006

UAE | Telecom

ST Rec. : Buy
LT Rec. : Buy

Current Price*: AED 17.55
LT Fair Value : AED 30.70

- Etisalat's 1H2006 results were impressive at both the local and Saudi operations. The mobile penetration rate in the UAE exceeded 100%, with subscribers reaching 5.0 million in the quarter ending June 2006, inline with our full year subscriber estimate.
- Mobily, Etisalat's subsidiary in Saudi, added 1.9 million subscribers in 1H2006 ending the half-year with 4.2 million, amounting to a 25% market share after only one year of operation. Mobily additions in 1H represent 74% of our full year 2006 forecast (2.6 million). The mobile penetration rate in Saudi currently stands at 67%.
- In 1H2006, Etisalat's net revenue and EBITDA grew 25% and 32% y-o-y respectively, while Mobily operations broke-even on an EBITDA and bottom line level, slightly ahead of our expectations. The higher-than-expected subscriber growth in the UAE and especially in Saudi warrant an upgrade in our forecasts.
- However, the greater than anticipated rise in the level of competition and the implementation of mobile number portability (MNP) in the UAE warrant a downward revision to our forecasts. From a valuation perspective, we believe that the anticipated upgrade of our estimated fair value for Mobily will mostly offset the anticipated downgrade of our estimated fair value for the UAE operations.
- We did not incorporate the impact of the award of the third Egyptian mobile license into our valuation for Etisalat in this note. However, we believe that it will be a challenge for Etisalat to create value on its sizeable USD2.9 billion license fee in the short to medium term. We will discuss the impact of this acquisition in an upcoming update.
- We maintain our ST/LT Buy recommendation on Etisalat with an unchanged LT fair value of AED30.7 representing 75% upside potential over and above the current share.



	2005a	2006e	2007e
EPS*	0.94	1.12	1.34
PER(x)	18.7	15.6	13.1
DPS	0.40	0.56	0.80
Div. Yield	2.3%	3.2%	4.6%
CFPS	1.1	1.7	1.8
PCF(x)	15.4	10.5	9.7
BVPS	3.5	4.0	4.6
PBV(x)	5.1	4.4	3.8

*Attributable

Stock Data:

Last Ex-Div Date	AED0.25 on 19 July 06
Mkt. Val. (mn)	AED79,633
Shares (mn)	4538
Av. Mthly Liqd. (mn)	AED431
52-Week High / Low	AED27.2 / 14.3
Bloomberg / Reuters	ETISALAT UH / ETEL.AD
Est. Free Float	40.0%

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*As at 02 August 2005

KINDLY REFER TO THE IMPORTANT DISCLOSURES AND DISCLAIMER ON PAGE 5.

A. OVERVIEW OF 1H2006 PERFORMANCE AND NEW DEVELOPMENTS

UAE Subscribers

Etisalat continued to deliver strong subscriber growth over the second quarter of 2006 despite the mobile market reaching 104% penetration. In the first half of 2006, Etisalat added approximately 460,000 subscribers, which is equal to our full year subscriber addition forecast. Fixed and internet lines also grew a healthy 5% and 34% y-o-y to 1.3 million and 0.6 million lines, respectively, in 2Q2006.

Mobily Subscribers (Saudi Subsidiary)

Mobily, Etisalat's 35%-owned affiliate in Saudi Arabia, added around 1.9 mobile subscribers in the first half of 2006, reaching 4.2 million subscribers, compared to 2.3 million at the end of December 2005. 1H2006 subscriber additions for Mobily are equal to 74% of our full year forecast of 2.6 million. In almost one year, Mobily has gained 25% market share from STC, the state-owned incumbent operator. According to press reports, STC mobile subscribers exceeded 12 million at the end of 1H2006, implying a mobile penetration rate of 67% for the Saudi market.

Table 1: Etisalat and Mobily Quarterly Subscriber Figures

UAE Market	1Q2005	2Q2005	1Q2006	2Q2006	Y-o-Y	2006e
Fixed Line Subs (mn)	1.2	1.21	1.25	1.27	5%	1.29
Subs Additions (mn)	0.00	0.01	0.05	0.02		0.05
Penetration Rate	28%	28%	27%	26%		26%
Mobile Subscribers (mn)	3.9	4.07	4.77	5.00	23%	4.97
Subs Additions (mn)	0.20	0.18	0.23	0.23		0.44
Penetration Rate	90%	91%	102%	104%		103%
Saudi Market						
Mobily	N/A	N/A	3.82	4.20	N/A	4.90
Additions	N/A	N/A	1.52	0.38	N/A	2.6
Market Share	N/A	N/A	25%	25%	N/A	27%
Penetration Rate		47%	63%	67%	N/A	72%

Sources: Etisalat, Arab News and EFG-Hermes Estimates

UAE Revenues and EBITDA

Etisalat reported a 25% y-o-y rise in local net revenues to AED7.7 billion. We attribute the growth in revenues mostly to the significant rise in mobile subscribers and, to a lesser extent, to the growth in fixed and internet lines. As the company does not report an EBITDA figure, we estimate from 1H2006 financials that EBITDA rose 32% y-o-y to AED6.0 billion, implying an EBITDA margin of 78% versus 74% in 1H2005. The improvement in the EBITDA margin is partially attributable to the decline in both out-payments to telecom operators and selling & general expenses in the six months ending June 2006 versus the same period last year. Given the better-than-expected 1H2006 results, we expect Etisalat to exceed our FY2006 EBITDA forecasts by 2-3%.

Mobily Revenues and EBITDA

Mobily reported a net profit of AED151 million in 2Q2006, rising four fold over the 1Q2006 figure. We have been forecasting a net loss of AED982 million for whole year. We will revise our full year estimates in our forthcoming update to reflect the substantial improvement in the company's operations in the first half of 2006.

Consolidated Net Profit

After the payment of the royalty, which is equivalent to 50% of net profit, Etisalat reported a 33% increase in its bottom line to AED2.8 billion in 1H2006, up from AED2.1 billion in 1H2005. We believe that the higher-than-expected EBITDA will lead to FY2006 net profit beating our FY expectations of AED5.1 billion by 10-12%.

The board of directors declared an interim dividend of AED0.25 per share to be distributed on 26 July 2006 implying a dividend yield of 1.4% (price as at 02 August 2006).

Table 2: Etisalat Quarterly Financial Highlights and Estimates

(AED mn)	1H2005	2005a	1H2006	Y-o-Y	2006e
Net Revenues	6,201	12,866	7,743	25%	14,339
Gross Revenues	7,482	15,568	8,888	19%	18,009
Total Expense	(2,914)	(5,760)	(2,860)	-2%	-7,255
EBITDA	4,569	9,808	6,028	32%	10,754
EBITDA Margin	61%	63%	68%		60%
Depreciation Expenses	(609)	(1,373)	(642)		(1,417)
Other Income (Expenses)	279	77	240		96
Profit before Royalty	4,238	8,512	5,626	33%	9,331
Royalty	(2,119)	(4,256)	(2,813)		(4,199)
Net Profit (AED mn)	2,119	4,256	2,816	33%	5,101

Sources: Etisalat and EFG-Hermes Estimates

Egypt's Third Mobile License

On the 4th of July 2006, an Etisalat-led consortium won the bid for the third mobile license in Egypt for a total consideration of USD2.9 billion. Etisalat is planning to offer 2G and 3G services and is expected to start operations in early 2007. Etisalat holds a 66% stake in the consortium with the remaining balance held by Egyptian partners. In our note "Third mobile License - Raising Risk Levels" published on 15 July 2006, we presented a business model that incorporated Etisalat's limited management guidance coupled with our own assumptions in an attempt to match both Etisalat's assumptions and the high price paid for the license. Our preliminary business model suggests that the operations in Egypt would turn EBITDA positive by the 3rd year of operations and free cash flow (FCF) positive by the fourth year of operations. We will be discussing the impact of this acquisition on Etisalat's valuation in our upcoming update.

B. IMPACT

UAE

We believe that the following reasons warrant a revision in our forecasts for the UAE operations: i) the aggressive uptake of mobile subscribers by Etisalat in preparation for upcoming competition in its home market, ii) we believe that the market share loss following the entry of the second mobile operator, Du, will be higher than suggested by our current forecasts especially with the high probability of an imminent introduction of Mobile Number Portability (MNP). We now believe that Du will be able to secure up to 30% mobile market share within 4-5 years of operation versus our previous estimates of 15%, iii) the TRA in the UAE has not yet indicated whether the royalty paid by Etisalat would be lowered. We were forecasting a gradual 5% decline in the royalty paid by Etisalat starting 2006 to stabilize at 30% of pre-royalty earnings in 2009, which we believe would leave room for positive surprise should the reduction in royalty be deeper than we forecast.

Saudi Arabia

On the Saudi front, we will revisit our forecasts for the market in general and for Mobily in particular given the following: i) Mobily's full year subscribers will most likely exceed our year-end 4.9 million subscriber forecast, ii) the substantial improvement in Mobily's margins, as it broke-even faster than we anticipated on an EBITDA and net profit level, iii) the approval of the implementation of MNP in the second half of 2006 by the Communication and Information Technology Commission (CITC), the telecom regulator in Saudi. We believe churn would favor of Mobily, at least in the short term.

Egypt

The price Etisalat paid for the third mobile license exceeded even the most bullish expectations in the market and was the most expensive third mobile license in the region on a per population measure. With free cash flow expected to turn positive in the fourth year of operations, at best, we believe that it will be a challenging job for Etisalat to recover its initial investment in the short to medium term. Furthermore, losses incurred by the Egyptian operation would have a dilutive impact on Etisalat's earnings at least in the first 3-4 years of operation.

Overall

We do not anticipate a significant decline in our fair value for Etisalat from the anticipated increase in competition in the UAE as mentioned in our last note¹. We believe that the negative impact in the UAE would partially be offset by an upgrade in our estimated fair value for Mobily especially after the implementation of MNP in the Saudi market which we believe would initially favor Mobily. We maintain our ST/LT Buy recommendation on Etisalat and our LT fair value of AED30.70 representing a 75% upside potential over and above the current share price of AED17.55.

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