

Etisalat

Etisalat in Sri Lanka & valuation maintained despite Dubai credit woe

Etisalat's 100% acquisition of Tigo, Millicom's Sri Lanka operation, was at an EV of USD207mn or 7.4x 2009E EBITDA. This marked Etisalat's second foray into South Asia in 2009 after India. Sri Lanka's total mobile market reached 12.7mn at end of June 2009, a 62.8% penetration rate, whilst Tigo ranked third with 2.2mn subs – a 17.2% market share. Sri Lanka's mobile market is very competitive with five incumbents and a sixth expected by end of 2009/beginning of 2010. Sri Lanka has relatively low ARPUs, yet we believe there is still growth potential in the northern and eastern regions. Until management reveals its strategy in Sri Lanka, we believe that risks facing Etisalat include (1) possibly having overpaid for Tigo and (2) execution delays till it can fully mobilize resources to manage the new operation. Despite Dubai's recent credit woes, we keep our LTFV and TP unchanged at AED24/share and AED20/share, respectively, while maintaining our Strong BUY rating with an upside potential of +82%.

A competitive market with low ARPUs: Bolstered by its high literacy rate, Sri Lanka has been a leader in introducing advanced technology (from analog to 3G networks) into South Asia. As such, it is a competitive market. Sri Lanka's mobile market witnessed aggressive price competition, depressing ARPUs to around USD3 in 2008, in line with its region's average. In early 2009, the entry of a fifth mobile operator depressed ARPUs even further to less than USD3. We believe growth potential in Sri Lanka still exists despite a relatively high penetration rate. As the low-density northern and eastern war-torn regions open up for mobile and fixed-line services, opportunities will emerge to drive subs and revenue growth. Furthermore, the new mobile operators should stimulate the market further.

Risks of overpaying and execution remain: Until Etisalat reveals its strategy for Tigo, we believe there are two specific risks. Firstly, Etisalat may have overpaid for Tigo given the competitive environment of the market. Secondly, it may be long before Etisalat can fully mobilize its resources to manage Tigo. We believe the faster Etisalat gets on the ground, the more value accretive its economies of scale, synergies, and hence Tigo will be.

Valuation and recommendation: We had included Tigo at acquisition cost in our initiation of coverage note dated 18th October 2009, so no change on this front. Given recent credit woes in Dubai, we saw Etisalat's value drop marginally by 1% and 2% when ERP is increased by +50bps and +100bps, respectively. Hence, we leave our LTFV and TP unchanged at AED24/share and AED20/share, respectively, and maintain our Strong BUY rating, given the 82% upside potential.

AED mn	2007 A	2008 A	2009 F	2010 F	2011 F
Revenues	21,340	26,119	29,620	32,027	34,456
Growth rate		22.4%	13.4%	8.1%	7.6%
EBITDA	15,488	17,257	19,703	21,998	23,124
Growth rate		11.4%	14.2%	11.6%	5.1%
EBITDA margin	72.6%	66.1%	66.5%	68.7%	67.1%
Net income	7,297	8,665	8,958	9,920	10,363
Growth rate		18.8%	3.4%	10.7%	4.5%
Net margin	34.2%	33.2%	30.2%	31.0%	30.1%
PER	10.8x	9.1x	8.8x	8.0x	7.6x
P/BV	3.3x	2.5x	3.0x	2.5x	2.1x
EV/EBITDA	N/A	4.2x	3.9x	3.5x	3.3x
Net debt/EBITDA	-0.3x	-0.5x	-0.4x	-0.4x	-0.4x
Dividend yield	3.8%	4.5%	5.5%	6.0%	6.3%

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

Source: Etisalat and CICR estimates

STRONG BUY (MAINTAINED)
LT FAIR VALUE | AED24
TARGET PRICE | AED20

COMPANY SYNOPSIS

Emirates Telecommunications Corporation (Etisalat) was established in 1976 as UAE's sole telecommunications service provider, under UAE Federal Government decree No.78 which was finally amended by Decretal Federal Code No.3/2003 stipulating the liberalization of the telecom sector. Etisalat's monopoly 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 established itself as a regional pioneer by introducing advanced technologies: mobile phone services (1982); GSM technology (1994); 3G and MMS (2003) and most recently BlackBerry service (2006). Driven by the 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 expanded its service footprint to the global market. Currently, Etisalat possessed a portfolio of investments in West Asia, South Asia, and Africa markets in 18 countries with an aggregate subscriber base of around 85mn. Etisalat stands 140th among the Financial Times Top 500 Corporations in the world in terms of market capitalization, and is ranked by The Middle East magazine as the 6th largest company in the Middle East in terms of capitalization and revenues.

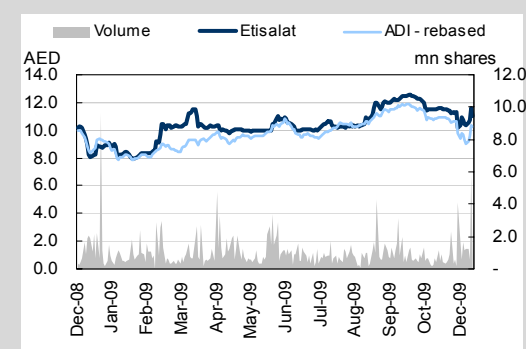
SHAREHOLDER STRUCTURE

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

STOCK DATA

Reuters; Bloomberg	ETEL.AD; ETISALAT DH
Recent price as of 15-Dec-09	AED 11.00
No. of O/S shares	7,187.4 mn
Market cap	AED 79,061 mn
52-wk high / low	AED 13.54/ AED 7.75
Avg. daily volume / turnover	1.11 mn / AED 11.65 mn

STOCK PERFORMANCE | 52 WEEKS



Source: Bloomberg

AMR HUSSEIN ELALFY, CFA
 AMR.ELALFY@CICH.COM.EG

NORAN ALI
 NORAN.ALI@CICH.COM.EG

Sri Lanka Telecom Market

Figure 1: Sri Lankan telecom market investment considerations

Potentials

- Favorable demographic conditions (68% of population between 15-64 years) provide sustainable market for mobile.
- End of the 30-year separatist fighting should open low-mobile density war-ravaged regions for investment.
- Proposed network sharing in new war-torn regions should reduce required opex and capex.
- 3G and valued-added services may boost ARPUs higher, given the country's high literacy rate.

Challenges

- Sri Lanka's high penetration rate compared to its regional counterparts provides a relatively limited room for growth.
- Low ARPU levels pose a threat to mobile operators' profitability.
- Intensified competition in both mobile and fixed-line segments may lead to faster-than-expected ARPU erosion.
- In the absence of any formal truce between the government and the rebels, potential eruption of any unrest in the war-ravaged regions might jeopardize investment.

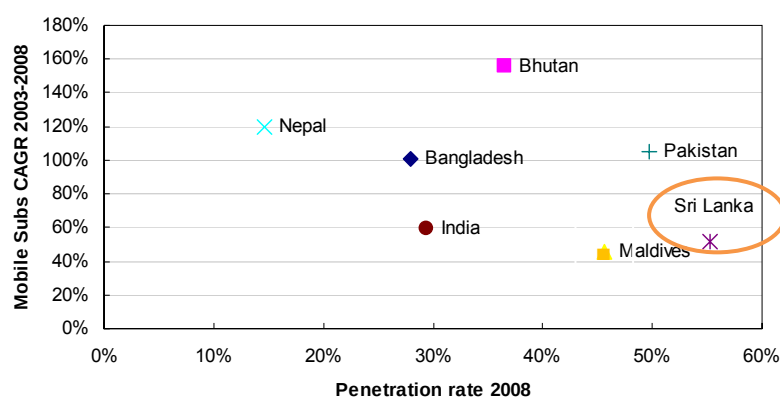
Source: CICR

Mobile market

The Sri Lankan mobile market is the most mature in the South Asian region. Back in 1989, Sri Lanka was the first South Asian country to introduce cellular phones when it launched an analog network. Later, liberalization of the mobile market succeeded in sustaining Sri Lanka's technological leadership and led to the introduction of both GSM in 1995 and 3G services in 2006. However, ARPUs have been depressed to significantly low levels, estimated at USD3 in 2008, in line with the region's average. Sri Lanka's market recorded the second lowest 5-year CAGR (2003-08) of 51% – after the Maldives – and the highest penetration rate of 55% in 2008 amongst its regional peers.

A mature market in South Asia

Figure 2: South Asia markets penetration rate vs. mobile growth



Source: ITU

Home to 20mn people, Sri Lanka's mobile market had a relatively moderate penetration rate of 62.8% and 12.7mn subscribers at end of June 2009. Driven by lower mobile line rental costs (relative to land line), reduced handset prices and an increasingly competitive market encompassing five operators (set to grow to six), mobile subscribers grew exponentially by a 7-year CAGR (2001-08) of 49% vs. 23% for fixed-line subscribers. Aggressive price competition triggered severe ARPU erosion, as **Dialog** and **Mobitel** – Sri Lanka's two largest operators – witnessed respective drops of 44% and 74% in their ARPUs from 2007 to 1Q09 to less than USD3.

A thriving mobile market

Having been completely state-owned, the Sri Lankan telecommunication industry's first deregulation move came when a separate regulatory body (**The Telecommunications Regulatory Commission "TRC"** of Sri Lanka) was established in 1996. Later in 1997, **Sri Lanka Telecom (SLT)** was privatized and offered to the public in an IPO in 2002/03. By 2007, mobile licenses were granted to major international operators, such as Luxemburg-based **Millicom International Cellular SA** (Tigo's former owner), **Hutch**, and **Bharti Airtel**, (India's largest mobile operator). In June 2009, Sri Lankan mobile operators numbered five:

1. **Dialog** (6.0mn subs, a market share of 47%);
2. **Mobitel** (3.0mn subs, 24%);
3. **Tigo** (2.2mn subs, 17%);
4. **Hutch** (0.5mn subs, 4%), and
5. **Airtel Lanka** (commenced operation in January 2009, 0.9mn subs, 8%).

Driven by a significantly high literacy rate¹, Sri Lanka managed to sustain its technological leadership as one of South Asia's pioneers when Dialog introduced 3G services in 2006. Afterwards, other operators followed suit, even introducing 3.5G (Mobitel, 2007). Airtel Lanka was the last entrant to the '3G club' in January 2009. Tigo is yet to join the club by 2010, leaving Hutch as the sole operator not to have embraced 3G technology.

Going forward, we expect Sri Lanka's mobile subscribers to grow by a 5-year CAGR (2008-13) of 18% to 25.4mn implying a 122% penetration rate. We believe the market's net additions will peak within 2009-2010 during which we expect subscribers to grow by around 32% p.a. on average, following the entry of two additional mobile operators (Airtel and **Reliance**). Hence, leading to more intensified competition in 2010 and beyond.

Following the ending of fighting between the government and separatist Tamil Tiger rebels, the TRC plans to encourage operators to establish new infrastructure and networks in the low-density northern and eastern war-torn regions. This is proposed to be done via network sharing schemes. Dialog was the first operator to announce its intension to provide services in several parts of the liberated Northern Province.

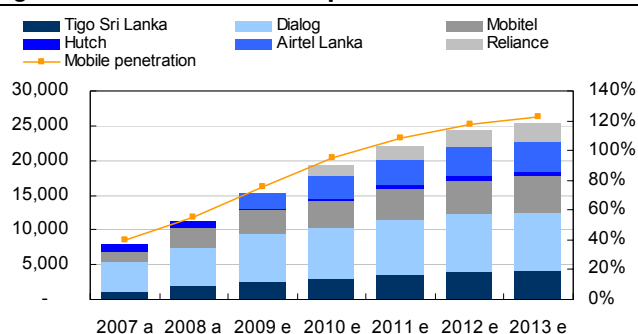
A deregulated market with international players

Sustaining its technological advancement

Sustained growth on the short-run stimulated by competition and the opening up of the war-torn regions

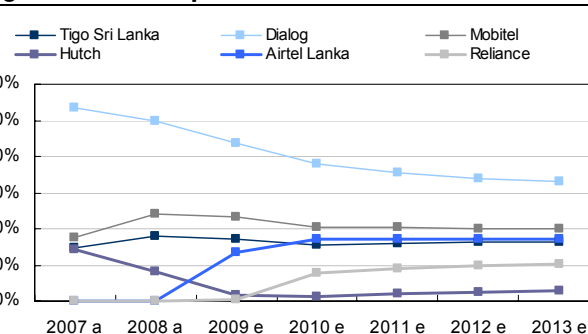
End of separatist fighting opens the door for new growth opportunities

Figure 3: Mobile Subs development & forecasts



Source: TRC, operators, and CICR estimates

Figure 4: Mobile operators' market share



Source: TRC, Operators, and CICR estimates

¹ Over 90% of the population aged 15+ years can read and write. This is compared to a regional average of 63%.

However, we expect mobile subscriber growth rate to wane as the market becomes saturated, with a penetration rate crossing 100% by 2011. Over the period 2011-2013, we expect mobile subscribers to grow by 10% p.a. on average (vs. 34% average rate over 2008-2010).

Fixed-line market

Sri Lanka's fixed-line market has been liberalized since 1996, encompassing four operators, keen to adopt advanced technologies such as CDMA. As often happens with mature telecom markets, Sri Lanka's mobile segment led the industry expansion at the expense of the fixed-line segment. Fixed-line subscribers grew by a 5-year CAGR (2003-08) of 30% compared to 51% recorded for mobile subscribers. The fixed-line market seems to have been negatively impacted by intensified mobile competition following the entry of Bharti Airtel by early 2009. Indeed, the fixed-line market started to show an initial contraction with subscribers decreasing by 2% in June 09 compared to December 2008. Subsequently, fixed-line penetration rate slipped to 16.8% vs. 17.2%, over the same time span.

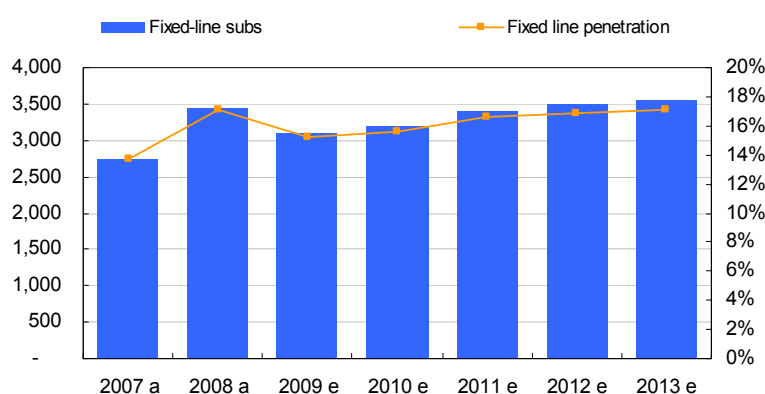
We expect the entry of another mobile operator to take its toll further on the fixed-line market, depressing subscribers by 10% YoY in 2009 to reach a penetration rate of 15.3% by the year-end. However, opening up of the war-torn regions and an expected commercial operation of new networks in 2010 should reverse the declining trend in the fixed-line market, lifting its growth rate to a 3-year CAGR (2010-13) of 4%.

....to be hampered by saturation on the horizon

Fixed-line market enters its contraction phase

Positive prospects for fixed-line driven by the opening up of war-torn regions

Figure 5: Fixed-line Subs development & forecasts



Source: TRC, Operators' reports & CICR estimates

Valuation and recommendation: Etisalat's management is yet to reveal its strategy in Sri Lanka or provide guidance on how it sees the market developing. We had included Tigo at acquisition cost in our SOTP valuation dated 18th October 2009. Today and against the backdrop of the recent credit woes in Dubai and the USD10bn aid extended by Abu Dhabi, we ran a sensitivity of how Etisalat's value may be affected given a higher equity risk premium (ERP). With Abu Dhabi credit-default swaps (CDS) spreads increasing by around 50bps on two months ago, we ran an exercise by increasing Etisalat's ERP on its UAE operation (c.88% of overall group value). This resulted in a 1.2% lower equity value for the UAE operation and 1.1% lower for Etisalat group's overall equity value. Even at 100bps higher ERP, Etisalat's value is reduced by only 2.1%. Hence, we maintain our LTFV and TP at AED24/share and AED20/share, respectively. Also, we maintain our rating at Strong BUY, given the 82% upside potential.

Etisalat's value drops by only 1% and 2% when ERP is upped +50bps and +100bps, respectively; LTFV, TP, and rating maintained

Contacts and Disclaimer:

CI CAPITAL RESEARCH

Mark Rorison | Group Director, Head of Research
Mark.Rorison@cich.com.eg

Amr Hussein Elalfy, CFA | Director
Amr.Elalfy@cich.com.eg

Mona Mansour | Director
Mona.Mansour@cich.com.eg

CI CAPITAL SECURITIES BROKERAGE (EGYPT & UAE)

Amr Mostafa | MD & Global Head of Securities Brokerage
Amr.Mostafa@cich.com.eg

DYNAMIC SECURITIES

Ahmed Roushdy | Managing Director
Ahmed.Roushdy@cich.com.eg

CI CAPITAL HOLDING

8, Nadi El-Seid Street, Third Floor
Dokki, Giza
Egypt

Reuters pages: COIW, COIX, COIY, and
COIZ

Bloomberg page: COIB <GO>

For more information,
please contact CI Capital Research on +2
(02) 33 38 62 59,
send e-mail to Research@cich.com.eg
or visit our website at www.cich.com.eg

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%	

DISCLAIMER

The information used to produce this market commentary is based on sources that CI Capital Research (CICR) believes to be reliable and accurate. This information has not been independently verified and may be condensed or incomplete. CICR does not make any guarantee, representation or warranty and accepts no responsibility or liability to the accuracy and completeness of such information. Expression of opinion contained herein is based on certain assumptions and with the use of specific financial techniques that reflect the personal opinion of the authors of the commentary and is subject to change without notice. It is acknowledged that different assumptions can always be made and that there is a wide choice of techniques that can be adopted each of which can lead to a different conclusion. Therefore, all that is stated herein is of an indicative and informative nature as forward-looking statements, projections, and fair values quoted may not be realized. Accordingly, CICR does not take any responsibility for decisions made on the basis of the content of this commentary. This commentary is made for the sole use of CICR's customers and no part or excerpt of its content may be redistributed, reproduced or conveyed in any form, written or oral, to any third party without the prior written consent of CICR. This commentary does not constitute a solicitation or an offer to buy or sell securities.