

Emirates Telecommunications Corporation (Etisalat)

Hold
Target Price
AED11.97

Market Data

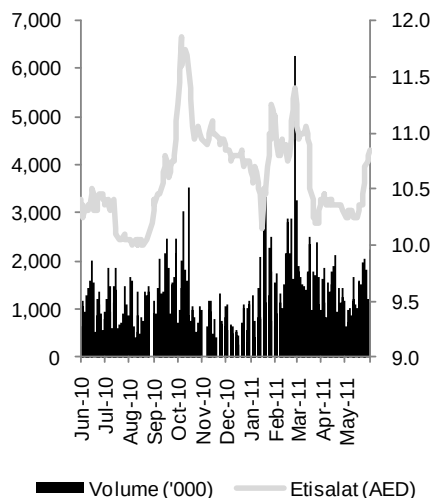
Bloomberg Code:	ETISALAT UH
Reuters Code:	ETEL.AD
CMP (June 15 2011):	AED10.90
O/S (mn)	7,906.1
Market Cap (AED mn):	86,176.9
Market Cap (USD mn):	23,462.3
P/E 2011e (x):	11.5
P/Bv 2011e (x):	2.1

Price Performance 1-Yr

High (AED):	11.85
Low (AED):	10.00
Average Volume: (000)	1,223.4

	1m	3m	12m
Absolute (%)	6.3	1.93	11.5
Relative (%)	3.0	-5.9	-2.0

Price Volume Performance



Source: Zawya

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- **Stiff competitive environment in UAE**
- **Seeking a change in status**
- **Likely royalty reduction – a major upside trigger**

Stiff competitive environment in UAE

The growth in domestic customer base is hard to achieve due to stiff competition. At the end of 4Q10 Etisalat's domestic mobile customer base increased marginally to 7.76mn from 7.74mn in 4Q09. In 1Q11, mobile customer base declined to 7.4mn. We believe that ARPU is also likely to remain under pressure. Going forward, UAE would still be the main revenue driver for Etisalat, although its cont. to the group revenue is on decline.

Seeking a change in status

Etisalat has been in talks with the government seeking a status change. The change in status, to the company under a commercial law which will allow foreign participation in the stock & will help in further increasing liquidity of the stock.

Indian operations - a concern

In our view the Indian operations remain a concern for investors following the reported arrest of one of the senior officials of Etisalat DB. Etisalat stated that they were not involved in the license process & remain committed to their operations in India.

Likely royalty reduction – a major upside trigger

On the back of Emirates Integrated Telecommunications Co. (Du), announced paying 15% of net profit as a royalty fee to the UAE government, the similar reduction in royalty is likely to be applicable to Etisalat as well. Etisalat pays half of its profit in royalties to the government. TRA also indicated towards royalty reduction for Etisalat, however, no timescale was offered for the same. Any downside revision in royalty payments for Etisalat will have significant impact on our projected financials & valuation of the stock.

Group financial forecast

Going forward we forecast a CAGR of 3.2% in group rev., 3.8% in group EBITDA & 3.4% in net profit, during our forecast period 2011-14. With regard to our assumption for the federal royalty payment, we kept it unchanged at 50%. We have made downward revisions to our 2011-14 est. to reflect competitive pressures in home market. We, therefore, revise our 2011 group revenue, EBITDA & net profit est. down by 1.1%, 10% & 3.2% respectively, mainly to reflect sagging revenue trend & margin pressures in UAE.

Valuation update

With downward revision in estimates, our DCF-based SOTP value for Etisalat works out to AED11.97 per share which represents 9.8% upside potential to the current market price of the stock. We, therefore, change recommendation on the stock from **BUY to HOLD**. At the current market price, Etisalat is trading at 2011e EV/EBITDA multiple of 5.1x & P/E of 11.5x.

Investment Indicators

Year	2010	2011e	2012e	2013e	2014e
Revenue (AED mn)	31,929	32,329	33,447	34,365	35,538
EBITDA (AED mn)	16,561	16,709	17,403	17,967	18,687
EBITDA Margin	51.9%	51.7%	52.0%	52.3%	52.6%
Net Profit (AED mn)	7,631	7,469	7,745	8,025	8,257
EPS (AED)	1.0	0.9	1.0	1.0	1.0
BV (AED)	4.9	5.2	5.6	6.0	6.5
EV / EBITDA (x)	5.2	5.1	4.9	4.7	4.5
P / E ratio (x)	11.2	11.5	11.1	10.7	10.4
P / BV ratio (x)	2.2	2.1	1.9	1.8	1.7

Source: Company reports & Global Research

Valuation & Recommendation

Valuation

We have used a discounted cash flow (DCF)-based sum-of-the-parts (SOTP) methodology to arrive at the fair value of Etisalat stock. Based on consolidation of the individual country operations, our SOTP valuation estimates the fair value of Etisalat's stock at AED11.97, which is 9.8% higher than the current market price of the stock.

Near term catalysts

Currently there are couple of near term developments the stock is awaiting for, which might act as positive catalysts for the stock price, if they materialize:

- i) Any downside revision in royalty payments for Etisalat will have significant positive impact on the valuation of the stock.
- ii) The change in status, to the company under a commercial law which will allow foreign participation in the stock and will help in further increasing liquidity of the stock.

Downward revisions in our forecasts

We have made downward revisions to our 2011-14 estimates to reflect competitive pressures in home market. We, therefore, revise our 2011 group revenue, EBITDA and net profit estimates down by 1.1%, 10% and 3.1% respectively, mainly to reflect sagging revenue trend and margin pressures in UAE. We expect, in 2011 group revenue to increase by 1.2% and net profit to decline by 2.1% to reach AED32.3bn and AED7.5bn respectively.

Etisalat 2011e

AED mn	Earlier Estimates	Revised Estimates	Change
Revenues	32,695	32,329	-1.1%
EBITDA	18,568	16,709	-10.0%
Net Profit (att. to holders of parent co.)	7,708	7,469	-3.1%

Source: Global Research

Going forward we forecast a CAGR of 3.2% in group revenue, 3.8% in group EBITDA and 3.4% in net profit during our forecast period 2011-14. With regard to our assumption for the federal royalty payment we kept it unchanged at 50%.

Recommendation

With downward revision in estimates, our DCF-based SOTP value for Etisalat works out to AED11.97 per share which represents 9.8% upside potential to the current market price of the stock. We, therefore, change recommendation on the stock from **BUY to HOLD**. At the current market price, Etisalat is trading at 2011e EV/EBITDA multiple of 5.1x and P/E of 11.5x.

Key Risks to Valuation

- **Stake increase or new acquisitions**

Any further stake increase in existing operations or new acquisitions or venturing in some other country can have significant impact on our financial forecasts.

- **Implementation of Mobile Number Portability (MNP)**

The next big thing to happen in the telecom sector of UAE and certain portfolio countries of Etisalat is the implementation of mobile number portability (MNP). We believe such a change will further strengthen competition among operators.

- **Forex movements**

Being a multi-country operator fluctuations of foreign currencies can have material impact on our financial forecasts.

- **Change in operational dynamics**

Going forward any change in operational dynamics in the countries where Etisalat operates, especially from the regulator, could impact the group's financials.

- **Assumed reasonable levels of competition**

We have assumed reasonable levels of competition among operators where Etisalat operates, however, higher or lower competition or entry of new operator could impact our financial forecasts.

Etisalat terminates its plan for Kuwait's Zain stake

Etisalat has terminated its discussion to buy a 46% stake in Kuwait's Mobile Telecommunications Co. (Zain group) from Al Khair National for Stock and Real Estate Company (Kharafi group company). The company cited current political unrest in the region, non-unanimous agreement of Zain shareholders and the forthcoming mandatory offer rules in Kuwait as the reasons behind cancellation. The Capital Market Authority (CMA) regulation which has been enacted requires the acquirer of more than 30% stake to extend its offer to all the shareholders. Etisalat made a conditional binding offer of KD1.7 per Zain share in November 2010. The near USD12bn stake acquisition would have given Etisalat access to new markets in the region such as Iraq, Kuwait and Morocco.

Recently, Etisalat's management gave the indication that they are not looking for new acquisitions at the moment, however, looking at the company's declining home operations, we strongly believe that it will pursue its expansion plans elsewhere in the region and beyond.

Likely royalty reduction – a major upside trigger

In February 2011, Emirates Integrated Telecommunications Company (Du), UAE's second telecommunications operator, announced that it will pay 15% of its 2010 net profit as a royalty fee to the government. The royalty payable to the federal government by Du will be effective from Jan. 1, 2010. For the year ended Dec. 31, 2010, the royalty will be payable at 15% of the company's net profit before any distribution. The company also announced that "ongoing royalty for subsequent years will be advised to the company in due course." The similar reduction in royalty payment is likely to be applicable to Etisalat as well.

Etisalat pays half of its profit in royalties to the UAE government, while domestic rival Du paid 15% in 2010. Recently the UAE Telecommunications Regulatory Authority (TRA) clarified that "any future decision to reduce royalty fees paid by telecoms Etisalat or Du will be made by federal authorities and not the country's telecom regulator." TRA also indicated that at one time we will have to reduce it for Etisalat, however, no timescale was offered for the reduction by the telecoms regulator. Any downside revision in royalty payments for Etisalat will have significant impact on our projected financials and valuation of the stock.

2011e EPS at Diff. Royalty Rates

	10%	15%	20%	25%	30%	35%	40%	45%	50%
EPS (AED)	1.7	1.6	1.5	1.4	1.3	1.2	1.1	1.0	0.9

Source: Global Research

Seeking a change in status

Etisalat has been in talks with the government seeking a status change from the current as a company under a special law to the company under a commercial law. Currently, Etisalat shares can be owned only by UAE nationals as it falls under the special law that restricts foreign ownership. The transition to an entity under the UAE commercial law from its current status as a company under a special law is essential to Etisalat to allow foreign investors.

Indian operations - a concern

In our view the Indian operations remain a concern for investors following the reported arrest of one of the senior officials of Etisalat DB. The arrest by India's Central Bureau of Investigation was part of a telecom scandal involving the sale of mobile licenses in India. Etisalat stated that they were not involved in the license process and remain committed to their operations in India. Besides expanding its network and building infrastructure in India, the company is planning to build 4G mobile broadband network using LTE (Long-Term Evolution) technology to tap fast-growing data market in the country.

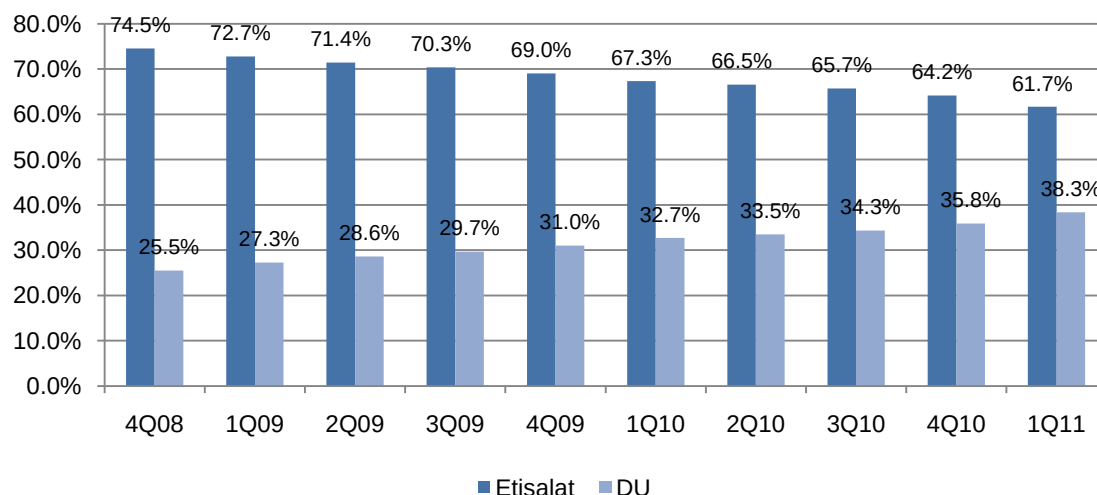
MNP in UAE

The Mobile Number Portability (MNP) will be implemented in UAE in 3Q11, as per the recent announcement from TRA. The earlier scheduled launch date for MNP was 1Q11, however, the Regulatory Authority had confirmed that it is running a bit late on schedule in launching the MNP, after unforeseen technical hurdles delayed the launch. The launch of MNP will give mobile users the choice to migrate to another service provider while retaining their existing numbers. In January, the regulator announced 1Q11 as the revised date for launching the service, which has been delayed on a number of occasions since it was first announced in 2009.

Stiff competitive environment in UAE

The growth in domestic customer base is hard to achieve. At the end of 2010 Etisalat reported domestic mobile customer base of 7.76mn which increased marginally over 7.74mn reported at the end of 2009. In 1Q11, mobile customer base declined to 7.4mn. Etisalat is facing stiff competition from DU. During 1Q11, DU added 272k mobile customers, achieving a QoQ growth of 6.3% while Etisalat's subscriber base declined by 330k QoQ. DU achieved significant mileage in terms of mobile customer market share which increased from 32.7% at the end of 1Q09 to 38.4% at the end of 1Q11. In the UAE, Etisalat's mobile ARPU declined to AED112 from AED139 in 2009 and in 1Q it declined by 4.8% YoY to AED118. At the end of 2010, the fixed-line customers were at 1.23mn and internet subscribers were at 1.32mn, reported a YoY loss of 72k and 8k respectively. We believe that since mobile market in UAE is near saturation, ARPU is also likely to remain under pressure. We believe that the key growth area in the UAE would be data and internet services. Going forward, UAE would still be the main revenue driver for Etisalat, although its contribution to the group revenue is on decline.

UAE - Mobile Customers Market Share



International operations revenue contribution

The revenue share of international operations increased from 16% in 2009 to 23% in 2010 and in 1Q11 as well. The YoY growth in international revenues and EBITDA was 46% and 55%, respectively, in 2010 and 15% and 11% in 1Q11. UAE is becoming a matured telecom market, therefore top-line growth from UAE will slowdown going forward. In 2010, revenue from UAE declined by 6.8% YoY to AED24.3bn from AED26.1bn in 2009. While in 1Q11, it declined by 1.2% YoY to AED6.3bn. We expect the share of revenue from international operations is likely to increase at a rapid pace going forward as revenue contribution from UAE is on decline while international operations are increasing their revenue contributions at a good growth rate. The contribution from its current international operations to the group revenue is likely to increase from 23% in 2010 to around 31.5% in 2014.

KPIs of Etisalat's Major Operations

	Subscriber base ('000)						ARPU (AED)				EBITDA Margin			
	2009	2010	Chg.	1Q10	1Q11	Chg.	2009	2010	1Q10	1Q11	2009	2010	1Q10	1Q11
UAE - GSM	7,741	7,764	0.3%	7,710	7,430	-3.6%	139	112	124	118	69.8%	62.4%	64.8%	60.6%
- Fixed line	1,309	1,237	-5.5%	1,300	1,130	-13.1%	186	164	174	137				
AT - Africa	4,771	5,756	20.6%	5,247	6,108	16.4%	25	28	26	25	26.6%	27.5%	16.8%	17.7%
Etisalat Misr	14,252	19,717	38.3%	16,720	20,718	23.9%	21	21	19	17	28.7%	35.4%	34.1%	36.6%
Zantel - Tanzania	1,394	1,729	24.0%	1,423	1,295	-9.0%	15	14	13	14	-29.3%	-37.3%	-44.4%	-6.7%
Canar - Sudan	137	97	-29.2%	132	86	-34.8%	187	210	194	298	14.4%	2.9%	3.4%	4.8%
Etisalat Afghan	1,541	2,484	61.2%	1,646	2,619	59.1%	20	28	28	26	-5.5%	11.1%	0.8%	20.9%
Etisalat Sri Lanka	-	3,391	0.0%	2,547	3,406	33.7%	-	11	10	11	-	17.6%	12.2%	22.2%

EBITDA Margin for UAE are for total operations

Source: Company Reports

Group Financial Performance

2010

Etisalat's revenue grew marginally by 1.9% YoY in 2010 to AED31.9bn while net profit declined from AED8.8bn in 2009 to AED7.6bn in 2010. In 2010, its operating expenses grew by 29.1% YoY to AED18.5bn. Operating expenses as a percentage of total revenue grew to 58.1% in 2010 from 45.8% in 2009. The group EBITDA declined by 14.8% YoY in 2010 to AED16.6bn, resulted in EBITDA margin of 51.9% which declined from 62.0% in 2009. Its finance income grew by 57.4% to AED917.6mn while finance cost declined by 32.7% to AED384.8mn in 2010.

1Q11

Etisalat's revenue grew marginally by 2.1% YoY & declined by 6.6% QoQ to AED8bn in 1Q11. The profit att. to equity holders of the parent co. declined by 8.9% YoY and 10.3% QoQ to AED1.8bn. Its operating expenses grew by 11.3% YoY to AED4.7bn. Operating expenses as a percentage of total revenue grew to 58.9% in 1Q11 from 54.1% in 1Q10. In 1Q11, consolidated EBITDA declined by 6.3% YoY to AED4.1bn, resulting in EBITDA margin of 51% which increased from 55.6% in 1Q10. Its finance income declined by 35.6% to AED181.4mn while finance costs increased significantly to AED144.5mn from AED9.8mn in 1Q10.

Financial Highlights

AED mn	2009	2010	YoY Chg.	1Q10	1Q11	YoY chg.
Sales Revenue	31,334	31,929	1.9%	7,871	8,040	2.1%
EBITDA	19,441	16,561	-14.8%	4,378	4,103	-6.3%
EBITDA Margin (%)	62.0%	51.9%	-1018 bps	55.6%	51.0%	-459 bps
Net Profit (att. to holders of parent co.)	8,836	7,631	-13.6%	1,994	1,817	-8.9%

Source: Company Interim Results and Global Research

Group Financial Forecast

Going forward we forecast a CAGR of 3.2% in group revenue, 3.8% in group EBITDA and 3.4% in net profit during our forecast period 2011-14. With regard to our assumption for the federal royalty payment we kept it unchanged at 50%. We have made downward revisions to our 2011-14 estimates to reflect competitive pressures in home market. We, therefore, revise our 2011 group revenue, EBITDA and net profit estimates down by 1.1%, 10% and 3.1% respectively, mainly to reflect sagging revenue trend and margin pressures in UAE.

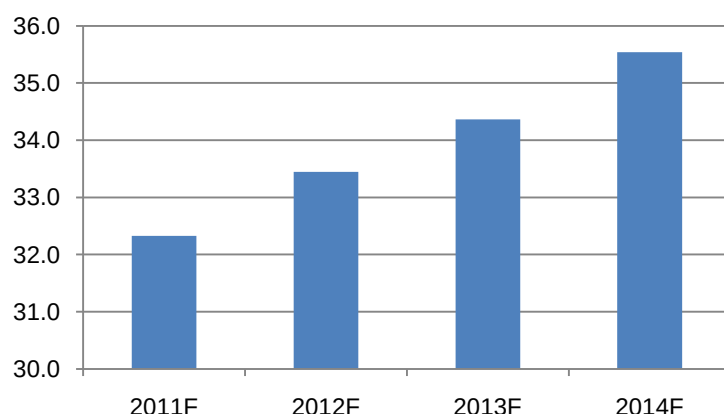
Etisalat 2011e

AED mn	Earlier Estimates	Revised Estimates	Change
Revenues	32,695	32,329	-1.1%
EBITDA	18,568	16,709	-10.0%
Net Profit (att. to holders of parent co.)	7,708	7,469	-3.1%

Source: Global Research

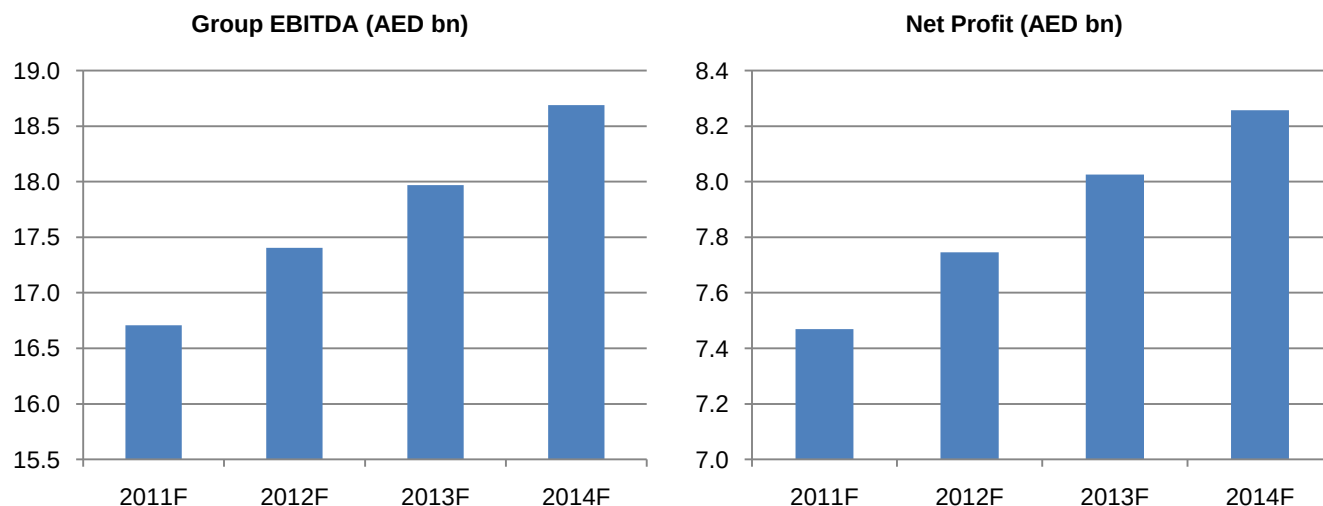
Group revenue is expected to increase by 1.2% YoY in 2011 to reach AED32.3bn. We expect group revenue to reach at AED35.5bn in 2014. The contribution from UAE operation to the group revenue is likely to decline from 77% in 2010 to 68.5% in 2014.

Group Revenue (AED bn)



Source: Global Research

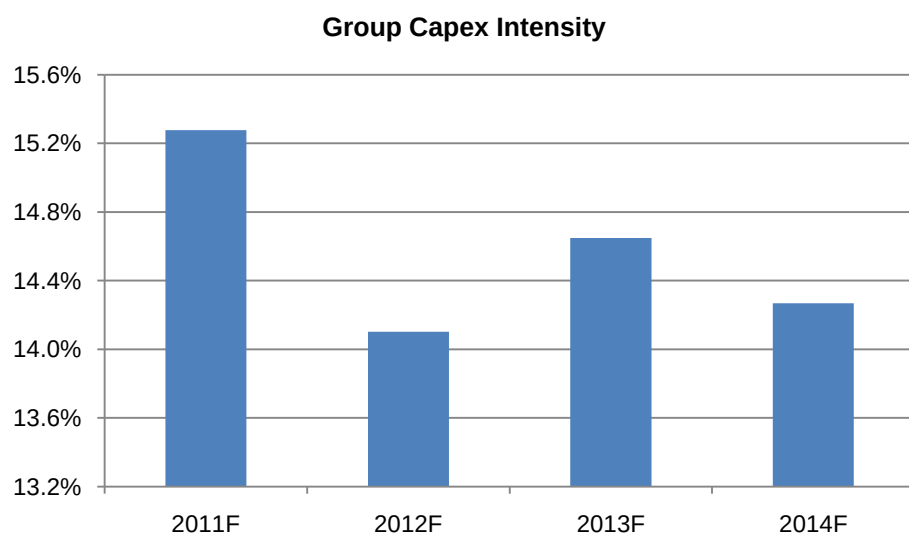
The group EBITDA is expected to increase at a YoY rate of 0.9% from AED16.6bn in 2010 to AED16.7bn in 2011 and by 2014 it is estimated to reach at AED18.7bn, resulting in a CAGR of 3.8% during 2011-14. During this period EBITDA margin is expected to increase from 51.7% in 2011 to 52.6% in 2014.



Source: Global Research

The net profit is estimated to decline 2.1% YoY from AED7.6bn in 2010 to AED7.5bn in 2011 and by 2014 it is estimated to reach at AED8.3bn, resulting in CAGR of 3.4% during 2011-14.

Etisalat invested heavily in modernization and development of infrastructure in the UAE, as the total cost of building the fibre optic network has reached AED6bn, in addition to investments in a 4G network. In 2010, the group capex declined by 14.8% YoY to AED5.8bn and in 1Q11 it declined by 27.7% YoY to AED1.1bn. The capex intensity went down from 21.6% in 2009 to 18.2% in 2010 while in 1Q it was at 14%. We expect capex intensity to come down to 15.3% in 2011.



Source: Global Research

Financial Statements

(AED mn)		2008	2009	2010	2011e	2012e	2013e	2014e
Income Statement	Revenue	29,360	31,334	31,929	32,329	33,447	34,365	35,538
	Revenue Growth	37.6%	6.7%	1.9%	1.2%	3.5%	2.7%	3.4%
	EBITDA	17,228	19,441	16,561	16,709	17,403	17,967	18,687
	EBITDA growth	10.7%	12.8%	-14.8%	0.9%	4.2%	3.2%	4.0%
	Depreciation and amortization	(2,484)	(2,535)	(2,985)	(3,231)	(3,444)	(3,660)	(3,831)
	EBIT	14,744	16,907	13,577	13,478	13,960	14,308	14,856
	Financial Charges	(564)	(571)	(385)	(406)	(428)	(442)	(450)
	Other revenues	2,672	1,328	1,968	1,825	2,103	2,402	2,429
	Profit Before Taxation	16,852	17,663	15,160	14,896	15,635	16,268	16,835
	Taxation	(8,852)	(9,080)	(7,731)	(7,582)	(7,862)	(8,147)	(8,382)
	Net Profit for the year	8,000	8,583	7,429	7,314	7,773	8,121	8,453
	Non-controlling interest	511	254	202	154	(28)	(96)	(196)
	Profit attributable to equity holders	8,511	8,836	7,631	7,469	7,745	8,025	8,257
	Net profit growth	16.6%	3.8%	-13.6%	-2.1%	3.7%	3.6%	2.9%
Balance Sheet	Cash and Bank Balance	11,295	11,309	10,277	11,004	12,111	13,341	14,629
	Receivables and Prepayments	5,945	7,981	8,721	9,605	10,564	11,619	12,611
	Inventories	183	272	316	348	383	421	463
	Total Current Assets	17,423	19,563	19,314	20,956	23,057	25,381	27,704
	Net property, plant and equipment	13,101	17,585	20,675	22,607	24,824	27,171	29,415
	Intangible assets	16,204	16,778	15,550	16,029	15,706	15,446	15,262
	Investments in JVs & associates & other	16,042	16,379	16,730	16,945	17,395	17,665	17,985
	Other non-current assets	148	1,074	3,338	3,428	3,541	3,682	3,859
	Total Fixed Assets	45,495	51,816	56,293	59,009	61,466	63,965	66,520
	Total Assets	62,918	71,379	75,607	79,966	84,524	89,346	94,224
	Accounts payable & accruals	18,685	19,389	20,078	21,285	22,253	23,258	24,099
	Short term borrowings	722	1,136	1,262	1,441	1,551	1,625	1,656
	Other current liabilities	2,009	2,963	3,138	3,138	3,138	3,138	3,138
	Long-term debt	2,644	3,546	5,377	5,592	5,870	6,048	6,143
	Other non-current liabilities	3,237	3,954	3,187	3,374	3,547	3,734	3,935
	Non-controlling interests	4,188	3,998	3,849	3,695	3,723	3,819	4,015
	Share capital	5,990	7,187	7,906	7,906	7,906	7,906	7,906
	Retained Earnings	2,555	2,568	2,774	5,499	8,500	11,782	15,295
	Other reserves	22,888	26,637	28,036	28,036	28,036	28,036	28,036
	Total Shareholders Equity	31,432	36,392	38,716	41,441	44,442	47,724	51,237
	Total Equity & Liability	62,918	71,379	75,607	79,966	84,524	89,346	94,224
Cash Flow	Cash Flow from Operating Activities	10,596	10,125	7,807	10,927	10,949	11,416	11,834
	Cash Flow from Investing Activities	(2,902)	(6,771)	(4,853)	(5,490)	(5,108)	(5,305)	(5,535)
	Cash Flow from Financing Activities	(5,642)	(3,407)	(4,372)	(4,710)	(4,735)	(4,881)	(5,011)
	Change in Cash	2,052	(53)	(1,418)	727	1,107	1,230	1,289
	Net Cash at End	11,295	11,309	10,277	11,004	12,111	13,341	14,629
Ratio Analysis	EBITDA Margin	58.7%	62.0%	51.9%	51.7%	52.0%	52.3%	52.6%
	Net Profit Margin	29.0%	28.2%	23.9%	23.1%	23.2%	23.4%	23.2%
	Return on Average Assets	14.8%	13.2%	10.4%	9.6%	9.4%	9.2%	9.0%
	Return on Average Equity	30.7%	26.1%	20.3%	18.6%	18.0%	17.4%	16.7%
	Net debt / EBITDA (x)	-0.5	-0.3	-0.2	-0.2	-0.3	-0.3	-0.4
	Interest coverage (x)	30.6	34.0	43.0	41.1	40.7	40.6	41.5
	Debt / Equity (x)	0.1	0.1	0.2	0.2	0.2	0.2	0.2
	Capex as % of sales	12.5%	21.6%	18.2%	15.3%	14.1%	14.6%	14.3%
	EV/EBITDA (x)	2.9	3.9	5.2	5.1	4.9	4.7	4.5
	EV/Revenues (x)	1.7	2.4	2.7	2.7	2.5	2.5	2.3
	EPS (AED)	1.4	1.1	1.0	0.9	1.0	1.0	1.0
	Book Value Per Share (AED)	5.2	4.6	4.9	5.2	5.6	6.0	6.5
	Market Price (AED) *	9.0	10.0	10.8	10.9	10.9	10.9	10.9
	Market Capitalization (AED mn)	54,085	79,061	85,386	86,177	86,177	86,177	86,177
	Dividend Yield	6.6%	6.0%	5.6%	5.5%	5.5%	5.5%	5.5%
	P/E Ratio (x)	6.4	8.9	11.2	11.5	11.1	10.7	10.4
	P/BV Ratio (x)	1.7	2.2	2.2	2.1	1.9	1.8	1.7

Source: Company Reports & Global Research

* Market price for 2011 and subsequent years as per closing prices on June 15, 2011

Disclosure

The following is a comprehensive list of disclosures which may or may not apply to all our researches. Only the relevant disclosures which apply to this particular research has been mentioned in the table below under the heading of disclosure.

Disclosure Checklist					
Company	Recommendation	Bloomberg Ticker	Reuters Ticker	Price	Disclosure
Etisalat	Buy	ETISALAT UH	ETEL.AD	AED10.90	1,10

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