



EFG - Hermes

Etisalat

1Q07 Results: Local Operations Surprise,
Although Not Home Alone

26 April 2007

UAE | Telecom

ST Rec. : Buy
LT Rec. : Buy

Current Price*: AED16.40
LT Fair Value : AED23.95

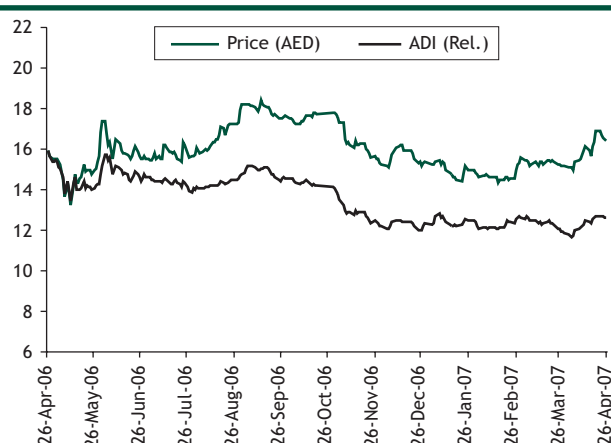
Strong Operational Results: 1Q2007 gross revenue, which is comprised only of UAE revenue, grew 27.6% Y-o-Y and 4.6% Q-o-Q to AED5.4 billion, 3.1% ahead of our estimates. Revenue growth was driven mostly by mobile operations, which accounted for 67% of 1Q2007 gross revenue.

Mobile Growth Can Still Surprise in a Mature Market: Local mobile subscribers grew by 21.3% Y-o-Y and by 4.7% Q-o-Q to 5.78 million, 1.8% ahead of our expectations. We estimate that the UAE penetration rate rose to 134% at the end of 1Q2007. The higher-than-expected mobile growth, we believe, was due to: i) a delay in the launch of the second operator, and ii) higher-than-expected growth in the overall size of the market, which could indicate that official population figures may be understated.

EBITDA Margin Exceeds 70%: We estimate the 1Q2007 EBITDA margin came in at 71.4%, up from an estimated 1Q2006 margin of 69.5% and significantly higher than the 4Q2006 EBITDA margin of 60.8%. The key swing factor for the EBITDA margin is net out payments (in-payments less out-payments) to telecom administrations, which have been on the decline since the beginning of 2006, due mainly to rising traffic volume from the Indian subcontinent.

Income from Associates Declines Q-o-Q: Income from associates, which is comprised of Etisalat's stake in the earnings of equity-consolidated operations, came in at only AED43 million, down from AED158 million in 4Q2006 but better than the AED101 million loss reported in 1Q2006. This was due to a decline in earnings from the Saudi and Pakistani operations, which are by far the biggest of Etisalat's investments, and to losses at other, smaller, investments. We believe that the Q-o-Q slowdown in Mobily (Saudi) earnings was due mainly to an increase in government revenue sharing to 15% from 10% of net revenue, in addition to the fact that 4Q2006, which coincided with the Hajj (Pilgrimage) season in December, was exceptionally strong. On the other hand, Paktel's earnings were dented by one-off provisions, which we believe could be related to restructuring after Etisalat took over its management from the government.

We Remain Buyers of Etisalat: We believe Etisalat delivered unexpectedly strong operational results for 1Q2007. Etisalat, however, will face a challenge to maintain such strong performance in upcoming quarters as it launches its Egypt operation and as competition intensifies in its home market. However, the profitable and fast-growing Saudi Arabia and Pakistan operations will provide some counterweight and should become a greater focus for investor attention. We maintain our LT Fair value estimate of AED23.95 and re-iterate our ST/LT Buy recommendation on the stock.



	2006a	2007e	2008e
EPS*	1.17	1.31	1.43
PER(x)	14.0	12.5	11.5
DPS	0.40	0.46	0.55
Div. Yield	2.4%	2.8%	3.4%
CFPS	1.70	1.70	1.71
PCF(x)	9.6	9.7	9.6
BVPS	4.29	4.77	5.65
PBV(x)	0.3	0.3	0.3

*Attributable

Stock Data:

Last Ex-Div Date	AED0.35 on 7 March 07
Mkt. Val. (mn)	AED81,857
Shares (mn)	4,991
Av. Mthly Liqd. (mn)	AED347 mn
52-Week High / Low	AED19.1 / 13.0
Bloomberg / Reuters	ETISALAT UH/ETEL.AD
Est. Free Float	40.0%

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*As at 26 April 2007

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Review of 1Q2007 Results

Subscriber growth can still surprise even though penetration is above 130%

Etisalat reported 5.78 million UAE mobile subscribers as of the end of 1Q2007, implying Y-o-Y growth of 21.3% and Q-o-Q growth of 4.7%. The 1Q mobile subscriber figure was 1.8% ahead of our expectation. We estimate that Etisalat's competitor, du, added just under 0.2 million subscribers, giving it an end-March market share of 3.3%, bringing the total UAE penetration rate as of the end of 1Q2007 to 134%.

We believe that the higher-than-expected growth in mobile subscribers was due to: i) higher-than-expected growth in the overall size of the market. There is a growing consensus that the official population figure reported by the government, the basis for our addressable market assumptions, is understated. And ii) a delay in the launch of the second operator, du, a launch that anecdotal evidence suggests did not go as smoothly as had been expected. On the other hand, fixed-line subscribers grew by around 3.9% Y-o-Y to 1.3 million, in line with our expectation.

Revenue 3.1% ahead of estimates on higher-than-expected mobile subscriber growth and ARPUs

Consolidated gross revenue (including in-payments and excluding both out-payments and discounts) for 1Q2007 grew 27.6% Y-o-Y and 4.6% Q-o-Q to AED5,414 million, 3.1% ahead of our estimates. The reported consolidated revenue is currently comprised of only local operation revenue. The two major regional operations: Mobily (Saudi, 35% owned) and Paktel (Pakistan, 26% owned) are treated as associated undertakings and therefore are reported below the operating profit line under the equity method.

Revenue growth in 1Q2007 was driven mainly by growth in mobile revenue, which we estimate was 35% Y-o-Y to AED3,610 million. This represents an estimated 66.7% of gross revenue (65% of net revenue, according to the company) versus an estimated 63% in 1Q2006. We estimate 1Q2007 global monthly ARPU (based on gross revenues) grew 11% Y-o-Y to AED211 (USD57.4), up from AED189 (USD51.6) in 1Q2006. We note, however, that the company's estimate of ARPU, which excludes incoming traffic revenue, was AED175 (USD47.7). We believe the growth in global ARPU was due partly to the pick-up in incoming traffic, which grew by 57% Y-o-Y in 1Q2007 to AED335 million, and to a possible pick-up in usage in 3G applications in 1Q2007 as a result of heavy advertising by the company ahead of the entrance of competition.

We estimate fixed-line, internet and data revenue grew by a combined 15% Y-o-Y in 1Q2007 to AED1,804 million. According to the company, fixed-line revenue alone (excluding data and internet revenue) represented around 16% of net revenue.

Local competition did not bite into the 1Q EBITDA margins which surpassed 70%

Etisalat does not report an EBITDA figure in its quarterly earnings release. We therefore calculate EBITDA from the net profit upward and base our EBITDA margin estimate for the quarter on gross revenue. Our EBITDA estimate, therefore, comprises of gross revenue less the following: i) operating costs, which include out-payments to telecom administrations, ii) SG&A expenses, which include discounts, and iii) regulatory expenses, which are comprised of contributions to ICT funds, spectrum fees and numbering fees.

Based on our calculations, the company achieved an EBITDA of AED3,865 million in 1Q2007, which represents Y-o-Y growth of 31% and Q-o-Q growth of 22.7%. The EBITDA was 9.8% ahead of our estimates, due both to higher-than-expected revenue and the EBITDA margin which came in at 71.4%, up from a 1Q2006 margin of 69.5% and higher than our 67.0% estimate for the quarter. The 1Q2007 EBITDA margin was also significantly higher than the 4Q2006 EBITDA margin of 60.8%. However, due mainly to accounting issues related to undue recognition of net out-payments (which is in-payments less out-payments) in the fourth quarter, the 4Q2006 EBITDA margin is understated relative to the first three quarters and was therefore the lowest in the year.

Net out-payments, however, have been declining steadily since the beginning of 2006 (after adjusting for the seasonal spike in 4Q2006). This is due mainly to the strong growth of in-payments which have been growing at a quarterly CAGR of 12%, on the back of growing traffic from the Indian subcontinent.

Finally, it appears that the entrance of local competition, which only launched in mid-February, did not have a significant impact on the margins of an operator with the scale of Etisalat. However, we believe that in the unique case of the UAE market, the impact on Etisalat's margin, as well as its revenue, will begin being felt as du's market share grows and a portion of Etisalat's subscriber starts migrating to du. We do not expect the migration to be significant until mobile number portability (MNP) is introduced, presumably toward the end of 2007.

Table 1: Etisalat Quarterly Net Out-payments

(AED mn)	1Q06	2Q06	3Q06	4Q06	1Q07
Inpayment	214	265	276	359	335
Outpayment	398	403	384	484	380
Net Outpayment	(184)	(138)	(108)	(125)	(45)

Source: Etisalat

The operations over which Etisalat exercises significant influence, but in which it owns less than a controlling stake, are consolidated under the equity method. This means that their impact on the group's income statement will be limited to Etisalat's stake in the net profit of these operations. The main operations consolidated in this way are Paktel and Mobily, which together account for almost all of the 'associates income' line on the income statement and for 93% of the value of investments on the Etisalat balance sheet.

Investment income from associates in 1Q2007 came in at only AED43 million, down from AED158 million in 4Q2006, but better than the AED101 million loss reported in 1Q2006. The decline in investment income from associates was due to a decline in earnings from the Saudi and Pakistani operations, which we explain below, and to losses at the level of other smaller investments. Etisalat did not make any new acquisitions in 1Q2007 and its stakes in existing associates did not change.

Table 2: Calculation of Etisalat's Major Subsidiaries Net Profit from Etisalat Balance Sheet

(AED mn)	Investments (Balance Sheet)			Etisalat Stake	Implied Profit	Reported Profit
	Dec-06	Mar-06	Difference			
Paktel	9,441	9,453	12	26%	46	NA
Etihad Etisalat	1,553	1,640	86	35%	247	246
Others	859	804	(55)	NM	(55)	NA
Total	11,854	11,896	43			

Sources: Etisalat and EFG-Hermes

i. Pakistan Telecommunication Company Limited (PTCL) - Paktel: We estimate that Paktel's net profit for the quarter ending March 2007 came in at AED46 million (USD12.5 million), implying a proportionate stake for Etisalat of AED12.0 million (USD3.3 million). The fiscal year for Paktel, which is listed on the Karachi Stock Exchange, ends in June. Paktel's net profit for the six months to end-December 2006, the most recently released results, was AED543 million (USD148 million), according to Etisalat's 1Q2007 earnings release. This implies that our estimate of AED46 million for Paktel's 1Q2007 earnings is exceptionally low when compared to the preceding six months earnings. According to Etisalat, Paktel's earnings were negatively impacted by one-off provisions, which we believe could be related to restructuring after Etisalat took over its management from the government.

ii. Etihad Etisalat - Mobily: On a Y-o-Y basis, Mobily did significantly well, with revenue and net profit increasing by 66.6% and 558%, a reflection of Saudi Arabia's buoyant mobile growth. We estimate that its penetration rate in Saudi Arabia reached 89% at the end of 1Q2007, up from 65% at the end of 1Q2006 and 84% at the end December 2006. On a Q-o-Q basis, however, revenue and net profit, the only two figures reported so far by Mobily, which is listed on the Tadawul Stock Exchange, declined by 1.3% and 24.0% to AED1,839 million and AED246 million. According to the company, this Q-o-Q decline was due to exceptionally good operational performance in 4Q2006, which coincided with the Hajj (Pilgrimage) season in December. Furthermore, Mobily started paying 15% of net revenue to the regulator in 1Q2007, up from 10% in 2006, as per its revenue-sharing agreement with the government. According to the company, this decreased the bottom line by around AED53 million. Mobily has not yet disclosed its subscriber figure for the quarter, but we estimate it came in at 7.1 million at the end of 1Q2007.

The benefit of the Saudi and Pakistani operations is beyond their contribution to Etisalat's earnings

The economic benefit of the Pakistani and Saudi operations, which operate in relatively high-growth markets, goes far beyond their contribution to net income, which is not material at the moment. Net income from associates represented 2.3% of the total net earnings for the quarter. The market value of Etisalat's stake in these operations, based on Etisalat's share in the market capitalization of both operations, represents 15.9% of Etisalat's total market capitalization of AED81.8 billion.

Net profit grew 37% Y-o-Y but was only 8% ahead of our estimates

Etisalat's 1Q2007 net profit jumped 37.4% Y-o-Y and 24.7% Q-o-Q to AED1,837 million. While EBIT for the quarter came 12.3% ahead of our estimates, net profit for the quarter was only 8% higher than what we expected. This was due mainly to the fact the company still pays 50% of its net profit to the government as royalty fees, while we were estimating that the company would start paying 47.5%. Royalties this quarter were AED1,837 million. Our assumption was based on the regulator's announcement at the end of 2006 that royalty fees would go down gradually within four years to 40% of the company's net profit. Etisalat showed a positive minority interest of AED70 million, which pertains mainly to the pre-operating expenses (losses) of the Egyptian operation.

AED655 million in capex spending on local and fully consolidated subsidiaries

The 1Q2007 capex figure of AED655 million pertains only to the fully consolidated subsidiaries, which at the moment include only the Egyptian and the Afghanistan operations, both of which have yet to be commercially launched. According to the company, 65% of the reported capex spending of AED655 million was undertaken by the Egypt subsidiary, which is expected to start operations by mid-May. The balance of the reported capex figure, AED229 million, was spent on both the local and Afghanistan operations.

Comment

Overall, we believe that Etisalat delivered unexpectedly strong 1Q2007 operational results. Despite the entrance of competition, Etisalat managed to increase its ARPUs and surprise in terms of both subscriber growth and EBITDA margin. We believe, however, that Etisalat will face a challenge in maintaining such strong performance in upcoming quarters as it launches its Egyptian operation and as competition intensifies in its home market. We believe this should shift investor's focus to the profitable and fast-growing Saudi Arabia and Pakistan operations. We remain buyers of Etisalat, which offers a 32% upside potential to our long-term fair value of AED23.95 million and trades at a sector-average 2008 P/E and EV/EBITDA multiples of 11.5x and 6.6x respectively.

Table 3: Etisalat Actual and Forecast KPIs and Income Statement

KPIs (000's)	1Q06	4Q06	1Q07a	Y-o-Y	Q-o-Q	1Q07e	diff.	FY06a	FY07e
Mobile Subs (UAE)	4,766	5,520	5,780	21.3%	4.7%	5,680	1.8%	5,520	6,230
Mobile Additions	232	260	260	12.1%	0.0%	160	62.5%	986	710
FL Subs (UAE)	1,251	1,285	1,300	3.9%	1.2%	1,296	0.3%	1,285	1,340
FL Additions	14	5	15	7.9%	200.0%	11	36.4%	48	55
Inc. Statement (AED mn)	1Q06	4Q06	1Q07a	Y-o-Y	Q-o-Q	1Q07e	Y-o-Y	FY06a	FY07e
Revenue	4,244	5,177	5,414	27.6%	4.6%	5,253	3.1%	18,714	20,677
Total Costs	(1,292)	(2,028)	(1,549)			(1,734)		(6,180)	(6,067)
EBITDA	2,952	3,149	3,865	31.0%	22.7%	3,520	9.8%	12,534	12,286
EBITDA Margin	69.5%	60.8%	71.4%	1.8 pp	10.6 pp	67.0%	4.4 pp	67.0%	59.4%
Depreciation	(304)	(435)	(325)			(366)		(1,391)	(2,411)
EBIT	2,647	2,715	3,541	33.8%	30.4%	3,154	12.3%	11,143	9,876
Margin	62.4%	52.4%	65.4%			60.0%		59.5%	47.8%
Interest Expense	-	(186)	(162)			(146)		(262)	(506)
Interest Income	122	146	167			54		476	234
Other Income (Expenses)	7	46	16			25		46	98
Associates	(101)	158	43			153		267	1,221
EBMI	2,675	2,879	3,604	34.7%	25.2%	3,239	11.3%	11,670	10,923
Minority Interest	-	69	70			-		50	751
EBR	2,675	2,947	3,674	37.4%	24.7%	3,239	13.4%	11,719	11,674
Royalty Fees	(1,337)	(1,474)	(1,837)			(1,538)		(5,860)	(5,134)
Net Profit	1,337	1,474	1,837	37.4%	24.7%	1,700	8.0%	5,860	6,540

Sources: Etisalat and EFG-Hermes estimates

DISCLOSURES

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