

Bahrain telecommunications Company

BSE Code: Batelco | Bloomberg Code: Batelco BI | Reuters Code: BTEL.BH

Current Market Price: BHD 0.550 (As of 11 August 2010)

[Initial Coverage: July 2008](#)

August 2010

Stock Volatility	Expected Return (July 2008)		
	Low	Medium	High
	Low		
	Medium		

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- Bahrain Telecommunications Co. (Batelco) is underperforming the Bahrain Stock Exchange (BSE). The stock has lost 4.35% YTD versus the index loss of 3.34%.
- The stock is currently trading at a TTM P/E of 7.8x; in 2009, the P/E has contracted by 7% YTD after contracting 9% in 2009. We place fair value P/E at 8x for the stock, indicating limited upside potential.
- Batelco first half 2010 revenues show a flat performance, coming in at USD 452 mn; for 2Q10 revenues were at USD 225 mn, a 2% YoY decline. Declining revenue comes from a myriad of factors including the increasing saturation of the home market, leading to falling ARPU's, in addition to recalculation of active subscribers in line with ITU stipulations.
- Batelco reported first half net earnings for 2010 of USD 124 mn, a 14% decrease YoY. 2Q10 net income came in at USD 59 mn, a 20% YoY decline (8% QoQ). Associate operations continue to post losses, at USD 7 mn in 2Q, bringing the 1H Share from Associates to a loss of USD 12 mn.
- While Batelco's home operations continue to account for nearly 68% of the top line, the bulk of foreign revenue comes from Batelco's Jordan operations (Umniah) which by the end of 2009 had increased its market share in Jordan to 27%. With approximately 4.77 million mobile subscribers, Jordan has a mobile penetration rate of 70%, which is low by GCC/MENA standards; implying significant room for growth in the Jordan mobile market
- The Bahrain mobile telecom market is highly saturated with a 120% penetration rate while fixed line penetration is at over 30% (the highest in the GCC); as a result, pursuit of inorganic growth through acquisitions is the expected way forward for Batelco. Consequently, we see 2010 net profit coming in at USD 267 mn, a 4% annual decline.

USD Mn	2006	2007	2008	2009	2010e
Gross Revenue	623	777	846	919	963
Net Profit	237	256	278	279	267
P/E	9.0	8.0	7.8	7.5	8.3
P/B	2.4	2.2	2.0	1.8	2.0
Market Cap (USD mn)	3,021	3,069	2,389	2,251	2,005
Stock Returns	3.66%	1.52%	-22.14%	-5.76%	-10.2%

Note: 2010 P/E, P/B as of latest earnings, Mcap as of latest date, Stock Returns is YTD
Source: Zawya, Gulf Base, Reuters, Company Financials

Discussion Notes

Future growth primarily driven by the group's operations in MENA countries outside its home market

Earnings growth

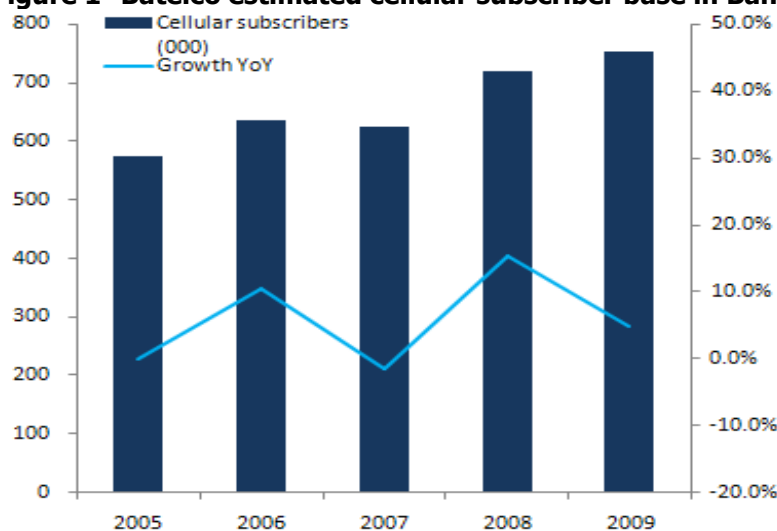
Batelco reported net earnings of USD 123.8 mn for the first half of 2010, a 14% decrease over the corresponding period of the previous year. As for the top line, the group reported gross revenue of USD 452 mn in 1H10, a flat YoY performance, on account of Viva Bahrain's entrance. In 2Q10, net earnings were at USD 59 mn, a 20% YoY decline and 8% lower than 1Q10 net earnings. While Bahrain operations continue to account for the bulk of revenues (roughly 68%), Batelco's revenue in the near future are likely to be driven by its operations in high growth/low penetration foreign markets. There is a common trend among GCC mobile operators, specifically companies like Batelco, which, due to oversaturation of home markets (Bahrain is at a 120% mobile penetration rate) are compelled to seek out inorganic growth through acquisitions in foreign markets that are categorized by low penetration.

The entry of Zain Bahrain, which now holds a market share of over 55%, in addition to the entry of STC's Viva Bahrain, will only serve to intensify competition in an already saturated market, driving down ARPU levels and limiting further subscriber growth.

Business Lines

Batelco operates in 7 markets, including Bahrain, and has consolidated mobile subscribers of 6.88 mn as of 1H10, a 47% YoY increase due largely to the folding in of STel's (India) over 1 mn subscribers. Bahrain mobile subscribers amounted to 869k in 1H10, a 16% YoY growth, while fixed line subscribers were down 5% to 192 k in the same period.

Figure 1- Batelco estimated cellular subscriber base in Bahrain¹



Source: TRA Bahrain, Batelco, Markaz Research

¹Batelco's subscriber base is not reported, hence subscriber numbers are estimated using overall Bahrain subscribers and estimate Batelco market share

Table 1- Breakdown of Affiliates

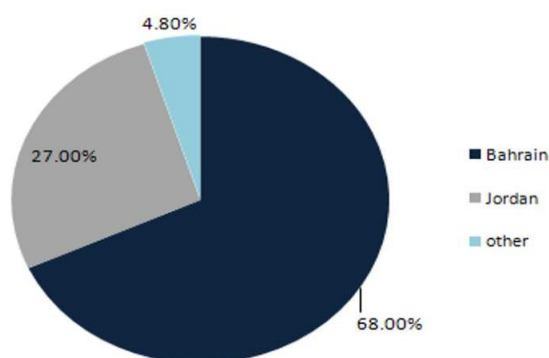
Company	Country	Ownership	Service	Subscribers
Qualitynet	Kuwait	44%	ICT solutions	N/A
Umniah	Jordan	96%	Telecom	1.6mn
Atheeb	K.S.A	15%	Telecom	N/A
Sabafon	Yemen	26.90%	Telecom	2.5mn
S-Tel	India	42.70%	Telecom	141,000
Batelco Egypt	Egypt	100%	Telecom	N/A

Sources: Batelco and Gulf base

Batelco saw its market share fall to 44.6% by the end of 2009 (820K mobile subscribers) following the entrance of Zain Bahrain

While Batelco does not provide a detailed breakdown of its operations outside of Bahrain, the bulk of foreign revenue comes from Jordan operations; in the form of its 96% stake in Umniah Mobile Company. Umniah had a 27% market share in Jordan as at the end of 2009, mobile subscribers were up 14% to 1.7 mn in the same period. With approximately 4.77 million mobile subscribers, Jordan has a mobile penetration rate of 70%, low by GCC/MENA standards; implying significant room for growth in the Jordan mobile market.

Figure 2- Revenue Segments 2009



Source: company's Annual report

Batelco saw its market share fall to 44.6% by the end of 2009 (820K mobile subscribers) following the entry of Zain Bahrain. Competition is set to intensify further with the arrival of STC's VIVA Bahrain early this year; Viva managed to grab 50k mobile subscribers within two weeks of launching. This will place downward pressure on ARPU levels in addition to limiting subscriber growth going forward.

Bahrain, like its GCC counterparts, is a very highly saturated market, with a mobile penetration rate of 120% at the end of 2009, a fixed line penetration of 30% and broadband penetration of over 80%, indicating limited growth opportunities going forward. Consequently, Batelco will likely exert focus on international operations to derive top line growth from markets with low saturation such as Jordan, Yemen, etc.

Jordan

In 2009, Batelco acquired a 47.7% of S Tel forming a joint venture with Siva group; S Tel is licensed to operate in 3 states

Batelco Operates in 6 foreign markets; Kuwait, Saudi Arabia, Yemen, Jordan, India and Egypt, of those 6 markets Jordan's Umniah Operator contributes 73% of non-domestic revenue. As of the end of 2009, Umniah had captured 27% of the Jordanian telecom market with 1.63 mn mobile subscribers; as of 1H10 Umniah's subscribers breached the 1.7 mn mark. The operation contributed 22% to Batelco's 2009 revenues, and is the Group's most profitable foreign operation.

India

In 2009, Batelco acquired a 47.7% of S Tel forming a joint venture with Siva group; S Tel is licensed to operate in 3 states and will start operating in Kashmir, Jammu & Assam by the end of 2010². With a penetration rate of 50%³, the Indian market, though highly competitive, offers some growth opportunity. However, with 15 operators, including big names Bharti, Tata, Vodaphone and Reliance, competing for a population of about 1.2 bn, it is unclear how much headway S Tel can hope to make in the market.

Broker Estimates

Net income has grown at a CAGR of 4% from 2004 and saw a flat growth in 2009 to USD 279mn due to muted top line growth and higher expenses in association with acquisitions. Furthermore, Batelco's 1H10 net income was reported as USD 124mn, a 14% decrease YoY.

Table 2: Consensus Estimate Table (2010 f)		
Annual (USD mn)	Taib Securities	Markaz
	May-10	Aug-10
ROA:	15.3%	14.8%
ROE:	19.9%	20.1%
Revenue:	945	963
Net Profit :	268	267
Growth (%)	-4%	-4%
Recommendation	Overweight	NA

Source: Reuters Knowledge, Markaz Research

² On March 2010 the Indian Department of telecom barred S tel from operating in three states Himachal Pradesh, Bihar and Orissa with only citing National security as a reason.

³ Telecom Regulatory Authority of India, Press Release, April 2010

Valuation

Batelco is underperforming the Bahrain Stock Exchange (BSE). The stock has lost 4.35% YTD versus the index loss of 3.36%. Turnover velocity spiked to 7.85% in 2008 before declining to 2% in 2009. The stock is currently trading at a TTM P/E of 7.8x; P/E has contracted 7% YTD after contracting 9% in 2009. We place fair value P/E at 8x for the stock, indicating limited upside potential. Given the high saturation and increased competition in the home market in addition to the costs associated with expansion, we expect Batelco to post a 4% decline in net profit to USD 267 mn due to a deceleration of revenue growth to 5% in 2010.

In terms of risk, the stock is trading in the middle of its MVX band (Figure 5) though significantly higher than that of the index. Hence, we expect the stock to provide low returns with Medium risk going forward.

Figure 3: Price Trend

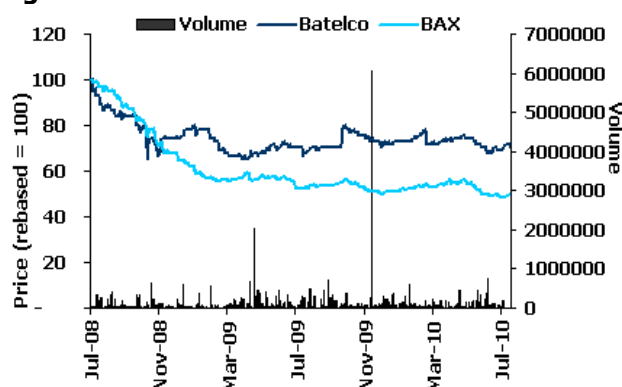
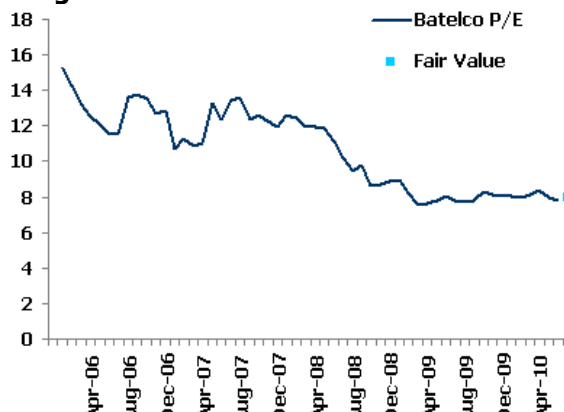
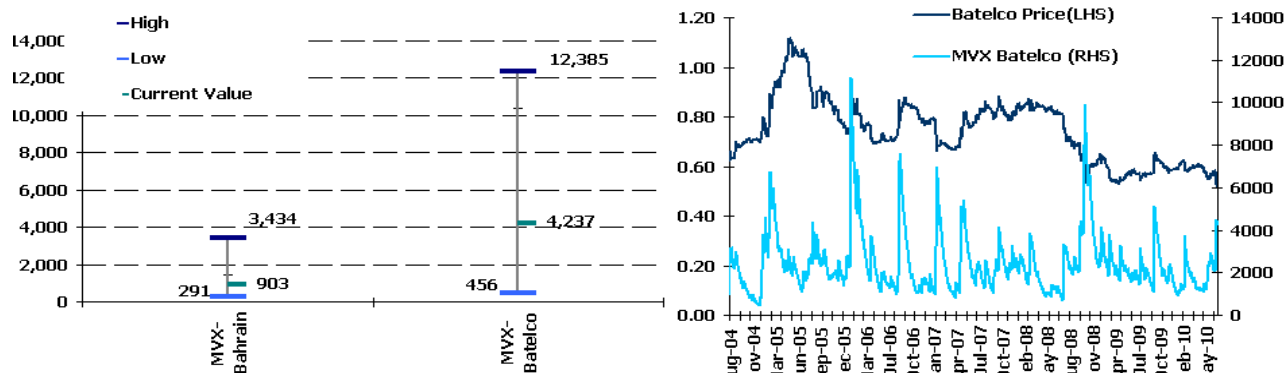


Figure 4: PE Trend



Source: Zawya, Thomson Datastream, Markaz Research

Figure 5: Markaz Volatility Index (July 2010)



Source: Reuters 3000Xtra, Markaz Research

Appendix 1: Key Statistics

Income statement						
(USD mn)	2005	2006	2007	2008	2009	2010e
Revenue	561	623	777	846	919	963
Gross Margin	459	465	548	596	644	674
Total operating expense	356	398	528	584	631	682
Net income	227	237	256	276	278	267
Balance Sheet						
(USD Mn)	2005	2006	2007	2008	2009	
Total Assets	1026	1275	1946	1894	1784	
Total Liabilities	166	314	869	696	476	
Total Shareholders' Equity	859	961	1077	1199	1307	
Key Ratios	2005	2006	2007	2008	2009	
Return on Assets (%)	22.1%	18.6%	13.1%	14.7%	15.7%	15%
Return on Equity (%)	26.4%	24.6%	23.8%	23.2%	21.4%	20%
Earnings Growth (%)	3.7%	4.4%	8.4%	8.4%	0.6%	-4%
Revenue Growth (%)	4%	11%	25%	9%	9%	5%
EV/EBITDA	7.87	8.91	8.52	7.94	6.85	
Price/Book	2.42	2.24	2	1.8	1.65	
Price/Earning	9.3	9.11	8.02	7.81	7.48	
Dividend Yield (%)	5.53	7.08	5.9	8.85	8.85	
EPS (USD)	0.23	0.2	0.22	0.19	0.2	
Assets Growth (%)	6.8%	24.3%	52.6%	-2.7%	-5.8%	
Annual trading volume	27.7	15.9	20.1	112	30.6	
Annual trading value (USD mn)	99.0	41.0	50.0	214.3	47.1	
Turnover velocity	N/A	1.38%	1.64%	7.85%	2.03%	
Market cap (USD mn)	2,915	3,021	3,069	2,389	2,251	

Source: Zawya, Gulf Base, Reuters, Company Financials

Table 2- Country telecom Data

	2005	2006	2007	2008	2009
Mobile subscribers(000)	767	907	1116	1,441	1,480
penetration	86%	94%	107%	130%	120%
Blended ARPU (US\$)	N/A	N/A	28.1	31	29.7
Fixed Line subscribers (000)	194	194	204	220	238
Fixed line penetration %	26.6%	26.1%	26.8%	28.4%	30.1%
internet (000)	155	210	250	403	649
user penetration %	21.3%	28.2%	32.9%	52%	82%

source: ITU, Bahrain TRA, company reports

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Low	Where the potential return is less than 10%
Medium	Where the potential return is between 10% and 25%
High	Where the potential return is greater than 25%

Definitions – Volatility (Risk)

High	Where the Current MVX and band width of stock is more than the respective country benchmark
Medium	Where the current MVX is lower than benchmark and band width higher than or lower than benchmark
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MVX refers to Markaz Volatility Index calculated by Markaz based on in-house proprietary model

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