

Q3 UPDATE: Emirates Telecommunications Corp. PJSC

October 23, 2008

Fair value estimate: AED 23.3
Recommendation: BUY
Domestic growth intact: focus overseas

Emirates Telecommunications Corporation PJSC (Etisalat) continued its robust operating performance in Q3 2008. Operating profit rose by 24.0% y-o-y to AED 2bn backed by strong subscriber additions in its domestic market. The Company posted increases in mobile and internet subscribers of 14% y-o-y and 33% y-o-y respectively despite tough competition from Emirates Integrated Telecom Company (EITC). In addition, the Company maintained its focus on international operations with Etisalat Misr expanding domestic coverage to 93% and Atlantique Telecom initiating its roaming service in West Africa, utilising Etisalat's international network. Also, last month Etisalat entered the Indian telecom market through the acquisition of a 45% stake in Swan Telecom for \$ 900mn. We believe the Company will maintain its current growth momentum in both domestic and international markets and expect revenue and free cash flows to increase at CAGRs of 12% and 16% respectively to 2010E.

Result Highlights

Net revenue: Etisalat reported net revenue of AED 6,626.3mn in Q3 2008, up 24.4% y-o-y, supported by the addition of mobile and internet subscribers in the UAE market.

Subscribers: In mobile and internet segments, Etisalat expanded its subscriber base by 3.2% q-o-q and 5.9% q-o-q, respectively. By contrast however, fixed-line activities reported largely unchanged 1.36 million subscribers. We expect the Company's domestic mobile subscribers to grow steadily at a CAGR of 6.3% and internet subscribers to increase strongly at a CAGR of 20.6% to 2010E.

EBITDA and Net profit: EBITDA and net profits rose by 16.4% y-o-y and 18.5% y-o-y to AED 2,643.6mn and AED 2,134.9mn respectively. Profitability, however came under pressure. While EBITDA margins fell from 42.6% to 39.9%, net profit margins declined from 33.8% to 32.2% due to increasing operating expenses. In our view, high network & establishment charges affecting international operations will continue to dampen the Company's medium term profitability.

Capital expenditure: The Company maintained its aggressive capital spending in the third quarter based around both organic and inorganic growth strategies. Capital expenditure totalled AED 2.7bn for the first nine months of 2008. Also, Etisalat invested AED 1bn in subsidiaries and other ventures. However, Q3 results did not include the Company's recent acquisition of a 45% stake in Swan Telecom for \$ 900mn with the transaction now expected to be completed in Q4 2008.

RESULT UPDATE

Share Data

Market Cap	AED 95.5 bn
Price	AED 15.95
Abu Dhabi Index	3,522.4
Reuters	ETEL.AD
Bloomberg	ETISALAT UH
Avg. Volume (52 Week)	2.1 mn
52-Week High/Low	AED 22.2 / 12.5
Shares Outstanding	5,990
Fair Value Estimate	AED 23.3
Rating	BUY

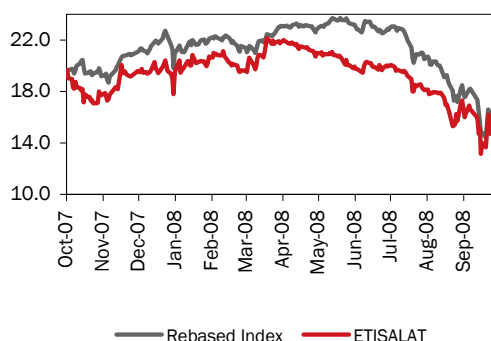
Key Figures

Year to 31 Dec	2007	2008
Revenue (mn)	21,339.9	26,173.7
Operating Profit (mn)	6,609.6	7,111.6
EBITDA (mn)	8,571.5	9,802.3
Net Profit (mn)	7,296.6	9,409.9
EPS (AED)	1.22	1.57
Operating Margin (%)	31.0%	27.2%
RoA (%)	13.7%	15.8%
RoE (%)	31.1%	32.8%
EV/Revenue	4.2x	3.3x
EV/EBITDA	10.5x	8.9x
P/E	13.1x	10.2x

Shareholding Pattern (%)

Government of UAE	60
Public & Others	40

Relative Performance



ETISALAT Q3 2008

The acquisition of a 45% stake in Swan Telecom for \$ 900mn appears an expensive investment by Etisalat. The purchase price implies a \$ 2bn valuation for Swan Telecom. Our analysis of the deal is based on P/B multiples as the Company has no current cash-flows with operations expected to commence in mid 2009. We conclude that based on an average P/B multiple of 5.2x for established companies with multi-regional exposure in India, the valuation of Swan Telecom implied by the terms of the Company's acquisition appears high at a P/B multiple of 6.9x.

However positively, we believe the transaction is wholly consistent with Etisalat's international strategy to expand in under-penetrated emerging markets, and to realise synergies from its existing worldwide network.

Figures in \$ mn	Market Cap ⁽³⁾	Book value	P/BV	Operating circles	Subscribers (mn) ⁽⁴⁾
Idea Cellular	5,603	921	6.1x	12	29.3
Bharti Airtel	33,288	4,915	6.8x	23	74.8
Reliance Communications	16,751	6,409	2.6x	20	52.5
Swan Telecom ⁽²⁾	2,000	292	6.9x	13	-

⁽¹⁾ Mobile Subscribers as on August 2008

⁽²⁾ Total license fees paid by Swan is \$ 365mn. We assume debt-equity ratio of 1:4 for the license fee.

⁽³⁾ Market Capitalisation as on 23 Sep 2008 as Swan acquisition was reported on the same day

Source: ADCB research

Outlook

In our view, the Company's domestic operations will remain a corporate cash-cow, supported by their wide coverage across UAE, and continuing introduction of new technologies and services. Also, an expatriate population in UAE of almost 80%, and a projected increase in population of 6.5% p.a. will ensure attractive growth in Etisalat's mobile subscribers, despite expected penetration of 168% in 2008E. As a result, we expect the Company to report a 4.4% CAGR in mobile subscribers between 2008-2015E. In addition, we forecast a robust 15.2% CAGR in internet subscribers over the same period, as internet penetration remains low.

We expect the Company's overseas operations to begin to add value over the next 2-3 years. We forecast a contribution to Group revenues from international operations of nearly 17.2% and 22.8% by 2010E and 2012E respectively, although low ARPU in these same countries will remain a concern.

Furthermore, we believe Etisalat's strong cash balance of AED 12bn and low debt/EBITDA ratio of 0.3x confer substantial strategic advantages in the current tight liquidity situation. These will support the Company's domestic and international capital expenditure requirements and assist its acquisition of international assets in distressed sales.

Key Figures

Quarterly Data	Q3'07	Q2'08	Q3'08	YoY %	QoQ%
(Figures in AED mn, except per share and Subscribers data)					
Net Revenue	5,327	6,383	6,626	24.4%	3.8%
EBITDA	2,270	1,833	2,644	16.4%	44.2%
EBITDA Margins	42.6%	28.7%	39.9%		
PAT	1,801	2,995	2,135	18.5%	(28.7%)
PAT Margins	33.8%	46.9%	32.2%		
Per Share Data (AED)					
EPS	0.30	0.50	0.36	18.5%	(28.7%)
Subscribers (In mn)					
Fixedline	1.32	1.35	1.36	3.0%	0.7%
Mobile	6.19	6.83	7.05	13.9%	3.2%
Internet	0.81	1.02	1.08	33.3%	5.9%

Source: Company data

Valuation

We have valued Etisalat using SOTP-based Discounted Cash Flow (DCF) and Peer-Based Multiple methods. Our weighted SOTP-based DCF (70%) and peer-based multiple (30%) valuations allocate a higher weight to our SOTP-based DCF model because it discounts firm-specific cash flows. Our fair value estimate of Etisalat is AED 23.3 for 2008 representing a premium of 46.2% to the current share price. We maintain our Buy rating.

Weighted Average Value per Share		
Valuation Method	Value (AED)	Weight (%)
Valuation based on SOTP	24.5	70%
Peer-based multiple valuation	20.6	30%
Weighted Average Fair Value	23.3	100%

Source: ADCB research

Cost of equity is derived by using the Capital Asset Pricing Model (CAPM). We make the following key assumptions in our model:

Risk free rate:	4.79% (Avg. 10 yr. US Treasury Bond Rate for three years)
Country Risk Premium:	0.9%
Equity Premium:	6.0%
Beta:	0.97 (Sector beta for emerging markets)
Cost of equity:	11.51%
WACC:	11.55%
Terminal growth rate:	3.5%
Terminal WACC:	11.33%

We have revised our cost of equity from 10.76% to 11.51% to reflect the increase in telecom sector beta from 0.85 to 0.97. Also, we have used the discounted acquisition value for the recent acquisition of a 45% stake in Swan Telecom in our calculation, as Swan Telecom has not commenced operations yet. The resulting value has been discounted at 30%, the average decline in Indian telecom companies' shares over the past two months. As a result, our SOTP-based DCF model yields a fair value per share of

AED 24.5. Based on a peer-group average estimated P/E multiple of 12.1x 2009E earnings, our forecast 2009E EPS for Etisalat of AED 1.70 implies a value of AED 20.6 per share.

SOTP Valuation of Etisalat				
Name of Associates	% share	Basis of valuation	Value (In AED mn)	Value per Etisalat's share (In AED)
UT Technologies LLC	50.00%	Book Value	50.0	0.01
Pakistan Telecommunication Company Ltd (PTCL)	26.00%	Market Value	1,413.2	0.24
Etihad Etisalat Company, KSA	26.25%	Market Value	5,515.4	0.92
Thuraya Satellite Telecommunications Company PJSC	28.04%	Book Value	493.7	0.08
PT Excelcomindo TBK	15.97%	Book Value	1,658.9	0.28
MDC-NG B.V., Neitherlands	40.00%	Book Value	884.6	0.15
Swan Telecom	45.00%	Acquisition Value	2,313.0	0.39
Other Investments		Market Value/Book Value	643.7	0.11
				2.17
DCF Valuation of Stand-alone Business				22.32
Valuation based on SOTP (In AED)				24.49

Source: ADCB research

Sensitivity of fair value estimate of Stand-alone Business, using different rates for terminal cost of capital and terminal growth rates:

		Terminal cost of capital				
		10.3%	10.8%	11.3%	11.8%	12.3%
Terminal Growth	2.5%	22.2	21.3	20.6	19.9	19.3
	3.0%	23.2	22.3	21.4	20.6	19.9
	3.5%	24.4	23.3	22.3	21.5	20.7
	4.0%	25.8	24.5	23.4	22.4	21.5
	4.5%	27.5	25.9	24.6	23.5	22.5

Source: ADCB research

Sensitivity of fair value estimate of Stand-alone Business, using different mobile ARPU and market share for 2015

		Market share in 2015				
		60.0%	62.5%	65.0%	67.5%	70.0%
Expected ARPU in 2015	140	21.1	21.3	21.5	21.7	22.0
	145	21.5	21.7	21.9	22.1	22.4
	150	21.8	22.1	22.3	22.6	22.8
	155	22.2	22.5	22.7	23.0	23.2
	160	22.6	22.9	23.1	23.4	23.6

Source: ADCB research

Comparable Company Trading Analysis												
Company	Stock Price	Fully Diluted Market	Fully Diluted Enterprise Value	P/E			Fully Diluted Enterprise Value / EBITDA			ROCE		
	23-Oct-08 (Local Ccy)	Cap (AED m)	Value (AED m)	Dec-07	Dec-08	Dec-09	Dec-07	Dec-08	Dec-09	FY07	FY08	FY09
Saudi Telecom Co.	64.50	126,339	132,193	10.7x	9.8x	9.7x	8.1x	6.9x	6.7x	34%	39%	40%
Mobile Telecommunications Company (Zain)	1.22	70,819	96,540	16.1x	16.0x	13.5x	10.2x	8.1x	6.7x	19%	21%	25%
Turkcell Iletisim Hizmetleri AS	7.85	49,562	43,190	12.7x	9.6x	8.9x	5.7x	5.4x	5.0x	33%	15%	36%
Orascom Telecom Holding	29.98	21,091	39,050	10.8x	7.0x	5.8x	4.9x	4.4x	3.9x	26%	26%	27%
Etihad Etisalat Co	30.60	14,984	23,035	8.8x	8.1x	7.2x	8.0x	5.9x	5.4x	20%	24%	24%
Qatar Telecom QSC	130.50	14,480	41,978	9.1x	7.9x	6.0x	9.7x	5.1x	4.4x	16%	28%	32%
Telecom Egypt SAE	12.60	14,743	17,226	7.7x	7.6x	6.3x	4.8x	4.8x	4.5x	17%	17%	17%
Emirates Integrated Telecommunications	4.55	18,200	18,111	NM	NM	52.5x	NM	NM	14.8x	(21%)	4%	46%
Egyptian Company for Mobile Services	99.36	6,799	9,015	5.3x	6.1x	5.8x	3.5x	3.1x	2.8x	58%	68%	66%
Oman Telecommunications Co	1.90	13,596	12,674	12.7x	10.3x	9.3x	6.9x	6.1x	5.7x	55%	76%	NA
Bahrain Telecommunications Co BSC	0.64	8,978	8,859	9.1x	8.9x	8.4x	6.9x	6.4x	6.1x	22%	NA	NA
Mean				10.3x	9.1x	12.1x	6.9x	5.6x	6.0x	25%	32%	35%
Median				9.9x	8.5x	8.4x	6.9x	5.7x	5.4x	22%	25%	32%
P/E multiple (Peer-group average)	12.1x											
EPS09E	1.70											
Equity Value	20.6											

Source: ADCB research, Reuters, Company data

ETISALAT Q3 2008

Income Statement					Key Ratios				
(AED M, Yr. ending Dec. 31)	2007	2008	2009	2010		2007	2008	2009	2010
Revenue	21,340	26,174	28,384	29,876	Per share data (AED)				
Operating costs	(5,852)	(8,035)	(9,012)	(9,784)	Shares outstanding (mn)	5,990	5,990	5,990	5,990
Royalty	(7,297)	(8,916)	(8,020)	(7,389)	EPS	1.22	1.57	1.70	1.87
Depreciation & Amortisation	(1,962)	(2,691)	(2,621)	(2,811)	Book value per share	4.02	4.94	5.94	7.05
Share in profits of associates	380	580	565	633					
Operating Profit	6,610	7,112	9,297	10,525	Operational Metrics				
Operating margin	31.0%	27.2%	32.8%	35.2%	Mobile Subscribers (mn)	6.37	7.21	7.44	7.66
EBITDA	8,571	9,802	11,917	13,336	Fixed line Subscribers (mn)	1.33	1.37	1.39	1.40
YoY Growth (%)	22.6%	14.4%	21.6%	11.9%	Internet Subscribers (mn)	0.88	1.15	1.35	1.54
Finance cost	(503)	(404)	(195)	(156)	Mobile ARPU (AED)	188	190	180	175
Other income	736	2,209	700	714	Fixedline ARPU (AED)	191	195	190	190
Deferred Tax Liability	(122)	(122)	(122)	(122)	Internet ARPU (AED)	162	155	155	150
PAT	6,720	8,794	9,680	10,961					
Minority Interest	576	616	484	219	Valuation ratios (x)				
Net Income	7,297	9,410	10,164	11,180	EV/Revenue	4.2x	3.3x	3.1x	2.9x
Net Margin	34.2%	36.0%	35.8%	37.4%	EV/EBITDA	10.5x	8.9x	7.5x	6.4x
YoY Growth (%)	24.5%	29.0%	8.0%	10.0%	P/E	13.1x	10.2x	9.4x	8.5x
EPS	1.22	1.57	1.70	1.87					
Balance Sheet									
Non-Current Assets	39,547	43,231	47,152	49,813	Performance ratio (%)				
YoY Growth (%)	22.2%	9.3%	9.1%	5.6%	Return on avg. assets	13.7%	15.8%	16.3%	17.3%
Cash & cash equivalents	9,433	10,845	7,810	11,233	Return on avg. net worth	31.1%	32.8%	29.7%	28.2%
Other current assets	3,468	4,636	5,076	5,373	Return on Capital Employed	29.5%	29.7%	31.5%	30.2%
Total Current Assets	12,901	15,481	12,886	16,606	Operating ratios (%)				
YoY Growth (%)	(4.8%)	20.0%	(16.8%)	28.9%	Revenue Growth	31.0%	22.7%	8.4%	5.3%
Total Assets	52,448	58,712	60,038	66,418	EBITDA Margin	40.2%	37.5%	42.0%	44.6%
					EBIT Margin	31.0%	27.2%	32.8%	35.2%
Short Term Borrowings	343	719	0	0	Net Profit Margin	34.2%	36.0%	35.8%	37.4%
Other current Liabilities	17,322	21,112	18,897	19,031	Balance Sheet ratios (%)				
Total Current Liabilities	17,665	21,831	18,897	19,031	Non-Current Assets Turnover Ratio	59.4%	63.2%	62.8%	61.6%
Long Term Borrowings	3,141	2,200	1,500	1,500	Total Assets Turnover Ratio	43.4%	47.1%	47.8%	47.3%
Other non-current Liabilities	5,746	3,859	3,309	3,171	Debt/Equity Ratio	14.5%	9.9%	4.2%	3.6%
Total non-current Liabilities	8,887	6,059	4,809	4,671	Net Debt/Equity Ratio	(24.7%)	(26.8%)	(17.7%)	(23.1%)
Total Liabilities	26,553	27,890	23,707	23,702					
Minority Interest	1,838	1,222	738	519					
Total Shareholders' Equity	24,057	29,599	35,593	42,197					
Total Equity & Liabilities	52,448	58,712	60,038	66,418					

Source: Company data, ADCB research

Investment Ratings:

Buy: More than 15% potential return. We recommend that investors buy the stock based on the annualised return to the shareholders over 6-24 months time horizon (percentage change from current price to the projected target price).

Sell: Negative potential return. We recommend that investors sell the stock based on the annualised return to the shareholders over the 6-24 months time horizon.

Hold: Between 0 and 15% potential return. We take a neutral view on the stock over the 6-24 months period.

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