



SHUAACAPITAL_{PSC}

Etisalat (ETEL.AD)

Equity Research

Initial coverage

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Sector Coverage Team

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Current Price:	AED 18.9*	Country:	United Arab Emirates
Fair value Target:	AED 24.2	Sector:	Telecom Services
Recommendation:	BUY	Exchange:	Abu Dhabi Securities Market

• Emirates Telecommunications Co. (Etisalat) is the UAE's only telecom services provider, operating a virtual monopoly in fixed, mobile and Internet services in the country. The company will soon be facing competition across all core business segments from new-comer Emirates Integrated Telecom Company's (EITC), which will be operating under the brand name Du.

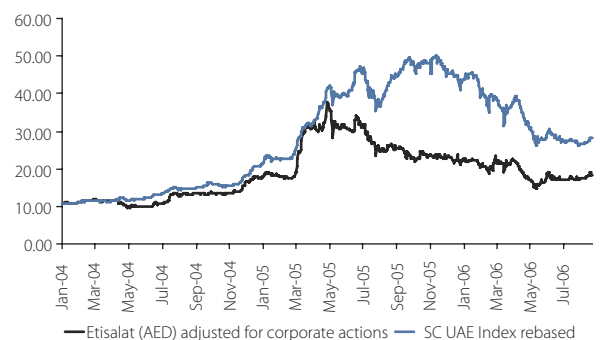
• In response to the prospect of losing market share in its home market, Etisalat has engaged into a new era of expansion. This strategy is further bolstered by a very healthy and rich financial position resulting in a potentially massive war chest for acquisitions. The company has an objective to become one of the top 10 telecom operators globally by 2010 in terms of market capitalization, revenues and profits.

• Using a sum-of-the-parts valuation method, we reached a target price for Etisalat of AED 24.2/share, implying a 28% upside potential to the current price of AED 18.9/share. Hence, we initiate coverage on Etisalat with a BUY recommendation. The stock now trades at a price to 2006E earnings of 14.8x and EV/EBITDA 2006E of 6.4x.

Year	Net profit (AED '000)	EPS (AED)	EBITDA (AED '000)	BV (AED '000)	BVPS (AED)	RoAE (%)	RoAA (%)	P/E (x)	EV/EBITDA (x)	P/BV (x)
Dec-08E	7,220,095	1.59	13,953,382	28,372,539	6.25	27.9%	17.3%	11.9	5.6	3.0
Dec-07E	6,441,989	1.42	13,010,475	23,421,194	5.16	30.2%	16.8%	13.3	6.0	3.7
Dec-06E	5,790,399	1.28	12,329,846	19,247,955	4.24	33.1%	19.1%	14.8	6.4	4.5
Dec-05	4,256,031	1.17	9,807,607	15,726,306	4.33	29.3%	19.2%	20.1	8.0	5.5

52-week range (AED)	14.6 - 26.4
Number of shares ('000)	4,537,500
Free Float (%)	40
Market cap (AED mn)	85,759
Market cap (USD mn)	23,348
Div Yld. 2005 (%)	2.7

Etisalat stock performance vs. SC UAE Index



*As at 23 August 2006

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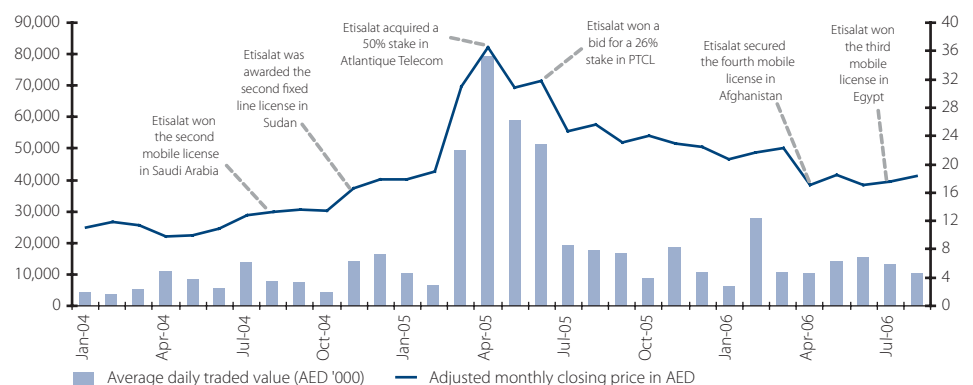
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Investment highlights

- Emirates Telecommunications Co. (Etisalat) is the UAE's only telecom services provider, operating a virtual monopoly in fixed, mobile and Internet services in the country. The company will soon be facing competition across all core business segments from new-comer Emirates Integrated Telecom Company's (EITC), which will be operating under the brand name Du.
- Despite the UAE telecom market having functioned within a monopoly to-date, the number of telecom users in the country is high, the networks are well developed and a wide range of services are available.
- In response to the prospect of losing market share in its home market, Etisalat has engaged into a new era of expansion. This strategy is further bolstered by a very healthy and rich financial position resulting in a potentially massive war chest for acquisitions. The company has an objective to become one of the top 10 telecom operators globally by 2010 in terms of market capitalization, revenues and profits.
- Etisalat has secured, either directly or through joint ventures, green-field licenses in Saudi Arabia (mobile license), Sudan (fixed line license), Afghanistan (mobile license) and Egypt (mobile license) and has acquired substantial minority stakes in integrated telecom operator Pakistan Telecommunications Company Limited (PTCL) and pan-African mobile company Atlantique Telecom. And in reference to its latest statements, it plans to bid for new licenses or acquire stakes in existing operators in 15 new markets.
- Etisalat's financial results as at H1 06 continued to be strong with a top-line and bottom-line Y-o-Y growth of 24.9% and 32.8% respectively. The company's EBITDA margin gained a further 2.2 points from end of 2005 to reach 78.4%, which is by far the highest EBITDA margin among regional peers. However, with the consolidation of the Egyptian and Afghani subsidiaries, Etisalat's margins should be under pressure going forward.
- Using a sum-of-the-parts valuation method, we reached a target price for Etisalat of AED 24.2/share, implying a 28% upside potential to the current price of AED 18.9/share. Hence, we initiate coverage on Etisalat with a BUY recommendation. The stock now trades at a price to 2006E earnings of 14.8x and EV/EBITDA 2006E of 6.4x.
- One event that could add significant value to the Abu Dhabi based telecom operator is whether the royalty fee, which stands currently at 50% of the company's annual net profit, is reduced to take into account the new competition that Etisalat will face in its home market. In our opinion, there is a high likelihood that the UAE government gradually reduces it to 30% by 2010, starting in 2007. However, as no official statement on this subject has been released, we took both scenarios into account in our valuation. One has to keep in mind that the telecom sector in the UAE is the largest revenue generator outside the oil sector for the federal government.



Company overview

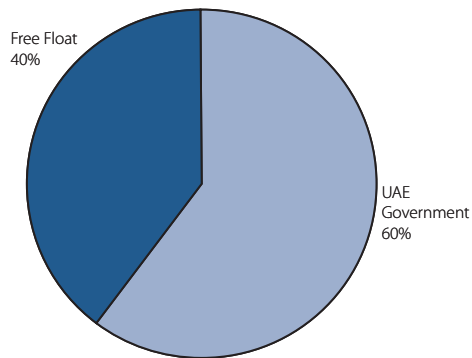
Etisalat anticipated the end of its 30 years monopoly by entering 15 new markets in the past two years

Emirates Telecommunications Co. (Etisalat) has been the sole telecommunications services provider in the UAE since its formation in 1976. The integrated operator introduced the GSM technology in the country in 1994 and, despite its monopoly status for 30 years, has built up a modern telecom infrastructure offering to its subscribers technologically advanced telecom services. Etisalat now operates in 15 markets through its various subsidiaries and associated companies.

In February 2006, Etisalat lost its monopoly with the licensing of a second telecom operator in the UAE and early May 2006 the company signed a new full service license valid for 20 years. The Abu Dhabi-based company did not pay an upfront fee for its newly awarded license but will have to pay a renewal annual fee of AED 1 mn.

Etisalat has been trading on the Abu Dhabi Stock Market (ADSM) since 23rd June 2002.

Etisalat's Ownership Structure



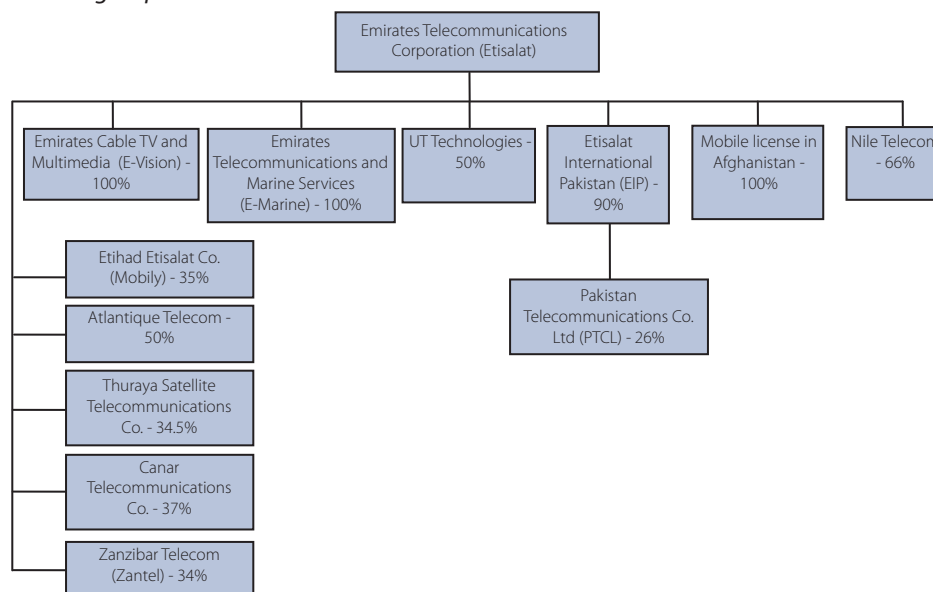
Source: Etisalat, SHUAA Capital

We estimate Etisalat to be the fifth largest company in the MENA region in terms of market capitalization

In July 2006, Etisalat has been granted membership of the International Telecommunications Union (ITU). Abu Dhabi-based Thuraya, which is one of Etisalat's associated companies, is the only other UAE member. ITU is an international body for the telecom development and standardization of telecommunications in the world.

The company was ranked 140th in the world in terms of market capitalization by the Financial Times Top 500 Corporations and is by our estimates currently the 5th largest company in the Middle East by the same measure.

Etisalat group chart



Source: Etisalat, SHUAA Capital

It is worth mentioning that Etisalat's Internet subsidiary, eCompany, was merged back into the main company in May 2006. As reflected in the chart above, Etisalat has now six subsidiaries and five associated companies.

Emirates Cable TV and Multimedia, E-Vision

E-Vision, which started commercial operations in April 2000, is a UAE cable TV provider, offering close to 200 channels in over 21 languages. The company's TV bouquets are offered under Showtime Cable, Orbit Vision, ART, Firstnet and Pehla. Service is now available in Abu Dhabi, Dubai, Sharjah, Ajman and Al Ain, and is expected to be rolled out across the country soon.

Emirates Telecommunications and Marine Services FZE, E-Marine

E-marine was incorporated in the Jebel Ali Free Zone (JAFZ), Dubai in June 1998. It operates in the field of submarine cable installation, maintenance, repair and storage throughout the region and beyond. This subsidiary owns three fully equipped cable ships and a modern cable depot in Abu Dhabi.

Etisalat International Pakistan (EIP)

EIP in which Etisalat owns 90% and Dubai Islamic Bank 10% was incorporated in the UAE on 27 June 2005 with the primary purpose of holding the investment in PTCL.

UT Technologies

Etisalat and Seven Emirates for Investment & International Trade (SEIIT) set up UT Technologies during the second quarter of this year. The objectives of the new company include construction and installation of telecom infrastructure and household network system with a capital of AED 100 mn.

More details on Etisalat's associated companies and foreign subsidiaries are provided later in this report under 'Etisalat's strategy' section.

Business divisions

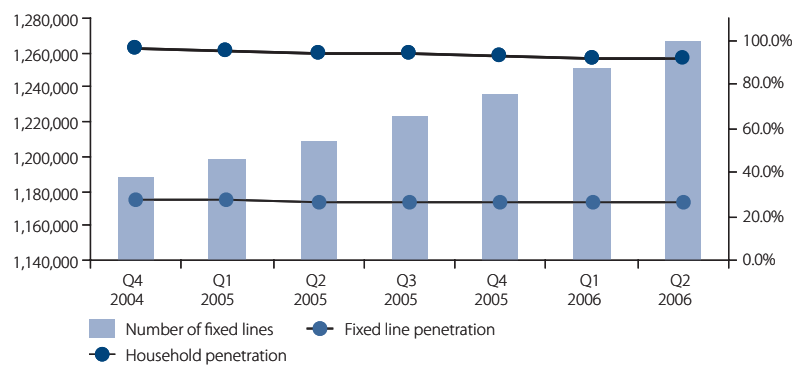
1.27 million fixed lines at the end of Q2 06, translating into a penetration rate of 26.1%

Fixed line division

Enterprise and individual customers benefit from various services on the fixed-line network such as ATM (Asynchronous Transfer Mode), Frame Relay, VSAT (Very Small Aperture satellite Terminal) and ISDN (Integrated Services Digital Network). Etisalat already started to migrate its fixed line services over the Next Generation Network (NGN) and is expected to complete the process by end of 2007. NGN is Internet protocol based and thus facilitates the simultaneous transmission of voice, video, data and Internet services over a single network, enabling true triple-play functionality.

Like most integrated operators within the MENA region, Etisalat's fixed line subscribers' growth has been slow due to the fixed-mobile substitution trend. At the end of June 2006, the UAE operator claimed 1.27 million fixed lines, which translated into a fixed line penetration of 26.1% and a household penetration of 91.3% if we assume an average household size of 3.5 (which is relatively conservative compared to the various available statistics).

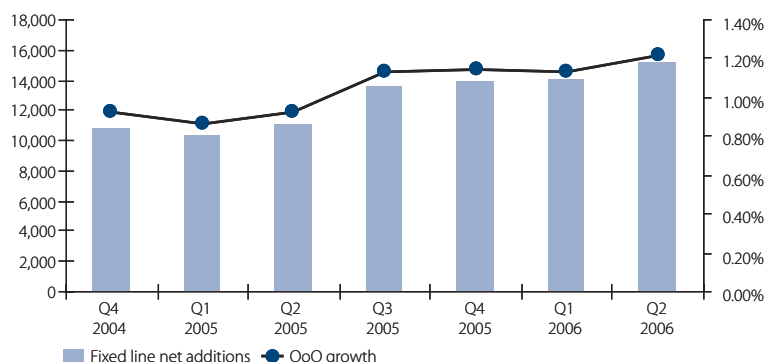
Etisalat's fixed line indicators in the UAE



Source: Etisalat, EIU, SHUAA Capital

Fixed line net additions have been steady for the past seven quarters with an average quarterly growth of 1%.

Etisalat's fixed line net additions



Source: Etisalat, SHUAA Capital

Etisalat is to focus on customer-care and value added services in the UAE to preserve its subscriber base

In expectation to the entrance of a second integrated operator in its domestic market, Etisalat adopted a new strategy to retain existing subscribers and attract new ones. This strategy for its home market consists in focusing on value added services rather than on prices. Thus, the company should release new features and services for its fixed line clients in the coming months before the second telecom operator starts commercial operations.

5.0 million mobile users at the end of Q2 06, implying a mobile penetration of 103%

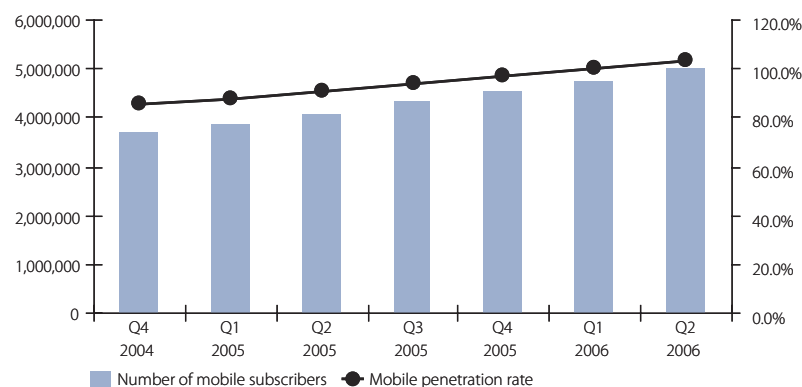
Mobile division

Etisalat offers an array of voice and data services including postpaid and prepaid (Wasel) SIM cards, WAP, GPRS, 3G, MMS, Push to Talk, etc. Etisalat's 3G services, launched in December 2003 under the Mubashir brand name, provide mobile phone users with a wide range of facilities including live video calls on 3G enabled phones, 128 Kbps high speed Internet access, video conferencing and streaming television content.

Etisalat has also deployed HSDPA across its W-CDMA (Wideband-CDMA) based network. With HSDPA, data downloads should be much faster, at speeds of between 400 Kbps and 600 Kbps, with a peak rate of 14.4 Mbps. In other words, the technology promises something surprisingly missing in early 3G mobile broadband networks, high data speeds similar to those of fixed-line ADSL services.

At the end of Q2 06, Etisalat had 5.0 million subscribers, implying a mobile penetration rate of 102.9% if we consider general consensus data on the UAE population.

Etisalat's mobile indicators in the UAE



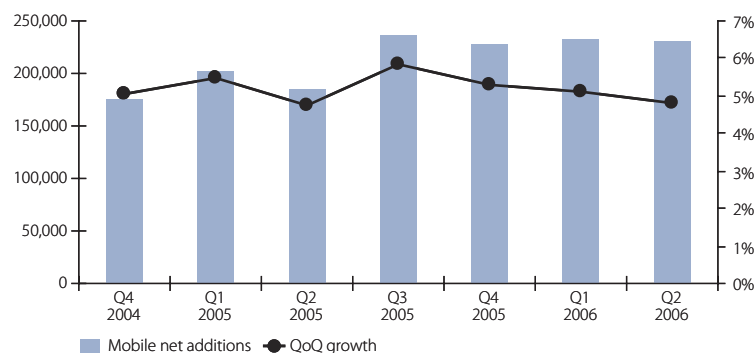
Source: Etisalat, EIU, SHUAA Capital

Despite strong growth in mobile subscribers, ARPU increased to AED 150 as of Q4 05

However, according to the findings of the latest census in July 2006, the UAE's population has reached only 4.1 million, which would translate into a mobile penetration of 121.8%. We are skeptical of the accuracy of this figure and choose to adopt the former as a representation of total population in the country.

Despite strong and steady QoQ subscribers' net additions, Etisalat's ARPU increased from AED 144 in Q4 04 to AED 150 in Q4 05.

Etisalat's mobile net additions



Source: Etisalat, SHUAA Capital

For postpaid mobile subscribers, Etisalat has concluded roaming agreements with over 265 operators. Prepaid subscribers were, until recently, able to only receive calls in many of these networks. However, Etisalat signed in July 2006 full prepaid roaming agreements with a number of operators in over 30 countries and more should be concluded in the near future. Wasel customers can now make calls from their mobile phones, and will be charged at applicable roaming rates.

Etisalat revealed that it will shortly launch a second mobile phone area code, although no specific date has yet been set. The Telecommunications Regulatory Authority (TRA) has awarded the company the use of area code 056. Future rival telecom services provider Du has already been awarded 055.

As part of its home market strategy, Etisalat indicated that it will focus on providing value to its mobile customers rather than entering into a price war with the second telecom operator, Du. As an example of new services being developed, Etisalat will introduce mobile payment services by the end of this year.

Internet division

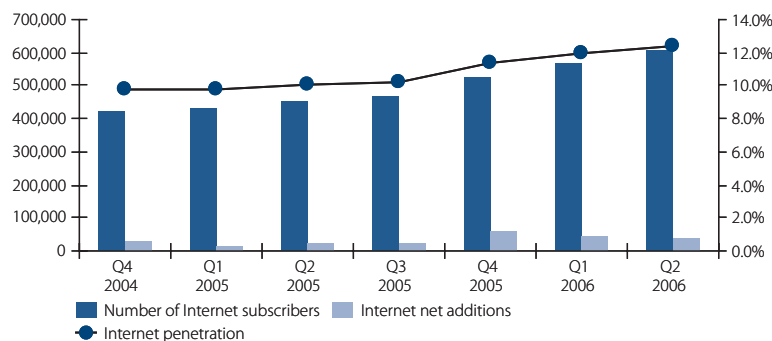
Etisalat offers a full range of Internet services to home and business users ranging from dial-up and broadband access, Internet leased line, mail service (Domain name), remote access solution, web hosting, etc.

Higher Internet penetration by focusing on broadband services

However, the company's primary focus is on broadband services with Al Shamil (home users) and BusinessOne (SMEs businesses). Besides, Etisalat has now approximately 170 iZone (broadband public Internet hotspots) located at convention centers, coffee shops and airports across the UAE.

In June 2006, Etisalat significantly increased its Internet bandwidth in the UAE with another 12 international links in addition to the 37 it had previously. The increased capacity of 7.5 Gbps is the highest bandwidth capacity available with any single provider in the region. By the end of 2006, Etisalat is planning to expand its international links to 60 with a capacity of 10 Gbps to meet growing demand for Internet services in the UAE.

Etisalat's Internet indicators in the UAE

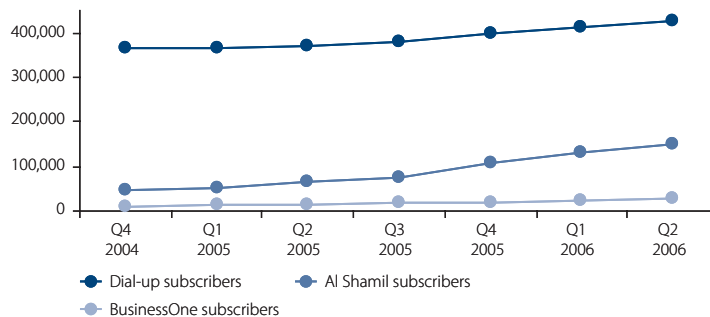


Source: Etisalat, EIU, SHUAA Capital

604,963 Internet subscribers in Q2 06 with 70.5% of them being dial-up users

Etisalat had 604,963 Internet subscribers in the UAE as at 30 June 2006. In more details, the Abu Dhabi based operator had 426,498 dial-up users, 149,576 Al Shamil subscribers and 28,889 BusinessOne connections, beside almost 3,000 leased lines for the large companies.

Etisalat's Internet subscribers breakdown



Source: Etisalat, SHUAA Capital

VoIP in the UAE is currently banned but should be authorized by Q1 07

Competition in VoIP expected to be stiff resulting in possible erosion of international calls revenues for Etisalat

As a result of Etisalat's strategy to concentrate on value added services rather than on prices, we do not expect Internet prices in the UAE to go down much further with new packages that should be launched very soon to feature more value for approximately the same price.

Concerning the hot topic of Voice over Internet Protocol (VoIP), Etisalat will be ready to deploy this technology, using Multi-Protocol Label Switching (MPLS), by the time the Telecommunication Regulatory Authority (TRA) has drafted the mandate on how and when VoIP can be deployed. VoIP is currently banned in the country but the UAE's telecom regulator is drafting a policy that should be finalized by the first quarter 2007 to allow the use of this technology. VoIP technology allows users to make low cost telephone calls (in particular international calls) using broadband, dial-up and wireless Internet connections.

However, Etisalat is not the only company trying to penetrate the VoIP market in the UAE. Efonica, a provider of VoIP technology based in Dubai Internet City, has initiated talks with UAE telecom providers, Etisalat and du, to legalize phone calls over the Internet. Efonica, which was acquired by US company Fusion Telecommunications in 2005, is rolling out a new free service on its website that allows subscribers to call any landline or mobile telephone number in the world. In other words, Efonica is positioning itself to become a global VoIP services provider competing with Skype. Fusion is already licensed to operate in Jordan and Bahrain and it expects to be granted a license to operate in Saudi Arabia next year should the country allow VoIP by the end of this year.

Cisco Systems, the global network solutions company, said it is also negotiating with both UAE telecom operators to launch VoIP in the country.

In July 2006, Etisalat signed two memoranda of understanding (MoUs) with Mitel Networks of UK, a provider of IP communications solutions. Mitel will provide Etisalat an IP-based voice platform which should allow the UAE operator to introduce cost-effective telephony solutions for small businesses and large residential customers. Thus, Etisalat is moving forward with its plans to migrate to an all-IP network, speed up fixed/mobile convergence and extend IP applications in the UAE market.

Other services

Etisalat has introduced the BlackBerry in the UAE, in a tie-up with Research In Motion. The hardware costs between AED 2,500 and AED 3,000 and Etisalat charges a setup and support fee of AED 22,000. It is initially targeting 10,000 corporate subscribers.

In May 2006, Etisalat signed two MOU with global communications technology provider Samsung to test and implement the company's WiMAX system and develop the concept of 'Smart Future Cities' in the UAE. The new Smart Home concept will deliver home control systems with entire ranges of devices and appliances used in homes and offices to be electronically linked by Samsung's HomeVita solution and Etisalat voice and data network. The system interlinks facilities and home appliances through a common network and can be controlled through the internet or mobile phones. The concept will first be marketed in the country's fast growing upscale townships on the waterfronts and islands, and later made available to other users.

The UAE telecom market

The UAE telecom market expected to be fully liberalised after 2015

With privatization and liberalization going on at full stream in the region, the UAE had one of the last surviving telecom sector monopolies, Qtel in Qatar being the last one. In April 2004, a presidential decree cancelled Etisalat's monopoly, while a federal order also established a Supreme Committee for the Supervision of the Telecommunications Sector (SCSTS) to restructure the telecom sector, grant licenses for new operators and oversee the government's 60% share in Etisalat. The SCSTS announced its intention to liberalize the telecom sector by 2015. The move comes as the UAE seeks to regularize the telecom market with the World Trade Organization (WTO) recommendations and as negotiations on a bilateral free trade agreement with the USA and Australia are moving forward.

UAE's membership to the World Trade Organisation (WTO) obtained in April 1996 made it mandatory to privatize its telecommunications activities and allow for competition. However, the UAE negotiated a temporary exclusion from the commitment until 2015.

The UAE telecom regulator was set up in October 2004

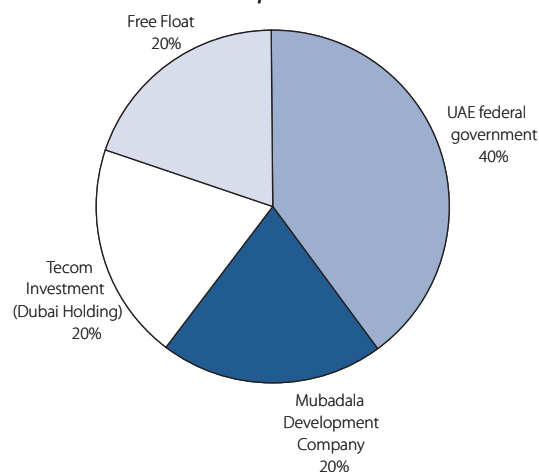
In October 2004, the SCSTS set up the Telecom Regulatory Authority (TRA). The TRA oversees the introduction of competition and is also responsible for frequency spectrum management in the country.

Whilst in theory Etisalat had a monopoly of telecom services and cable TV in the UAE, Dubai-based real estate developer Emaar Properties launched in 2002 a subsidiary called Sahm Technologies (Sahm). Sahm linked all Emaar's residential and business developments with an IP-based fibre optic network infrastructure, providing telephony, TV and Internet access. In 2005, Dubai Technology and Media Free Zone (Tecom) took over Sahm Technologies and became the sole telecommunications services provider in the 'New Dubai' areas. Tecom provides telephony, Internet access and television connection to all new projects in the 'New Dubai' areas, including those of Emaar and Nakheel.

Du was established at the end of 2005 and was awarded a 20-year full services license in February 2006

Emirates Integrated Telecom Company's (EITC), the country new telecom operator, which will be operating under the brand name 'Du', was formed at the end of 2005 by the federal government of the UAE, the Abu Dhabi state-owned Mubadala Development Company, and Tecom Investment, an affiliate company of Dubai's state-owned Dubai Holding. The company was awarded the UAE's second telecom license on 12 February 2006, authorizing it to install, operate, and manage a public telecom network providing services across the UAE. Du obtained the 20-year full service license (fixed line, mobile, Internet and international telecom connectivity) for an upfront license fee of AED 124.5 million.

Du's ownership structure



Source: Du, SHUAA Capital

Du will pay an annual renewal fee of AED 1 mn in addition to the AED 124.5 mn upfront license fee already disbursed

Like Etisalat, Du will have to pay an annual renewal fee of AED 1 mn. Both operators will also pay a royalty fee to the government. While Etisalat pays half of its profits as royalty, the TRA has not finalized the terms for Du yet. It could be on a gradual basis.

Tecom was acquired in January 2006 for AED 1.2 bn valuing each Tecom's subscriber at a staggering AED 63,158 (USD 17,195)

In January 2006, Du acquired Tecom for AED 1.2 bn. The deal valued each Tecom's 19,000 customers at USD 17,195, which is at least 12 times higher than any acquisition that took place in the past year. It is still not clear whether Du has to give up Tecom's monopoly in the New Dubai areas at the same time as Etisalat gives up its monopoly over the rest of the UAE. It is also not confirmed whether Tecom areas would retain unrestricted access to the Internet. They are presently exempt by law from the proxy server.

The second telecom operator raised AED 2.42 bn in its March 2006 IPO, which was over-subscribed 167 times. 800 million shares or 20% of the company's total four million shares were offered to UAE individuals only at a price of AED 3/share. Du started trading on the Dubai Financial Market on 22 April 2006.

It is worth mentioning that Du has opened its link to a global telecoms and Internet system. The system will provide its customers the capability to make international calls and connect to broadband Internet services without the need to use Etisalat infrastructure. The link will be provided by Flag Telecom's Falcon submarine cable system, which stretches from Suez to Mumbai and links to the global Flag submarine cable.

Etisalat's strategy

Corporate restructuring and competitive strategy

Etisalat is going through a managerial and operational restructuring exercise. The company's operations in the UAE are being consolidated into three regions: Abu Dhabi, Dubai, and Northern Emirates. Meanwhile, a separate entity called Etisalat Services is being created to manage the group's specialized business units and subsidiaries including Ebtikar (specialized card manufacturing unit set up in 1996 that services the industries of telecommunications -pay phones, GSM, Internet- health, parking and others), e-marine (see above for details), Etisalat Academy (professional training center) and Emirates Data Clearing House (EDCH – established in 1994, EDCH offers electronic data transfer and financial services like simplified roaming, improved profitability, data and financial clearing and settlement, and negotiations of roaming agreements for clients) as well as management, development and maintenance of properties.

New corporate image in May 2006 with a new slogan 'Reach'

Etisalat unveiled a new corporate image in May 2006 with a new logo and a new slogan, 'Reach'. The new brand identity accompanied by a customer-centric strategy arrives at a time when competition in its domestic market will start soon and international expansion is gaining pace.

Etisalat's strategy in the UAE is to focus on customer satisfaction and value added services to compete with new-comer Du

In short, Etisalat's strategy will focus on customer satisfaction and added value services rather than on prices. Etisalat will continue to be technology driven providing the latest services while rationalizing costs in order to improve profitability. A testimony of this new strategy is (i) the agreement that Etisalat signed with Skywards, the award-winning frequent flyer program of Emirates and SriLankan Airlines, to develop a loyalty program for customers of the telecoms operator and (ii) the introduction of 16 new services in the next six months in the three main divisions, fixed line, mobile and Internet. Etisalat also signed an AED 200 mn contract with Ericsson in March 2006 to enhance its network capacity, capabilities, and coverage in the country in order to handle effectively the increasing subscribers' growth.

It is also worth noting that Etisalat signed a MoU with Siemens Communications to support the UAE operator in its continuing international expansion strategy. Under the agreement, Etisalat will consider Siemens Communications to be one of its preferred suppliers for the entire scope of communication technologies. We have seen lately major telecom players in the region signing medium to long term agreements with equipment and network providers in order to optimize services and be more cost efficient.

Etisalat: on a buying spree

Aggressive international expansion in order to diversify sources of income

As the UAE market tightens and in response to the prospect of losing market share when Du starts commercial operations, Etisalat has chosen a strategy to aggressively expand internationally. This strategy is further bolstered by a very healthy and rich financial position, and lack of substantial debt on the company's books, resulting in a potentially massive war chest for acquisitions. Etisalat has at various occasions stated its objective to become one of the top 10 telecom operators globally by 2010 in terms of market cap, revenues and profits.

Etihad Etisalat (Mobily), Saudi Arabia - 35%

Etisalat is one of the seven founding shareholders of Etihad Etisalat (Mobily) with a 35% stake in the latter. Mobily owns and operates GSM and 3G networks in Saudi Arabia. The company received a 25-year mobile license in August 2004 and started commercial operations end of May 2005.

As per the Communications and Information Technology Commission (CITC) licensing requirements, Mobily had entered into a management agreement with Etisalat. Etisalat receives an annual management fee of AED 36.7 mn (USD 10 mn) for services provided under the agreement. The term of the agreement is for a period of seven years and can be automatically renewed for successive periods of five years.

We have devoted a separate section for the initiation of coverage on Mobily as the company went public in October 2004 and is currently listed on the Saudi Stock Market (TADAWUL). The company is the tenth largest listed company in Saudi Arabia in terms of market capitalization.

In April 2005, acquisition of a 50% management stake in Atlantique Telecom for EUR 100 mn

Atlantique Telecom, West Africa - 50%

In addition to a 10-year management service agreement, Etisalat acquired a 50% stake in Atlantique Telecom (AT) in April 2005 in a deal that was valued in excess of EUR 100 mn. AT owns majority shareholdings in mobile operators in seven West African countries: Burkina Faso, Gabon, Central African Republic, Benin, Togo, Niger and Ivory Coast. The total estimated population of these countries is approximately 50 million. Etisalat will receive an annual compensation of EUR 2 mn for management services.

The Ivory Coast is AT's newest GSM license with the network launched end of July 2006. AT operates in Ivory coast through its subsidiary Moov Company. With a population of over 18 million (approximately 40% under the age of 14) and only 13% mobile penetration, the Ivory Coast represents a promising market with a high growth potential for the years to come.

Etisalat has provided loan facilities of AED 44.3 million (EUR 10 mn) to AT. The loan is payable over 5 years and carries an interest rate of 7% per annum. The interest income earned during 2005 amounted to AED 2.2 million (2004: Nil).

Pakistan Telecommunications Company Ltd (PTCL) - 26%

Pakistan Telecommunications Company Limited (PTCL) has been operating in Pakistan since 1996 and had launched its mobile subsidiary, Ufone in 2000. As PTCL's monopoly ended in December 2002, the government opened Local Loop (LL) and Long Distance & International (LDI) telecom services for private participation.

In June 2005, Etisalat won a USD 2.6 bn bid for a 26% management stake in PTCL

In June 2005, Etisalat won a USD 2.6 bn bid for a 26% management stake in state-owned PTCL. The government, which held 88% of the integrated telecom operator, offered 26% of the company's total 5.1 billion shares as part of its privatization plan.

Etisalat's bid surpassed China Mobile and Singapore Telecom that bid at USD 1.41 bn and USD 1.17 bn respectively. It is worth mentioning that PTCL's public offer has been Pakistan's biggest privatization to-date. At the time the privatization took place, the market price of PTCL shares on Karachi Stock Exchange was hovering around PKR 66/share compared to Etisalat's bid price of PKR 117/share.

The first installment of USD 260 mn was paid to the Pakistani government in the same month. As per the original schedule, the full payment and the handing and taking over of PTCL was supposed to be completed by 28 August 2005. However, the Abu Dhabi based company asked Pakistan to revise the payment plan and put in additional conditions for the deal to go through. Later, it developed some differences on 'certain issues' and missed various deadlines to complete the transaction. After intense negotiations, Pakistan's government and Etisalat finally reached an agreement in December 2005. The Cabinet Committee on Privatization approved the deal on 6 January 2006 and amended the payment structure as desired by Etisalat.

Take over of PTCL's management in April 2006 after lengthy negotiations with Pakistan over the payment plan and other issues

Under the new agreement, Etisalat paid Pakistan USD 1.13 bn upfront before the 12 April 2006 deadline with the remaining amount of USD 1.2 bn to be paid in nine semi-annual equal installments. Etisalat International Pakistan (EIP), a 90% subsidiary of Etisalat, has taken over management control of PTCL on April 12, 2006.

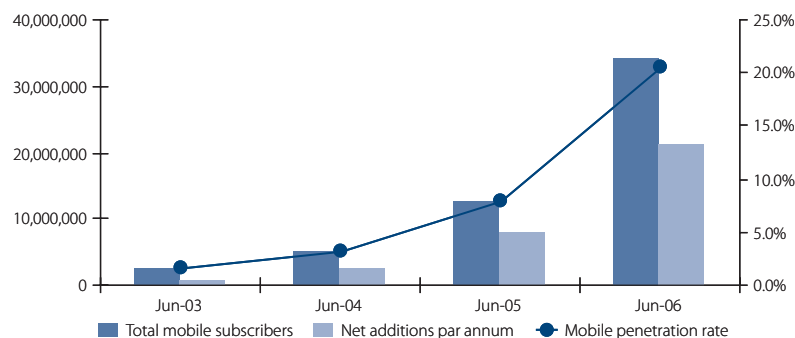
Pakistan's mobile market grew by 167% in one year time to reach 34.1 million mobile users as of June 2006, implying a penetration rate of 20.5%

Six mobile operators share Pakistan's mobile market leading to stiff competition with incremental ARPU of less than USD 4

Etisalat's decision to go-ahead with the deal despite the fact that it had made a substantially higher bid than its competitors for the acquisition was also prompted by the explosive growth in Pakistan's mobile market. The number of mobile subscribers in Pakistan surged 167% Y-o-Y to 34.1 million by end of June 2006. A total of 21.3 million new mobile connections were sold in one year time (i.e. 1.78 million/month on average) by the six mobile phone companies. The increased number of service providers intensified competition bringing prices down. The country's mobile penetration grew from 7.9% to 20.5% in just one year.

At the end of June 2006, Mobilink (Orascom Telecom) led the market with 17.1 million GSM subscribers, followed by Ufone (PTCL), which was serving 7.5 million people across the country. With the arrival of Norwegian Telenor and UAE-based Al Warid Telecom in March 2005 and May 2005 respectively, both competition and subscriber base grew at a much faster pace, as the new entrants attracted 3.21 million and 4.86 million subscribers respectively. Paktel, which offers both, AMPS (Advanced Mobile Phone System) and GSM services, enjoyed 1.04 million subscribers and Instaphone offering only AMPS service had 336,696 users.

Mobile indicators in Pakistan



Source: PTA, Companies' Reports, SHUAA Capital

However, the new fiscal year (June 2006 - June 2007) may not witness such a phenomenal jump in customer numbers as companies may enter areas where they have not yet initiated services, which will require network expansion and investment. For instance, PTCL signed a contract valued at USD 100 mn with the Chinese company Huawei to extend the capacity of its network to 10 million subscribers (vs. 7.5 million as at June 2006).

On the fixed line front, there were 5.3 million fixed line users in the country by end of March 2006. Around 98% of fixed line subscribers were PTCL clients with the remaining 2% shared by National Telecommunication Corporation (NTC), which only serves the government, and Special Communication Organization (SCO), which only services the northern areas of Pakistan. PTCL may have started a price war by drastically slashing its domestic and international tariffs increasing the pressure on its telecom rivals. The PTCL reduction in tariffs for domestic and international calls works out to around 15%. Effective 5 August 2006, PTCL introduced a single reduced, uniform domestic nationwide, round-the-clock tariff, replacing its distance-based tariff that varied for different times during day-and-night.

Liberalisation of the fixed line business also led to increased competition

The Pakistan Telecommunications Authority (PTA) has recently awarded two more Long Distance & International (LDI) licenses, in addition to the existing 12 companies that were already licensed. Now, there are 14 LDI operators in Pakistan. All of these companies except the two new ones started their commercial operations during 2005.

The growth of broadband in Pakistan is not impressive, which is mainly attributed to high bandwidth tariffs offered by PTCL. PTCL is the sole bandwidth provider in Pakistan and its tariffs are quite high if compared with other countries. On average, less than 1,000 subscribers per month are being added in the subscribers' base of broadband in Pakistan (including DSL and Cable). In March 2006, DSL subscribers in Pakistan reached 19,462 compared to 17,450 in December 2005.

Payphones in Pakistan provide easy access to general masses that cannot afford phone at home. The growth of this segment was impressive over the past years as use of pay-phones was significant while other telecom services were not affordable. During 2003-04 and 2004-05 fiscal years, number of payphones increased by 45% and 51% respectively. However, this growth slowed down after deregulation of the telecom sector in the country. Indeed, payphones showed a growth of only 2.5% during the first half of 2005-06 (June to December 2005). Furthermore, during January-March 2006, this growth was even reversed and registered a decline of 9.4% as low tariffs are offered by other services like mobile and LDI calling cards.

In the face of PTCL tariff reduction, and similar moves on the part of other private operators that could be made in the future, the PTA has a hard choice to make: allow the telecom companies to operate and compete under a free market environment and let benefits of competition be passed on to customers or, implement some rules that may already have been over-run by market forces and newest technology.

As a result of new competition in both fixed line and mobile, PTCL's revenues and profitability dropped in 2005-06 fiscal year

Increased competition in the mobile and fixed line segments since the beginning of 2005 had of course negative consequences on PTCL's financial results. The company's revenues dropped by 11.1% Y-o-Y during the first nine months of its 2005-06 fiscal year (June 2005 - June 2006) as long distance and international revenues in particular shrunk significantly. PTCL had to share this lucrative market with the 12 new LDI companies that started operations in 2005. As a result of this new competition, long distance and international call rates also plummeted eroding the company's profitability. PTCL's net profit for the first nine months of FY 2006 plunged 28.3% Y-o-Y and the company's recent decision to further decrease long distance and international tariffs will not be of any help to improve profitability margins. Moreover, with Mobile Number Portability (MNP) expected to be implemented by end of October 2006, we expect competition among mobile companies to intensify and prices to continue to go down. The MNP is a system, which enables a mobile phone subscriber to have the same number while switching the mobile operator. Further cut in tariffs is also supported by the fact that new operators such as Telenor and Warid need to capture bigger market share and hence tap into lower segments of the population. At the moment, Telenor and Warid are facing very low ARPUs of less than USD 4.

In April 2006, Etisalat secured the fourth mobile license in Afghanistan for USD 40.1 mn

Fourth mobile license, Afghanistan - 100%

In April 2006, Etisalat reached an agreement with Afghanistan to provide mobile phone services in the country. Etisalat secured the fourth GSM license in the country for USD 40.1 mn. The license is valid for 15 years. Etisalat will compete with Telecom Development Company Afghanistan (TDCA) which operates under the brand name of Roshan, the Afghan Wireless Communications Company (AWCC) and Investcom-owned Areeba. Areeba is the latest mobile operator to launch its network as it started commercial operations in July 2006.

AWCC was the first GSM operator to launch mobile services in Afghanistan in April 2002. The company signed a 15-year contract with the Ministry of Communications, which has a 20% stake in AWCC. Though Roshan was second to launch mobile operations in July 2003, the company had around 900,000 customers of the country's 1.5 million mobile users at the end of June 2006. Roshan is owned by the Aga Khan Fund for Economic Development (51%), Monaco Telecom International (35%), MCT (9%) and Alcatel (5%).

In 2005, the Afghan communications ministry decided to auction a further two licenses on top of the two operators already operational, Roshan and AWCC. Investcom, which was recently acquired by South Africa's MTN, won the bid for the third mobile license in September 2005 with a USD 40.1 mn offer. It is worth mentioning that Investcom first attempted to secure the second mobile license in Afghanistan with a bid of just USD 1 mn that was ultimately won by Roshan in July 2003 with a bid at USD 5 mn. A Saudi-US consortium, Watan Mobile Afghanistan, came second with USD 30.0 mn, and agreed to match Investcom's bid to secure the GSM fourth license. However, the consortium missed the deadline to complete the transaction. After Watan failed to make the license fee payment in time, instead of starting afresh a new bidding process or considering other interested bidders Etisalat was simply handed over the fourth license.

Launch of operations in Afghanistan in Q1 07 and we expect the company to capture 16% market share by 2011

In May 2006, Dubai-based Modern Technology International (MTI) received a unified telecom license for providing fixed, data and wireless services using a CDMA network in seven Northern provinces of Afghanistan (total of 30 provinces). Wasel Telecom, MTI's local subsidiary, expects to unveil its commercial services by November this year and aims to have a customer base of 500,000 after three years of operations.

Though the mobile market will now be shared by five operators, we still believe that Etisalat should be able to secure a 'reasonable' market share as mobile penetration rate remains very low and almost 50% of the population are 15 years of age or younger. However, security concerns and operational difficulties (electricity, competent staff, etc.) could reduce the speed of mobile users' growth and change the plans of mobile operators.

Afghanistan - Mobile	2005	2006E	2007E	2008E	2009E	2010E	2011E
Population	25,400,000	26,187,400	26,946,835	27,674,399	28,421,608	29,188,991	29,977,094
Adressable population	14,986,000	15,712,440	16,437,569	17,434,871	18,474,045	19,556,624	20,684,195
Mobile Penetration rate	4.3%	7.8%	13.0%	18.4%	23.1%	27.2%	30.7%
Number of mobile operators	Roshan - AWCC	Roshan - AWCC - Areeba - Wasel	Roshan - AWCC - Areeba - Wasel - Etisalat	Roshan - AWCC - Areeba - Wasel - Etisalat	Roshan - AWCC - Areeba - Wasel - Etisalat	Roshan - AWCC - Areeba - Wasel - Etisalat	Roshan - AWCC - Areeba - Wasel - Etisalat
Year end respective market share	66% - 34%	58% - 36% - 5% - 1%	50% - 30% - 11% - 4% - 5%	42% - 27% - 15% - 7% - 9%	37% - 25% - 18% - 9% - 11%	33% - 23% - 20% - 10% - 14%	32% - 23% - 19% - 10% - 16%
Year end total mobile subscribers	1,090,000	2,038,300	3,505,876	5,083,520	6,557,741	7,934,867	9,204,445
Annual net additions	447,300	948,300	1,467,576	1,577,644	1,474,221	1,377,126	1,269,579
YoY Growth	70%	87%	72%	45%	29%	21%	16%
Etisalat's mobile subscribers	-	-	175,294	457,517	721,352	1,110,881	1,472,711
Year end ARPU in USD	-	-	3.8	4.0	4.6	5.1	5.6

Source: Roshan, EIU, SHUAA Capital

We expect Etisalat to start operations by early 2007 and to spend around USD 300 mn in capex in the first three years of operations. We also might see Etisalat buying a stake in Afghan Telecom, the 100% government-owned incumbent in the near future, to complement its services offered in the country.

In November 2004, Etisalat, through Canartel, was awarded the second fixed line license in Sudan for EUR 45 mn

Canar Telecommunications Co. Ltd, Sudan - 37%

Etisalat is one of the ten founding shareholders of Canartel and holds a 37% equity stake for which the company invested AED 80.9 million. Moreover, Etisalat entered into a renewable five-year management service agreement with Canartel in March 2005. Under the terms of this agreement, Etisalat is entitled to an annual fee at the rate of 3% of gross revenue or 5% of net profit (whichever is higher) exclusive of local taxes for services provided under the agreement. No fee was recognized during 2005 as Canartel began commercial operations only at the end of 2005.

In November 2004, the National Telecommunication Commission (NTC), Sudan's regulatory authority, awarded Canartel a 15-year license to install and operate the second nationwide fixed line network. Etisalat-led Canartel won the bid with a EUR 45 mn (USD 53.7 mn) offer. Canartel set up a completely IP-based network using CDMA technology and launched commercial operations in Khartoum in November 2005. Included in this launch was a limited area mobile service allowing subscribers to use their phone up to 1.5 kms from the source. However, the handover protocol is disabled.

Canartel managed to attract 18,000 subscribers in its first month of operation. In terms of pricing, when monthly charges are included, the two fixed line operators have an identical cost per minute. Nevertheless, fixed line prices compare very favorably with the mobile operators as they are over five times cheaper.

Despite deregulation of the fixed and mobile telephony markets, the overall telecom market in Sudan still remains one of the least competitive in the region and fixed line penetration is among the lowest in the world. Canartel has an objective of 500,000 fixed lines in its first year of operation.

We do not expect the fixed line segment to pick up considerably in Sudan and hence Canartel to contribute significantly to Etisalat's bottom line. We believe that the fixed to mobile substitution trend applies even more in the African continent where fixed line networks are almost non-existent. For instance, the incumbent and integrated operator, Sudatel in which Etisalat has a 4.6% stake, had 1.1 million fixed lines in March 2006, down from 1.2 million in June 2005. It is hard to say whether this drop is imputable to Canartel's launch of operations but one thing is sure the number of fixed line is decreasing and once disconnected, subscribers hardly ever reconnect.

Canartel might be interested in a unified license in order to provide mobile services. It will simply have to activate the handover protocol and its fixed-mobile subscribers will become mobile subscribers. However, Canartel may have to wait a couple of years before bundled offers (fixed, mobile and Internet) make their mark in the country.

Thuraya's private placement in Q2 06 brought down Etisalat's stake in the company from 34.5% to 26%

Thuraya Satellite Telecommunications, UAE - 26%

Thuraya is a private stock company that was incorporated in April 1997 in Abu Dhabi, UAE. Etisalat's holding in Thuraya went down from 34.5% at the end of December 2005 to 26% now after Thuraya's private placement that took place in Q2 06.

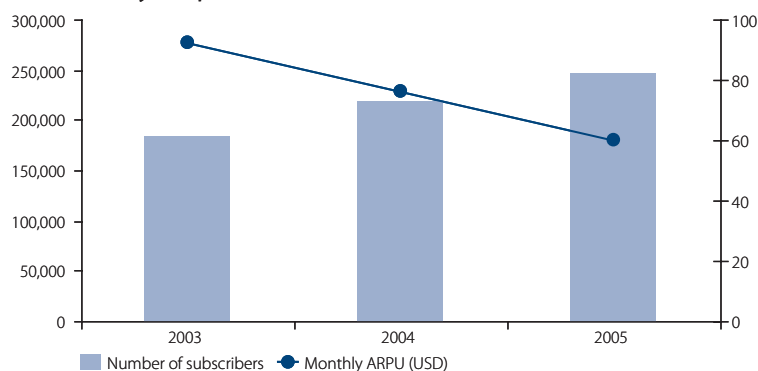
Thuraya offers satellite-based mobile services, offering voice, data, fax and high-speed Internet services. Through partnership with national and international mobile operators, the company provides coverage to more than 122 countries in Europe, North, Central and large parts of Southern Africa, the Middle East and Central and South Asia. Thuraya also plans to expand its service coverage to the Far East and Australia after the expected launch of its Thuraya-3 satellite in January 2007 with commercial operations to start in April 2007.

Thuraya offers dual-mode handheld terminals, which support satellite and GSM connectivity. Thuraya complements GSM networks, allowing its subscribers to remain connected whenever the national network is out of reach, in urban as well as remote areas.

In May 2005, Thuraya introduced high-speed Internet connectivity, ThurayaDSL with transmission of data at a rate of up to 144 Kbps. ThurayaDSL provides services including high-speed Internet access, instant messaging, email, file transfer and virtual private networks. The company also plans to offer enhanced high-speed data service, ThurayaDSL+ with transmission speeds of up to 432 kbps in the near future.

Thuraya's products and services are distributed through a network of service providers and retail distributors throughout the company's coverage area. The distribution network currently comprises 57 service providers such as Etisalat, France Telecom, AXIOM Telecom, Qtel and Satcom. Thuraya's end-users can choose between a range of postpaid and pre-paid tariffs distributed by the service providers.

Thuraya's operations indicators



Source: Thuraya, SHUAA Capital

Strong subscribers' net additions and operating efficiencies resulted in an improvement of Thuraya's 2005 revenues and profitability

In 2005, Thuraya's revenues grew 14.6% from AED 1.03 bn in 2004 to AED 1.18 bn whereas its bottom line jumped by 208.6% to AED 296.3 mn. Despite a rise in revenues, the company managed to decrease its operating expenses, hence improving its profitability significantly.

Etisalat has provided a primary gateway facility to Thuraya in Sharjah (UAE) that serves the entire Thuraya coverage area. A total amount of AED 19.4 mn (2004: AED 23.4 mn) was charged to Thuraya for the use of this facility. Etisalat is also entitled to a 2% loan guarantee fee from Thuraya for corporate guarantees issued by the Corporation to a consortium of banks for Thuraya.

Etisalat has presence in Zantel since 1999 and operates now fixed line line and mobile services nation-wide

Zanzibar Telecom Ltd, Tanzania - 34%

Zantel Telecom Limited (Zantel) began offering services in 1999, with a small share (18%) owned by the Zanzibari government, and larger shares going to Etisalat (34%), Meeco International (24%) and Kintbury Investment (24%). In February 2005, the Tanzania Communications Regulatory Authority (TCRA) handed the company a license to operate on the mainland where the incumbent Tanzania Telecommunication Company Ltd (TTCL) monopoly over the fixed line sector ended. TTCL was the only fixed line operator to have a nation wide license (including Zanzibar) as opposed to Zantel, which had the right to operate in Zanzibar only. However, in February 2005 the license of Zantel has been extended to cover Tanzania entirely.

The provision of data communication and Internet services is fully competitive in Tanzania.

Zantel is one of the four mobile operators with 6% market share and one of the two fixed line companies

On the mobile telephony front, Zantel is in competition with three other mobile operators namely Vodacom Tanzania, Celtel (MTC) and MIC Tanzania (Millicom). The number of people with mobile phones in Tanzania reached 3.88 million by the end of March 2006, up from just 126,646 back in 2000. Vodacom Tanzania led the way with 2,082,500 subscribers, ahead of Celtel with 1,067,000, MIC Tanzania with 509,846 and Zantel with 230,000.

The upsurge in popularity of mobile services has had a negative impact on fixed line services though. By May 2006 the number of fixed line telephone users had fallen to 145,000 from 154,420 at the start of the year (network capacity is about 250,000 connections). People have been quick to take advantage of the increased convenience and availability of wireless services and are switching away from traditional copper wire services.

The TCRA has also awarded a full services license to Benson Informatics Limited (BOL) authorizing the company to operate both wireline and wireless services. BOL is expected to start operations in the next few months.

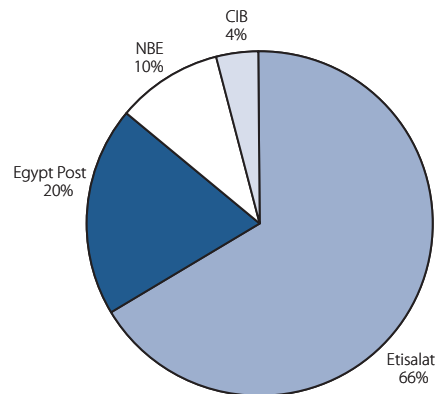
In prior years, Etisalat provided a term loan of AED 25.7 million (USD 7 million) to Zantel, which was fully settled during 2005. The interest income earned during 2005 amounted to AED 0.5 mn (2004: AED 1.8 mn). Under the terms of the management agreement, Etisalat collected AED 2.2 mn in 2005 (2004: AED 3.3 mn) as management fees and other income.

In July 2006, Etisalat won the third mobile license in Egypt with a bid at USD 2.9 bn

Nile Telecom, Egypt - 66%

Early July 2006, an Etisalat-led consortium won the third mobile license with a bid at EGP 16.7 bn (USD 2.9 bn), which represented a premium of 568% on the USD 434 mn reserve price fixed by the National Telecommunications Regulatory Authority (NTRA). It was also almost 20% above the second highest bidder. The first runner-up was MTC of Kuwait with a bid at EGP 14.2 bn (USD 2.46 bn) and the second runner-up was Q-tel of Qatar with an offer at EGP 12.2 bn (USD 2.12 bn). The third mobile license is valid for 15 years until in 2021, and will be renewable every five years thereafter.

Etisalat consortium's composition



Source: Etisalat, NTRA, SHUAA Capital

With a mobile penetration of 18.9% as of Q2 06 and a population of 74 million, Egypt presents good prospects for growth

In addition to the upfront license fee of USD 2.9 bn, Etisalat will have to pay an annual fee representing 6% of its total gross revenues. Initially, for every increase of EGP 100 mn in the bid value (starting at USD 434 mn), the royalty fee should have increased by 0.2%. However, the regulator decided to cap it at 6%.

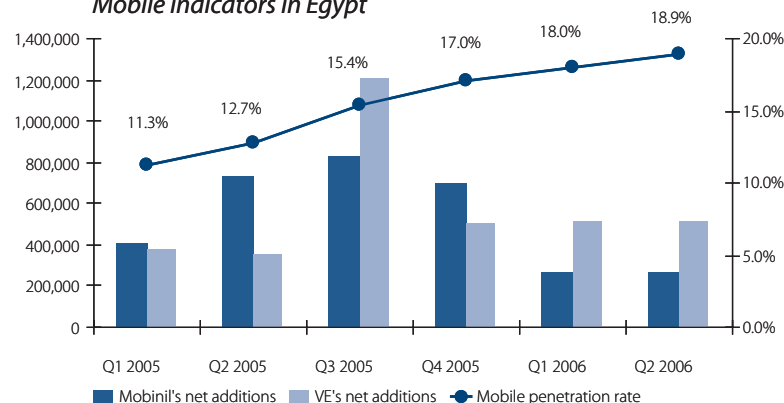
Currently, the Egyptian GSM market is a duopoly shared by Vodafone Egypt and Mobinil and presents the following situation.

Q2 06	Vodafone Egypt	Mobinil
Number of subscribers (active)	6,915,000	7,231,000
Market share	49%	51%
Blended ARPU for the quarter - EGP	79.4	69
Blended ARPU for the quarter - USD	13.8	12.0

Source: Mobinil, Vodafone Egypt, SHUAA Capital

Egypt is one of the last GSM markets in the Arab world to offer such a low penetration rate (18.9% as at 30 June 2006) in such a large country (population of 74 million at the end of 2005).

Mobile indicators in Egypt



Source: Mobinil, Vodafone Egypt, SHUAA Capital

To put into perspective the price paid by Etisalat, it is worth noting that Mobinil and Vodafone Egypt's market capitalizations reached USD 2.71 bn and USD 3.80 bn respectively as at 04 July 2006. In other words, Etisalat could have theoretically acquired Mobinil, which is an operating, profitable and well-established player in the Egyptian market, at a discount of 7% to the price of the license. It is also worth mentioning that in 1998, the two incumbents acquired a 15-year license covering a 900 MHz spectrum for EGP 1,755 mn (USD 304 mn). In 2005, they completed an agreement with the NTRA to acquire a license for a 1,800 MHz spectrum against payment of EGP 1,240 mn (USD 215), of which EGP 200 mn (USD 34.7 mn) was paid upon signing the agreement. The remaining amount is to be paid over a 4-year period equally to the NTRA. Hence, total license fees for each of the two incumbents were around USD 519 mn.

We also found interesting to compare the award of the second mobile license in Saudi Arabia and the third mobile license in Egypt, both won by an Etisalat-led consortium:

	Saudi Arabia	Egypt
Population (mn)	24.6	74.0
GDP/Capita (USD at PPP)	12,560	4,060
Mobile penetration rate at the time of acquiring the license	40%	18.9%
Average ARPU level at the time of acquiring the license (USD)	55.0	12.9
Validity of the license	25 years	15 years
Price (USD mn)	3,250	2,897

Source: EIU, SHUAA Capital

It should be noted that in Saudi Arabia, it was the second mobile license valid for 25 years whereas in Egypt it was the third mobile license valid for 15 years.

We estimated it should take more than 13 years of the third mobile operator's net profit to pay back the USD 2.9 bn license fee

After considering new elements and more recent data from the two incumbents, we believe that the USD 2.9 bn upfront fee paid by the consortium should eat up more than 13 years of the company's net profit based on what we believe to be the most likely scenario.

Egypt - Mobile	2006E	2007E	2008E	2009E	2010E	2011E
Population	75,352,360	76,708,702	78,089,459	79,495,069	80,925,981	82,382,648
Addressable population	49,732,558	51,394,831	53,100,832	54,851,598	56,648,186	57,667,854
Mobile Penetration rate	22.4%	28.6%	34.5%	40.0%	44.8%	49.1%
Number of mobile operators	Mobinil - VE	Mobinil - VE - Etisalat	Mobinil - VE - Etisalat	Mobinil - VE - Etisalat	Mobinil - VE - Etisalat	Mobinil - VE - Etisalat
Year end respective market share	51% - 49%	47% - 47% - 6%	44% - 44% - 12%	40% - 42% - 18%	38% - 39% - 23%	37% - 39% - 24%
Year end total active mobile subscribers	16,863,891	21,923,058	26,965,361	31,819,126	36,273,804	40,445,291
Annual net additions	4,278,898	5,059,167	5,042,303	4,853,765	4,454,678	4,171,487
Y-o-Y Growth	34%	30%	23%	18%	14%	11.5%
Etisalat's mobile subscribers	-	1,315,383	3,235,843	5,727,443	8,342,975	9,706,870
Year end ARPU in EGP	-	59	55	51	49	49.5
Year end ARPU in USD	-	10.2	9.5	8.8	8.5	8.6

Source: Etisalat, Mobinil, Vodafone Egypt, EIU, SHUAA Capital

We forecasted the third mobile player, which enjoys both a 2G and 3G operating license, to launch commercial services at the end of Q1 07. Beyond 2010, we forecasted the third mobile operator to reach a market share of 25% that we assumed stable for the rest of our forecast period. We kept ARPU at around USD 8.5 till 2013 and then we gradually increased it to USD 9.2 by 2019. By 2019, we forecasted mobile penetration rate to reach 65.6% with a total of 62.3 million active mobile users.

Etisalat's mobile license in Egypt should allow its users to enjoy a "seamless" service across the region as the population movement between Saudi Arabia, the UAE and Egypt is rather high. Thus, connecting these three countries should attract new subscribers, especially in Egypt as it means that roaming charges will likely fall for consumers.

The table below summarizes our main assumptions against Etisalat's Management guidance:

	SHUAA Capital's assumptions	Etisalat's Management guidance
Market share	Expected to reach 25% within five years	Expected to reach 30% within five years
ARPU	Expected to decrease to USD 8.5/month in the next five years	Likely to fall to levels of around USD 8/month in the next few years
Penetration rate	Expected to reach 44.8% by end of 2010	Expected to exceed 50% by end of 2010
Capex	Expected to exceed USD 1 bn in four years	Expected to exceed USD 1 bn in total
Start of commercial operations	End of Q1 2007	End of Q1 2007

Source: Etisalat, SHUAA Capital

The third mobile operator should start operations in Q1 07 with Mobile Number Portability (MNP) to be introduced on the day it begins

The higher than expected sale price of Egypt's third mobile license has pushed up the cost of 3G concessions for Vodafone Egypt and Mobinil. The NTRA stated that the cost of a 3G license for any of the two mobile operators wishing to upgrade their 2G concession would be equal to 20% of the winning bid for the third mobile license. Hence, each incumbent would have to disburse USD 580 mn to offer services in par with the third mobile operator. Early August, Mobinil revealed that it would defer its decision whether to apply for a 3G license for a year. In response to this decision, the company was notified by the NTRA that it should obtain a license for introducing the EDGE technology, which is similar to 3G. However, Mobinil claims that it does not have to pay any fees to offer EDGE services, noting that it has launched this type of services since January 2006. It is worth noting that Mobinil has plans to expand its EDGE service to the majority of its sites in Cairo, Alexandria, and certain tourist resorts by end of 2006.

If Vodafone Egypt decides to follow Mobinil and postpone its offering of 3G services, the new mobile operator will be the only 3G services provider and hence will have a competitive edge. However, we believe that demand for 3G services in Egypt should not be significant in the short to medium term and as the new company is expected to launch commercial operations at the end of Q1 07 this competitive edge should be limited in time. Thus, the one year deferral should not be a big handicap for the two incumbents.

Another advantage we see in the new mobile company is the possible help of one its shareholders, the Egyptian Post, and its 3,400 offices across the country, to reach potential subscribers.

The new company will operate under the brand name of 'Nile Telecom'. It has also been confirmed that Etisalat will have six seats in the new company's board of directors (BOD), which is equivalent to 2/3 of the BOD's nine seats.

Nile Telecom has been granted a 011 code by the NTRA to start offering its mobile services in the country.

The official signing of the license did not take place on 16 August 2006 as originally scheduled but on August 21, 2006. Each consortium member paid its proportionate part of the license and Etisalat in particular disbursed USD 1.9 bn. We assumed that Etisalat used USD 1 bn of the syndicated loan that was recently signed with the remaining USD 900 mn coming from the company's own cash.

Nile Telecom plans to start commercial operations initially in Cairo, Alexandria, Sharm el-sheikh and Hurgada. Until it establishes the rest of its network, it plans to sign roaming agreements with local operators MobiNil and Vodafone Egypt to cover the rest of the country. The NTRA should introduce Mobile Number Portability (MNP) on the day the

Etisalat will also bid for an international voice gateway license in Egypt next September

third operator begins operations. The MNP allows users to switch from one operator to another while retaining their mobile number. Under MNP rules, a user must remain with an operator at least a year before switching to another. Nile Telecom is also currently in negotiations with the NTRA to obtain an international voice gateway license. The company will take part in an auction that should take place next September and that has already been rescheduled twice this year, mainly due to the NTRA being pre-occupied with the third mobile license. The NTRA will actually sell two international gateway licenses. In addition to Nile Telecom, companies that have already expressed an interest in bidding for the international gateway license include Emak for Information Systems (Al Kharafi Group), and a consortium formed by Raya Holding and British Telecom. The NTRA affirmed that both local mobile operators, MobiNil and Vodafone Egypt will be excluded from bidding for the international license. With the issuance of those two licenses, Telecom Egypt (TE) will lose its international voice monopoly. We believe that the international voice gateway license auction might also be as contested as the recent third mobile license.

Missed opportunities

Lost bids in Tunisia, Serbia and Armenia to acquire stakes in integrated and mobile operators

In March 2006, Etisalat made a bid for a 35% stake in Tunisia's state-owned Tunisie Telecom. However, the partial privatization of the Tunisian telephone company was won by Dubai's Tecom-DIG (Dubai Investment Group) consortium with an offer TND 3.05 bn (USD 2.24 bn) outbidding French Vivendi which offered TND 2.76 bn (USD 2.03 bn).

Also, Etisalat submitted a bid in May 2006 to acquire a 70% stake in Serbia's mobile operator Mobi63. Etisalat was in competition with nine other interested parties, including Deutsche Telekom, France Telecom, Mobikom of Austria, Egypt's Orascom Telecom (OTH), Norway's Telenor, TeliaSonera, Sweden's Tele2, Israel's Cellcom and Russia's OJSC Mobile. After the auction process that took place on 31st July 2006, Telenor of Norway won 100% ownership and a 10-year operating license beating the two other short-listed companies, OTH and Mobikom of Austria. The EUR 1.51 bn (USD 1.9 bn) bid outstripped even government expectations of around EUR 1 bn (including the EUR 220 mn license fee). The company was 70% owned by the government while the remaining 30% was owned by a group of Austrian investors who originally agreed to sell their stake if the bid exceeds EUR 1.1 bn.

Finally, Etisalat's consortium which included investment company Istithmar and Emergent Telecom Ventures failed to secure the bid for a 90% stake in ArmenTel, the Armenian fixed and mobile operator. The stake, which was owned by the Greek operator OTE, was awarded to a consortium consisting of Russia's Sistema Group, India's VTEL holdings and Armenia's Knightsbridge Associates. Sistema is expected to take control of ArmenTel's monopoly fixed-line business, while VTEL and Knightsbridge will take the responsibility of the company's mobile operations. The amount of winning bid is not yet confirmed. However, the 90% is estimated to be worth over USD 300 mn. In April 2006, ArmenTel claimed a fixed line subscriber base of nearly 595,000 and around 320,000 mobile users. ArmenTel's 90% acquisition should be completed in late August after approval of OTE's board.

Potential acquisitions going forward

In the Middle East and GGC region, Etisalat is eyeing a second fixed-line license in Saudi Arabia and Syria's third mobile license, while other regional opportunities include the acquisition of a stake in incumbent operators in Algeria and Nigeria.

Saudi Arabia

The kingdom's telecom regulator, the Saudi Communications and Information Technology Commission (CITC) has decided to delay until 2007 its plan to award both fixed and mobile licenses. The CITC put the delay down to technical issues regarding frequencies. It had initially scheduled to grant the licenses in Q4 06. The awarding of new licenses will break up the fixed-line monopoly of incumbent Saudi Telecommunications Company (STC), and inject new growth into the mobile market with a third mobile license. The acceleration in the liberalization of Saudi Arabia's telecom industry is due in particular to the country's ascension to the WTO in December of last year.

We provide more details on Saudi Arabia's mobile market later in this report under our coverage of Mobily.

***Fixed line license in Saudi Arabia
to be awarded early 2007***

On the fixed line front, STC had some 3.82 million lines in operation by end-2005, which implied a fixed line penetration rate of 16%, but a household penetration level of 79% as the average household size in the kingdom is slightly above five. Hence, while interest should be high in the third mobile license, we anticipate weak demand for the second fixed license. Several other Middle Eastern countries (notably Morocco) have had problems attracting interest in alternative fixed-line licenses. In order to attract interest, the regulator is currently reviewing the policy options for the scope of the second fixed-line operator, including the possibility of unified licensing and the liberalization of international services. The growth in the fixed line segment should come from Internet and broadband connections as penetration rates remained very low by the end of 2005 with 12.8% and 0.3% (52,000 ADSL connections) respectively.

It would make sense, in our opinion, if Etisalat bids for a fixed line license in Saudi Arabia as it would complete its mobile services offer, especially when we know that the medium and long-term future may be dominated by bundled offers and the convergence of fixed, mobile and broadband services.

***The UAE operator is negotiating with
Syria to enter the country's mobile market
and could strike a deal anytime soon***

Syria

The Syrian GSM market is currently a duopoly shared by Syriatel and Areeba (Investcom). The table below presents a snapshot of historical data on the two existing players:

Syriatel	2004	2005
Number of subscribers	1,038,511	1,510,000
Net additions	-	216,740
Y-o-Y Growth	-	16.8%
Market share	54%	51%
Blended ARPU in USD (average for the year)	35	29
Areeba	2004	2005
Number of subscribers	870,517	1,465,470
Net additions	-	291,343
Y-o-Y Growth	-	24.8%
Market share	46%	49%
Blended ARPU in USD (average for the year)	33.5	27.8
Total mobile subscribers	1,909,028	2,975,470
Population	18,580,000	19,030,000
Mobile penetration rate	10.3%	15.6%

Source: Investcom, Syriatel, SHUAA Capital

In February 2001, both operators were awarded a BOT (Build, Operate and Transfer) contract to operate a GSM 900/1800 network in the country for a period of 15 years. The BOT contracts also include a renewal option for an additional period of three years, subject to governmental approval. The BOT contracts authorize to provide mobile services but do not cover an international gateway and number portability. Upon expiry of the BOT contracts, both operators are required to transfer to the Syrian Telecommunications Establishment (STE) ownership of the network, including all equipment and network infrastructure, free of charge. In accordance with the terms of the BOT contracts, a third mobile operator may be licensed after the end of the seventh year of the BOT contracts, i.e. after February 2008.

The terms of the BOT contracts dictate that Areeba and Syriatel must operate under the same conditions regarding tariffs, coverage and revenue sharing. As a result, prices competition is less intense in Syria than in other markets in the MENA region. Increase of market share must be achieved through quality of service, product differentiation, marketing approach and brand awareness. Concerning the revenue sharing scheme, the STE is entitled to a gradual percentage of both operators billed gross revenues, except that the STE is entitled to 100% of interconnection charges on mobile-to-fixed calls and international calls originated from the operators' network. The percentage of revenue sharing which increases gradually through the life of the BOT contracts is as follows:

- 30% of revenues in the first three years of the contract;
- 40% of revenues in the following three years of the contract;
- 50% of revenues in the remaining nine years of the contract; and
- 60% of revenues during the extension of the contract for an additional three-year period.

Egypt-based Orascom Telecom (OTH) founded Syriatel in 2001 in cooperation with its local shareholder, Drex Technologies (owned by Rami Makhoul, a first cousin of the president of Syria, Bashar Assad). In July 2003, OTH agreed to dispose of its 25% stake in Syriatel after settling a legal dispute with Drex. OTH holds no longer any shares in Syriatel and received cash consideration as compensation for its initial investment, loans made to Syriatel and expenses incurred.

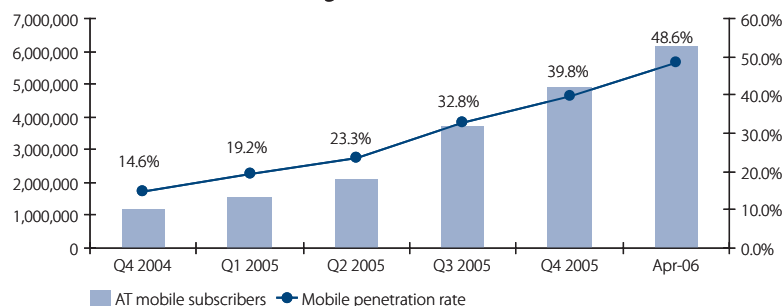
When and what type of license (BOT or renewable license) Etisalat is likely to pursue in Syria remains unknown, and it may even opt to buy into Syriatel. We believe that all options are possible at this stage, however, we believe that we may see a 'negotiated sale or award' rather than an auction.

**35% stake in incumbent Algeria Telecom.
The partial privatization should
take place before the end of 2006**

Algeria

In North Africa, after having secured the third mobile license in Egypt, Etisalat plans to take part in the partial privatization of Algeria Telecom. The Abu Dhabi based company will be one of the 43 potential bidders comprising of regional and international firms including France Telecom, Telefonica, Portugal Telecom and Deutsche Telekom bidding for a 35% stake in the Algerian operator. No date has been set for the sale but it should take place before the end of this year. Algeria Telecom had an estimated 3.2 million fixed-line clients and 6.14 million mobile subscribers at the end of April 2006. It is worth noting that around 97% of mobile subscribers are prepaid users.

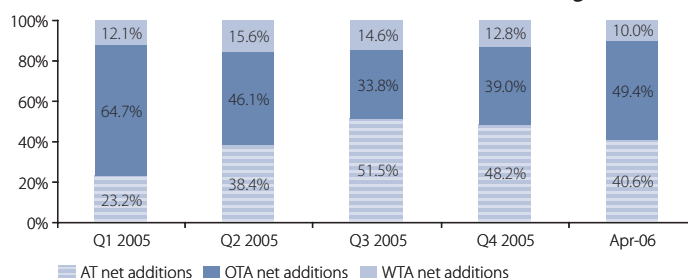
Mobile indicators in Algeria



Source: ARPT, SHUAA Capital

Though Algeria Telecom Mobile (Mobilis) had in 2005 the largest subscriber net additions (3.73 million) in the MENA region, it had on the other hand the lowest ARPU level with USD 9/month.

Mobile subscribers net additions breakdown in Algeria



Source: ARPT, SHUAA Capital

By the time the public offering takes place, Algeria Telecom should have around 11.5 million subscribers split into 3.5 million fixed lines and 8 million mobile users. Given the hype in prices for green-field licenses and acquisitions of existing companies in the telecom industry in the MENA region, we believe that each Algeria Telecom subscribers should be bought at more or less USD 1,000. Thus, it would value the 35% stake in the Algerian operator at around USD 4 bn. It is worth noting that the Algerian telecom market is a rather competitive one with three GSM operators (one of them being Mobilis-Algerie Telecom) and two fixed line networks (Algerie Telecom and Consortium Algerien de Telecommunications, a 50-50 JV between Orascom Telecom and Telecom Egypt). If we look closely at the table below, we can note that the two most expensive acquisitions in the past year of integrated operators valued each subscriber much more than USD 1,000.

Date	Name of operator	Acquired by	% of acquisition	Total transaction price (USD mn)	Number of subscribers at time of acquisition	Price/subscriber (USD)
Apr-05	Celtel - Africa	MTC - Kuwait	100	3,360	5,658,000	594
Jun-05	PTCL - Pakistan	Etisalat - UAE	26	2,598	7,198,500	1,388
Dec-05	Madacom - Madagascar	MTC - Kuwait	100	97	250,000	388
Dec-05	Telsim - Turkey	Vodafone - UK	100	4,550	9,700,000	469
Feb-05	Mobitel - Sudan	MTC - Kuwait	61	1,332	2,050,000	1,065
Mar-06	Tunisie Telecom - Tunisia	Tecom - UAE	35	2,250	4,600,000	1,398
May-06	Investcom - Africa and ME	MTN - South Africa	100	5,526	5,700,000*	969
May-06	Vmobile - Nigeria	MTC - Kuwait	65	1,005	5,000,000	309
Jun-06	Umniah - Jordan	Batelco - Jordan	96	415	505,000	856

* SHUAA Capital estimates for Q1 06
Source: SHUAA Capital

Etisalat's acquisition of a 35% stake in Algeria Telecom would make strong sense to us and thus we see the UAE operator as a very serious contender.

Nigeria

Early July 2006, Nigeria's Bureau of Public Enterprises (BPE) announced the sale of a 75% stake in Nigerian Telecommunications (Nitel) to Transnational Corporation (Transcorp) for USD 750 mn. Under the terms of the deal Transcorp was required to pay the first installment of USD 500 mn within seven days and the balance within 60 days. Transcorp has Britain's BT Group as a technical partner and Etisalat as a technical and equity partner. However, Transcorp failed to pay the USD 500 mn in time and a decision whether to grant an extension or revoke the deal is awaited from the National Council on Privatisation. Transcorp claims the reason behind the delayed payment is a number of 'unresolved issues' but discussions with the BPE are reportedly still going on. The BPE is likely to agree to extend the payment date to 60 days, meaning that the full purchase price will fall due in early September.

Etisalat could secure the purchase of a 75% stake in Nitel if the USD 750 mn are paid in time, before 4th September 2006

15 new markets and AED 100 bn worth of investments over the next few years

Furthermore

Etisalat aims to bid for new licenses or acquire stakes in existing operators in 15 new markets in total including India, Yemen, Russia, Greece, Uzbekistan, Tajikistan and West Africa. In order to achieve its ambitious plan, Etisalat is planning to double its international investment from AED 50 bn to AED 100 bn over the next few years.

It is worth pointing out that Etisalat has had a tendency to bid aggressively for its acquisitions or green-field licenses:

	Date of acquisition	Etisalat's price (USD bn)	Runner-up name & price (USD bn)
Etihad Etisalat (Mobily) - 2nd mobile license in KSA	Aug-04	3.25	MTN - 2.95
Pakistan Telecommunications Co. Ltd (PTCL) - 26% stake	Jun-05	2.6	China Mobile - 1.4
3rd mobile license in Egypt	Jul-06	2.9	MTC - 2.5

Source: SHUAA Capital

We see Etisalat's aggressive expansion strategy as a good mean to supplement any revenue erosion that should take place once the second telecom operator starts commercial operations in its home market, but also to utilize effectively its large reserves of cash. However, we believe that it is very important for Etisalat to enter the right markets and to pay a 'fair' price for its acquisitions if it wants to continue to create clear value through this process.

Financial analysis and Forecasts

2005 Recap

Etisalat has one of the higher revenues growth rate among regional integrated operators on the back of strong mobile operations

Etisalat reported consolidated net revenues of AED 12.9 bn in 2005, up 23.3% Y-o-Y. It is worth mentioning that net revenues are stated after deducting net outpayments to other telecom administrations of AED 913 mn (vs. AED 1.02 bn in 2004). Also, companies in which Etisalat owns less than 50% plus one share are considered as associated companies. Investments in associated companies are accounted in the consolidated financial statements using the equity method and are initially recognized at cost.

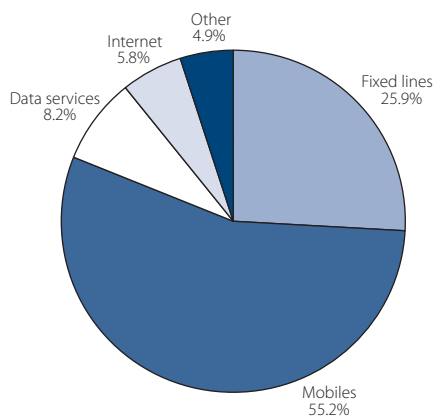
Integrated operator	FY 05 Revenues Growth
Etisalat	23.3%
Qtel	27.1%
Jordan Telecom	2.8%
Omantel	9.4%
Batelco	3.9%
STC	6.7%
Telecom Egypt	9.4%
Maroc Telecom	18.0%

Source: SHUAA Capital

The two fastest growing telecom companies in 2005 were Qtel and Etisalat, which could be explained by their monopoly status, and high underlying population growth.

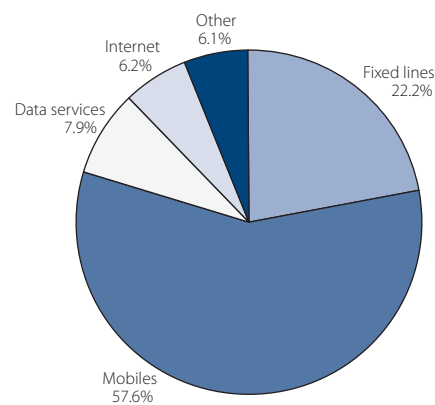
Fuelling this growth in consolidated revenues was a 29% jump in revenues from mobile services. We compared below Etisalat's revenues mix in 2004 and 2005.

Etisalat's revenues mix in 2004



Source: Etisalat, SHUAA Capital

Etisalat's revenues mix in 2005



The growth in mobile revenues was the result of strong subscribers' net additions during FY 05. Etisalat increased its number of mobile users by 851,000 in 2005 (vs. 711,000 in 2004). By the end of 2005 there were 4.5 million mobile users implying a 97% penetration rate in the UAE.

**Despite an exceptional EBITDA margin,
Etisalat's net profit is negatively
impacted by a 50% royalty fee**

On the profitability front, EBITDA grew 21.2% Y-o-Y to reach AED 9.8 bn. EBITDA's growth was slower than revenues' growth as operating expenses increased more significantly following the numerous operations in which Etisalat was newly involved during 2005 (Mobily, Atlantique Telecom, Canar Telecom). Thus, EBITDA margin slightly decreased but remained very strong at 76.2% vs. 77.5% in 2004.

Integrated operator	FY 05 EBITDA Margin
Etisalat	76.2%
Qtel	58.5%
Jordan Telecom	48.3%
Omantel	66.5%
Batelco	47.3%
STC	53.7%
Maroc Telecom	56.8%
Telecom Egypt	52.4%

Source: SHUAA Capital

Consolidated net profits jumped 24.5% to AED 4.3 bn supported by interest income, which rose 134.2% to AED 0.28 mn. The high interest income was the result of a high cash position on Etisalat's balance sheet throughout the year. The company closed FY 05 with AED 9.7 bn in cash on its balance sheet.

Integrated operator	FY 05 Net Profit Margin
Etisalat	33.1%
Qtel	39.9%
Jordan Telecom	24.5%
Omantel	25.0%
Batelco	41.3%
STC	38.3%
Maroc Telecom	28.3%
Telecom Egypt	21.8%

Source: SHUAA Capital

The reason behind the big gap between the EBITDA margin and the Net Profit margin is that Etisalat is required to pay a royalty fee equivalent to 50% of its annual net profit to the UAE government.

H1 06 Recap

Below is a table summarizing Etisalat's financial results and key ratios for H1 06.

In AED '000	H1 2006
Revenues	7,742,767
Y-o-Y Growth	24.9%
Operating expenses	1,672,428
EBITDA	6,070,339
EBITDA Margin	78.4%
Depreciation and amortization	642,134
EBIT	5,428,205
Margin	70.1%
Interest income	220,974
Share of results of associated companies	-19,205
Pre-tax profit	5,629,974
Taxes - Federal royalty	2,813,120
Net profit after tax	2,816,854
Minority interest	3,733
Net profit	2,813,121
Margin	36.3%

Source: Etisalat, SHUAA Capital

Though mobile penetration in the UAE reached 97.1% at the end of 2005, Etisalat's mobile subscribers' net additions remained steady during H1 06 with 461,632 new users. The telecom firm now serves 5 million mobile customers in the country, which represents a penetration of 102.9%. Fixed line subscribers increased to 1,266,154 while Internet subscribers stood at 604,963.

In March 2006, Etisalat increased its paid-up capital to AED 4.54 bn through bonus shares and doubled its authorized capital to AED 8 bn. This leaves ample room for the company to raise capital in the future in order to fund its aggressive expansion plans.

Etisalat also signed in July 2006 an agreement with a syndicate of 22 local, regional and international banks, which gave the company a USD 3 bn revolving line of credit. The multipurpose facility can be used to finance any activity including investments and acquisitions of target companies and forging of new partnerships.

Forecasts

Du should start mobile operations in Q1 07 and we forecast the second telecom operator to capture 23% market share by 2010

It has first been announced that Du will start with mobile services in Q3 06 and then Q4 06. We anticipate a further delay in the company's launch of commercial operations to early Q1 07 as the two telecom operators concluded negotiations on commercial and technical issues early August 2006. The network agreement detailing interconnection charges (revenues sharing) in particular should be signed the first week of September 2006 under the umbrella of the TRA. It is worth mentioning that the two sides were initially supposed to reach an agreement on these matters by end of February 2006.

Du aims to capturing a 30% share of the UAE mobile market over the next three to four years. Though population growth in the UAE is high and expatriate workforce is important, we find this objective ambitious as both operators and the TRA insisted on the fact that competition will not be based on tariffs and that there will be no price war. The two telecom companies will mainly compete on technology, services, customer care and marketing. Hence, we also do not foresee a big drop in ARPU going forward.

UAE - Mobile	2005	2006E	2007E	2008E	2009E	2010E
Population	4,670,000	5,043,600	5,396,652	5,720,451	6,006,474	6,306,797
Addressable population	4,062,900	4,438,368	4,803,020	5,148,406	5,465,891	5,739,186
Mobile penetration rate	97.1%	106.6%	113.7%	115.4%	117.3%	120.0%
Number of mobile operators	Etisalat	Etisalat	Etisalat - Du	Etisalat - Du	Etisalat - Du	Etisalat - Du
Year end respective market share	100%	100%	90% - 10%	85% - 15%	81% - 19%	77% - 23%
Year end total mobile subscribers	4,534,480	5,377,268	6,136,061	6,600,957	7,044,688	7,566,270
Total net additions par annum	851,363	842,788	758,793	464,897	443,731	521,581
Y-o-Y Growth	23.1%	18.6%	14.1%	7.6%	6.7%	7.4%
Etisalat's mobile subscribers	4,534,480	5,377,268	5,522,455	5,610,814	5,706,198	5,826,028
Year end ARPU in AED	150	158	154	153	152	151

Source: Etisalat, EIU, SHUAA Capital

Existing Etisalat subscribers will be able to switch to Du without changing their number. But the code will change from 050 to 055. However, still unresolved is what fees subscribers will be charged to take their numbers with them when switching. We believe that some subscribers could be refrained to switch to Du's network as they will have to change their code. Moreover, if Mobile Number Portability (MNP) fees are considered to be too expensive it will also discourage subscribers to move from Etisalat to Du. Thus, Etisalat's churn rate (number of mobile users who discontinue their use of Etisalat's network divided by the average number of total mobile subscribers) could turn to be lower than initially expected.

We expect Du to launch fixed line and Internet services at the end of 2007 or beginning 2008

We expect Du's fixed line and broadband services to be rolled out during 2007 with commercial operations to be launched in end of 2007 or early 2008. As the household penetration rate in the UAE reached 91.3% at the end of June 2006, the prospects in the fixed line business are also rather limited. However, a strong population growth coupled with considerable property deliveries in Dubai and across all the emirates should ensure regular and steady residential fixed line net additions going forward. Moreover, the fixed-line subscriber base should also be supported by the business segment which continues to flourish in the country on the back of strong economic growth.

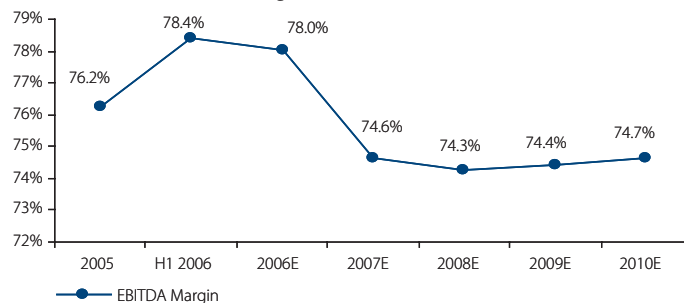
In general, the numerous real estate developers' projects and the economic boom in the UAE create a hunger for telecoms and are the main drivers for telecom services demand in the country. Though Etisalat will have to share its home market with Du, we believe that the 'cake' is getting bigger, which should facilitate the incumbent's transit towards an oligopoly status.

We expect overseas subsidiaries in Afghanistan and Egypt to boost Etisalat's revenues but to put pressure on its margins

In terms of financial results, we expect Etisalat to grow at CAGR of 10.8% from 2006 to 2010 with revenues derived from UAE operations to grow at a CAGR of 7.7%. The difference between the two rates can be attributed to Etisalat's subsidiaries revenues in Egypt and Afghanistan. The two overseas subsidiaries should represent 13.4% of Etisalat's total revenues by 2010. Revenues generated from Etisalat's mobile segment in the UAE should grow at CAGR of 5.1% as the mobile market in the country reached saturation and competition is expected to hit the market in Q1 07.

On the profitability front, we expect the EBITDA margin to gradually decrease from its peak of 78.4% reached in H1 06 to 74.7% in 2010. We believe that operating expenses in Egypt and Afghanistan will put pressure on the overall company's profitability as long as the two subsidiaries will continue to build up operations.

Etisalat's EBITDA margin

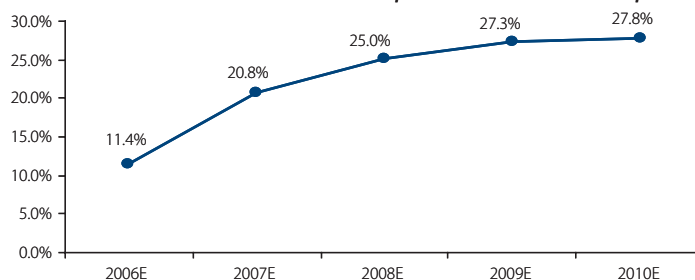


Source: Etisalat, SHUAA Capital

We anticipate associated companies' income to strongly contribute to Etisalat's bottom line starting in 2007

Share of results of associated companies should contribute more significantly to the company's bottom line going forward with Mobily and PTCL being the largest contributors. It is worth mentioning that Mobily has been profitable since Q1 06.

Contribution of associated companies to Etisalat's net profit



Source: Etisalat, SHUAA Capital

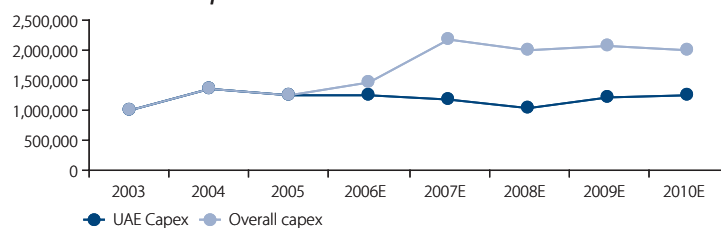
Etisalat's total capex should increase going forward mainly due to new investment requirements in overseas subsidiaries

We forecast Etisalat's net profit to reach AED 5.79 bn in 2006. Beyond 2006, we gradually reduced the royalty fee to take into account the likelihood that the government starts lowering it. We applied equal weighting (50/50) to a scenario whereby the royalty fee is kept at 50% and a scenario whereby it is gradually reduced to 30% by 2010.

Etisalat's capex reached AED 1.26 mn in 2005, down from AED 1.36 bn in 2004. In the UAE, we anticipate a slowdown in capex as networks are well developed and levels of penetration are high. However, overall investments should remain on the upward trend for two main reasons:

- 1) Etisalat should start its new operations in Afghanistan and Egypt soon
- 2) Fixed-mobile convergence should gain pace in the medium term and hence some investments in new technologies should be required

Etisalat's capex breakdown



Source: Etisalat, SHUAA Capital

Valuation

We performed a sum-of-the-parts valuation incorporating the value of Etisalat and its consolidated subsidiaries (Etisalat group) in addition to the value of each associated company. We used the DCF as well as the multiple-based methods to value the Etisalat group.

Etisalat group DCF valuation (UAE+Afghanistan+Egypt)

We considered two scenarios for the royalty fee in our Etisalat group DCF valuation

We arrived at an estimated equity value for Etisalat group of **AED 88.3 bn**, or **AED 19.5/share** based on a Discounted Cash Flow (DCF) exercise.

Key assumptions used in our DCF valuation:

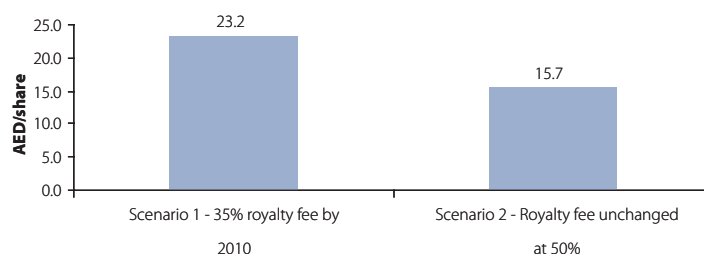
- Risk free rate of 5.91% derived from the yield on a simulated 10-year Qatar sovereign.
- Market risk premium of 5%, which we apply across the board on all MENA equity markets.
- Industry beta of 0.85.
- Based on the above assumptions, a cost of equity of 10.2% was arrived at.
- The group's cost of debt stands at 5.9%, as per Etisalat's syndicated loan that was recently signed.
- A Weighted Average Cost of capital (WACC) of 10.2% was calculated.
- A terminal growth rate of 4% was chosen as Etisalat's gained exposure in the past two years to markets that have a high growth potential.

Our DCF valuation is based on a 5-year consolidated cash flow forecast (2006 - 2010) as we estimate it is a reasonable forecast period for the telecom sector. We also took into account two scenarios on which we applied the same weighting:

1) As Du is expected to launch mobile services in Q1 07, there is a high likelihood in our opinion that the federal government starts lowering Etisalat royalty fee from the current 50%. A lower royalty fee for Etisalat should take place gradually however, in parallel of introducing it for Du. We believe that this process should be spread over the next four years so that Du has the time to build up its operations and establish a good presence in the UAE. By 2010, the royalty fee applicable to Etisalat should have been reduced to 30%.

2) As there is still no official announcement on the royalty fee regime, we also considered the scenario whereby the UAE government decides to keep it at 50% for Etisalat in addition to gradually implementing it for Du.

Etisalat group DCF valuation range



Source: SHUAA Capital

Etisalat group multiple-based valuation

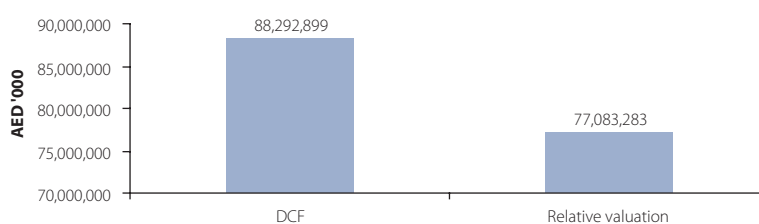
Firm	Market cap (USD '000)	EV/REV 06	EV/EBITDA 06	P/E 06
Batelco	2,652,661	4.6	8.6	11.8
STC	57,060,580	6.0	11.4	15.4
Omantel	2,298,821	3.3	7.0	11.3
Qtel	7,001,209	6.6	11.0	17.4
Maroc Telecom	12,117,511	4.9	8.3	16.0
Jordan Telecom	1,574,859	2.8	6.3	17.6
Telecom Egypt	3,531,519	2.6	4.8	10.0
Average	12,319,594	4.4	8.2	14.2
Cesky Telecom (CZK)	6,887,850	2.5	5.3	18.4
Magyar Telekom (HUF)	4,064,480	1.7	4.3	10.8
Telekom Malaysia (MYR)	8,370,130	2.4	5.3	15.2
Telkom SA (ZAR)	10,280,960	1.6	3.8	8.5
Average	7,400,855	2.0	4.7	13.2
Total average	9,860,225	3.2	6.4	13.7
Etisalat	22,609,663	4.8	6.2	14.3

Source: SHUAA Capital

We have selected regional and emerging market peers (integrated telecom operators) to conduct the relative valuation. Etisalat's stock trades above the EV/Revenues 06 and P/E 06 averages but under the EV/EBITDA 06 average. However, Etisalat's multiples compare more favorably to regional peers averages, which are higher than the ones of emerging markets operators. The reason Etisalat's EV/EBITDA 06 is below both averages, regional and emerging markets, is because the company's EBITDA margin stands at a very high level.

By equally applying the forward EV/Revenues, EV/EBITDA and P/E averages of 3.2x, 6.4x and 13.7x respectively, we arrive at an estimated equity value for Etisalat of **AED 77.1 bn** or **AED 17.0/share**.

Etisalat valuation range



Source: SHUAA Capital

The difference between the two valuation methods can be explained by the fact that the multiple-based valuation does not capture the contribution of the two subsidiaries, which are both expected to start commercial operations early 2007, and the income from associated companies that we forecast to become significant in 2007.

For this very reason, we chose to apply a 70% weighting to our DCF valuation and 30% to our relative valuation.

Associated companies valuation

The table below summarizes the proportionate value of Etisalat's associated companies which were obtained using DCF, multiples or book value methods.

Associated company – Ownership	Valuation method	Proportionate value
Pakistan - 26%	Multiples	3,911,316
Mobily - 35%	DCF	18,946,604
Thuraya - 26%	Transaction value	1,351,350
Atlantique Telecom - 50%	BV	384,868
Canar Telecom - 37%	BV	31,940
Zantel - 34%	BV	18,739
UT Technologies - 50%	BV	50,000
Total	-	24,694,817

Source: SHUAA Capital

We reached a total equity value for Thuraya of AED 5.2 bn after taking into account the price per share of AED 2.25 that was considered for the company's private placement that took place in Q2 06.

Total value of Etisalat

When we add Etisalat group value to the associated companies value, we arrive at a sum-of-the-parts value of **AED 109.6 bn** or **AED 24.2/share**, implying a 28% upside potential. Hence we initiate coverage on Etisalat with a BUY recommendation. The stock now trades at a price to 2006E earnings of 14.8x and EV/EBITDA 2006E of 6.4x.

Financials

Consolidated Balance Sheet (AED '000)

Year to December	2004	2005	2006E	2007E	2008E	2009E
Assets						
Bank and cash balances	7,801,763	9,658,510	5,704,524	9,444,622	14,166,932	19,689,552
Debtors	1,261,428	1,538,834	1,900,480	2,092,423	2,254,563	2,409,690
Inventories	86,386	104,545	110,629	122,058	131,516	120,485
Other current assets	455,847	1,664,759	1,367,711	1,517,007	1,634,558	1,747,025
Total Current Assets	9,605,424	12,966,648	9,083,344	13,176,111	18,187,568	23,966,752
Associated undertakings	1,946,018	2,207,715	11,787,089	11,787,089	11,787,089	11,787,089
Other investments	226,672	365,210	512,538	512,538	512,538	512,538
Net fixed assets	8,605,542	8,480,300	8,248,136	7,780,680	7,024,675	6,254,450
Loans to associated undertakings	-	35,472	26,604	17,744	8,884	-
Intangible assets	-	-	7,035,092	6,552,748	6,070,404	5,588,060
Total Non-Current Assets	10,778,232	11,088,697	27,609,459	26,650,800	25,403,590	24,142,137
Total Assets	20,383,656	24,055,345	36,692,803	39,826,911	43,591,159	48,108,889
Liabilities						
Creditors	4,095,589	5,126,705	6,250,568	6,896,316	7,430,702	7,941,979
Other current liabilities	1,775,234	1,878,002	2,054,537	2,266,792	2,442,443	2,610,498
Amounts payable on acquisition of an investment	-	-	978,884	978,884	978,884	978,884
Proposed dividend	825,000	907,500	1,134,375	1,134,375	1,134,375	1,134,375
Total Current Liabilities	6,695,823	7,912,207	10,418,364	11,276,367	11,986,403	12,665,736
Long term debt	-	-	3,673,000	2,754,750	1,836,500	918,250
Amounts payable on acquisition of an investment	-	-	2,936,652	1,957,768	978,884	-
Other non-current liabilities	402,558	416,832	416,832	416,832	416,832	416,832
Total Non-Current Liabilities	402,558	416,832	7,026,484	5,129,350	3,232,216	1,335,082
Share Capital	3,300,000	3,630,000	4,537,500	4,537,500	4,537,500	4,537,500
Development reserve	2,800,000	3,300,000	3,800,000	4,300,000	4,800,000	5,300,000
Asset replacement reserve	2,900,000	3,400,000	3,900,000	4,400,000	4,900,000	5,400,000
General reserve	4,250,000	5,320,000	6,462,500	8,512,500	10,562,500	12,612,500
Retained profit	35,275	76,306	547,955	1,671,194	3,572,539	6,258,071
Total Shareholders' Equity	13,285,275	15,726,306	19,247,955	23,421,194	28,372,539	34,108,071
Total Liabilities and Equity	20,383,656	24,055,345	36,692,803	39,826,911	43,591,159	48,108,889

Source: Etisalat, SHUAA Capital

Consolidated Income Statement (AED '000)

Year to December	2004	2005	2006E	2007E	2008E	2009E
Revenues	10,433,779	12,865,894	15,804,134	17,436,862	18,788,021	20,080,751
Operating expenses	2,343,848	3,058,287	3,474,287	4,426,387	4,834,639	5,138,942
EBITDA	8,089,931	9,807,607	12,329,846	13,010,475	13,953,382	14,941,809
Depreciation and amortisation	1,236,096	1,372,873	1,659,516	2,322,574	2,644,114	2,972,958
EBIT	6,853,835	8,434,734	10,670,330	10,687,901	11,309,268	11,968,851
Finance charges	-	-	72,236	192,833	133,146	78,510
Interest income	119,780	280,502	289,476	137,000	137,000	137,000
Other income	38,915	59,020	-	-	-	-
Share of results of associated companies	14,244	-251,312	658,400	1,279,834	1,646,398	1,899,998
Pre-tax profit	7,026,774	8,522,944	11,545,971	11,911,902	12,959,520	13,927,338
Taxes	-	-	-	13,353	59,515	139,084
Federal royalty	3,417,642	4,256,031	5,772,985	5,651,811	5,805,002	5,860,008
Net profit after tax	3,609,132	4,266,913	5,772,985	6,260,092	7,154,518	8,067,330
Extraordinary items	-191,490	-10,882	-	-	-	-
Minority interest	-	-	-17,413	-181,898	-65,578	63,048
Net profit	3,417,642	4,256,031	5,790,399	6,441,989	7,220,095	8,004,282

Source: Etisalat, SHUAA Capital

Consolidated Free Cash Flow Statement (AED '000)

Year to December	2006E	2007E	2008E	2009E
EBITDA	12,329,846	13,010,475	13,953,382	14,941,809
Federal royalty	-5,772,985	-5,651,811	-5,805,002	-5,860,008
Annual renewal fee	-1,000	-1,000	-1,000	-1,000
Taxes	-	-8,813	-39,280	-91,795
Change in Working Capital	756,133	442,375	362,789	367,181
Minority interest	17,413	181,898	65,578	-63,048
Capex	-1,421,896	-2,189,340	-2,016,734	-2,077,278
Acquisitions	-11,889,095	-978,884	-978,884	-978,884
Free Cash Flow	-5,981,584	4,804,899	5,540,849	6,236,977

Source: Etisalat, SHUAA Capital

Key ratios

Year to December	2004	2005	2006E	2007E	2008E	2009E	CAGR
Growth							
Revenues	13.1%	23.3%	22.8%	10.3%	7.7%	6.9%	14.0%
EBITDA	-	21.2%	25.7%	5.5%	7.2%	7.1%	13.1%
Net profit	-	24.5%	36.1%	11.3%	12.1%	10.9%	18.6%
Equity	15.3%	18.4%	22.4%	21.7%	21.1%	20.2%	20.8%
Assets	14.1%	18.0%	52.5%	8.5%	9.5%	10.4%	18.7%
Leverage							
Interest coverage (x)	-	-	170.7	67.5	104.8	190.3	
Debt / Equity (x)	-	-	0.2	0.1	0.1	0.0	
Debt / Market Cap (x)	-	-	0.04	0.03	0.02	0.01	
Margins & profitability							
EBITDA margin	77.5%	76.2%	78.0%	74.6%	74.3%	74.4%	
Profit margin	32.8%	33.1%	36.6%	36.9%	38.4%	39.9%	
RoAE	27.6%	29.3%	33.1%	30.2%	27.9%	25.6%	
RoAA	17.9%	19.2%	19.1%	16.8%	17.3%	17.5%	
Valuation							
Number of shares ('000)	4,537,500	4,537,500	4,537,500	4,537,500	4,537,500	4,537,500	
EPS (AED)	1.04	1.17	1.28	1.42	1.59	1.76	
DPS (AED)	0.50	0.50	0.50	0.50	0.50	0.50	
BVPS (AED)	4.03	4.33	4.24	5.16	6.25	7.52	
Share Price (AED)	18.90	18.90	18.90	18.90	18.90	18.90	
P/E (x)	25.1	20.1	14.8	13.3	11.9	10.7	
P/BV (x)	6.5	5.5	4.5	3.7	3.0	2.5	
EV / EBITDA (x)	9.7	8.0	6.4	6.0	5.6	5.3	
Dividend yield	2.6%	2.6%	2.6%	2.6%	2.6%	2.6%	

Source: Etisalat, SHUAA Capital

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