

Emirates Telecommunications Corp. (Etisalat)

August 2010

ADSM Code: Etisalat.ADSM | Reuters Code: ETEL.AD | Bloomberg Code: Etisalat UH
Current Market Price: AED 10.05 (As of August 09, 2010)
Initial Coverage: [June 2008](#)

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

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Low			
Medium			
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- Emirates Telecommunication Corporation (Etisalat)'s stock price increased 5.9% YTD in 2010, outperforming the Abu Dhabi General Index (ADX), which fell 8.5%. In 2009, the company's stock price had increased 43%, while the index rose 16%.
- Currently, Etisalat trades at a P/E of 9.1x, down 5.9% on YTD basis. The company's PE expanded 16% in 2009. We place the fair value PE at 10x, indicating a limited upside potential.
- Etisalat's 2Q10 revenues declined marginally by 0.98% YoY to USD 2.2 Bn. However, its operating expenses surged 32.5% YoY to USD 1.3 Bn during the same period. Consequently, operating margins contracted 15 percentage points (pps) YoY to 42% in 2Q10. The company's net income dipped 22.5% YoY to USD 1.1 Bn during the quarter.
- Etisalat's customer base by the end of Q2-10 stood at 10.47 Mn subscribers, up 6.6% YoY. Mobile subscribers count stood at 7.8 Mn during the period, while broadband customers count reached 1.4 Mn.
- Etisalat's revenue increased 2% YoY to USD 4.4 Bn in 1H10. However, the company's operating margin decreased 12 pps to 44% in this period due to the 29% YoY rise in operating expenses. Etisalat recorded a net profit of USD 1.1 Bn, down 15.8% from 1H09.
- The company's net income grew 7% YoY to USD 2.4 Bn in 2009. However, its revenues increased at a slower pace of 5% YoY to USD 8.4 Bn in the year. Etisalat's customer base expanded 5.9% YoY to 10.38 Mn subscribers in 2009. Mobile subscribers grew to 7.74 Mn during the period, up 6.3% YoY.
- We expect Etisalat's revenues to increase 4% YoY to USD 8.7 Mn in 2010, primarily led by its expansion strategy. Furthermore, the company has invested around USD 1.4 Bn in its fiber-optic network in order to expand its service portfolio; this is likely to strengthen its service offerings. The network is expected to be completed by the end of 2011. We expect the company's net income to decline 13% YoY to USD 2.0 Bn in 2010.

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USD Mn	2004	2005	2006	2007	2008	2009	2010F
Net Revenues	2,840	3,502	4,434	5,809	7,992	8,392	8,711
Net Operating Profit	1,824	1,082	1,523	1,799	1,655	2,214	1,408
Net Profit	930	1,158	1,581	1,829	2,178	2,336	2,032
P/E (LFY)	17.86	19.74	11.15	13.89	6.28	8.47	9.14
P/B (LFI)	4.57	5.36	3.40	4.20	1.71	2.06	1.99
M. Cap (USD Mn)	16,528	22,941	17,754	27,503	14,591	20,423	21,843
Stock Returns		39%	-23%	55%	-47%	43%	6% (YTD)

2010 figures - P/E, P/B on 2Q10 ending results and M.Cap. as on 09 August 2010

Source: Reuters Knowledge, Bloomberg, Markaz Research

Discussion Note

2009 Expectations vs. Actual – Looking Back

Earnings

FY2009 net profit came in at USD 2.3 Bn, a 7% YoY decline over 2008

Etisalat's net profit growth decelerated to 7% YoY (USD 2.3 Bn) in 2009, mainly due to the trickle down effect of slow top-line growth. The company's operating expenses declined 2% YoY to USD 6.2 Bn in the year. The fall was due to the 29% YoY decline in other operating expenses to USD 837 Mn, partially offset by a 15.7% YoY increase in the interconnect cost to USD 3.84 Bn during the same period. Consequently, its operating margin expanded 56 bps YoY to 26.4% in 2009.

Etisalat's capital expenditure (capex) increased 74% YoY to USD 1.85 Bn in 2009, primarily due to the company's initiative to enhance its network. During the year, Etisalat acquired Tigo, a mobile operator in Sri Lanka, in line with its strategy to expand its network in emerging markets.

In 2Q10, Etisalat's operating expenses grew 32.6% YoY to USD 510 Mn. The increase was mainly led by the 10% YoY rise in staff cost to USD 290 Mn and 137.2% YoY growth in other operating expenses to USD 449 Mn during the quarter. As a result, net income declined 22.5% YoY to USD 510 Mn in 2Q10.

In 1H10, Etisalat's operating expenses grew 29% YoY to 2.45 Bn, much more than the growth in revenues, primarily due to the increase in interconnect cost (18.4% YoY to USD 544 Mn) and other operating expenses (70% YoY to USD 820 Mn). The company's net income fell 15.8% YoY to USD 1.05 Bn in the same period.

Etisalat's revenue for the year 2009 increased 5% YoY to USD 8.4 Bn

Revenues

Etisalat's revenues increased 5% YoY to USD 8.4 Bn in 2009, mainly driven by the growth in data and internet traffic. Data and internet revenues grew 10.2% YoY to USD 6.5 Bn in the year, contributing 21% to the company's total revenue. Etisalat's UAE mobile customer base expanded 6.3% YoY to 7.74 Mn, while its internet subscriber base grew 15.4% YoY to 1.31 Mn. However, fixed line subscriber base contracted 3.6% YoY to 1.33 Mn. The company's average monthly revenue per user (ARPU) in 2009 for cellular services, fixed line and broadband stood at USD 41, USD 53 and USD 50, respectively.

Revenues for 2Q10 increased 5% YoY to USD 2.16 Bn. However, the ARPU for cellular, fixed line and broadband services declined to USD 40, USD 51 and USD 48, respectively, compared to 2009. Etisalat's revenue grew 1.9% YoY to USD 4.4 Bn in 1H10. The company had 7.80 Mn mobile, 1.28 Mn fixed line and 1.39 Mn internet subscribers at the end of this period.

Looking forward – 2010

We expect Etisalat's revenues to increase 3.8% YoY to USD 8.7 Bn in 2010, primarily due to the expected strong growth in customer acquisition led by its strategy to expand network coverage. In addition, recent steps taken by the regulator to further deregulate the sector have helped the company to provide fixed line and broadband services in new regions of the UAE. We expect this factor to aid top-line growth. Etisalat is likely to witness a 4.4% YoY increase in its subscribers to 10.84 Mn by the end of 2010, mainly led by its expanding network coverage and telecommunication services in the UAE. Segment-wise, we expect the number of mobile subscribers to increase 4% YoY to 8.02 Mn,

Growing competition has limited customer acquisition growth over the recent years. We expect mobile subscriber base to rise 4.4% to 10.84 Mn in 2010.

fixed line subscribers to contract 1% to 1.30 Mn and broadband subscribers to rise 14% YoY to 1.52 Mn in 2010.

Table 1: Etisalat - Subscriber trends and its forecast

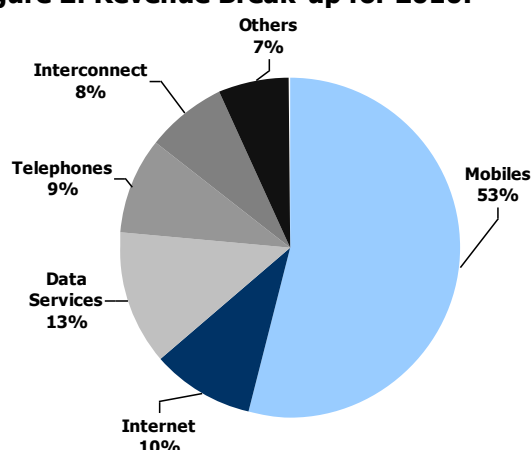
Number of Subscribers	2004	2005	2006	2007	2008	2009	2010e
Cellular Segment							
No. of Total Subscribers (million)	3.68	4.53	5.52	6.37	7.29	7.74	8.02
Percentage of Total Subscribers	70%	72%	74%	74%	74%	75%	74%
YoY Growth		23%	22%	15%	14%	6%	4%
Fixed Line Segment							
No. of Total Subscribers (million)	1.19	1.24	1.29	1.33	1.36	1.31	1.30
Percentage of Total Subscribers	22%	20%	17%	15%	14%	13%	12%
YoY Growth		4%	4%	3%	2%	-4%	-1%
Broadband Segment							
No. of Subscribers (million)	0.42	0.53	0.66	0.88	1.15	1.33	1.52
Percentage of Total Subscribers	8%	8%	9%	10%	12%	13%	14%
YoY Growth		26%	25%	33%	32%	15%	14%
Number of Total Subscribers	5.29	6.30	7.47	8.57	9.80	10.38	10.84

Source: Company Filings, Markaz Research

Furthermore, Etisalat has invested around USD 1.4 Bn in its fibre-optic network in order to broaden its service portfolio. This investment is expected to take the top broadband speeds to 32 MBps and enable the company to provide advanced high definition voice services and next generation TV services such as 3D, through its eLife bundles. These steps are likely to boost the company's top-line growth and strengthen its customer base in the longer term.

We expect Etisalat's operating expenses to rise 18% YoY to USD 7.3 Bn in 2010. However, in the medium to long term, geographic expansion is likely to benefit the company as it creates more revenue drivers and diversifies its exposure away from a single market, a trend seen in the telecom industry.

Figure 2: Revenue Break-up for 2010F



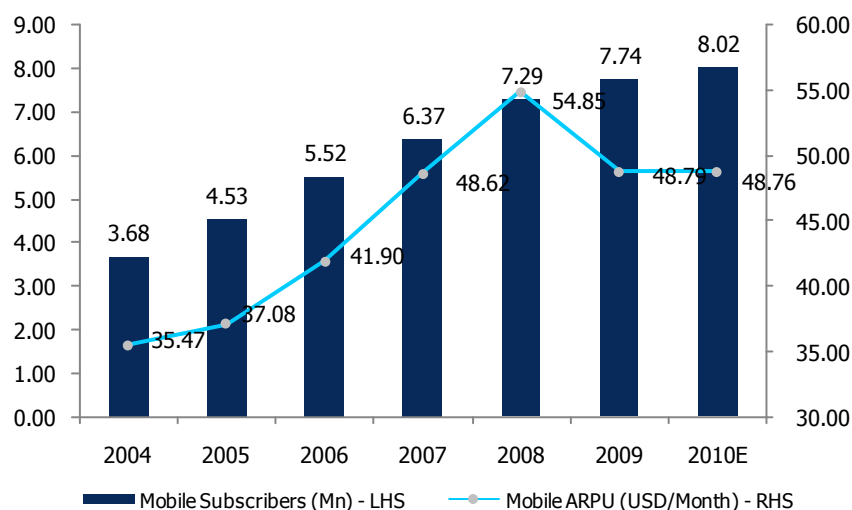
Source: Markaz Research

Going forward, we expect Etisalat's to continue facing downward pressure on ARPU, while expect the mobile subscriber base to increase to 8.02 (up 3.6% YoY in 2010). Owing to intensifying competition and maturing domestic telecom market, we expect the monthly ARPU to remain flat at USD 48.76 in 2010. Etisalat's ARPU during the period 2004-09 grew at a CAGR of 6.58% to USD 48.8 in 2009 (Figure 3).

Etisalat has invested around USD 1.4 Bn in its fibre-optic network in order to broaden its service portfolio

Telecom Regulatory Authority's (TRA) recent announcement to suspend Blackberry service in the UAE adds to our concern

Figure 3: Mobile Subscriber Growth and ARPU Trend



Source: Company Financials, Markaz Research

Recent Developments

BlackBerry Suspension: The Telecom Regulatory Authority's (TRA) recent announcement to suspend Blackberry service in the UAE from October 2010 onward raises some concern about revenue growth, going forward. Blackberry services are currently being used by a significant proportion of the total mobile subscribers in UAE. The total subscriber base of Blackberry in UAE stands at around 500,000 users. The suspending of these services is expected to affect the company's top-line, going forward.

Post release of the Blackberry suspension news, the two major players in UAE, Etisalat and Emirates Integrated Telecommunication Company (Du), have become more active in marketing their Blackberry services to sustain top line growth and market share. In response to the Blackberry suspension, Etisalat launched a high value mobility packages for its existing Blackberry customers, offering bundled services such as SMS and MMS as well as mobile internet data services and offer value far in excess of the monthly fee. Etisalat has also offered add-on packages, providing a free smartphone for customers signing in on 12 month contract or free monthly minutes to customers without yearly commitment and without free smartphone.

Although this strategy could help the company maintain market share, it could also exert some cost pressures due to the discounts offered.

Zain Stake: Recently, it was reported that the Kuwaiti telecom firm, Zain, is in talks with Etisalat for the sale of majority stake¹. It was also reported that Etisalat has signed a non-disclosure agreement with Zain to study its assets. In the event of successful completion of the deal, Etisalat is likely to broaden its regional network and reduce overall risk arising from increasing competition within its home market (entry of mobile operator "DU" is pressuring domestic market share). Apart from its home market, Etisalat's only presence in the Gulf is in Saudi Arabia. A stake purchase in Zain allows Etisalat to enter Kuwait,

The TRA's Blackberry services ban is a cause for concern

We expect Etisalat's ROA to contract by 3 percentage points (pps) YoY to 9% in 2010

¹ Source: Reuters

Bahrain and Iraq. As a result, if the deal goes through, our financial estimates would stand to be substantially revised.

Broker Estimates

We expect Etisalat's ROA to contract by 3 percentage points (pps) YoY to 9% in 2010, considering its geographic expansion and network upgrade. The company's ROE is also expected to decline from 24% in 2009 to 18.5% in 2010. Etisalat's EBITDA is likely to fall by 10% YoY to USD 4.5 Bn, mainly led by the rising contract cost and slower sales growth. Furthermore, we expect the company's net income to decrease by 13% YoY to USD 2.0 Bn in 2010.

Table 2: Broker Estimates

Annual (USD Mn)	Broker Estimate Table (2010 f)				
	Nomura	Belton Financials	EFG Hermes	Securities Invst	Markaz
Date of Estimates	Jan-10	Jan-10	Jul-10	Jul-10	Aug-10
ROA:	-	14%	-	-	9.0%
ROE:	-	23%	-	21%	18.5%
Revenue:	8,482	9,536	8,440	8,625	8,711
EBITDA:	5,238	3,681	4,786	4,898	4,551
EBIT:	4,481	2,949	4,055	4,129	4,326
Net Profit:	2,244	2,944	2,145	2,141	2,032
Growth	-4%	26%	-8%	-8%	-13%
Recommendation	Buy	Outperform	Buy	Overweight	

Source: Zawya, Reuters Knowledge, Markaz Research

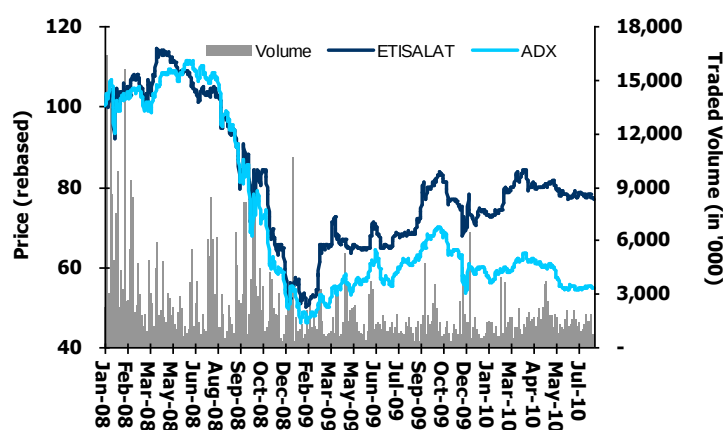
Brokerage houses expect Etisalat's 2010 revenues to be somewhere around USD 8.4 Bn, anticipating a decline. EBITDA is expected to contract and range between USD 4.7 Bn and USD 5.2 Bn in 2010. Etisalat is forecasted to register a net profit of about USD 2.2 Bn in the year, down nearly 8% from that in 2009.

Valuation

Etisalat's stock price increased 5.9% YTD in 2010, outperforming the ADX, which fell 8.5%. In 2009, the company's stock price rose 43%, while the index climbed 16% (Figure 11). Etisalat's current PE stands at 9.1x; its PE multiple has declined 5.9% since 2009. Furthermore, we place the fair value PE at 10.0x, indicating limited upside potential. Etisalat's turnover velocity fell to 4.11% in 2009 (from 11.3% in 2008) due to the decline in trading values.

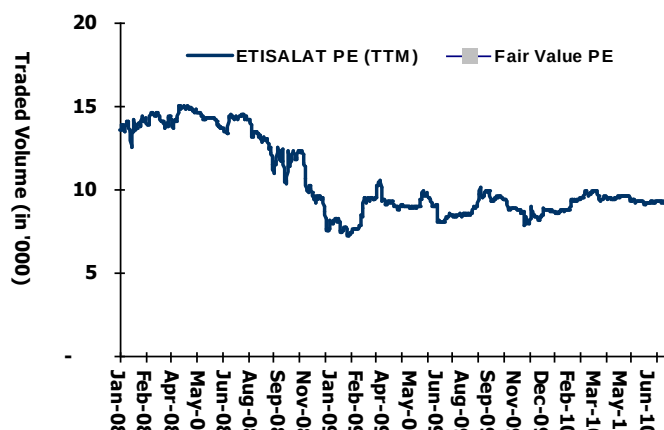
The company's expansion initiative is expected to boost its top line; however, the suspension of Blackberry services warrants caution. Growing competition from DU in the UAE is also a cause for concern, as it exerts pressure on Etisalat's ARPU and market share. However, the completion of its fiber-optics line in 2011 could help the company expand its top line by enabling it to increase the services provided, and thereby, strengthen its customer base both within and outside the UAE. We expect Etisalat's net income to decrease 13% YoY to USD 2.0 Bn in 2010. Overall, we expect the stock to yield low returns with a Low volatility as per the Markaz Volatility Index.

Figure 4: Price & Volume Trend



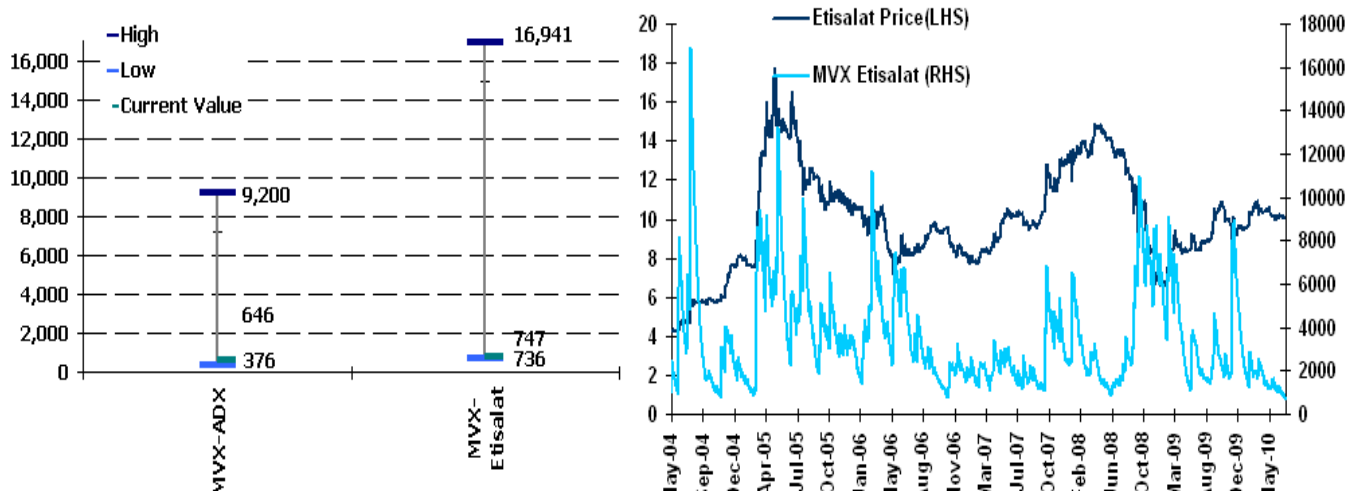
Source: Bloomberg, Markaz Research

Figure 5: PE Trend & Fair Value



Source: Bloomberg, Markaz Research

Figure 6: Markaz Volatility Index (July 2010)



Source: Bloomberg, Markaz Research

Appendix 1: Key Statistics

Income statement (USD mn)	2004	2005	2006	2007	2008	2009	2010e
Net Revenue	2,840	3,502	4,434	5,809	7,992	8,392	8,711
Operating Profit	1,824	1,082	1,523	1,799	1,655	2,214	1,408
Net Profit	2,840	3,502	4,434	5,809	7,992	8,392	2,032
Balance Sheet (USD Mn)	2004	2005	2006	2007	2008	2009	2010e
Total Current Assets	2,615	3,613	3,801	3,512	4,752	5,332	
Non-Current Assets	2,934	3,009	8,695	10,765	12,374	14,098	
Total Assets	5,548	6,622	12,496	14,276	17,126	19,429	
Total Liabilities	1,932	2,341	7,274	7,728	8,570	9,523	
Total Shareholder's Equity	3,616	4,281	5,223	6,548	8,556	9,906	
Key Ratios	2004	2005	2006	2007	2008	2009	2010e
Return on Equity (%)	25.7%	27.1%	30.3%	27.9%	25.5%	23.6%	18.5%
Return on Assets (%)	16.8%	17.5%	12.7%	12.8%	12.7%	12.0%	9.0%
Revenue Growth (%)	13.1%	23.3%	26.6%	31.0%	37.6%	5.0%	3.8%
Earnings Growth (%)	19.0%	24.5%	36.5%	15.7%	19.0%	7.3%	-13.0%
Historical EV (USD Mn)	16,528	22,941	19,655	28,358	15,311	21,354	
P/E	17.86	19.74	11.15	13.89	6.28	8.47	
Price/Book	4.57	5.36	3.40	4.20	1.71	2.06	
EPS (USD)	0.12	0.15	0.20	0.25	0.29	0.30	
BVPS (USD)	0.46	0.54	0.66	0.83	1.08	1.25	
DPS	0.06	0.06	0.09	0.10	0.15	0.16	
Market Price (AED)	7.68	10.66	8.25	12.78	6.78	9.49	
Assets Growth (%)		19%	89%	14%	20%	13%	
Equity Growth (%)		18%	22%	25%	31%	16%	
Annual Trading Volume (mn)	327	250	388	542	614	279	
Annual Trading Value (USD mn)	915	2,870	1,089	1,751	2,368	720	
Turnover Velocity	6%	15%	5%	8%	11.25%	4.11%	
M Cap (USD mn)	16,528	22,941	17,754	27,503	14,591	20,423	
Source: Zawya, Reuters, Company Financials							

Appendix 2: Etisalat's presence- International

Etisalat has a huge network spread across the regions. The company has strong presence in the Middle East, Africa and Asia which gives it scale and diversifies its revenues and risk. The details of the company existence in various countries, license details, ownership and penetration rate is given below:

Table 3: Etisalat's operation details- Region and Country-Wise in 2009

Company, Country	License Type	Ownership	Penetration Rate
Africa			
Atlantique Telecom & Moov, West Africa	Mobile	82%	43%
Canar, Sudan	Fixed	82%	35%
Etisalat Misr, Egypt	Mobile & Internet	66%	76%
EMTS - Etisalat, Nigeria	Mobile	40%	48%
Zantel, Tanzania	Mobile & Fixed	51%	38%
Middle East			
Etisalat, UAE	Mobile, Internet & Fixed	100%	(Mobile) 204% (Fixed) 30% (Internet) 27%
Etihad Etisalat (Mobily), KSA	Mobile & Internet	27%	126%
Thuraya, UAE	Satellite Telecommunication	28%	59%
Asia			
Etisalat, Afghanistan	Mobile	100%	34%
Etisalat DB, India	Mobile	45%	43%
PT XL Axiata Tbk, Indonesia	Mobile	13%	78%
Pakistan Telecom. Co. Ltd, Pakistan	Mobile, Internet & Fixed	26%	(Mobile) 59% (Fixed) 2%
Tigo, Sri Lanka	Mobile	100%	38%

Source: Company Financials, Markaz Research

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Markaz Company Research Coverage			
	MSCI Arabian Markets Conventional	MSCI Arabian Markets Islamic	Local Index
Saudi Arabia	60%	64%	78%
Kuwait	83%	92%	56%
Qatar	92%	90%	95%
UAE	79%	25%	58%
Bahrain	79%	100%	21%
Oman	63%	100%	50%
Egypt	62%	100%	45%
Jordan	39%	0%	32%
Morocco	50%	70%	24%
MENA	79%	93%	63%

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Definitions - Return

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

Definitions – Volatility (Risk)

High	Where the Current MVX and band width of stock is more than the respective country benchmark
Medium	Where the current MVX is lower than benchmark and band width higher than or lower than benchmark
Low	Where the current MVX is lower than the benchmark and the band width lower than the benchmark

MVX refers to Markaz Volatility Index calculated by Markaz based on in-house proprietary model

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