



27 December 2006

Initiation of Coverage

Emirates Telecommunication Corporation (Etisalat)

Strong Buy

General Information

RIC	ETEL.AD
Bloomberg code	ETISALAT UH
Market cap	AED76,457 mil
Net bank debt	(AED684 mil)
Enterprise value	AED75,773 mil
Shares outstanding	4,537.5 mil
Free float	40%

Valuation

Target price	AED23.10
Market price	AED16.85
Upside potential	37.1%

Money Talks

Summary

■ Etisalat: Background and Operations

Etisalat is a holding company that was established in 1976, and is now one of the major telecom operators in the Middle East, Africa, and South Asia in terms of revenues and cellular subscribers. The company has four major lines of business: cellular and data (65.5% of FY05 operating revenue), fixed line (22.2%), internet (6.2%), and other operating revenues including cable television (6.1%).

■ Regional Penetration

Starting in 2004, and following the Telecom Regulatory Authority's (TRA) decision to end Etisalat's monopoly and liberalize the UAE telecom sector, Etisalat decided to undertake an aggressive expansion plan to maintain profitability. Over two years, Etisalat paid around USD5.92 billion acquiring cellular licenses in Saudi Arabia, Egypt, Sudan, and Afghanistan. In addition, Etisalat acquired mobile operations in Pakistan, and Central and West Africa at an average cost of USD770 per subscriber.

■ 9M06: Significant Growth and Improved Profitability

Etisalat's 9M06 operating revenue increased by 26.2% YoY to AED11.82 billion, from AED9.36 billion in 9M05, and came on the back of 22.2% growth in cellular subscribers, to 5.3 million. Etisalat has been able to capitalize on its subscriber base growth and achieve better synergies, thus reducing its cost structure and improving profitability margins by 3–5%. However, we believe that profitability margins will decline in the short run following Etisalat's first phase of regional expansion and the entrance of a second telecom operator in the UAE market.

■ We recommend "Strong Buy" for Etisalat

We initiate coverage of Etisalat with a "Strong Buy" recommendation, based on our DCF-based price target of **AED23.10/share**. Our target price offers 37.1% upside potential to current market price of AED16.85/share. Based on our analysis, shares of Etisalat trade at a forecast P/E of 13.6x for FY06e and 14.1x for FY07f.

Key Performance Indicators

AED (unless stated otherwise)	04A	05A	06E	07F	08F
Revenues (Mil)	10,434	12,866	15,857	16,449	16,979
Net Inc. before App. (Mil)	3,418	4,256	5,771	5,584	5,779
EPS	0.75	0.92	1.24	1.20	1.23
EPS Growth	18.5%	23.6%	34.9%	-3.7%	3.0%
P/E	22.6x	18.3x	13.6x	14.1x	13.7x

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I. Investment Summary

Emirates Telecommunications Corporation (Etisalat) was established in 1976 as a holding company to provide telecommunication services in the UAE and the region as a whole. Etisalat's current authorized capital is AED8.0 billion, and its paid-in capital amounts to AED4.54 billion, distributed over 4.54 million shares with a par value of AED1.0 per share. The UAE government owns 60% of Etisalat while the remaining 40% is free float listed on the Abu Dhabi Securities Market.

Etisalat has four major lines of business: cellular and data (65.5% of FY05 operating revenue), fixed line (22.2%), internet (6.2%), and other operating revenue (6.1%). Other operating revenue includes cable television and submarine cable.

Etisalat has enjoyed a monopoly for all telecom services in the UAE since its inception in 1976. However, after signing the General Agreement for Tariffs and Trade (GATT), the UAE government established the Telecommunications Regulatory Authority in 2004 to regulate the telecom market. Subsequently, the decision was made to end Etisalat's monopoly. In 2005, Emirates Integrated Telecom Company, 40% owned by the government, announced the establishment of the UAE's second telecom operator, Du, whose operations are expected to commence in 1Q07.

Du will enter the cellular market when it is fully saturated with a penetration rate of around 110%. Therefore, in order to gain market share, Du will have to offer attractive prices and innovative products. In anticipation of a second telecom operator's entrance into the UAE market, Etisalat announced a new strategic plan to diversify its product offerings in the local market. Etisalat will also undertake a regional expansion plan to diversify its sources of revenue.

Etisalat has already spent approximately USD5.92 billion acquiring cellular licenses in Saudi Arabia, Egypt, Sudan, and Afghanistan. In addition, it has acquired existing operations in Pakistan, and Central and West Africa at an average cost per subscriber of USD770.

Moreover, Etisalat has announced that it plans to invest a further USD13.62 billion in the next 3–4 years so that it can become one of world's top-ten cellular operators in terms of subscribers by 2010. Etisalat is exploring several markets to implement its aggressive expansion plan, including: Algeria, Libya, Lebanon, and Syria in the MENA region; Russia and Armenia in Europe; and several other countries in West and Central Africa.

Sustained Top Line Growth from FY02a to FY10f

We believe that Etisalat is set to deliver sales of AED15.86 billion in FY06e, up 23.3% YoY. In FY07f, we expect sales of AED16.45 billion, up only 3.7% YoY because after Du enters the UAE telecom market, Etisalat's top line will fall as ARPUs decline. However, starting in FY07f we believe that Etisalat will maintain continuous growth in its top line, but with lower growth rates than the 16% average it enjoyed from FY02 to F06e.

Continuous sales growth comes on the back of the following:

- Population growth backed by a strong and expanding economy, which together will lead to an increase in GDP per capita and growth in cellular and fixed line penetration rates.
- Greater subscription to 3G technology, which will boost data revenue through new services.
- The acquisition of new cellular licenses in Egypt and Afghanistan.

Table 1: Key Indicators (FY05a – FY08f)

AED Mil.	FY05a	FY06e	FY07f	FY08f
Sales	12,866	15,857	16,449	16,979
<i>Growth in Sales</i>	<i>23.3%</i>	<i>23.3%</i>	<i>3.7%</i>	<i>3.2%</i>
Operating Profit	8,232	10,930	10,125	10,260
<i>Operating Margin</i>	<i>64.0%</i>	<i>68.9%</i>	<i>61.6%</i>	<i>60.4%</i>
Total Assets	24,055	38,669	42,181	44,778
<i>Growth in Total Assets</i>	<i>18.0%</i>	<i>60.7%</i>	<i>9.1%</i>	<i>6.2%</i>

Source: Etisalat, HC Brokerage

In FY07f, Etisalat's operating margins will drop by around 7% as operations begin in Egypt and Afghanistan. It is our belief that in terms of operating profit Etisalat will breakeven in Egypt and Afghanistan in FY09f and FY10f, respectively.

Fluctuations in Bottom Line Margin

We expect Etisalat to post FY06 net income of AED5.77 billion (EPS of AED1.27), a 35.6% YoY rise from AED4.26 billion (EPS of AED0.94) in FY05. We assume that the key driving growth factors will be growth in sales coupled with a better management of costs, thus improving the company's EBITDA and net margins. In addition, we believe that Etisalat will record investment income of around AED313 million from its 26%-owned Pakistani operation.

In FY07f we forecast net income of AED5.58 billion (EPS of AED1.23), with a decline coming from expected losses from operations in Egypt and Afghanistan. As a result, the net margin will decline from 36.4% to 34.0%. However, from FY08f to FY10f the net margin will gradually increase until it reaches 41.0%.

Over time, the net margin will increase as investment income rises from operations in Saudi Arabia and Pakistan, and as losses from cellular operation in Egypt and Afghanistan diminish.

Our DCF-based price target of AED23.1 suggests “Strong Buy”

We are initiating coverage on Etisalat with a “**Strong Buy**” recommendation, based on our DCF-based target price of **AED23.1**/share, which offers 37.1% upside potential to the market price of AED16.85/share. Etisalat's shares trade at a forecast P/E of 13.6x for FY06e and 14.1x for FY07f.

Table 2: Share Sensitivity to WACC (AED)

Perpetual Growth Rate	10.9%	WACC 11.9%	12.9%
4%	24.7	21.2	18.6
5%	27.4	23.1	19.9
6%	31.1	25.5	21.6

Source: HC Brokerage

Multiples Valuation price target of AED22.5

A multiples valuation for Etisalat results in a “**Strong Buy**” recommendation and is based on a target price of **AED22.5**, which offers 33.4% upside potential to current market price of AED16.85. This valuation is based on estimated results for 2006, which reflect the prevailing market conditions of its peer group. We gave EV/EBITDA multiples a 75% weighting and P/E multiples a 25% weighting.

We are weighting EV/EBITDA higher than P/E because the former is more indicative of Etisalat's value because the 50% royalty fee that Etisalat pays skews its P/E ratio. As this royalty declines over time, Etisalat's P/E valuation will become a more reliable indicator of its value.

Table 3: Multiples Valuation

AED	Weight	Target Value Per Share	Weighted Target Value Per Share
Multiple Valuation			
EV / EBITDA	75%	24.1	18.1
Price / Earnings (P/E)	25%	17.7	4.4
Total Value	100%		22.5

Source: Bloomberg, HC Brokerage

Table 4: Multiples Used for Comparison

Company	Country	EV/EBITDA	P/E
West Europe			
Telecom Italia	Italy	9.7x	13.6x
British Telecom	England	9.3x	13.7x
Deutsche Telecom	Germany	8.7x	14.7x
Portugal Telecom	Portugal	8.5x	17.2x
France Telecom	France	5.3x	11.3x
Average		8.3x	14.1x
Middle East and Africa			
Orascom Telecom	Egypt	8.9x	17.8x
Maroc Telecom	Morocco	8.0x	16.8x
MTN	South Africa	7.2x	13.7x
Telecom Egypt	Egypt	5.8x	12.5x
Jordan Telecom	Jordan	4.7x	11.5x
Average		6.9x	14.5x
GCC			
Qatar Telecom	Qatar	16.0x	12.6x
MTC	Kuwait	13.9x	12.2x
Bahrain Telecom	Bahrain	9.5x	12.3x
STC	Saudi Arabia	8.3x	13.9x
Wataniya Telecom	Kuwait	7.2x	14.9x
Average		11.0x	13.2x
Weighted Average		8.7x	13.9x

Source: Bloomberg, HC Brokerage

The weighted average calculated for multiples is based on equal allocations for the GCC, Middle East and Africa, and West Europe regions.

II. Company Background

Emirates Telecommunications Corporation (Etisalat) is a Holding Company that was established in 1976 to provide telecommunication services in the UAE and the GCC region. The company's current authorized capital is AED8.0 billion, and paid-in capital amounts to AED4.54 billion distributed over 4.54 million shares with a par value of AED1.0 per share. The UAE government owns 60% of Etisalat while the remaining 40% is free float listed on the Abu Dhabi Securities Market.

Etisalat has increased its paid-in capital three times over the last three financial years: first by distributing a 0.1 stock dividend to raise paid-in capital from AED3.0 billion to AED3.3 billion in FY04, then by another 0.1 stock dividend to raise paid-in capital to AED3.63 billion in FY05, and finally through a 0.25 stock dividend to raise paid-in capital to AED4.54 billion in FY06.

Etisalat is one of the major telecom operators in the Middle East, South Asia, and Africa in terms of revenues and cellular subscribers and has operations in the UAE, Saudi Arabia, Sudan, Pakistan, and several countries in West Africa. The company has four major lines of business: cellular and data (65.5% of FY05 operating revenue), fixed line (22.2%), internet (6.2%), and other operating revenue (6.1%). Other operating revenue includes cable television and submarine cable.

Etisalat acquired two new cellular licenses in Egypt and Afghanistan and is expected to start operations in both countries during 1Q07.

Etisalat has enjoyed a monopoly for all telecom services in the UAE since its inception in 1976. However, after signing the General Agreement for Tariffs and Trade (GATT), the UAE government established the Telecommunications Regulatory Authority in 2004 to regulate the telecom market. Subsequently, the decision was made to end Etisalat's monopoly. In 2005, Emirates Integrated Telecom Company, 40% owned by the government, announced the establishment of the UAE's second telecom operator, Du, whose operations are expected to commence in 1Q07. The UAE market will be almost fully saturated when Du arrives.

Table 5: UAE Telecom Industry

	FY02	FY03	FY04	FY05	9M06
Population (000s)	3,800	4,000	4,300	4,600	5,000
Cellular					
Subs (000s)	2,428	2,972	3,683	4,534	5,260
Penetration Rate	63.9%	74.3%	85.7%	98.6%	105.2%
Fixed Line					
Subs (000s)	1,094	1,136	1,188	1,237	1,280
Penetration Rate	28.8%	28.4%	27.6%	26.9%	25.6%
Internet					
Subs (000s)	309	347	418	527	630
Penetration Rate	8.1%	8.7%	9.7%	11.5%	12.6%

* Local citizens (Emiratis) represent around 25% of the population.

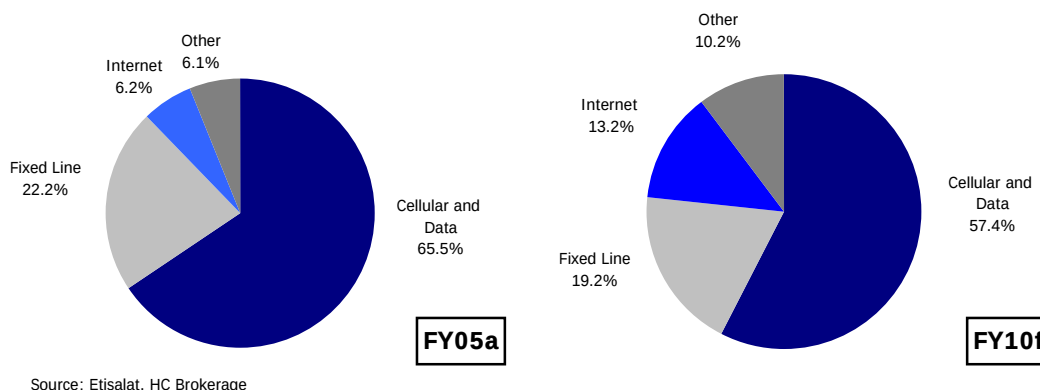
** Around 15% of the population has two cellular lines.

*** Internet usage is around 3.5x the penetration rate, assuming that each household contains 3–4 persons.

Source: Etisalat, EIU, HC Brokerage

III. Etisalat's Lines of Business

Chart 1: Etisalat's Local Sales Breakdown (FY05a – FY10f)



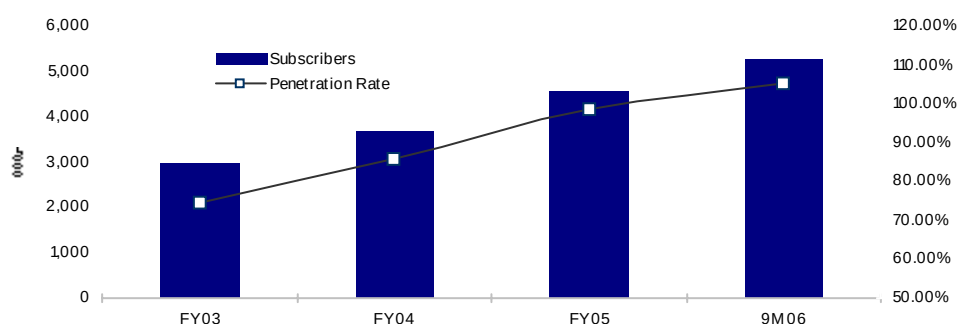
Source: Etisalat, HC Brokerage

1. Cellular and Data

Cellular and data operations are Etisalat's major line of business, contributing around 65.5% of FY05 net operating revenue. The UAE mobile communication market was inaugurated in 1994 when Etisalat launched its GSM services, and has steadily grown: from around 130,000 subscribers in 1995, to 1.9 million customers by the end of 2001, and reached 5.3 million in September 2006 with a penetration rate of around 105%. This significant growth is due to the following factors:

- Growth in the economy has led to increased investment, and thus higher demand for foreign labor, both white and blue collar. Foreign nationals represent around 75% of the population.
- High GDP per capita of around USD28,760 in 2005 resulting in around 15% of the population owns two cellular lines.

Chart 2: Etisalat's Cellular Subs and Penetration Rate



Source: Etisalat, HC Brokerage

3G Services

Etisalat was the first operator in the Middle East to launch 3G services, and did so in December 2003 using Universal Mobile Telecommunication System (UMTS) technology. In its first two years of operations, Etisalat was able to capture 8,700 3G subscribers. However, it added 16,300 3G subscribers in the first 9 months of 2006, bringing its total number of subscribers to 25,000, or 0.5% of its total subscribers.

It is our belief that 3G subscription has been slow to catch on in part because Etisalat wasn't forced to pay any additional license fee to the telecom regulator. Had 3G spectrum been purchased, we believe that there would have been more pressure on Etisalat to stimulate usage and add subscribers.

Competition

Etisalat is expected to enjoy a monopoly position in the UAE's cellular market until 1Q07, when Du launches its operations as the UAE's second mobile operator. Du will not only compete with Etisalat in the wireless segment but also in the fixed line and internet service markets.

Du entered the cellular market when it is fully saturated with a penetration rate of around 105%. Therefore, in order to gain market share, Du will have to offer attractive prices and innovative products. In anticipation of a second telecom operator's entrance into the UAE market, Etisalat announced a new strategic plan to diversify its product offerings in the local market. Etisalat will also undertake a regional expansion plan to diversify its sources of revenue.

The entrance of a second competitor into a saturated market will cause Etisalat to focus on increasing its 3G subscriber base and stimulating usage of value added services. In FY05 data services contributed 12.1% of cellular service revenues, and 7.9% of Etisalat's net operating revenue. Etisalat will augment this revenue segment in the future with several new products:

- **Video Streaming to Mobiles (VSTM):** Etisalat will provide 3G customers the opportunity to turn their mobile screens into televisions.
- **Multimedia Message Service (MMS) Roaming:** Etisalat plans to offer its subscribers the ability to send high bandwidth messages from anywhere in the world with help from its international roaming partners.
- **Mobile Payments:** Etisalat plans to issue a new service that will allow its customers to use their mobile phones as an alternative to credit cards. The customer will hold his mobile set near a suitably equipped vending machine and push a pin number in order to pay for purchases.
- **Mobiles for Children:** In order to penetrate a new market segment, Etisalat announced that it has reached an agreement with Spacetoon, a television channel for children, to offer mobile handsets for kids aged 6 to 14. The handset will allow kids to merge photos with Spacetoon characters.

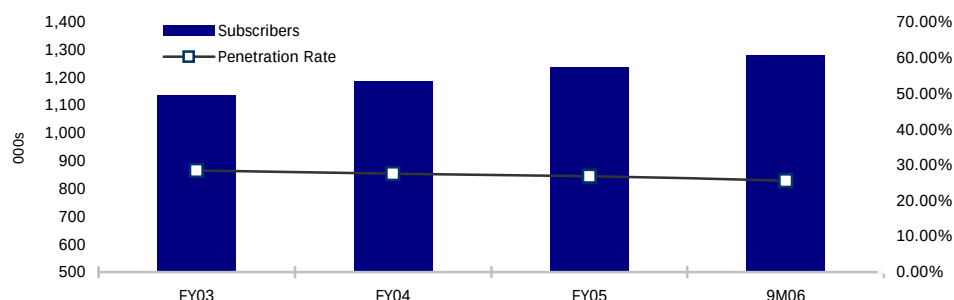
It is our belief that continuous growth in the UAE economy, driven by the hike in international oil prices, will set the stage for future growth in value added services. We will discuss Etisalat's regional presence in more details later.

2. Fixed Line

Fixed line operations are Etisalat's second major line of business and contributed around 22.2% of FY05 net operating revenue. Etisalat began fixed line services at its inception in 1976, and has maintained a monopoly since. Etisalat's penetration rate has been declining by around 1% annually over the last four years, from 28.8% in 2002 to 25.6% in 9M06. As a result, fixed line operations' share of operating revenue has declined from about 33% in FY02 to 22% in FY05. This is mainly because the UAE's population growth has been greater than Etisalat's subscriber growth. There are other reasons as well:

- The UAE fixed line market is almost saturated, with a household penetration rate of 89.6% and a total penetration rate of 25.6%, the second highest rate in the MENA region.
- Foreign residents, who make up 75% of the population, prefer using cellular lines, especially as they may not need a fixed line for an extended period.

Chart 3: Etisalat's Fixed Line Subs and Penetration Rate



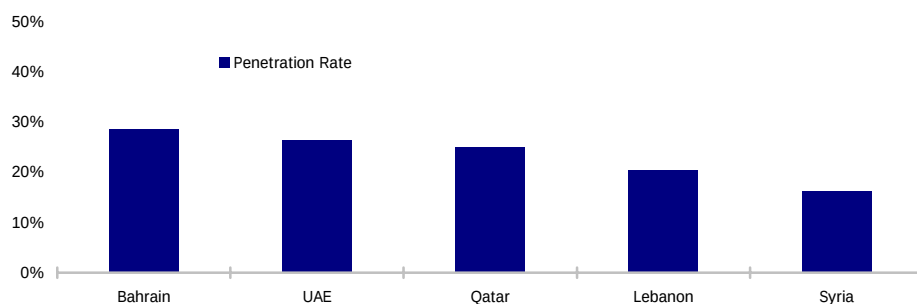
Source: Etisalat, HC Brokerage

Competition

Du, the UAE's second mobile operator, has entered a fully-saturated fixed line market. As a result, we believe that Etisalat will not face much competition because:

- We expect Du to focus on the cellular market, which has greater growth than the fixed line market.
- The capital expenditures that are required to build a nationwide fixed line network wouldn't generate enough future revenue to justify the investment.

Chart 4: MENA Region Top 5 Fixed Line Penetration Rate

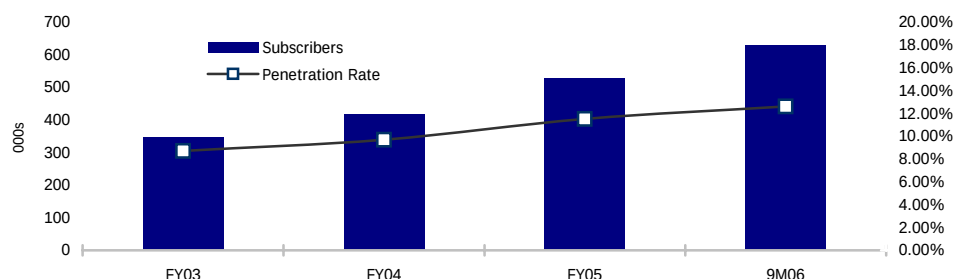


Source: Zawya, HC Brokerage

3. Internet

Internet services contributed around 6.2% of Etisalat's FY05 net operating revenue. Internet was first introduced in the UAE in 1995 with the launch of Integrated Services Digital Network (ISDN) in 1996 and Asymmetric Digital Subscriber Line (ADSL) in 2000. In June 2004, Etisalat founded eCompany, which offers advanced e-solutions and data services for corporate and retail customers. In July 2005, eCompany launched iZone, a public internet service that currently provides Wi-Fi broadband internet across 170 locations in the UAE. Residents can use this service through prepaid cards, and visitors can use it through their mobile handset roaming bill. Moreover, eCompany recently reached an agreement with Boeing to provide broadband internet at 30,000 feet for some of the world's top airlines.

Chart 5: Etisalat's Internet Subs and Penetration Rate



Source: Etisalat, HC Brokerage

Competition

We believe that the internet segment will see intense and severe competition in the future due to phenomenal growth in the corporate sector, which will require new and innovative communication solutions. In order to fulfill the needs and requirements of its corporate customers, Etisalat is currently launching several new products:

- **Internet Protocol – Virtual Private Network (IP – VPN):** Etisalat will provide secure voice, data, and video transmission, which will all be available internationally through several partnership agreements.
- **Corporate General Packet Radio Systems (GPRS):** Etisalat wants to use GPRS technology to increase the bandwidth of data transmission by facilitating connectivity from remote locations, where laying cable is not cost effective, or where there are requirements for full mobility.
- **IP Centrex:** Etisalat is exploring the use of IP Centrex to backhaul all voice, data, and computing requirements to a central location, operated and maintained by Etisalat.

4. Other Operating Revenue

Other operating Revenue includes cable TV, multimedia, and other related services. Etisalat introduced Pay TV services in 2000 through its subsidiary Emirates Cable TV and Multimedia. The expected economic boom should lead to significant near-term growth in this sector. In 2001, the UAE established Dubai Media City, a free zone area that allows 100% foreign ownership and guarantees freedom of speech for broadcasting channels. As a result, several international and regional media firms, including MBC, Reuters, CNBC, and CNN, have set up offices there.

Etisalat recently signed an agreement with STC and Iraq's Telecommunication and Post Co. to construct a submarine cable linking the UAE, Saudi Arabia, and Iraq. This will serve as another source of operating revenue.

IV. Regional Presence

1. Majority Stakes

a. Egypt

In July 2006, a consortium led by Etisalat won the bid for Egypt's third mobile license for USD2.9 billion, or a license fee per capita of USD39.8. The first runner-up was a consortium lead by Kuwait's MTC with a bid of USD2.5 billion. Etisalat owns 66% of its winning consortium, Egypt Post Office 20%, National Bank of Egypt 10%, and CIB 4%. Operations are expected to begin in 1Q07 under the commercial name "**Etisalat Misr**".

Table 6: Regional GSM License Fees Per Capita

Country	Population (Mil.)	Year of Acquisition	Operator	License Fee / Capita (USD)	GDP / Capita (USD)
Egypt	73.3	1998	MobiNil	8.1	1,340
Egypt	73.3	1998	Vodafone Egypt	8.1	1,340
Algeria	32.9	2001	Djezzy	23.7	2,775
Tunisia	10.1	2002	Tunisiana	46.4	2,860
Saudi Arabia	25.0	2004	Mobily	143.0	12,510
Pakistan	157.6	2005	PTCL	63.5	644

Source: Etisalat, Vodafone Egypt, Orascom Telecom, World Bank, HC Brokerage

Etisalat's mobile license in Egypt includes a 2G and 3G component. Should either of Egypt's other two mobile operators, MobiNil and Vodafone Egypt, wish to acquire a 3G license, each must pay around USD580 million (20% of the license fee paid by Etisalat).

MobiNil and Vodafone Egypt currently have a market share of 50.5% (8.1 million subscribers) and 49.5% (7.9 million subscribers), respectively, implying a penetration rate in Egypt of 21.9%.

Table 7: Egyptian Cellular Market Overview

	FY04	FY05	9M06
Population (000s)	71,501	72,503	73,267
I. MobiNil			
Number of Subscribers (000s)	4,016	6,696	8,106
Growth Rate (YoY)	34.3%	66.7%	35.2%
II. Vodafone Egypt			
Number of Subscribers (000s)	3,569	6,125	7,933
Growth Rate (YoY)	30.1%	71.6%	34.0%
III. Total Cellular Market			
Total Subscribers	7,585	12,821	16,039
Growth Rate (YoY)	32.3%	69.0%	34.6%
Penetration Rate	10.6%	17.7%	21.9%

Source: MobiNil, Vodafone Egypt, HC Brokerage

We forecast that the penetration rate in Egypt will reach 40.5% by the end of 2010, representing a total market of 31.6 million subscribers among a total population of 78.1 million. Our analysis suggests that Etisalat will capture 13.9% market share, or 4.4 million subscribers, by the end of 2010.

b. Afghanistan

In April 2006, Etisalat reached an agreement with the government of Afghanistan to acquire a 15-year cellular license for a total consideration of USD40.1 million. Afghanistan has a total population of around 25.8 million and very low GDP per capita: USD228. Purchasing power parity (PPP) adjusted GDP per capita is USD800.

As of June 30, 2006, there were 1.5 million subscribers in the Afghani market split between three telecom players, representing a very low penetration rate of 5.8%. A fourth operator will enter the market in 4Q06, and Etisalat is expected to join as the country's fifth operator in 1Q07.

We forecast that Afghanistan's penetration rate will reach 29.0% by the end of 2010, representing a total market of 8.4 million subscribers among a total population of 29.1 million. Our analysis suggests that Etisalat will capture 1.7 million subscribers by the end of 2010, representing a 20.0% market share.

2. Minority Stakes

a. Saudi Arabia

In August 2004, Etisalat was awarded a 25-year license to own and operate GSM and 3G services in Saudi Arabia for a fee of USD3.46 billion. The license was purchased by the **"Etihad Etisalat"** consortium, which is 35%-owned by Etisalat, 15%-owned by the Saudi General Organization for Social Insurance, and 30%-owned by five Saudi partners. 20% is traded as free float on the Saudi Stock Exchange. Operations began in May 2005 under the commercial name **"Mobily"**. Etisalat maintains management control.

Saudi Telecommunications Company (STC) held a monopoly in the Saudi telecom market until the Communication and Information Technology Commission (CITC), an independent market regulator, was established in 2001. CITC awarded Etihad Etisalat the second mobile license in 2004, and announced that two additional mobile licenses would be granted in 1H07.

When Mobily entered the Saudi market, STC had about 9.7 million subscribers and a penetration rate of about 41.0%.

Mobily added more than 2.2 million subscribers in its first 6 months of operations, raising Saudi Arabia's penetration rate to around 58.0% as of December 31, 2006. On September 30, 2006, Mobily's subscriber base had grown to 4.8 million, representing a market share of 28.4% and a penetration rate of around 67.1%. Mobily has been the fastest growing telecom company in the MENA region in terms of adding subscribers during its first year of operations.

Table 8: QoQ Key Performance Figures

SAR Mil.	1Q06	2Q06	3Q06	9M06
Operating Revenue	1,127	1,450	1,705	4,282
Cost of Service	519	646	749	1,914
Operating Expenses	276	353	398	1,028
Depreciation	201	213	216	630
Operating Profit	131	237	342	710
Operating Margin	11.6 %	16.4 %	20.1 %	16.6 %
Other Income (Expense)	(93)	(121)	(126)	(340)
Earnings Before Zakat	37	116	217	370
Zakat	0	0	0	0
Net Income	37	116	217	370
Net Margin	3.3 %	8.0 %	12.7 %	8.7 %
EBITDA	331	451	558	1,341
EBITDA Margin	29.4 %	31.1 %	32.7 %	31.3 %

Source: Mobily, HC Brokerage

Among Mobily's noteworthy key performance figures is its exponential sales growth since its launch in May 2005. Mobily first broke even in 1Q06, and has been able to increase profitability margins by 4% to 10% on a QoQ basis in the first 9 months of 2006.

Mobily is currently traded on the Saudi Stock Exchange (Tadawul) and has a market cap of SAR26.0 billion (USD6.93 billion).

b. Pakistan

In June 2005, Etisalat won a bid to acquire 26% of Pakistan Telecommunication Company (PTCL), with management control, for USD2.6 billion (USD1,000 per subscriber). Etisalat tried to reduce its offer to USD1.4 billion, the value of the second-highest bid, by China Mobile, but the Pakistani government refused. In the end, Etisalat reached an agreement with Pakistan to pay USD1.4 billion as an upfront fee, and the remaining USD1.2 billion in nine equal installments.

PTCL maintained a fixed line monopoly until 2003. Currently, Pakistan has around 5.3 million fixed line subscribers, resulting in a very low penetration rate of about 3.4%. PTCL has a market share in the fixed line segment above 95.0%.

In the cellular market, PTCL has around 7.5 million subscribers and about 20.2% market share through its subsidiary "PTML". Six players operate in Pakistan, which has a population of 157.6 million and a penetration rate of 23.6%.

Table 9: PTCL Key Historical Financial Indicators

Figures in USD Mil.	FY05	FY06	1Q07
Income Statement			
Operating Revenue	1,404	1,386	358
EBITDA	867	743	197
EBITDA Margin	61.8%	53.6%	55.0%
Net Income	456	376	97
Net Margin	32.5%	27.1%	27.0%
Balance Sheet			
Total Debt	265	270	252
Total Equity	1,664	1,797	1,894
Total Assets	2,528	2,909	3,000
Debt / Equity	0.16x	0.15x	0.13x
ROA	18.0%	12.9%	12.9%
ROE	27.4%	20.9%	20.4%

* The company's financial year ends on June 30th.

** Exchange Rate Used: Pakistani Rupee 1 = USD0.0167

Source: PTCL, HC Brokerage.

PTCL is currently traded on the Pakistani Stock Exchange and has a market capitalization of USD4.1 billion.

c. Atlantique Telecom: West and Central Africa

In April 2005, Etisalat acquired a 50% stake in “**Atlantique Telecom**,” a major African mobile operator, for around EUR100 million. Included in the deal was a 10-year management contract, through which Etisalat earns a management fee of EUR2.0 million. Atlantique Telecom has operations in seven countries: Benin, Burkina Faso, Central African Republic, Gabon, Ivory Coast, Niger, and Togo.

Table 10: Atlantique Telecom's Operating Markets (December 2005)

Country	Population (000s)	GDP Per Capita	GDP Per Capita (PPP Adjusted)	Number of Mobile Operators	Penetration Rate
Benin	8,400	USD512	USD1,100	4	5.3%
Burkina Faso	13,200	USD394	USD1,200	2	4.3%
Central African Republic	4,000	USD350	USD1,100	2	1.5%
Cote d'Ivoire	18,200	USD885	USD1,600	2	12.1%
Gabon	1,400	USD5,786	USD7,000	3	47.0%
Niger	14,000	USD243	USD1,000	2	2.2%
Togo	6,100	USD361	USD1,600	2	7.2%
Total	65,300	USD623	USD1,411	17	7.2%

Source: World Bank, CIA Factbook, Information Telecommunication Union (ITU), HC Brokerage

Atlantique Telecom does not disclose subscriber figures for the markets it operates in; however, we estimate that in December 2005 the company had around 950,000 subscribers for its operations in Benin, Burkina Faso, Central African Republic, Gabon, Niger, and Togo. Operations in Cote d'Ivoire commenced in July 2006.

Atlantique Telecom presents an attractive investment opportunity for Etisalat: it has operations in 7 countries, which combined have a total population of around 65.3 million people and a very low weighted average penetration rate of 7.2%.

However, we believe that poverty will remain the main hurdle to expanding penetration rates. These 7 countries have a weighted average GDP per capita of around USD623 (PPP adjusted average GDP per capita of around USD1,411). Moreover, poor infrastructure and political instability in the region will persist, providing another obstacle for significant subscriber growth.

d. Sudan

Table 11: Sudanese Telecom Market

	2003	2004	2005
Population (000s)	32,900	35,500	36,200
GDP Per Capita (USD)	377	608	765
Mobile Subscribers (000s)	720	1,050	2,230
Penetration Rate	2.2%	3.0%	6.2%
Fixed Line Subscribers (000s)	937	1,029	1,160
Penetration Rate	2.8%	2.9%	3.2%

Source: ZAWYA Dow Jones, Sudatel, HC Brokerage

i) Kanartel

In November 2004, Etisalat was awarded the second fixed line license service in Sudan through its consortium “**Kanartel**” for a total consideration of EUR45 million. Etisalat owns a 40% stake in the consortium.

ii) Sudan Telecommunications Company (Sudatel)

Etisalat owns a 4.6% stake in Sudan Telecommunications Company (Sudatel), which it purchased for AED37.5 million. Sudatel is Sudan's major fixed line provider, and until February 2006 provided mobile services through its 61% owned subsidiary "Mobitel," which it then sold to MTC for USD1.3 billion. At the time of its acquisition, Mobitel had 1.96 million subscribers, representing an 88% market share of 36.2 million total subscribers. Sudan has a penetration rate of 6.2%.

e. Other Investments

i) Thuraya Satellite Telecommunication Company: Etisalat owns 26% of Thuraya, which was established in 1997 by a consortium of regional telecom operators, including Etisalat, Qatar Telecom, MTC, Telecom Egypt, and Sudan Telecommunications Company.

Thuraya offers relatively cheap satellite-based mobile telephone services with data, fax, and high-speed internet services to around 130 countries in Europe, Africa, Middle East, and Asia, covering an estimated total population of about 2.3 billion.

Thuraya has a current subscriber base of around 341,000, and total assets of AED3.19 billion. In FY05, the company generated total revenues of AED1.18 billion, and earned a net profit of AED296 million.

ii) Zanzibar Telecom: Etisalat purchased 34% of Zanzibar Telecom Company in the United Republic of Tanzania at an investment cost of AED10.4 million. As of December 31, 2005 the Tanzanian market had a penetration rate of 5.2% out of a total population of 38.3 million, and a GDP per capita of USD316 (PPP adjusted GDP per capita of USD700).

iii) Qatar Telecom: Etisalat purchased 1% of Qatar Telecom (QTel) at an investment cost of AED37.5 million. Qatar Telecom has a monopoly in Qatar, which had a penetration rate of around 107% as of September 2006 for a total population of 0.8 million. The country's GDP per capita in 2005 amounted to USD53,890.

V. What Lies Ahead: Expansion Opportunities

In order to overcome local market saturation and new expected competition, Etisalat announced that it will implement a regional expansion plan to diversify its sources of revenue. Etisalat has already spent about USD5.92 billion acquiring licenses in Saudi Arabia, Egypt, Sudan, and Afghanistan, in addition to purchasing existing operations in Pakistan, and Central and West Africa, at an average acquisition cost per subscriber of USD770.

Moreover, Etisalat announced its intention to invest a further USD13.62 billion over the next 3–4 years in order to become a member of the top 10 club for total cellular subscribers globally. There are several markets in which Etisalat could implement this aggressive expansion plan.

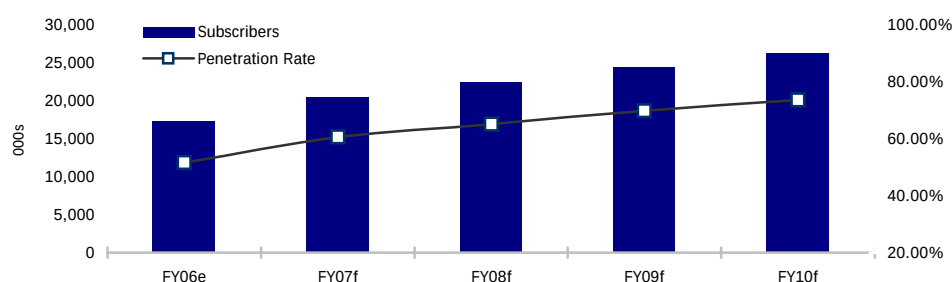
1. MENA Region

a. Algeria

The Algerian government has announced its intention to privatize a 35% stake in Algérie Telecom. Several companies have expressed interest, including major West European operators like Telefonica SA, France Telecom, and Portugal Telecom. Algérie Telecom is Algeria's major fixed line operator with an estimated subscriber base of more than 3.2 million, representing a market share of more than 95%. Algérie Telecom is also Algeria's second largest mobile operator, with around 2.8 million subscribers as of September 30, 2006, representing a market share of about 18.0%.

The Algerian cellular market is currently divided between three players: Orascom Telecom, Algérie Telecom, and Wataniya, and has a current penetration rate of around 44.0%, or 14.6 million subscribers. Our projections indicate that the penetration rate in the Algerian market will reach 73.7% by the end of 2010.

Chart 6: Algeria's Forecasted Subscribers and Penetration Rate



Source: HC Brokerage

b. Lebanon

The Lebanese government previously announced its intention to offer two mobile licenses for sale before the end of 2006. However, recent Israeli attacks and an aggravated political situation have delayed the offering, which will likely be postponed until at least 2H07. Currently, the Lebanese market is divided equally between two players, MTC and Fal Dete, which both run their businesses through a management contract granted by the government.

c. Libya

The Libyan market is very attractive given its low penetration rate, 7.1% as of December 31, 2005 for a total population of around 5.9 million, and its GDP per capita of USD6,576 (PPP adjusted GDP per capita of USD11,800). The Libyan market is currently divided between two governmental operators: Al Madar and Libyana. There are rumors that a stake in each operator will be privatized.

d. Syria

The Syrian market is also currently divided between two players: Syriatel and Areeba (MTN Investcom), which have a market share of 53.4% and 46.6%, respectively. As of December 31, 2005 the Syrian market had a penetration rate of 16.5%, for a total population of about 19.0 million, and GDP per capita of USD1,384 (PPP adjusted GDP per capita of USD3,900). The Syrian government plans to offer a third mobile license in 1Q08, which we expect Etisalat to be interested in.

Table 12: Potential Cellular Markets in the MENA Region for Etisalat

Country	Population (000s)	GDP Per Capita	GDP Per Capita (PPP Adjusted)	Number of Mobile Operators	Penetration Rate
Algeria	32,900	USD3,109	USD7,200	3	41.9%
Lebanon	3,600	USD6,167	USD6,000	2	28.2%
Libya	5,900	USD6,576	USD11,800	2	7.1%
Syria	19,000	USD1,384	USD3,900	2	16.5%

* Figures are as of December 31, 2005

Source: World Bank, CIA Factbook, ZAWYA Dow Jones, HC Brokerage

2. Other Possible Cellular Markets

a. Nigeria

In July 2006, Etisalat formed a consortium with British Telecom and Nigeria's Transportation Corporation to acquire a 75% stake in the Nigerian government-owned "Nitel," which is a fixed line operator with a subsidiary, "MTEL," for cellular operations. The deal was concluded for a total consideration of USD750 million, which required payment of USD500 million by mid-July 2006 and USD250 million by mid-September 2006. However, following Etisalat's purchase of Egypt's 3rd mobile license on July 4, 2006 for USD2.9 billion, enthusiasm for the Nigerian operation fell, and Etisalat failed to pay the Nigerian government on time. The Nigerian National Council for Privatization is currently discussing potential termination of the deal.

b. West and Central Africa

Etisalat has plans to increase the number of markets that its 50%-owned subsidiary Atlantique Telecom operates in from 7 to 10 in the next 2–3 years by establishing operations in West and Central Africa. Such a move would create synergies among the group's existing operations in the region.

c. Europe

Etisalat previously announced its intention to acquire Greek mobile operator "TIM Hellas," but after studying the deal's economics, the choice was made not to pursue a bid. However, Etisalat has stated that it is still looking for other opportunities in Europe. We believe that Etisalat may be eyeing Armenia and Russia.

3. Other Possible Investments

a. Saudi Arabia

Etisalat plans to bid for Saudi Arabia's second fixed line license, which should be granted in 1H07, to provide a full array of services in the Saudi market. STC currently holds a monopoly in the Saudi fixed line market, which has an estimated penetration rate of around 16%, and a household penetration of 80%, based on an average family size of 5 people.

b. Egypt

To complement its recently acquired Egyptian cellular license, Etisalat plans to bid for an international telephone license, which is expected to be granted in 1H07. Telecom Egypt currently has a monopoly on international calls, which generated revenues in excess of USD400 million in FY05.

VI. Financial Review of Results

9M06: Significant Growth and Improved Profitability

Etisalat's 9M06 net operating revenue rose 26.2% to AED11.82 billion, from AED9.36 billion in 9M05. Significant increases to Etisalat's subscriber base drove the growth.

Table 13: Evolution of Etisalat's Subscriber Base and Operating Revenue

	1Q06	1H06	9M06
Cellular Subscribers	4,766	4,996	5,260
Growth Rate (QoQ)	5.1%	4.8%	5.3%
Growth Rate (YoY)	23.0%	22.8%	22.2%
Fixed Line Subscribers (000s)	1,251	1,266	1,280
Growth (QoQ)	1.1%	1.2%	1.1%
Growth (YoY)	4.0%	4.7%	4.3%
Internet Subscribers (000s)	570	606	630
Growth (QoQ)	8.2%	6.2%	4.0%
Growth (YoY)	31.0%	62.9%	34.1%
Quarter Sales (AED Million)	3,685	4,058	4,072
Growth (QoQ)	5.2%	10.1%	0.4%
Total Sales (AED Million)	3,685	7,743	11,815
Growth (YoY)	21.4%	24.9%	26.2%

Source: Etisalat, HC Brokerage

By capitalizing on subscriber base growth, achieving better synergies and reducing its cost structure, Etisalat has improved its profitability margins by 3–5%.

Table 14: Etisalat's 9M06 Income Statement

AED Million	9M06	9M05	Growth
Operating Revenue	11,815	9,362	26.2%
Operating Expenses	2,322	2,171	7.0%
Depreciation	957	914	4.7%
Operating Profit	8,537	6,277	36.0%
Operating Margin	72.3%	67.1%	
Interest Expense	76	0	100.0%
Other Income (Expense)	330	185	78.3%
EBT	8,791	6,462	36.0%
Taxes (Royalty Fee)	4,386	3,231	35.7%
Net Income Before Minority	4,405	3,231	36.3%
Minority Interest	19	0	100.0%
Net Income	4,386	3,231	35.7%
Net Margin	37.1%	34.5%	
EBITDA	9,494	7,191	32.0%
EBITDA Margin	80.3%	76.8%	

Source: Etisalat, HC Brokerage

Etisalat's total assets grew by a whopping 60.7% during 9M06, from AED24.06 billion in December 2005 to AED38.65 billion in September 2006. Contributing to the jump was: the AED9.61 billion represents the acquisition of 26% of Pakistan Telecommunication Company (PTCL), operating license fees for Egypt, AED7.06 billion, and Afghanistan, AED0.14 billion.

Etisalat has fueled this growth, which has resulted in a 21.7% increase in shareholders' equity, from AED15.73 billion to AED19.14 billion, through company profits and AED6.98 billion in long-term debt.

Binding Growth

Etisalat announced on July 17, 2006, that it had reached an agreement with a consortium of 22 banks to establish a USD3.0 billion line of credit. The facility is available for 1 year from the agreement date at an interest rate of LIBOR + 22 basis points, and is renewable for a second year at Etisalat's discretion for LIBOR + 25 basis points. As of September 30, 2006, Etisalat had drawn USD1.9 billion from the line of credit.

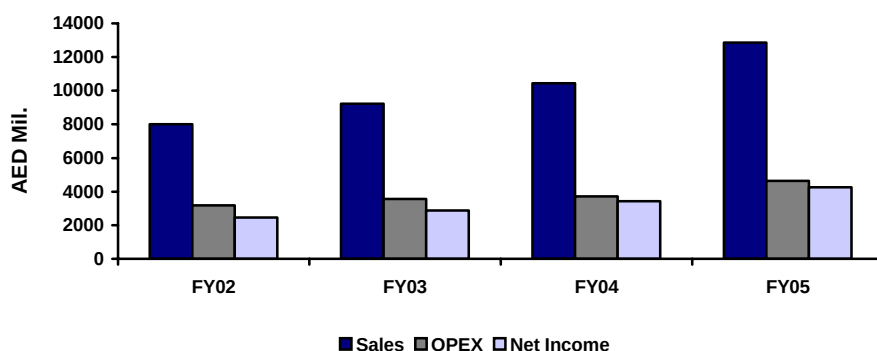
Etisalat was able to gain such ease of access to credit both because of its strong financial position and because it had previously been debt free. Currently, Etisalat has a debt/equity ratio of just 0.4x.

Historical Performance (FY02 – FY05)

Etisalat's sales grew at an average annual rate of 17.2% from 2002 to 2005. During this period, sales increased by 60.7%, from AED8.00 billion in FY02 to AED12.87 billion in FY05 (AED11.82 billion in 9M06). Substantial subscriber growth, from 2.4 million on December 31, 2002 to 4.5 million on December 31, 2005 (5.3 million on September 30, 2006), was the main driver of the top line, and was possible due to:

- Etisalat's monopoly position in the UAE market.
- A significant economic boom in the UAE following the hike in international oil prices.

Chart 7: Historical Performance



Source: Etisalat, HC Brokerage

Profitability Margins

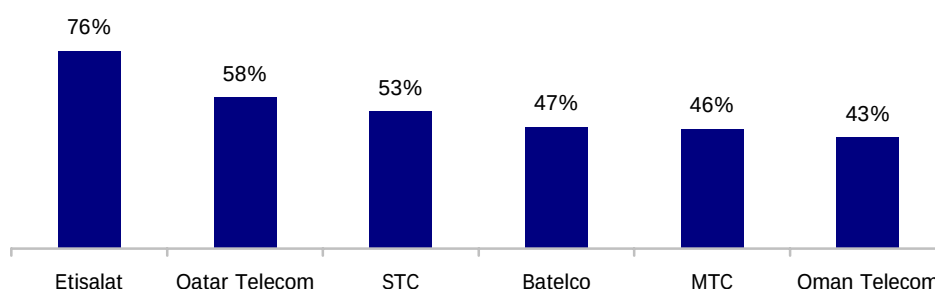
From FY02 to FY05, Etisalat was able to achieve sales growth slightly higher than increases in operating expenses, which meant that margins improved. The operating margin rose from 60.3% to 64.0%, while the net margin increased from 30.7% to 33.1%.

Etisalat has reached agreements with several international equipment vendors to upgrade its network as it expands its operations, and the resulting CAPEX has raised depreciation and amortization expenses. From 2002 to 2005, depreciation represented an average of 35% of operating expenses; thus Etisalat has been able to achieve high and stable EBITDA margins, in the range of 75–77%.

Etisalat is among the world's most efficient telecom operators, with an EBITDA margin of 75.0% in FY05 and 80.3% in 9M06. Etisalat's monopoly in a country with GDP per capita of USD28,760 has been a major factor in maintaining such high margins. When the UAE's second telecom operator begins operations, and as Etisalat expands regionally over the next few years, we expect the EBITDA margin to decline significantly.

Chart 8: GCC Peer Group Benchmarking

EBITDA Margin



For the latest available financial year.

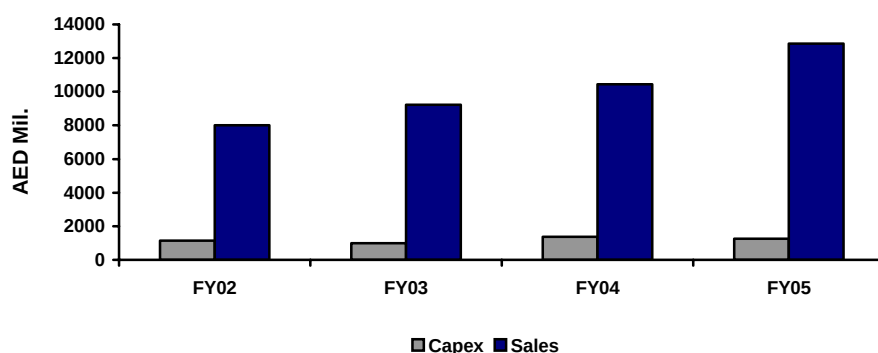
Source: Company Financial Reports, Bloomberg, HC Brokerage

Steady Expansion

Etisalat's expansion – assets grew by 49.8% between 2002 and 2005, from AED16.06 billion to AED24.06 billion (AED38.65 billion in 9M06) – has primarily come from building its core operations: improving the company's network and building its subscriber base.

Etisalat spent AED4.76 billion (USD1.30 billion) on CAPEX from FY02–05, and 9M06 CAPEX amounted to AED977 million (USD266 million). In FY05, CAPEX represented 9.8% of total sales. Future CAPEX for the UAE operations should be limited and consist mainly of maintenance and upgrades; however, building networks in Egypt and Afghanistan will require substantial CAPEX, especially in the first years of operation. Etisalat's profitability has allowed it to finance such spending without taking on any debt.

Chart 9: CAPEX / Sales (FY02 – FY05)



Source: Etisalat, HC Brokerage

Excess Liquidity

Despite substantial cash outlays from 2002 to 2005 of around AED4.76 billion, Etisalat has maintained a very strong liquidity position. Etisalat's continuously growing operating revenues have enabled it to finance expansion, but without affecting liquidity. The latest financial results show that as of September 30, 2006 Etisalat had a cash balance of AED7.66 billion (USD2.09 billion).

Etisalat's excess cash, along with its low debt/equity ratio of only 0.4x, gives it an advantage in implementing its regional acquisition plans.

Table 15: Key Liquidity Indicators

	FY02	FY03	FY04	FY05	9M06
Current Ratio	1.19	1.49	1.43	1.64	1.19
Cash Ratio	0.99	1.32	1.17	1.22	0.89

Source: Etisalat, HC Brokerage

VII. Forecasts & Valuation

1. UAE

Etisalat has maintained a monopoly in the UAE, which as of September 30, 2006 had 5.3 million mobile subscribers, representing a penetration rate of around 105.2%. The UAE's 1.3 million fixed line subscribers represent a penetration rate of 25.6%, and 0.6 million internet subscribers represent a penetration rate of around 12.6%.

Starting from 1Q07, Etisalat will lose its monopoly when Du launches its operations as the UAE's second telecom operator. Because the cellular and fixed line markets are saturated, we believe that competition between service providers will mainly be based on attractive prices and innovative products. We also believe that Etisalat has the means to remain the market leader in both segments. Our forecasts indicate that within the next 5 years Du will be able to capture 28% market share in the cellular market, and 7% market share in the fixed line market.

Even though competition in a saturated market will lead to lower ARPUs for Etisalat's operations, we nonetheless expect that Etisalat will be able to maintain slight growth in its top line sales for the UAE. Main growth drivers include:

1. Boosted data revenue through use of value added services and 3G technology.
2. An increase both the number of foreign workers and GDP per capita following robust economic growth.
3. Higher broadband usage among corporate customers as the economy booms.

Table 16: Revenue Assumptions

	FY06e	FY07f	FY08f	FY09f	FY10f
Population	5,100	5,500	5,800	6,000	6,200
1. Cellular and Data Revenue					
Penetration Rate	110.0%	114.0%	117.0%	119.0%	120.0%
Market Share	100%	90.0%	80.0%	75.0%	72.0%
Etisalat Subscribers (000s)	5,610	5,643	5,429	5,355	5,357
Total Cellular Revenue (AED Mil.)	10,610	10,510	9,908	9,676	9,679
2. Fixed Line Revenue					
Penetration Rate	25.4%	25.4%	25.4%	25.4%	25.4%
Market Share	100.0%	99.0%	97.5%	95.5%	93.0%
Etisalat Subscribers (000s)	1,297	1,385	1,438	1,457	1,466
Total Fixed Line Revenue (AED Mil.)	3,112	3,057	3,112	3,184	3,236
3. Internet					
Penetration Rate	13.0%	15.0%	16.5%	18.0%	19.0%
Market Share	100.0%	96.0%	91.0%	87.0%	84.0%
Internet Subs (000s)	663	792	871	940	990
Total Internet Revenue (AED Mil.)	1,193	1,568	1,845	2,070	2,224
4. Other Revenue	942	1,130	1,356	1,560	1,716
Total Net Sales (AED Mil.)	15,857	16,265	16,221	16,490	16,855

*Other revenue includes cable television, multimedia, and other related services.

Source: HC Brokerage

2. Egypt

Egypt's cellular market has historically grown steadily, from 194,000 subscribers at the end of 1998 to 5.7 million by the end of 2003, and 16.0 million in September 2006. But in 2005, Egypt saw its fastest cellular growth ever: an increase of 69%, from 7.6 million subscribers on January 1, 2005 to 12.8 million subscribers on December 31, 2005. The penetration rate subsequently increased from 10.6% in 2004 to 17.7% in 2005. The main drivers for cellular growth were:

- The introduction of new attractive prepaid plans.
- 5.0% growth in Egypt's GDP in 2005.
- The introduction of a new tax law which reduced taxes on personal income to a flat 20%, which resulted in increased disposable income.
- Steady population growth and a low penetration rate, especially compared to regional markets.

Egypt's total number of cellular subscribers rose from 12.8 million on January 1, 2005 to 16.0 million on September 30, 2006, implying 25.1% growth. In Egypt's market two mobile operators, Mobinil and Vodafone Egypt, currently have a share of 50.5% (8.1 million subscribers) and 49.5% (7.9 million subscribers), respectively.

Starting in 2007, the Egyptian cellular market duopoly will turn into a 3-player market when Etisalat begins operations, following its consortium's winning bid of USD2.9 billion, plus royalties of 6% of gross operating revenue, for Egypt's 3rd mobile license. The consortium is 66% owned by Etisalat, 20% by the Egyptian Post Office, 10% by National Bank of Egypt, and 4% by CIB.

Etisalat is expected to launch its Egyptian operations in 1Q07, as soon it rolls out its network in Cairo, Alexandria, Hurghada, and Sharm Al Sheikh. There will be a two year period during Etisalat can use the networks of Mobinil and Vodafone Egypt in other governorates. Within its first year of operations, following the roll out of a 3G network, Etisalat is expected to start providing its 3G services.

We estimate that Etisalat will spend around AED5.51 billion (USD1.5 billion) over the next three years rolling out a nationwide 2G network, and a 3G network in select large cities.

Our projections also suggest that Etisalat will be able to attract 800,000 subscribers in its first year of operations, and by the end of 2010 capture a market share of around 13.9%, in a market of 31.6 million with a penetration rate of about 40.5%.

Table 17: Egyptian Cellular Market Assumptions

	FY06e	FY07f	FY08f	FY09f	FY10f
Population (000s)	73,590	74,694	75,815	76,952	78,106
Penetration Rate	22.6%	27.9%	33.0%	37.4%	40.5%
Total Cellular subscribers (000s)	16,667	20,834	25,001	28,751	31,626
Etisalat Market Share	0.0%	3.8%	8.8%	12.0%	13.9%
Etisalat Total Subscribers (000s)	0	800	2,189	3,439	4,397

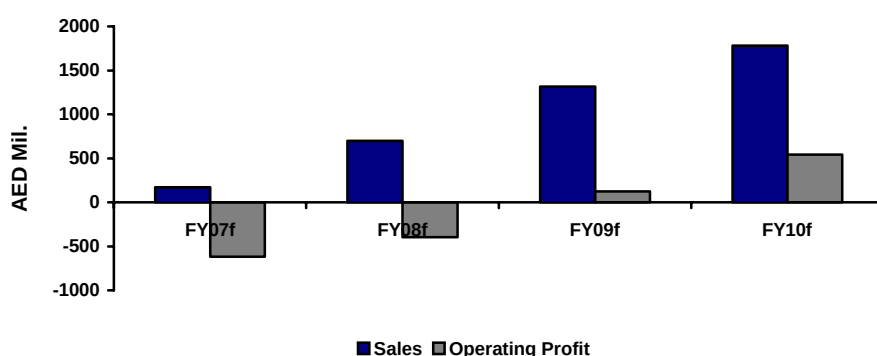
Source: HC Brokerage

We expect increased competition in Egypt to result in better quality of service and new innovative prepaid plans. Market growth will be spurred by the following factors:

- A low cellular penetration rate, especially within the region.
- Forecasted real GDP growth of 7–8% over the next 3–5 years.
- Steady population growth of 1.5% per annum.

According to our projections, Etisalat will be able to breakeven in terms of EBITDA, operating profit, and net income in FY08f, FY09f, and FY10f, respectively. Starting in FY11f, Etisalat should be able to maintain an EBITDA margin of about 40.0%.

Chart 10: Etisalat Misr's Forecasted Performance



Source: HC Brokerage

3. Afghanistan

As of June 30, 2006 the Afghanistan market had 1.5 million subscribers, representing a very low penetration rate of around 5.8%, which is split between three telecom players. A fourth cellular operator will enter the market in 4Q06, and Etisalat is expected to join as a fifth operator in 1Q07.

We forecast that Afghanistan's penetration rate will reach 29.0% by the end of 2010, representing a total market of 8.4 million subscribers, based on total population of 29.1 million. Our analysis suggests that Etisalat will capture 1.7 million subscribers by the end of 2010, representing a market share of 20.0%.

Table 18: Afghani Cellular Market Assumptions

	FY06e	FY07f	FY08f	FY09f	FY10f
Population (000s)	26,200	26,986	27,661	28,352	29,061
Penetration Rate	8.0%	14.0%	20.0%	25.0%	29.0%
Total Cellular Subscribers (000s)	2,096	3,778	5,532	7,088	8,428
Etisalat Market Share	0.0%	5.0%	10.0%	15.0%	20.0%
Etisalat Total Subscribers (000s)	0	189	553	1,063	1,686

Source: HC Brokerage

Afghanistan has a total population of around 25.8 million and a very low GDP per capita: USD228 (PPP adjusted GDP per capita of USD800). As a result, we forecast an ARPU of only USD4.0 in the Afghani market.

FY06e top line growth, plus better cost management, trickles down into healthy net earnings

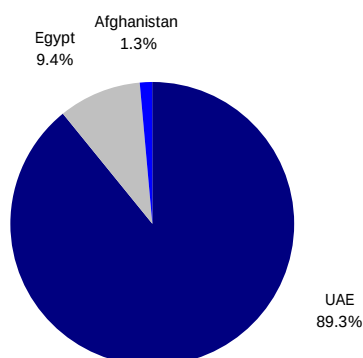
Sustained Top Line Growth from FY02a to FY10f

We believe that Etisalat is set to deliver AED15.86 billion in FY06e sales, up 23.3% YoY. And in FY07f the top line should grow 3.7% YoY to AED16.45 billion as the UAE's second telecom operator enters the market and ARPUs decline by 10%. However, starting in FY07f we believe that Etisalat will maintain continuous growth in its top line operations, but with lower growth rates than the FY02-06e average of 16%.

Continuous sales growth will be catalyzed by the following factors:

- A growing UAE economy will lead to an increased investments, which will lead to higher GDP per capita and growth in cellular and fixed line penetration rates, even as the population grows.
- More 3G subscribers will boost data revenue through value added services.
- The acquisition of new cellular licenses in Egypt and Afghanistan.

Chart 11: Etisalat's FY10f Sales Breakdown



FY10f

Source: HC Brokerage

Etisalat's operating margin and EBITDA margin will drop by around 7% starting in FY07f as operations begin in both Egypt and Afghanistan. Our analysis suggests that Etisalat will breakeven, in terms of operating profit, starting FY09f in Egypt and FY10f in Afghanistan.

Table 19: Key Indicators (FY05a – FY08f)

AED Mil.	FY05a	FY06e	FY07f	FY08f
Sales	12,866	15,857	16,449	16,979
<i>Growth in Sales</i>	<i>23.3%</i>	<i>23.3%</i>	<i>3.7%</i>	<i>3.2%</i>
Operating Profit	8,232	10,930	10,125	10,260
<i>Operating Margin</i>	<i>64.0%</i>	<i>68.9%</i>	<i>61.6%</i>	<i>60.4%</i>
Total Assets	24,055	38,669	42,181	44,778
<i>Growth in Total Assets</i>	<i>18.0%</i>	<i>60.7%</i>	<i>9.1%</i>	<i>6.2%</i>

Source: Etisalat, HC Brokerage

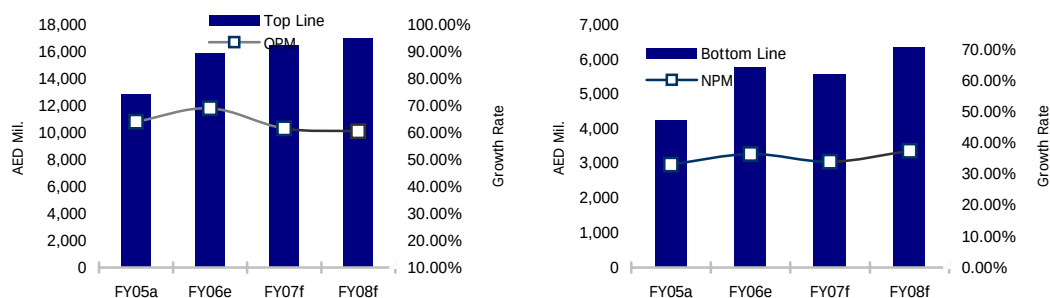
Fluctuations in Bottom Line Margin

We expect Etisalat to post net income of AED5.77 billion (EPS of AED1.27) in FY06, a 35.6% rise YoY from AED4.26 billion (EPS of AED0.94) in FY05. Our assumption is that the key driving factor for growth will be higher sales coupled with a better cost management, thus improving the EBITDA and net margins. In addition, we believe that Etisalat will record investment income of around AED313 million from its 26%-owned Pakistani operation.

We forecast that net income will drop to AED5.58 billion (EPS of AED1.23) in FY07f due to expected losses for operations in Egypt and Afghanistan. As a result, the net margin should decline from 36.4% to 34.0%. However, from FY08f to FY10f the net margin will gradually rise until it reaches 41.0%.

A continuous increase in the net margin will be on the back of expected investment income from operations in Saudi Arabia and Pakistan, and diminishing losses from operations in Egypt and Afghanistan, both of which will break even in terms of net income in FY10f.

Chart 12: Etisalat's Top Line and Bottom Line Performance (FY04a – FY07f)

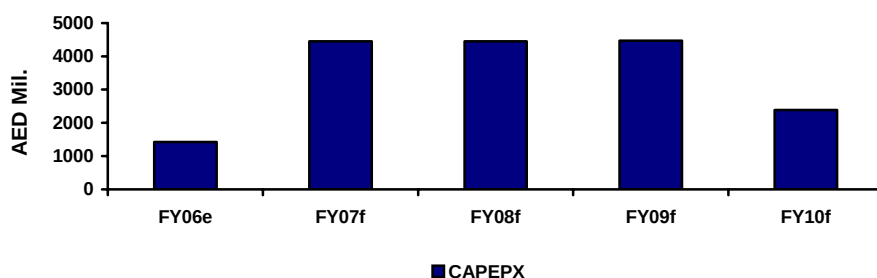


Source: Etisalat, HC Brokerage

FY06e CAPEX bill estimated at AED1.4 billion

Etisalat spent around AED5.5 billion (USD1.5 billion) on CAPEX over the last three years improving its network and fully rolling out its 3G network in the UAE. In 9M06, Etisalat spent AED977 million on CAPEX, and in FY06 is expected to spend AED1.4 billion, or 9% of total sales. CAPEX spending for FY07 to FY09 is expected to reach AED13.4 billion as Etisalat rolls out new networks in Egypt and Afghanistan. And starting from FY10, we believe that Etisalat will spend around 10% of total sales on CAPEX annually, mainly for maintenance and capacity upgrades.

Chart 13: CAPEX (FY06e – FY10f)



Source: HC Brokerage

Our DCF Valuation Implies a Target Price of AED23.1/share

Based on a DCF target price of **AED23.1** per share, which offers 37.1% upside potential to the current market price of AED16.85, we are recommending **“Strong Buy”** for Etisalat.

Table 20: Share Sensitivity to WACC (AED)

Perpetual Growth Rate	10.9%	WACC 11.9%	12.9%
4%	24.7	21.2	18.6
5%	27.4	23.1	19.9
6%	31.1	25.5	21.6

Source: HC Brokerage

Valuation Assumptions

- In our DCF valuation we have consolidated Etisalat's operations in the UAE, Egypt, and Afghanistan.
- Etisalat's acquisitions, including Etihad Etisalat, PTCL, Kanartel, and Atlantique Telecom, have been accounted for using the equity method. These subsidiaries were not consolidated because Etisalat's share in these investments is less than 50%.
- We have applied a single WACC of 11.9%.
- We have estimated Etisalat's free cash flow for the next 5 years and assumed a perpetual growth rate of 5.0%, thereafter.
- We have not accounted for any further acquisitions by the company.

Royalty Fee

Etisalat currently pays 50% of its net income as a royalty fee to the UAE government in exchange for its monopoly. However, we expect that the royalty fee will gradually decline over the next few years as the telecom sector is liberalized.

Because we expect Du, Etisalat's competitor in the UAE, to record losses over its first three years in operation, we project that the royalty fee paid by Etisalat will remain at 50% in FY06e, FY07f, and FY08f. According to our estimates, the royalty fee should then decline to 45% in FY09f and 40% in FY10f.

If the **royalty fee** remains **50% through FY10**, we would **downgrade** our fair equity value to price **AED19.0** per share. However, if the royalty fee declines to **30% by FY10**, we **upgrade** our fair equity value to **AED26.3** per share.

Sensitivity Analysis

Case 1: A 10% Increase in Egyptian Operations: If Etisalat is able to generate revenues in Egypt 10% higher than our forecast assumptions, we upgrade our fair equity value to **AED23.25** per share.

Case 2: ARPU declines by a further 10% in the UAE: If the ARPU in the UAE declines by 10% more than we have forecasted, we downgrade our fair equity value to **AED22.1** per share.

Multiples Valuation price target of AED22.5

A multiples valuation for Etisalat suggests a **“Strong Buy”** recommendation, based on a target price of **AED22.5**, which offers 33.4% upside potential to the current market price of AED16.85. This multiples valuation is based on 2006 estimated results, which reflect the prevailing market conditions of Etisalat's peer group. We give a 75% weighting to the EV/EBITDA method, and a 25% weighting to P/E multiples.

The weighting of EV/EBITDA is disproportionate to P/E because it is a more indicative of Etisalat's value given the 50% royalty fee that Etisalat pays, which skews its P/E ratio. As the royalty fee declines in the future, subsequent valuations could rely more evenly on P/E.

Table 21: Etisalat's Multiples Valuation

AED	Weight	Target Value Per Share	Weighted Target Value Per Share
Multiples Valuation			
EV / EBITDA	75%	24.1	18.1
Price / Earnings (P/E)	25%	17.7	4.4
Total Value	100%		22.5

Source: Bloomberg, HC Brokerage

Table 22: Comparable Multiples

Company	Country	EV/EBITDA	P/E
West Europe			
Telecom Italia	Italy	9.7x	13.6x
British Telecom	England	9.3x	13.7x
Deutsche Telecom	Germany	8.7x	14.7x
Portugal Telecom	Portugal	8.5x	17.2x
France Telecom	France	5.3x	11.3x
Average		8.3x	14.1x
Middle East and Africa			
Orascom Telecom	Egypt	8.9x	17.8x
Maroc Telecom	Morocco	8.0x	16.8x
MTN	South Africa	7.2x	13.7x
Telecom Egypt	Egypt	5.8x	12.5x
Jordan Telecom	Jordan	4.7x	11.5x
Average		6.9x	14.5x
GCC			
Qatar Telecom	Qatar	16.0x	12.6x
MTC	Kuwait	13.9x	12.2x
Bahrain Telecom	Bahrain	9.5x	12.3x
STC	Saudi Arabia	8.3x	13.9x
Wataniya Telecom	Kuwait	7.2x	14.9x
Average		11.0x	13.2x
Weighted Average		8.7x	13.9x

Source: Bloomberg, HC Brokerage

The weighted average calculated using comparative multiples is based on equal allocations for GCC, Middle East, Africa, and West Europe.

VIII. Financial Statements

AED MM (unless stated otherwise)	05A	06E	07F	08F	09F
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Income Statement

Revenues	12,866	15,857	16,449	16,979	17,945
Operating Expenses	4,634	4,927	6,324	6,719	7,013
Operating Income	8,232	10,930	10,125	10,260	10,933
Interest Expense	0	122	377	293	209
Interest Income	280	420	332	332	321
Investment Income	0	313	867	1,143	1,291
Other Non Operating Income (Expenses)	0	2	2	2	2
Pre-Tax Income	8,512	11,543	10,950	11,444	12,312
Income Tax	4,256	5,771	5,475	5,722	5,541
Minority Interest	0	0	-110	-57	169
Net Inc. before Appropriations	4,256	5,771	5,584	5,779	6,603

Balance Sheet

Assets					
Cash & Marketable Securities	9,656	7,698	7,706	6,891	7,368
Net Receivables	2,853	2,247	2,331	2,406	2,543
Inventory	105	123	158	168	176
Other Current Assets	351	469	948	1,331	1,360
Total Current Assets	12,967	10,537	11,143	10,796	11,446
Net Fixed Assets and Projects Under Const.	7,111	8,378	10,855	12,884	14,491
Investments	2,573	12,517	12,948	13,295	13,799
Other Non Current Assets	36	7,237	7,235	7,233	7,231
Total Assets	24,055	38,669	42,181	44,207	46,967
Liabilities					
Short-Term Debt	0	1,396	1,400	1,396	1,397
Accounts Payable	6,176	7,757	9,957	10,579	11,041
Other Current liabilities	1,736	4,191	4,431	4,658	5,204
Total Current Liabilities	7,912	13,345	15,788	16,633	17,641
Long-Term Debt	0	5,585	4,188	2,792	1,396
Other Long Term Liabilities	417	413	409	405	400
Minority Interest	0	0	(110)	(167)	3
Shareholders' Equity	15,726	19,327	21,905	24,545	27,527

Free Cash Flow Statement

NOPLAT	4,040	5,329	4,903	4,936	5,759
Non-Cash Items	1,387	1,526	1,971	2,416	2,863
Gross Cash Flow	5,427	6,854	6,873	7,351	8,622
Gross Investments	(1,907)	(4,604)	(2,806)	(4,209)	(3,617)
Operating Free Cash Flow	3,520	2,250	4,067	3,142	5,006
Non-Operating Cash Flow	260	(9,249)	598	736	870
Free Cash Flow to Investors	3,260	(7,000)	4,665	3,878	5,876

IX. Etisalat in Brief

Company Overview

Emirates Telecommunications Corporation (Etisalat) was established in 1976 as a holding company to provide services in the UAE and the GCC. Today, Etisalat is a major telecom player in the Middle East, South Asia, and Africa and has operations in the UAE, Saudi Arabia, Pakistan, and several countries in West and Central Africa. In addition, Etisalat acquired two new cellular licenses in Egypt and Afghanistan. Operations in both countries are to begin in 1Q07. Etisalat has four major lines of business: mobile and data (65.5% of FY05 operating revenue), fixed line (22.2%), internet (6.2%), and other operating revenue (6.1%). Other operating revenue includes cable television and submarine cable. Etisalat is 60%-owned by the UAE government, while 40% is traded on the Abu Dhabi Securities Market. Currently the company has paid-in capital of AED4.54 billion, distributed over 4.54 billion shares with a par value of AED1 per share.

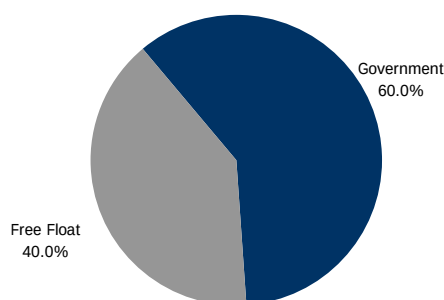
Key Attractions

- Etisalat is the market leader for all telecom activities in the UAE.
- Sales and profitability have grown continuously over the last four years.
- Etisalat has strong leverage, and a liquidity position that enables it to finance all necessary expansion.
- Expansion of operations outside the UAE will benefit from expected growth in emerging markets.

Key Concerns

- Saturation of local cellular and fixed line markets.
- Services are largely dependent on the economic conditions of the population.
- New competition at home might result in a price battle for capturing and/or maintaining market share.
- Strong expansion plans might backfire, if not properly managed.

Shareholder Structure



Investment Ratings

Stock Liquidity	Upside Potential					
High	>30%	30% to 20%	20% to 10%	10% to 0%	0% to -25%	Less than -25%
Mid	>35%	35% to 25%	25% to 15%	15% to 5%	5% to -20%	Less than -20%
Low	>40%	40% to 30%	30% to 20%	20% to 10%	10% to -20%	Less than -20%
Recommendation	Strong Buy	Buy	Accumulate	Hold	Reduce	Sell

HC Brokerage – Cairo, Egypt

HC Brokerage

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HC Securities & Investment

HC Securities & Investment, the holding company for HC group, owns HC Brokerage and Hussein Choucri Financial Advisors. Investment banking is engaged in raising capital and providing advice in the areas of corporate finance, mergers and acquisitions, restructuring, divestitures and spin-offs, capital market services, project finance and real estate. Asset management offers portfolio and mutual fund services.

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