

2Q2010 Results: Lower Fair Value on UAE Pressure

RESULTS REVIEW

TELECOMMUNICATIONS | UAE

≡ Cutting Fair Value: EBITDA Margin Underperforms Estimate for the Second Time

We lower our fair value (FV) estimate for Etisalat by 13% to AED12.5/share (from AED14.5/share) as a result of lowering our estimated equity value for the company's UAE operation given the disappointing EBITDA margin which again came weaker than expected. We also increase our total revenue estimates starting in 2010, reflecting mainly higher-than-expected revenue growth from the international operations and, to a lesser extent, from the UAE operation.

≡ Fundamentally Cheap so We Keep Our Buy Rating... Allowing Foreign Ownership is the Long-awaited Catalyst

After adjusting our forecasts, the company still trades at cheap multiples compared to the average multiples of regional telecoms. Etisalat trades at an estimated 2010 P/E of 10.4x (versus an average of 10.2x) and an estimated 2010 EV/EBITDA of 4.1x (versus an average of 5.3x). Given the 21% upside potential that our new FV offers over the current market price, we maintain our Buy rating on the stock. Again, we reiterate our view that the main catalyst for Etisalat's share price is allowing foreign ownership of the stock, a move that we do not know when to expect.

≡ What Is Happening in the UAE? It is Competition

Since the beginning of the year, Etisalat has been very active in launching new offers and promotions that mostly target the tariffs of the international, roaming and corporate segments. We do not believe that the decline in tariffs was matched by increases in traffic as we saw UAE revenue decline by 15% Q-o-Q in 1Q2010 and then stabilise in 2Q2010. We have also seen consolidated EBITDA margin come under pressure for the past three quarters, which we believe is due to pressure on the UAE operation.

KEY FINANCIAL HIGHLIGHTS

December Year End (AED mn)	2009a	2010e	2011e	2012e
Revenue	30,831	31,007	32,416	33,763
EBITDA	19,503	17,584	18,664	19,695
EBITDA Margin	63.3%	56.7%	57.6%	58.3%
Net Profit	8,836	7,882	8,295	8,806
EPS (AED)	1.12	1.00	1.05	1.11
DPS (AED)	0.49	0.40	0.40	0.42
Net Debt (Cash)	(9,354)	(8,993)	(8,516)	(8,171)
P/E* (Attrib.) (x)	9.3	10.4	9.9	9.3
EV/EBITDA (x)	3.6	4.1	3.8	3.6
P/BV* (x)	2.3	2.2	2.2	2.1
P/CF* (x)	8.9	7.4	7.4	7.4
Div. Yield	4.7%	3.8%	3.8%	4.1%

*Prices as at 26 July 2010

Source: Etisalat, EFG Hermes estimates



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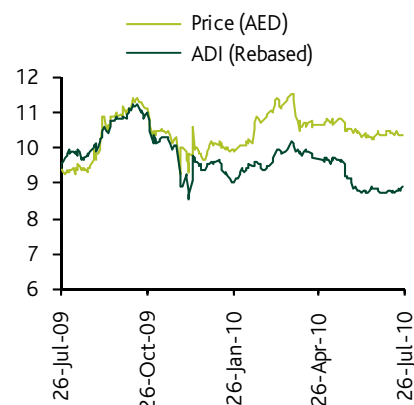
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STOCK DATA

Price	AED10.40*
Fair Value	AED12.54
Last Div. / Ex Date	AED0.35 on 01 Apr 2010
Mkt. Cap / Shares (mn)	AED82,224 / 7,906
Av. Mthly Liqdt (mn)	AED180.8
52-Week High / Low	AED11.55 / AED9.27
Bloomberg / Reuters	ETISALAT UH / ETELAD
Est. Free Float	40%

SHARE PRICE PERFORMANCE RELATIVE TO ADI REBASED





I. 2Q2010 RESULTS HIGHLIGHTS

RESULTS IN A NUTSHELL

Etisalat's top line for 2Q2010 was in line with our estimate, exhibiting a modest Q-o-Q growth on strong international growth. The EBITDA margin, however, disappointed again for the second quarter in a row and came in four percentage points below our estimate, at 54.4%. We do not know the reason behind the EBITDA margin weakness, but we do believe that the UAE operation could be under pressure as it contributes the most to the consolidated EBITDA.

We believe that income from associates surprised positively due to stronger-than-expected operational results at PTCL in Pakistan and Excelcomindo in Indonesia (Mobily had already posted its 2Q2010 results last week, which were integrated into our estimates for Etisalat's income from associates). Lastly, earnings were 9% below our estimates at AED1.9 billion and below consensus estimates.

REVENUE IN LINE – UAE MISSES BUT INTERNATIONAL COMPENSATES

Total revenue for 2Q2010 was in line with our estimate, coming in at AED8.1 billion (+1.5% Q-o-Q). UAE revenue contributed with 79% of the total and missed our forecast by 2%, while international revenue came in ahead of our estimate by 7%.

UAE: Etisalat was able to stabilise revenue generated from the UAE during 2Q2010 after the significant quarterly drop of 1Q2010. We believe that UAE revenue came in, however, 2% below our estimate due to one of the following reasons (we do not have a breakdown between mobile and fixed-line revenues at this stage): i) weaker-than-expected mobile usage levels since the mobile subscriber number was in line with our estimate, and/or ii) lower-than-expected fixed-line revenue, as fixed lines as at the end of June were 1.28 million, lower than our expected 1.29 million lines.

International: Revenue from international operations (Egypt, Afghanistan and Atlantique Telecom in Africa) surprised positively again during 2Q2010, growing 6% Q-o-Q, 7% higher than our estimate. We estimate that Egypt is the largest contributor to international revenue, at over 50%.

EBITDA MARGIN STILL WEAK

We have expected the EBITDA margin to improve in 2Q2010 to 58.3%, but it actually disappointed for the second quarter in a row, coming in at 54.4%. As mentioned above, we do not know the particular reason behind the margin weakness, but we do believe that the UAE operation could be under pressure as it contributes the most to the consolidated EBITDA.

ASSOCIATES SURPRISE POSITIVELY

Associates' contribution in 2Q2010 more than doubled on a Q-o-Q basis to AED219 million, mostly on strong performance at the Saudi operation, Mobily, the biggest contributor to the associates line, which saw its earnings increase 26% Q-o-Q during the quarter. We believe that income from associates was 35% higher than expected due to better performance at PTCL in Pakistan and Excelcomindo in Indonesia. Both companies are listed on their local stock exchanges, but have not yet published their detailed financials.

**FIGURE 1: ETISALAT QUARTERLY INCOME STATEMENT**

In AED million, unless otherwise stated

KPIs ('000's)	2Q09a	3Q09a	4Q09a	1Q10a	2Q10a	Y-o-Y	Q-o-Q	2Q10e	Var.
Active Mobile Subs (UAE)	7,260	7,440	7,740	7,710	7,800	7%	1.2%	7,765	0.5%
Mobile Additions	653	180	300	(30)	90			55	
FL Subs (UAE)	1,330	1,310	1,310	1,300	1,280	-4%	-1.5%	1,290	-0.8%
FL Additions	(19)	(20)	-	(10)	(20)			(10)	
Income Statement (AED mn)									
UAE Revenue	6,779	6,414	7,480	6,319	6,336	-6.5%	0.3%	6,473	-2.1%
International Revenue	846	949	1,244	1,625	1,729	104.4%	6.4%	1,623	6.5%
Total Revenue	7,625	7,364	8,724	7,945	8,065	5.8%	1.5%	8,096	-0.4%
Total Costs	(2,423)	(2,384)	(4,100)	(3,567)	(3,679)			(3,375)	
EBITDA	5,202	4,980	4,624	4,378	4,386	-15.7%	0.2%	4,721	-7.1%
<i>EBITDA Margin</i>	<i>68.2%</i>	<i>67.6%</i>	<i>53.0%</i>	<i>55.1%</i>	<i>54.4%</i>			<i>58.3%</i>	
Depreciation & Amortisation	(668)	(665)	(715)	(702)	(711)			(690)	
EBIT	4,534	4,314	3,909	3,676	3,676	-18.9%	0.0%	4,031	-8.8%
Margin	59.5%	58.6%	44.8%	46.3%	45.6%			49.8%	
Net Interest Income (Expense)	(55)	46	(101)	272	24			40	
Other Income (Expense)	97	-	-	(62)	(268)				
Associates	191	165	314	98	219	14.5%	122.4%	163	34.6%
Earnings before Minority Interest	4,767	4,525	4,122	3,984	3,651	-23.4%	-8.4%	4,234	-13.8%
Minority Interest	90	49	(44)	24	66			(61)	
Earnings before Taxes Royalty Fees	4,857	4,574	4,078	4,008	3,717	-23.5%	-7.3%	4,173	-10.9%
Deferred Taxes	(27)	(66)	(98)	(19)	27			(42)	
Earnings before Royalty Fees	4,830	4,508	3,979	3,989	3,744	-22.5%	-6.1%	4,131	-9.4%
Royalty Fees	(2,415)	(2,254)	(1,990)	(1,994)	(1,872)			(2,065)	
Net Profit	2,415	2,254	1,990	1,994	1,872	-22.5%	-6.1%	2,065	-9.4%

Source: Etisalat, EFG Hermes estimates



II. NEW FORECASTS AND FAIR VALUE

NEW FORECASTS

Following 1H2010 results, we adjust our consolidated forecasts for Etisalat. We increase our total revenue estimates starting in 2010, reflecting mainly higher-than-expected revenue growth from the international operations and, to a lesser extent, from the UAE operation. We reduce, however, our EBITDA margin forecasts, mainly on lower margins in the UAE. We now expect a consolidated FY2010 EBITDA margin of 56.7% versus 66.2% previously.

So, what is actually happening in the UAE? Competition and the slowdown in economy take their toll... After the non-stop growth in mobile subscribers in the UAE from 2006 to 2008, subscriber additions started to slow down. This was a result of the market approaching saturation and, more importantly, the slowdown in the UAE economy, specifically the population growth slowdown as expats left the country. Despite the above 100% penetration rate in 2006, mobile additions were growing Y-o-Y due to the strong population growth, not because of tariff cuts. Both operators in the UAE have now started to realise that the market is close to saturation, and that they must launch more aggressive offers to only modestly increase their subscriber base, improve/stabilise their usage levels and maintain healthy operating margins.

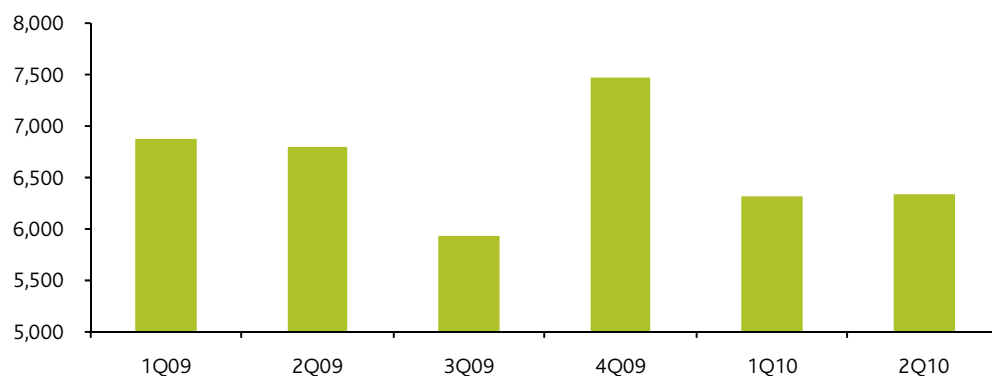
Initiatives taken by the UAE's Telecom Regulatory Authority (TRA) announced in May 2010, whereby the TRA has reduced the regulations of new offers and allowed operators to introduce some new packages without needing regulatory approval, should encourage more aggressive competition between the two operators.

Since the beginning of the year, Etisalat has been very active in launching new offers and promotions, mostly targeting the tariffs of the international, roaming and corporate segments. Additionally, du has also been very aggressive, slashing tariffs through different temporary offers.

We do not believe that the decline in tariffs were matched by increases in traffic as we saw UAE revenue decline by 15% Q-o-Q in 1Q2010 and then later stabilise in 2Q2010 (refer to figure 2 below). We also saw consolidated EBITDA margin come under pressure for the past three quarters, which we believe is due to pressure on the UAE operation.

**FIGURE 2: ETISALAT UAE QUARTERLY REVENUE**

In AED million, unless otherwise stated



Source: Etisalat, EFG Hermes estimates

FIGURE 3: ETISALAT OLD VERSUS NEW FORECASTS

In AED million, unless otherwise stated

	2009a		2010e		Chg.	2011e		Chg.	2012e		Chg.
	Old	New	Old	New		Old	New		Old	New	
UAE Revenue	26,617	24,915	25,843		4%	25,740	26,397	3%	26,826	27,069	1%
International Revenue	4,214	4,106	5,164		26%	4,870	6,019	24%	5,427	6,694	23%
Total Revenue	30,831	29,021	31,007		7%	30,610	32,416	6%	32,253	33,763	5%
EBITDA	19,503	19,226	17,584		-9%	20,121	18,664	-7%	21,162	19,695	-7%
EBITDA Margin	63.3%	66.2%	56.7%			65.7%	57.6%		65.6%	58.3%	
Depreciation & Amortisation	(2,534)	(2,755)	(2,686)		-2%	(2,945)	(2,968)	1%	(3,153)	(3,251)	3%
Associates	682	267	629			248	642		641	951	
Net Interest Income (Expense)	12	157	329			21	270		(2)	291	
Others	-	85	(130)			(52)	(53)		(55)	(56)	
Earnings before Taxes & Minority Interest	17,663	16,980	15,725		-7%	17,393	16,554	-5%	18,593	17,629	-5%
Minority Interest	253	205	79			157	49		132	19	
Earnings before Taxes	17,915	17,185	15,804		-8%	17,550	16,603	-5%	18,726	17,648	-6%
Taxes & Zakat	(244)	-	(40)			-	(14)		-	(35)	
Earnings before Royalty Fees	17,671	17,185	15,764		-8%	17,550	16,590	-5%	18,726	17,613	-6%
Royalty Fees	(8,836)	(8,593)	(7,882)			(8,775)	(8,295)		(9,363)	(8,806)	
Net Profit	8,836	8,593	7,882		-8%	8,775	8,295	-5%	9,363	8,806	-6%

Source: Etisalat, EFG Hermes estimates



VALUATION

We lower our fair value (FV) to AED12.5/share from AED14.5/share mostly due to the 18% cut to our estimated equity value for the company's UAE operation (represents 81% of total value) as a result of the pressured EBITDA margin. We, however, increase our estimated equity value for all of the other international operations, where we were traditionally conservative, since they delivered stronger-than-expected operational results.

FIGURE 4: ETISALAT SOTP DCF VALUATION

Country	Consolidation Method	Valuation Method	Equity Value (AED mn)	Etisalat Stake	Attrib. Equity (AED mn)	% of Valuation
UAE	Full	DCF	80,518	100%	80,518	81.2%
Saudi	Equity	DCF	46,376	27%	12,902	13.0%
Egypt	Full	DCF	4,498	66%	2,969	3.0%
Pakistan	Equity	DCF	6,912	26%	1,930	1.9%
Excelcomindo	Equity	DCF	11,231	13%	1,494	1.5%
Atlantique Telecom	Full	DCF	1,221	100%	1,221	1.2%
Afghanistan	Full	DCF	331	100%	331	0.3%
Nigeria	Equity	DCF	182	40%	73	0.1%
Swan Telecom	Equity	DCF	(5,596)	45%	(2,518)	-2.5%
Others		Book Value			195	0.2%
Total (AED mn)					99,114	
Value per Share (AED)					12.54	

Source: EFG Hermes estimates



III. FINANCIAL STATEMENTS

INCOME STATEMENT (DECEMBER YEAR END)

In AED million, unless otherwise stated

	2009a	2010e	2011e	2012e	2013e
Net Revenue					
UAE	26,617	25,843	26,397	27,069	27,556
Egypt	2,628	3,334	4,005	4,517	4,926
Afghanistan	218	329	365	381	405
AT & Others	1,368	1,501	1,649	1,796	1,909
Total Net Revenue	30,831	31,007	32,416	33,763	34,795
EBITDA					
UAE	18,449	15,635	16,234	16,918	17,222
Egypt	772	1,090	1,446	1,689	1,912
Afghanistan	(12)	25	64	86	111
AT & Others	761	834	920	1,002	1,055
Total EBITDA	19,503	17,584	18,664	19,695	20,301
<i>EBITDA Margin</i>	63%	57%	58%	58%	58%
Depreciation and Amortisation	(2,534)	(2,686)	(2,968)	(3,251)	(3,485)
Net Operating Profit	16,969	14,898	15,696	16,444	16,816
<i>NOP (EBIT) Margin</i>	55%	48%	48%	49%	48%
Net Interest Income (Expense)	12	329	270	291	336
Other Income (Expenses)	-	(130)	(53)	(56)	(58)
Income from Associates	682	629	642	951	1,258
Earnings before Minority Interest	17,663	15,725	16,554	17,629	18,353
Minority Interest	253	79	49	19	(4)
Earnings before Taxes & Royalty Fees	17,915	15,804	16,603	17,648	18,348
Taxes	(244)	(40)	(14)	(35)	(50)
Earnings before Royalty Fees	17,671	15,764	16,590	17,613	18,298
Royalty Fees	(8,836)	(7,882)	(8,295)	(8,806)	(9,149)
Net Attributable Income	8,836	7,882	8,295	8,806	9,149

Source: Etisalat, EFG Hermes estimates

**BALANCE SHEET (DECEMBER YEAR END)**

In AED million, unless otherwise stated

	2009a	2010e	2011e	2012e	2013e
Cash & Liquid Assets	11,309	12,716	12,727	13,054	13,219
Receivable & Prepayment	5,796	5,539	5,191	5,432	5,619
Due from Telecom Administrations	2,185	1,905	1,952	2,004	2,042
Inventory	272	285	288	289	294
Total Current Assets	19,562	20,445	20,157	20,779	21,175
Net Plant	17,585	20,237	22,565	24,499	25,876
Investments	16,378	18,659	19,448	20,399	21,657
Licenses + Other Intangibles	16,778	13,868	13,419	12,969	12,520
Others	1,073	2,511	136	136	136
Total Assets	71,377	75,720	75,725	78,783	81,364
CPLTD	1,079	1,422	2,122	50	50
Due to Other Telecom Admin.	1,485	3,347	3,326	3,316	3,376
Other Current Liabilities	20,924	20,077	17,666	18,272	18,710
Total Current Liabilities	23,488	24,846	23,114	21,638	22,136
LTD	2,295	4,053	4,103	7,149	6,989
Shareholder Loan	525	525	525	-	-
Others	4,680	4,682	4,728	4,777	4,828
Minority Interest	3,998	4,594	5,190	5,795	6,415
Total Liabilities & Minority Interest	34,987	38,700	37,661	39,360	40,368
Net Worth	36,392	37,021	38,063	39,423	40,996

Source: Etisalat, EFG Hermes estimates

CASH FLOW STATEMENT

In AED million, unless otherwise stated

	2009a	2010e	2011e	2012e	2013e
Cash Operating Profit after Tax	10,424	9,662	10,356	10,853	11,102
Change Working Investment	(1,223)	1,525	784	301	268
Cash Flow Post Chg in Working Investment	9,200	11,187	11,139	11,154	11,370
Capex & Investments	(5,079)	(4,589)	(4,547)	(4,436)	(4,112)
Free Cash Flow	4,122	6,598	6,593	6,717	7,257
Non-operating Cash Flow	(3,114)	506	305	806	850
Net Financing	(3,057)	(5,441)	(6,885)	(6,842)	(8,072)
Change in Cash	(2,049)	1,663	12	682	35

Source: Etisalat, EFG Hermes estimates

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Neutral	(10%) and 15%
Sell	Below (10%)

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