

November 23, 2009

Fair Value Estimate: AED 16.53
Recommendation: Buy

Executive Summary

Emirates Telecommunication Corporation (Etisalat)'s domestic operations should remain highly cash generative due to its scaled-up operations and market-leading position. We expect its mobile subscriber base to increase to 7.78 million in 2010 despite the proposed introduction of mobile number portability (MNP) and low population growth forecast of 3.6%. Further, we anticipate stable growth in data and internet services as the Company expands its Fibre-To-the-Home (FTTH) network across the under-penetrated UAE internet market, enabling it to offer bundled services and capture most new subscribers. We expect Etisalat to increase its internet subscriber base to 1.46 million in 2010 from 1.27 million in Q3 2009. Due to competitive pressures, we forecast 2.6% and 4.3% lower mobile and internet business ARPUs respectively in 2010.

Internationally, we forecast continued strong growth for Etisalat due to its strategy of targeting under-penetrated markets in the Middle East, Asia and Africa. We believe the expected launch of services in India, the acquisition of Tigo in Sri Lanka, and a potential license in Libya could help it to increase its existing subscriber base to 100 million by the end of 2010. However, International operations carry execution and operation risks. Despite heavy initial network operation costs in these markets, we expect Etisalat to maintain its EBIT margin at ~29% in 2010.

We upgrade our capex estimates to AED 4.8bn (earlier AED 4bn) due to the acquisition of Tigo in Sri Lanka. We believe Etisalat has sufficient liquidity to finance its capex requirements helped by strong cash flows from its domestic operations, an available cash balance of AED 12.9bn and a debt/equity ratio of 0.1x as of September 30, 2009.

Valuation: We have upgraded our fair Value for Etisalat from AED 16.06 to AED 16.53, implying a 47% upside potential from the current price. We maintain our Buy recommendation on the stock.

RESULT UPDATE

Share Data

Market Cap	AED 80.9 bn
Price	AED 11.25
Abu Dhabi Index	2,865.3
Reuters	ETEL.AD
Bloomberg	ETISALAT UH
Avg. Volume (52 Week)	1.0 mn
52-Week High/Low	AED 12.65 / 7.75
Shares Outstanding (mn)	7,187.4
Fair Value Estimate	AED 16.53
Rating	BUY

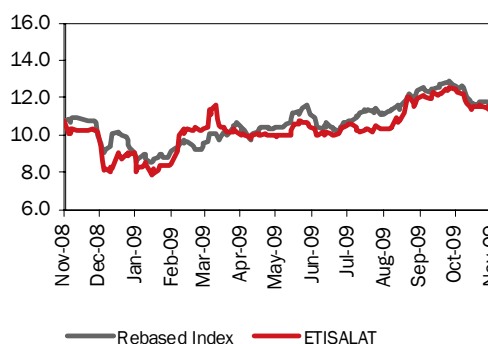
Key Figures

Year to 31 Dec	2008A	2009E
Revenue (mn)	26,119.1	29,340.8
Operating Profit (mn)	7,439.1	8,743.2
EBITDA (mn)	9,956.7	11,279.2
Net Profit (mn)	8,665.0	8,995.9
EPS (AED)	1.21	1.25
Operating Margin (%)	28.5%	29.8%
RoA (%)	14.3%	13.2%
RoE (%)	30.8%	27.3%
EV/Revenue	2.8x	2.4x
EV/EBITDA	7.2x	6.3x
P/E	9.3x	9.0x

Shareholding Pattern (%)

Government of UAE	60
Public & Others	40

Relative Performance



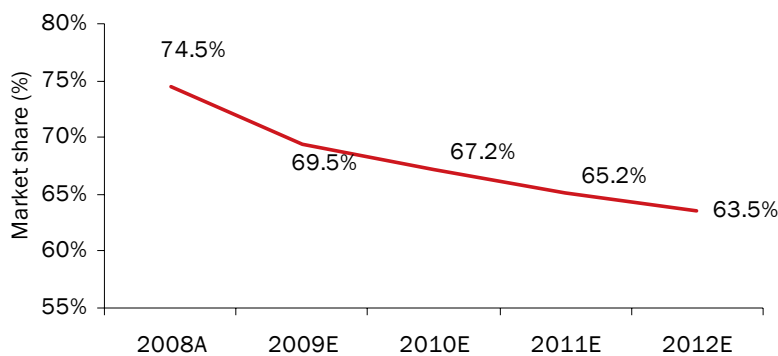
ETISALAT

Investment Rationale

Domestic voice business to remain under pressure

The Company reported the addition of ~180,000 mobile subscribers in Q3 2009, contrary to our expected decline of ~80,000. This growth was achieved as a result of promotional offers that includes free Wasel lines, which offset the impact of a lower population and subscriber churn to du. Etisalat has also announced 3G plans including free Wasel connections to encourage higher usage.

Etisalat's share in the UAE mobile market

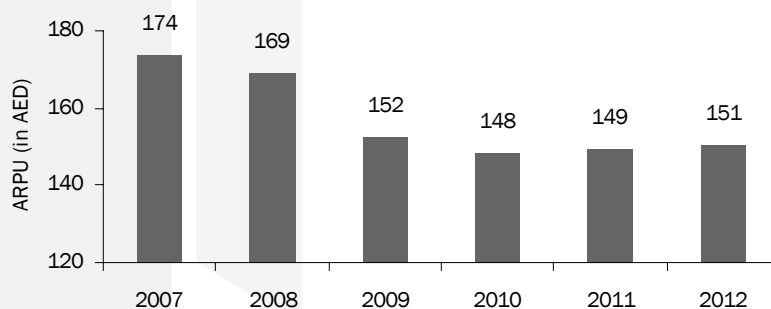


Source: Company data and ADCB research

While the recovery in mobile subscriber additions in Q3 2009 following a decline in Q2 this year is positive, we believe the introduction of mobile number portability (MNP) could result in churn in favour of du. We therefore assume a churn rate of 0.8% for Etisalat in 2010. As a result, we have reduced our mobile market share estimates for Etisalat for 2010 from 67.5% to 67.2%. However, with the UAE economy expected to recover next year we believe the churn rate will stabilize from 2011 as the influx of expatriates once again picks up, resulting in population growth of 3.6% in 2010 and 6.5% in 2011 (2009: -1%).

We expect Etisalat's ARPU to decline in the near term as a result of various discount offers introduced by the Company to retain its subscribers. We forecast ~10% y-o-y lower mobile ARPU of AED 152 (~USD 41) in 2009. However, promotional plans for 3G and other new value-added services (VAS), including mobile money transactions, will support the ARPU of high-end subscribers. Consequently, we forecast a stable mobile ARPU of AED 148-151 during 2010-12.

Mobile ARPU in the UAE



Source: Company data and ADCB research

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Fiber-To-The-Home to drive internet and data revenue

The latent potential in the UAE Internet market was demonstrated by Etisalat increasing its subscribers in Q3 2009 by ~45,000 to 1.27 million. We expect Etisalat's robust subscriber growth in the internet segment to partly compensate for slower revenue increases in the voice business. We raise our forecasts and expect subscribers to increase to 1.31 million and 1.46 million by the end of 2009 and 2010, respectively.

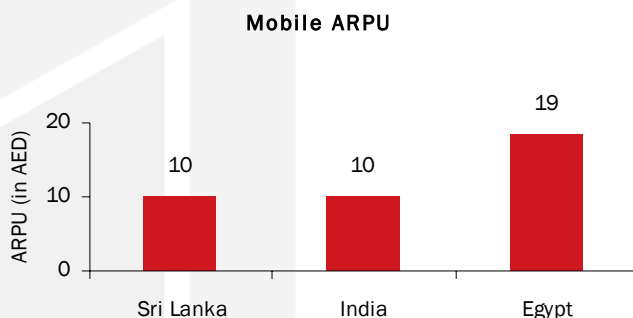
In addition, we foresee an increasing take-up of bundled services by Etisalat's subscribers as the Company continues to roll out Fiber-To-The-Home (FTTH) across UAE. Etisalat has already connected over 500,000 homes through e-Life, and intends to connect over 1 million by the end of 2011. While the FTTH has enabled Etisalat to launch the fastest broadband speed of 30Mbps in the Middle East, we believe increasing penetration of bundled services including IPTV, Video On Demand, online gaming, and fixed line voice, could help it establish strong customer loyalty.

Continued focus on international expansion

Etisalat is strategically focused on entering under-penetrated markets in Africa, the Middle East and Asia (i.e. those with a penetration of less than 50%) in order to expand its current subscriber base of 85 million to 100 million by 2010, and 200 million by 2012. The Company also aims to enlarge its International revenue contribution from currently ~11% to 30% by 2011. In order to achieve these objectives, Etisalat proposes entering various attractive international markets including Iraq (talks are continuing between Etisalat and Korek Telecom), Syria, Lebanon, and Algeria. Despite having its Iranian license cancelled in May, the Company remains interested in the Iranian market.

Consistent with its international expansion strategy, Etisalat has bid for a third mobile license in Libya and has proposed a substantial USD 825mn investment plan. A final decision by the Libyan authorities is expected by the end of this year. In our view, the Libyan telecom market could represent a large growth opportunity for Etisalat being still relatively under-penetrated (76%) with 4.8 million mobile subscribers in 2008.

Moreover, Etisalat has recently entered the Sri Lankan market with its USD 207mn acquisition of a 100% stake in SARK Corporation N.V., the holding company for Tigo Sri Lanka, the second largest mobile operator in Sri Lanka with 2.25 million subscribers and a 21% market share at the end of September 2009. Based on comparable Sri Lankan Operators, we estimate Tigo's ARPU to be in the range of ~AED 10 similar to that of India.



Source: ADCB research

Current international operations also performing well

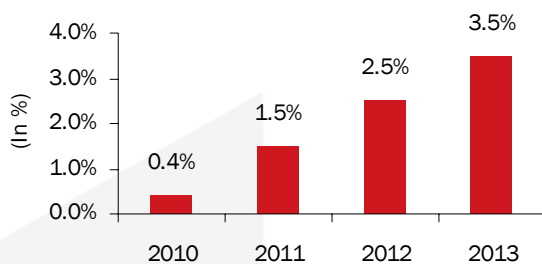
Etisalat continued to improve its financial performance in its existing overseas markets. The Company's revenue from international operations increased 47.8% y-o-y to AED 2,492mn for the nine months ended September 30, 2009. Furthermore, over the same period Etisalat reduced operating losses in its international operations to AED 488.9mn from AED 756.3mn in the first nine months last year due to benefits from improved economies of scale.

But increasing market share in India could be challenging

The Indian telecom market has become extremely competitive with the entry of new companies in various business segments. Increasing competitive pressures have resulted in the introduction of aggressive pricing for long distance calls and 'per second billing' by all existing operators. The combination of a regulated market and a large number of operators has resulted in India having one of the lowest telecommunication charges in the world.

Despite adopting the outsourcing model and signing a network sharing contract with Reliance Communications in order to roll out services rapidly, we believe Etisalat faces major challenges in achieving critical mass and breaking even during the next 2-3 years. We therefore expect the Company to acquire a market share in India of 1.5% by 2011, assuming attractive subscriber growth based on lower penetration in semi-urban and rural India. Moreover, we assume ARPU of ~AED 10 for Etisalat in 2010, significantly lower than ARPU's of Bharti Airtel and Idea Cellular (AED 17-19), due to the impact of 'per second billing'. As a new entrant Etisalat will have to offer lower pricing to attract new subscribers. We highlight the uncertainties regarding the license as a risk.

Market Share in India



Source: ADCB research

Solid domestic cash flows to support increasing overseas capex requirements

We have raised our full year capex estimates from AED 4bn to AED 4.8bn to reflect increased spending in connection with the Company's Asian venture. Although it shares sites with Reliance Communications in order to reduce costs in India, we still expect substantial capex over the next three years. Currently, our estimates do not discount the possibility that the Company might bid for 3G licences in India or its proposed investment in Libya.

We believe Etisalat should be able to finance its requirements from strong cash flow in domestic markets supported by its healthy net cash position of AED 10.3bn at the end of September this year.

We maintain our Buy rating

We increase our target price from AED 16.06 to AED 16.53 to reflect a better than expected addition of subscribers in the Company's domestic market. Moreover, its comfortable leverage and cash balances, together with its exposure to many under-penetrated markets in Asia, Africa and the Middle East support our current Buy rating on the stock.

Catalysts

- Lower royalties:** Telecom companies in UAE currently pay 50% of profits in royalties to the Government. If this percentage is reduced, free cash flows available to shareholders will increase providing a strong trigger for the stock price.
- Mobile Number Portability (MNP) in India:** The introduction of MNP in India's highly competitive market could provide Etisalat with an opportunity to attract high-end customers from existing players using predatory pricing.

Valuation

We have valued Etisalat using SOTP-based Discounted Cash Flow (DCF) and Peer-Based Multiple methods. Our weighted SOTP-based DCF (70%) and peer-based multiple (30%) valuations allocate a higher weight to our SOTP-based DCF model because it discounts firm-specific cash flows. Our fair value estimate for Etisalat is AED 16.53 per share for 2009 implying a premium of 47% to the current share price. We maintain our Buy recommendation.

Weighted Average Value per Share		
Valuation Method	Value (AED)	Weight (%)
Valuation based on SOTP	16.95	70%
Peer-based multiple valuation	15.56	30%
Weighted Average Fair Value	16.53	100%

Source: ADCB research

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

Risk free rate:	4.12%
Country Risk Premium:	1.8%
Equity Premium:	6.0%
Beta:	0.95 (Sector beta for emerging markets)
Cost of equity:	11.62%
WACC:	11.39%
Terminal growth rate:	2.5%
Terminal WACC:	11.52%

SOTP Valuation of Etisalat				
Name of Associates	% share	Basis of valuation	Value (In AED mn)	Value per Etisalat's share (In AED)
UT Technologies LLC	50.00%	Book Value	58.7	0.01
Smart Technologies	50.00%	Book Value	43.0	0.01
Pakistan Telecommunication Company Ltd (PTCL)	26.00%	Market Value	1,064.0	0.15
Etihad Etisalat Company, KSA	27.46%	Market Value	8,154.7	1.13
Thuraya Satellite Telecommunications Company PJSC	28.04%	Book Value	460.7	0.06
PT Excelcomindo TBK	15.97%	Market Value	840.4	0.12
Emerging Markets Telecommunications Services Ltd.	40.00%	Book Value	483.5	0.07
Other Investments		Market Value/Book Value	616.0	0.09
DCF Valuation of Stand-alone Business				1.63
Valuation based on SOTP (In AED)				15.31
Valuation based on SOTP (In AED)				16.95

Source: ADCB research

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

		Terminal cost of capital				
		10.5%	11.0%	11.5%	12.0%	12.5%
Terminal Growth	1.5%	15.2	14.8	14.4	14.0	13.7
	2.0%	15.8	15.3	14.8	14.4	14.0
	2.5%	16.4	15.8	15.3	14.9	14.4
	3.0%	17.1	16.5	15.9	15.4	14.9
	3.5%	17.9	17.2	16.5	15.9	15.4

Source: ADCB research

Based on a peer group average estimated P/E multiple of 12.5x 2010E earnings, our forecast 2010E EPS for Etisalat of AED 1.25 implies a value of AED 15.6 per share.

Comparable Company Trading Analysis												
Company	Stock Price	Fully Diluted		P/E			Fully Diluted			ROCE		
	22-Nov-09	Market Cap	Enterprise Value				Enterprise Value / EBITDA					
	(Local Ccy)	(AED m)	(AED m)	Dec-08	Dec-09	Dec-10	Dec-08	Dec-09	Dec-10	FY08	FY09	FY10
Saudi Telecom Co	47.60	93,243	125,074	8.6x	8.1x	7.8x	6.3x	5.7x	5.5x	30%	29%	27%
Mobile Telecommunications Co KSC	0.96	47,552	77,291	9.4x	10.0x	8.7x	8.8x	5.8x	5.3x	17%	15%	16%
Orascom Telecom Holding	11.40	20,555	37,519	11.8x	29.6x	26.2x	4.3x	23.6x	22.3x	21%	26%	28%
Etihad Etisalat Co	29.89	30,234	36,710	8.7x	11.9x	11.0x	9.9x	8.1x	7.4x	27%	24%	22%
Qatar Telecom QSC	43.50	21,694	60,842	8.2x	7.4x	7.2x	7.0x	5.3x	4.9x	23%	21%	19%
Telecom Egypt SAE	150.00	20,433	18,869	9.0x	9.1x	8.3x	6.2x	5.4x	5.2x	11%	12%	13%
Emirates Integrated Telecommunications Co	16.88	14,680	16,471	NM	NM	32.0x	NM	14.3x	8.8x	0%	9%	16%
Egyptian Company for Mobile Services	190.93	12,850	16,043	9.4x	9.5x	9.1x	5.2x	4.6x	4.3x	99%	67%	58%
Oman Telecommunications Co	1.32	9,445	9,465	7.3x	8.0x	7.5x	5.1x	4.7x	4.8x	33%	35%	31%
Bahrain Telecommunications Co BSC	0.60	8,348	8,515	8.2x	7.8x	6.8x	6.1x	5.9x	5.5x	24%	22%	21%
Emirates Telecommunication Corporation	11.25	80,858	70,575	9.3x	9.0x	9.0x	7.2x	6.3x	5.8x	28%	28%	26%
Mean				9.0x	11.3x	12.5x	6.5x	8.4x	7.4x	28%	26%	25%
Median				8.7x	9.1x	8.5x	6.2x	5.8x	5.4x	23%	23%	22%
P/E multiple (Peer-group average)	12.5x											
EPS10E	1.25											
Equity Value	15.6											

Source: ADCB research, Reuters, Company data

Quarterly

Income Statement					Operating Metrics				
(AED mn, Qtr. ending)	Q3 2009	Q4 2009	Q1 2010	Q2 2010	(AED/ million, Qtr. ending)	Q3 2009	Q4 2009	Q1 2010	Q2 2010
Revenue	7,364	7,233	7,376	7,584	Operational Metrics				
% growth	(3.4%)	(1.8%)	2.0%	2.8%	Mobile Subscribers (mn)	7.44	7.57	7.61	7.68
EBITDA	2,891	2,878	2,814	2,920	Fixed line Subscribers (mn)	1.31	1.31	1.31	1.31
% margin	39.3%	39.8%	38.1%	38.5%	Internet Subscribers (mn)	1.27	1.31	1.35	1.39
Operating Profit	2,226	2,162	2,074	2,180	Mobile ARPU (AED)	152	150	148	148
% margin	30.2%	29.9%	28.1%	28.7%	Fixedline ARPU (AED)	194	188	188	188
Net Profit	2,254	2,149	2,176	2,262	Internet ARPU (AED)	182	182	175	175
% margin	30.6%	29.7%	29.5%	29.8%					
EPS	0.31	0.30	0.30	0.31					

Yearly

Income Statement					Key Ratios				
(AED M, Yr. ending Dec. 31)	2007	2008	2009	2010		2007	2008	2009	2010
Revenue	21,340	26,119	29,341	30,816	Per share data (AED)				
Operating costs	(5,852)	(8,862)	(9,601)	(10,336)	Shares outstanding (mn)	7,187	7,187	7,187	7,187
Royalty	(7,297)	(7,773)	(9,008)	(9,281)	EPS	1.02	1.21	1.25	1.25
Depreciation & Amortisation	(1,962)	(2,518)	(2,536)	(2,960)	Book value per share	3.35	4.04	4.77	5.49
Share in profits of associates	380	473	547	604	Operational Metrics				
Operating Profit	6,610	7,439	8,743	8,844	Mobile Subscribers (mn)	6.37	7.30	7.57	7.78
Operating margin	31.0%	28.5%	29.8%	28.7%	Fixed line Subscribers (mn)	1.33	1.36	1.31	1.32
EBITDA	8,571	9,957	11,279	11,804	Internet Subscribers (mn)	0.88	1.15	1.31	1.46
YoY Growth (%)	22.6%	16.2%	13.3%	4.7%	Mobile ARPU (AED)	174	169	152	148
Finance cost	(503)	(414)	(370)	(116)	Fixedline ARPU (AED)	206	201	193	183
Other income	736	1,318	482	554	Internet ARPU (AED)	157	170	183	175
Deferred Tax Liability	(122)	(177)	(200)	(200)	Valuation ratios (x)				
PAT	6,720	8,166	8,656	9,081	EV/Revenue	3.5x	2.8x	2.4x	2.2x
Minority Interest	576	499	340	(112)	EV/EBITDA	8.7x	7.2x	6.3x	5.8x
Net Profit	7,297	8,665	8,996	8,969	P/E	11.1x	9.3x	9.0x	9.0x
Net Margin	34.2%	33.2%	30.7%	29.1%	Performance ratio (%)				
YoY Growth (%)	24.5%	18.8%	3.8%	-0.3%	Return on avg. assets	13.7%	14.3%	13.2%	12.8%
EPS	1.02	1.21	1.25	1.25	Return on avg. net worth	31.1%	30.8%	27.3%	24.6%
					Return on Capital Employed	29.5%	28.2%	27.9%	25.8%
Balance Sheet					Operating ratios (%)				
Non-Current Assets	39,547	45,285	48,980	50,944	Revenue Growth	31.0%	22.4%	12.3%	5.0%
YoY Growth (%)	22.2%	14.5%	8.2%	4.0%	EBITDA Margin	40.2%	38.1%	38.4%	38.3%
Cash & cash equivalents	9,433	11,295	12,821	14,864	EBIT Margin	31.0%	28.5%	29.8%	28.7%
Other current assets	3,468	5,492	6,944	6,856	Net Profit Margin	34.2%	33.2%	30.7%	29.1%
Total Current Assets	12,901	16,787	19,765	21,720	Balance Sheet ratios (%)				
YoY Growth (%)	(4.8%)	30.1%	17.7%	9.9%	Non-Current Assets Turnover Ratio	59.4%	61.6%	62.3%	61.7%
Total Assets	52,448	62,072	68,745	72,664	Total Assets Turnover Ratio	43.4%	45.6%	44.9%	43.6%
Short Term Borrowings	343	722	700	700	Debt/Equity Ratio	14.5%	8.2%	7.6%	6.6%
Other current Liabilities	17,322	22,127	23,701	23,435	Net Debt/Equity Ratio	(24.7%)	(30.7%)	(29.8%)	(31.1%)
Total Current Liabilities	17,665	22,850	24,401	24,135					
Long Term Borrowings	3,141	1,648	1,900	1,900					
Other non-current Liabilities	5,746	3,973	3,971	2,858					
Total non-current Liabilities	8,887	5,621	5,871	4,758					
Total Liabilities	26,553	28,471	30,272	28,894					
Minority Interest	1,838	4,556	4,216	4,329					
Total Shareholders' Equity	24,057	29,045	34,257	39,441					
Total Equity & Liabilities	52,448	62,072	68,745	72,664					

Source: Company data, ADCB research

Investment Ratings:

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

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

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

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