

Wataniya Telecom

Overweight

Target price (KWD)	4.00
Share price (KWD)	2.94
Potential total return (%)	36.1

Dec	2006a	2007e	2008e
HSBC EPS	0.17	0.18	0.20
HSBC PE	17.1	16.1	14.6
Performance	1M	3M	12M
Absolute (%)	8.9	7.3	2.8
Relative ^a (%)	7.6	-0.6	-33.0

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A good mix of telecoms assets; we initiate with an Overweight rating and KWD4.00 target price

- **Exposure to high-value and growing markets; Kuwait is still the company's key market, contributing c54% of EV**
- **High growth and good value: we forecast a 2007e-09e EBITDA CAGR of 16% and 9% free cash flow yield by 2009e**
- **We initiate coverage with an Overweight and TP of KWD4.00**

Wataniya Telecom is the holding company for wireless telecom operators in six countries, with activities in both wealthy markets like Kuwait and growth markets like Algeria and Tunisia. These three markets jointly contribute c96% of the group's EV, and Kuwait alone for c54%. We believe new competition in Kuwait from STC (7020.SE, Overweight, SAR75.5) will be offset by growth in market subs, which we expect to double over the next 10 years, driven by high population growth (a 10-year CAGR of c3.5% on our estimates) and increasing mobile penetration. ARPUs in Kuwait look sustainable in the mid-forties (USD), driven by the high proportion of expats in the population (c50%) and high GDP per capita. We expect Algeria to become the group's growth engine and drive earnings once it becomes profitable in a couple of years. Government spending and the liberalisation of the Algerian economy, with the resultant attraction of foreign capital, could be key catalysts for this market, stimulating telecoms usage and spending. ARPU seems to be bottoming out and we expect EBITDA margins to rise from 25% to c41% in the next five years. We believe Algeria will contribute c25% to group FCF in 2012e, up from its currently negative contribution. Synergies from Wataniya's parent Qtel should bring benefits in terms of roaming capacity and cheaper equipment procurement.

Wataniya is one of the few Gulf telecoms stocks completely open to foreign investment. It is both a value and growth play, with a gearing ratio of c5%, a free cash flow yield of 8.2% in 2009e and a dividend yield of 5.3% in 2009e, on our estimates. We expect earnings to grow at a CAGR of c17.3% in the next five years, ultimately driven by profitable operations in Algeria, Saudi Arabia, Maldives and Palestine. Since these activities will not be profitable immediately, earnings growth is likely to be attractive at a later stage, making DCF rather than relative valuation an appropriate methodology for Wataniya. Based on a 50% DCF and 50% sum-of-the-parts weighting we have reached a target price of KWD4.00 per share for Wataniya Telecom, implying a potential return of 36%. We therefore initiate with an Overweight rating.

Index ^a	ABU DHABI INDEX
Index level	4777.86
RIC	NMTC.KW
Bloomberg	NMTC KK

Source: HSBC

Enterprise value (KWDm)	1427
Free float (%)	25
Market cap (USDm)	4,927
Market cap (KWDm)	1,347

Source: HSBC

Financials & valuation

Financial statements

Year to	12/2006a	12/2007e	12/2008e	12/2009e
Profit & loss summary (KWDm)				
Revenue	428	420	452	502
EBITDA	178	148	166	197
Depreciation & amortisation	-63	-75	-74	-76
Operating profit/EBIT	115	73	92	121
Net interest	-12	-15	-9	-8
PBT	101	74	82	112
HSBC PBT	106	79	97	126
Taxation	-3	-2	-3	-4
Net profit	73	80	78	104
HSBC net profit	78	83	92	119

Cash flow summary (KWDm)

Cash flow from operations	168	102	163	181
Capex	-89	-108	-83	-75
Cash flow from investment	-123	-34	-83	-75
Dividends	-34	-50	-53	-53
Change in net debt	-44	-49	-26	-53
FCF equity	43	46	70	105

Balance sheet summary (KWDm)

Intangible fixed assets	162	150	135	121
Tangible fixed assets	345	362	385	398
Current assets	132	206	235	296
Cash & others	59	120	146	200
Total assets	716	766	803	863
Operating liabilities	172	211	212	234
Gross debt	213	225	225	225
Net debt	154	105	78	25
Shareholders funds	268	304	341	375
Invested capital	408	387	396	381

Ratio, growth and per share analysis

Year to	12/2006a	12/2007e	12/2008e	12/2009e
Y-o-y % change				
Revenue	21.3	-2.0	7.6	11.0
EBITDA	46.4	-17.0	12.1	18.6
Operating profit	248.3	-36.7	26.0	31.5
PBT	111.1	-26.9	11.4	36.3
HSBC EPS	45.8	6.2	10.3	29.1

Ratios (%)

Revenue/IC (x)	1.0	1.1	1.2	1.3
ROIC	29.7	23.0	26.2	33.7
ROE	31.4	29.1	28.5	33.2
ROA	15.1	12.1	12.1	14.8
EBITDA margin	41.6	35.3	36.7	39.2
Operating profit margin	26.8	17.3	20.3	24.0
EBITDA/net interest (x)	14.5	10.1	17.6	23.4
Net debt/equity	46.7	32.0	22.2	6.4
Net debt/EBITDA (x)	0.9	0.7	0.5	0.1
CF from operations/net debt	108.9	96.9	207.7	722.6

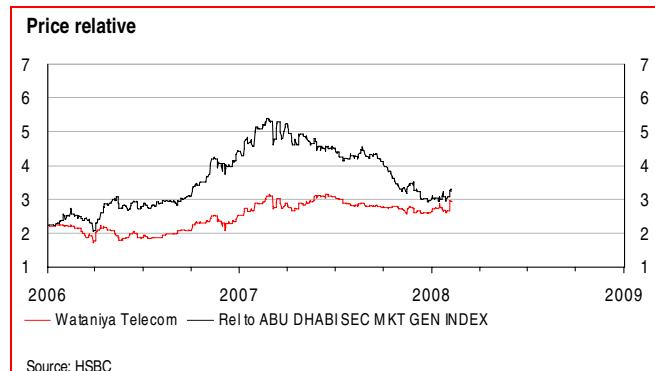
Per share data (KWD)

EPS reported (fully diluted)	0.16	0.17	0.17	0.23
HSBC EPS (fully diluted)	0.17	0.18	0.20	0.26
DPS	0.11	0.12	0.12	0.16
NAV	0.59	0.67	0.75	0.82

Valuation data

Year to	12/2006a	12/2007e	12/2008e	12/2009e
EV/sales	3.4	3.4	3.1	2.7
EV/EBITDA	8.3	9.6	8.5	6.9
EV/IC	3.6	3.7	3.5	3.5
PE*	17.1	16.1	14.6	11.3
P/NAV	5.0	4.4	3.9	3.6
FCF yield (%)	3.2	3.5	5.3	7.9
Dividend yield (%)	3.7	4.0	3.9	5.3

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 06 Feb 2008

Investment summary

- ▶ A portfolio of growth and high-value assets
- ▶ 2007e-09e EBITDA CAGR of 16%, 2009e free cash flow yield of 8.2%
- ▶ SOTP gives a value of KWD3.97 and DCF analysis, KWD4.05. We initiate with an Overweight rating and a target price of KWD4.00 per share

We are Overweight – key positives

- ▶ Early-mover advantage for acquisitions in the region, implying a higher return to shareholders on those operations.
- ▶ Synergies from Qtel: roaming and equipment procurement.
- ▶ The stock is one of the few Middle East telecoms companies completely open to foreign investments. The company's free float is 25%.
- ▶ On 26 December 2007, the Kuwaiti government approved a law reducing capital gains tax from 55% to 0%. Although the tax was reportedly never collected, we nonetheless believe that it acted as a significant deterrent to fund flows. Many funds had to provision against any implied tax liability and write down NAVs accordingly, which was scarcely an incentive for funds to invest in Kuwaiti stocks. This tax change should, we believe, boost the Kuwaiti capital markets.
- ▶ Kuwait is a rich market with high ARPUs. In spite of new competition, we expect market subs to double in the next 10 years, giving it the growth needed to continue generating 54% of the company's EV.
- ▶ Qtel's acquisition of a 51% stake in Wataniya last year did not directly benefit minority shareholders, although they could gain if the company were to buy out the remaining stake at a later date. However, we do not expect such a move in the near future, as Qtel's balance sheet is already too stretched for further acquisitions. That said, Wataniya's low gearing could allow Qtel to use it as a vehicle for further acquisitions.
- ▶ The company no longer operates in the volatile Iraqi market following the liquidation of its assets there last year. This reduced Wataniya's discount rate – hence its higher valuation.
- ▶ The Algerian operations are strong, with scope for market share improvement, and ARPU there seems to be bottoming out. We expect margin improvement to drive profitability.
- ▶ We estimate a free cash flow yield of 8.2% and a dividend yield of 5.3% for 2009e at current prices.

Early-mover advantage

M&A activity in the MENA region has surged in recent years, as operators have tried to acquire more assets to diversify their portfolios and combat saturation in their home markets.

Wataniya was among the first companies to begin expanding its footprint via an acquisition-based strategy. This enabled it to acquire assets at relatively cheap prices.

The M&A scenario in MENA region is now much more intense, with many operators fighting for few assets – not just MENA operators, but also some European and American players whose current markets are becoming saturated. This competition has led to consistent increases in the bidding price for telecoms assets. Some recent acquisitions have been made at high multiples (please see next section). Wataniya's early move meant that it was able to expand its network into some of the most promising markets in the MENA region – eg Kuwait, Algeria and Tunisia at a relatively low cost.

Value and growth: a sound portfolio

The early-mover advantage is not Wataniya's sole benefit; it also boasts a portfolio that is strong in both value and growth terms. This balanced portfolio includes the Kuwait operation – a cash cow in a high-ARPU market contributing around 80% of group free cash flow – as well as growth assets like Tunisia and Algeria, both of which have a high subscriber base (both present and potential). In addition, it has some small operations

in Saudi Arabia ('push-to-talk'), Maldives (where it is the second operator in a small market) and Palestine (officially the second operator).

Bottom line set to improve

Markets like Saudi Arabia, Maldives, Palestine and Algeria do not currently make a significant contribution to Wataniya's operations, but we believe they will eventually have a positive effect on its margins and bottom line. Saudi Arabia and Maldives are currently EBITDA negative (and are also negative on net income, along with Algeria), which is acting as a drag on the bottom line. However, we expect Algeria to break even in 2008 and start making money from 2009 onwards. Indeed, we view this as the key market in terms of the company's growth: ARPU appears to be bottoming out, while EBITDA margins look set to rise from 25% currently to c41% in the next five years. We expect Algeria to account for c25% of group free cash flow in 2012e – a strong improvement from its current negative contribution.

Kuwait to come under pressure...

STC's entry into Kuwait's wireless market will probably intensify competition, taking a toll on Wataniya's KPIs. However, we expect market subs in Kuwait to double in the next 10 years, driven by high population growth (a 3.5% CAGR on our estimates). Furthermore, the high proportion of expats in Kuwait (c50% of the total population) should help the company maintain ARPUs in the mid-forties (in USD).

Number of operators before Wataniya's entry

Region		Comments
Kuwait	1	Currently Zain and Wataniya offer wireless services; but STC won the third licence and is expected to start services in 2008
Tunisia	1	Tunisie and Tunisiana (JV between Orascom and Wataniya) are the only two players
Algeria	2	Orascom is the market leader with Wataniya and Algeria Telecom closely fighting for second position
Saudi Arabia	-	Only 'push-to-talk' wireless operator (brand name 'Bravo') in Saudi Arabia
Maldives	1	Dhiraagu, the incumbent, is the only other player
Palestine	1	Palcel is the only authorised operator, although several Israeli operators also provide wireless services

Source: HSBC

...but other markets to ensure future growth

We expect Wataniya's other operations to do well in the future, providing growth. Tunisia-based Tunisiana is steadily increasing its market share in a duopoly market; Algeria has high potential growth, and we expect the opening-up of the economy to foreign capital and higher government spending to be key catalysts for growth. Saudi Arabia and Maldives are small operations, but we expect them to make a positive impact on the company's bottom line in the future as they improve their profitability (both are currently EBITDA negative). We believe the new operation in Palestine will add to both the top and bottom line (from 2008 onwards).

Acquisition by Qtel to prove advantageous

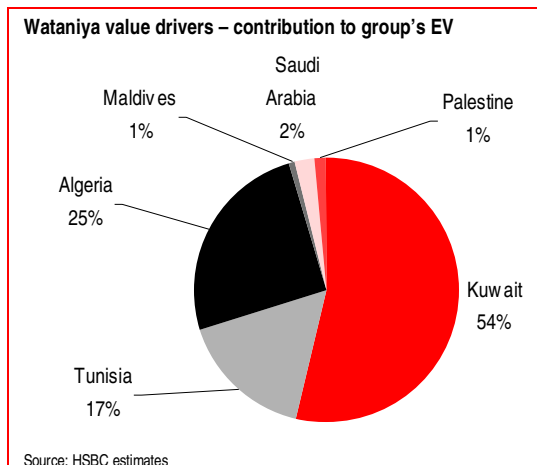
In our view the acquisition of a 51% stake by Qtel has certain benefits for Wataniya:

- ▶ a larger geographic footprint, which will enable it to provide better services to its customers and gain roaming synergies;
- ▶ operational synergies via cheaper procurement from equipment vendors, as Qtel has better bargaining power than Wataniya.

Although Qtel's purchase of a controlling stake last year did not benefit minority shareholders particularly, they could gain if the company were to buy out the remaining stake at a later date; however, we do not expect any such move in the near future as Qtel's balance sheet is already too stretched for further acquisitions. That said, if Qtel did make any acquisitions – either directly or using Wataniya as an acquisition vehicle (its gearing is low at c5%) – we fear that overpayment could be value dilutive for Wataniya's shareholders.

DCF and SOTP provide upside potential

We valued Wataniya's operations using a combination of SOTP and DCF as we believe relative multiples are unlikely be an accurate indicator of the company's profitability. The operations in Algeria, Saudi Arabia, Maldives and Palestine will not be profitable in the immediate future, but will, we believe, offer attractive earnings growth at a later stage. This makes DCF a more appropriate methodology for Wataniya than relative valuation. Based on a 50% DCF and 50% SOTP weighting, we reached a price target of KWD4.00 per share for Wataniya Telecom, implying upside of around 36.1%.



The company is an attractive value play as well: we expect the free cash flow yield to be c8.2% and the dividend to be 5.3% in 2009e. We estimate that the company will become net cash positive by 2010 given that the dividend payout ratio is c67% every year.

We have valued Qtel at QAR295, implying potential upside of 5.4% with a Neutral rating. We advise investors to take exposure to Wataniya Telecom rather than its parent company.

Wataniya Telecom – diversified operations

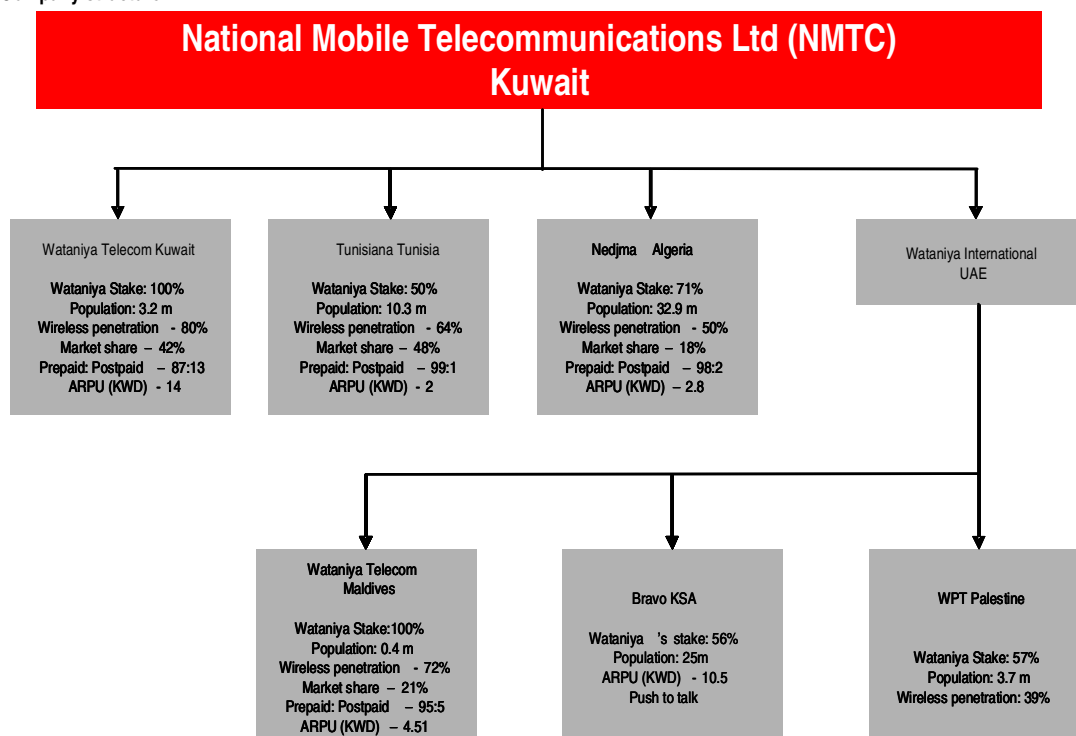
- ▶ Present in six countries in Middle East and Africa
- ▶ Kuwait the key contributor, followed by Algeria and Tunisia
- ▶ Saudi Arabia, Palestine and Maldives are smaller markets

Company Overview

In 1999, MTC's 14-year monopoly in Kuwait came to an end with the establishment of National Mobile Telecommunications Company (NMTC). Better known as Wataniya Telecom, it was the country's first private telecoms operator, and its

launch marked the beginning of liberalisation. Backed by KIPCO (Kuwait Investment Projects Company), it soon captured a significant proportion of the total market, but to counter signs of saturation, Wataniya started to expand into other untapped markets in the region. Its strategy was to focus on regional expansion, targeting

Company structure

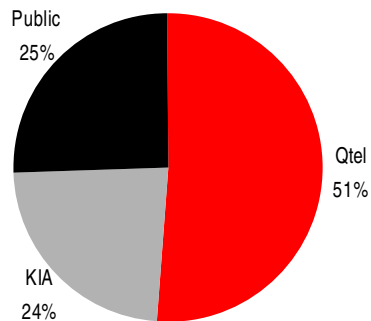


Source: HSBC estimates

under-penetrated markets where demand for telecoms services is growing rapidly. The company's first investment outside Kuwait came in 2002, when it acquired a 50% stake in the Tunisian operator, Tunisiana. With its partner Orascom, it has captured a market share of 46%, providing tough competition for the Tunisian incumbent, Tunicell.

In 2003 it acquired a licence to operate Nedjma, a mobile network in Algeria – one of the fastest-growing markets in the region. Wataniya's acquisition of a 14% market share placed it in head-on competition with the market leader, Orascom, and the incumbent, Algerie Telecom. In the same year, it also acquired one of the three licences issued in Iraq (through Asiacell Cayman Islands). Thereafter, it won a licence to operate a network in Maldives in 2005, and this was followed by the launch of Bravo, which has built and is operating the first (and only) push-to-talk wireless network in the Kingdom of Saudi Arabia. In September 2006, Wataniya International won the bid for the second GSM licence in Palestine (KD101m), and in November 2007, it was allocated frequencies for operating in the region.

Shareholders' structure



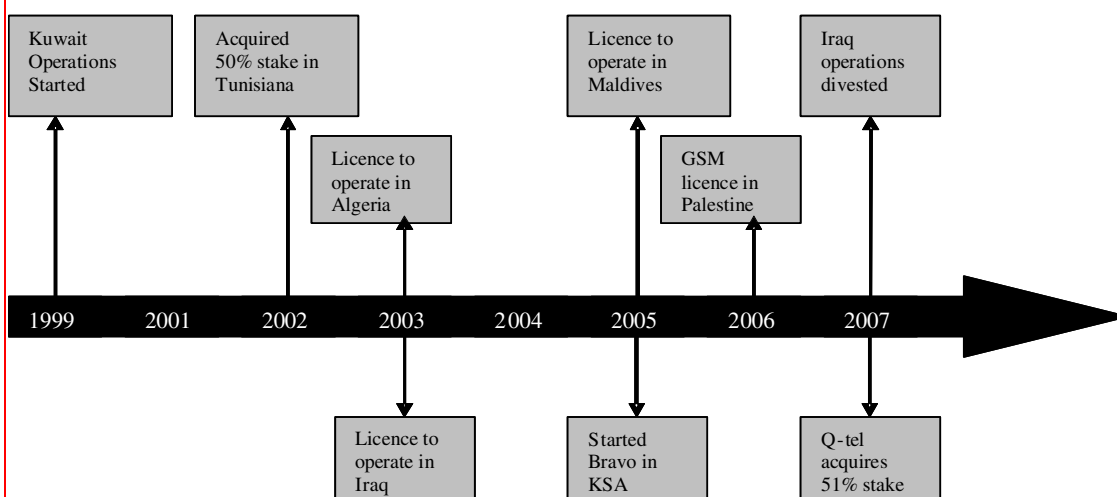
Source: HSBC

The company's shares have been trading on the Kuwait Stock Exchange (KSE) since July 1999.

Iraq operations liquidated in 2007

When the regulatory authority in Iraq failed to renew the interim licence of Asiacell-Wataniya after December 2006, the majority shareholder of Asiacell Cayman Islands, which was incorporated in the Cayman Islands, filed for voluntary liquidation of the company in the Grand Court of the Cayman Islands. On 1 April 2007, Wataniya resolved to discontinue the operations of Asiacell with effect from 1 January 2007.

Wataniya's progress



Source: Company report

Recent M&As in MENA

Date	Acquirer	Acquisition	Stake	Transaction price (USD m)	Price/Subscriber (USD)	EV/EBITDA (TTM)
Jun-07	STC	Maxis Communications	25%	3,050	870	10.5
Mar-07	Qtel	Wataniya Telecom	51%	3,720	730	11.9
May-06	MTN	Investcom	100%	5,530	969	13.6
May-05	MTC	Celtel	100%	3,360	594	13.3

Source: HSBC

Algeria – potential growth market

Algeria is the largest market in Wataniya's portfolio of countries: its population of 33.5m represents 44% of the population under coverage. However, Nedjma's subscribers account for only 24% of parent Qtel's subscriber base due to the company's low market share of only 18%. The opening up of the Algerian economy could act as a key catalyst for future growth in the telecoms sector.

We expect market penetration to continue to show good growth and reach 100% by end- 2017.

Nedjma has been steadily increasing its market share, mainly at the expense of Algerie Telecom, and we expect it to continue growing, stabilising at 20%. We believe ARPUs will fall over the next couple of years as Nedjma attempts to boost its market share through pricing. After that, as the market stabilises and data revenue inflows grow, we expect ARPUs to increase steadily to USD10. We foresee EBITDA margin expansion – driven by more on-net traffic and the maturing of the operations – and expect it to reach c44% in the long run.

Qtel acquired a controlling stake in Wataniya

In March 2007, Qtel acquired 233.7 million shares in Wataniya from KIPCO and other related parties, equivalent to 51% of the pan-Arab mobile operator. The transaction included two additional stakes of 9% apiece in Wataniya's operations in Algeria and Iraq. The total consideration for the transaction was KWD1.075bn (USD3.72bn).

We believe Qtel's acquisition of a controlling stake enhances Wataniya's prospects, given the synergies that are likely to accrue to Wataniya – eg access to Qtel's centralised procurement system, which should allow capex saving and roaming synergies.

Valuation

- ▶ Kuwait contributes more than 50% of Wataniya's EV; Algeria and Tunisia are the other key contributors
- ▶ SOTP gives a value of KWD3.97; DCF analysis gives KWD4.05
- ▶ Relative multiples do not indicate potential profitability in Algeria in the years to come; We initiate coverage with an Overweight rating and a target price of KWD4.00 per share

Valuation estimate

We have valued Wataniya Telecom using two methods:

- ▶ SOTP;
- ▶ DCF for the group.

Valuation summary

Method	Base case	Weight
DCF	4.05	50%
SOTP	3.97	50%
Target price	4.00	
Current price PE 2009e	12.8x	
Target PE 2009e	17.4x	

Source: HSBC estimates

We have valued Wataniya's operations in each country separately, treating the Tunisian operations as a joint venture. Tunisia is a 50-50 JV between Orascom Telecom and Wataniya.

DCF-based SOTP

We have used the DCF method to value the operations in Kuwait, Algeria, Tunisia, Saudi Arabia, Maldives and Palestine. Our SOTP analysis gives us a 12-months-forward fair equity value of KWD1.808bn or KWD3.97 per share. This implies group EV/EBITDA of 9.4x and

EV/sales of 3.7x for 2009e. The implied multiples look on the high side – mainly on account of the Algerian operations, which contribute c25% to the group's valuation but are currently loss making. Kuwait is the largest contributor to the group's valuation, accounting for around c54% of its EV. Kuwait is the richest country in Wataniya's portfolio, has high ARPUs and its market subscribers are set to double in the next 10 years, on our estimates.

SOTP: key assumptions

Operation	Cost of capital	Terminal growth rate
Kuwait	10.8%	2.5%
Tunisia	10.5%	2.0%
Algeria	11.5%	3.0%
Saudi Arabia	10.8%	3.0%
Palestine	18.0%	4.0%
Maldives	10.5%	3.0%

Source: HSBC estimates

We have used a WACC of c10.8% for Kuwait; this is 80 basis points higher than for its competitor, Zain because Wataniya's leverage is lower. Our WACC is based on a debt-to-asset ratio of c5%; we also used an unleveraged cost of equity of 11.05% for Kuwait, derived from a risk-free rate of 5%, a market risk premium of

SOTP valuation summary for Wataniya Telecom (in KWDm)

Wataniya SOTP valuation	Total EV	Wataniya Holding	Subsidiary(S)/ Joint Venture(J)	Wataniya proportionate share	Proportion of total operating EV	Method	Implied EV/Sales 2009e	Implied EV/EBITDA 2009e
Kuwait	991.6	100%	S	992	54%	DCF	4.1	8.9
Tunisia	613.4	50%	J	307	17%	DCF	3.6	7.2
Algeria	470.5	71%	S	471	25%	DCF	3.5	10.3
Maldives	12.3	100%	S	12	1%	DCF	3.1	17.7
Saudi Arabia	43.3	56%	S	43	2%	DCF	2.7	14.0
Palestine	27.5	57%	S	27	1%	DCF	2.5	N/A
Total EV	2,159			1,852			3.7	9.4
Group proportional net debt	105			105				
Minorities	167			167				
Non-core assets	48			48				
Equity value	1,935			1,628				
Shares (fully diluted)	456			456				
Value per share				3.57				
12- month price target				3.97				

Source: HSBC estimates

5.5% for emerging markets and an unleveraged asset beta of 1.1x. We have adopted an explicit forecast period ending in 2017, and then used a terminal growth rate ranging from 2% to 4%, depending on each market's free cash flow growth in the last few years. Our SOTP valuation estimates are highly sensitive to cost of capital and terminal growth rate assumptions.

Group DCF

We have used a three-stage DCF to value the group's operations separately. Our methodology incorporates the assumption that Wataniya Telecom will not generate supernormal returns in the long run and that ROIC will eventually converge to cost of capital.

We have used a 10-year explicit forecast period followed by a semi-explicit period of eight years, during which we assume earnings growth to be constant; this is finally followed by a fade period extending out to 2045, over which we assume that ROIC and cost of capital converge.

We believe Wataniya is a growth-orientated company whose key growth contributors are Algeria, Kuwait and Maldives. Since we expect Algeria's free cash flow to be growing at a double-digit rate at the end of our explicit forecast period and this operation contributes around 25%

to the group's valuation, we have used an eight-year semi-explicit forecast period thereafter. Our cost of capital incorporates an unleveraged cost of equity of c11.05% and a WACC of 10.76% using a debt-to-asset ratio of 5%.

Based on our three-stage DCF valuation, we calculated an equity value of KWD1.66bn for the group, which implies an appraised share price of KWD3.65 per share. This gives us a 12-month target price of KWD4.05 per share for Wataniya.

Key assumptions

	2008e	2009e	2010e	2011e	fading to	2046e
Asset turn (x)	1.25	1.30	1.38	1.45	fading to	1.00
Pre-tax margin (%)	23.4	26.9	29.0	30.8	fading to	11.1
Tax effect (%)	3.0	3.0	3.0	3.0	fading to	3.0
ROIC (%)	28.4	34.0	38.9	43.4	fading to	10.8
Cost of capital (%)	10.8	10.8	10.8	10.8	fading to	10.8
Turnover growth (%)	7.6	11.0	9.4	7.5	fading to	1.5
IC growth (%)	6.4	3.4	2.2	1.9	fading to	4.5
ROIC - Cost of capital	17.7	23.2	28.1	32.6	fading to	0.0

Source: HSBC estimates

Based on a 50% DCF and a 50% SOTP weighting we reached a price target of KWD4.00 per share for Wataniya Telecom (upside of around 36.1%).

EMEA wireless operators: relative valuation summary

Company	HSBC rating	Currency	Current price	EV/EBITDA			PE			EBITDA CAGR (2007-09e)	EPS CAGR (2007-09e)
				2007e	2008e	2009e	2007e	2008e	2009e		
Mobily	Overweight (V)	SAR	67.5	14.6	9.6	7.7	25.1	13.4	10.4	29.9%	55.0%
MTS	Overweight	USD	83.0	8.5	7.3	5.9	16.1	11.9	9.3	20.3%	31.7%
MTN	Overweight	ZAR	118.5	7.4	5.4	4.2	15.9	11.6	9.2	24.3%	31.2%
Mobinil	Overweight	EGP	220.0	6.6	6.3	5.7	12.7	12.1	12.0	12.3%	2.6%
Cellcom	Overweight	ILS	107.7	5.6	5.4	5.2	13.2	11.8	10.6	2.5%	11.3%
Turkcell	Neutral	USD	22.4	5.8	4.7	4.2	12.0	10.8	9.9	11.7%	10.1%
Vimpelcom	Overweight (V)	USD	33.8	9.5	7.6	6.3	21.6	15.2	12.1	18.2%	33.7%
Zain	Neutral (V)	KWD	4.3	13.3	8.7	7.2	25.8	66.1	45.4	24.5%	-24.6%
Bharti Airtel	Overweight	INR	853.7	14.8	10.8	8.6	25.5	19.4	16.0	30.4%	26.3%
China Mobile	Overweight	CNY	113.6	11.7	9.6	8.3	26.4	20.4	18.3	15.0%	20.1%
Orascom	Overweight (V)	USD	73.9	8.9	7.6	6.1	11.5	22.6	15.6	13.8%	-14.3%
Wataniya	Overweight	KWD	2.94	9.8	8.5	6.9	17.1	17.2	12.8	15.3%	15.5%

Source: HSBC estimates

Relative valuation- may not indicate the true potential

Wataniya Telecom currently trades at a 2009e PE of 12.8x against our earnings growth expectation of c15.5% (2007-09e). On an EV/EBITDA basis it trades at 6.9x 2009e against our EBITDA growth expectation of a 15.3% CAGR in 2007-09e. We believe multiples may not provide an accurate indication of this company's true potential, as Algeria, which constitutes c25% of the group's valuation, is currently showing losses. We expect this market to break even in 2008 and start making money from 2009 onwards, implying that its earnings growth will be attractive at a later stage. This makes DCF a more appropriate methodology for Wataniya than relative valuation in our view.

However, if we compare Wataniya with growing Asian mobile operators such as Bharti Airtel (BRTI.BO, Overweight, TP INR 1,140) and China Mobile (0941.HK, Overweight, TP CNY 168), which we also expect to show growth at a later stage on account of their high initial capex and opex, we find Wataniya trading at cheaper multiples. Based on our target prices, we expect Bharti Airtel to trade at a 2009e PE of 21.3x and China Mobile at 27.1x. Our target price implies a 2009e PE of 17.4x for Wataniya Telecom.

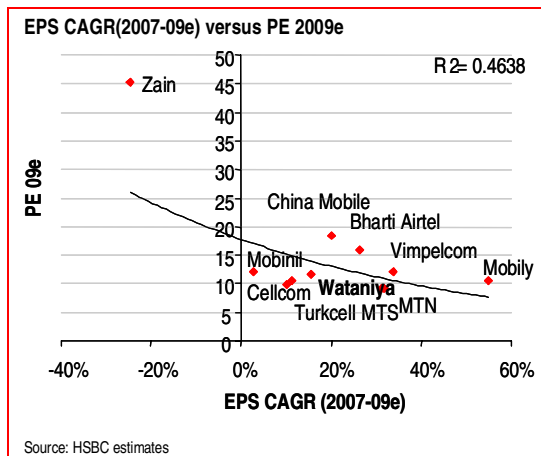
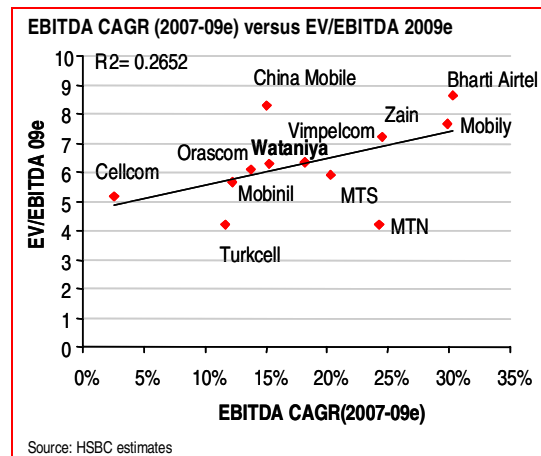
Conclusion

We believe Wataniya Telecom has a sound mix of telecoms assets, offering both value and potential growth. Given its low leverage ratio of c5%, we believe Wataniya's parent Qtel could use it as a vehicle for further growth by acquisition. The

DCF Valuation summary (in KWD m)

Discounted economic profit		Discounted cash flow	
PV of economic profit	1,524	PV of operating free cash flows	1,886
PV of tax shield	0	PV of tax shield	0
Opening invested capital	362		
Appraised value of the enterprise	1,886	Appraised value of the enterprise	1,886
Value of non-core assets	48	Value of non-core assets	48
Value of debt	-105	Value of debt	-105
Value of minorities	-167	Value of minorities	-167
Appraised value of the equity	1,662	Appraised value of the equity	1,662
Number of shares	456	Number of shares	456
Appraised share price	3.65	Appraised share price	3.65
12 months value	4.05	12 months value	4.05

Source: HSBC estimates



synergies arising from Qtel's acquisition of a stake in Wataniya should benefit the latter more the former: the parent is a bigger company and has better bargaining power with equipment vendors.

We initiate coverage with an Overweight rating and a 12-month target price of KWD4.00 per share.

Risks to our valuation

- Competition in Kuwait could be worse than we currently expect. If STC managed to generate higher market share than we forecast, or if an aggressive price war took hold in the country, this could depress ARPU and margins. Given that Kuwait accounts for c54% of our base-case valuation, we believe this would have a material impact on the overall valuation.

- The privatisation of Algerie Telecom is significant for our base-case assumptions. If Etisalat managed to secure the bid, this could lead to aggressive competition in the Algerian market.
- Any conflicts between Orascom Telecom and Wataniya in their management of the Tunisian JV could lead to operational and management inefficiency at Tunisiana.
- Political instability in the region could lead to a slowdown in the regional economies.
- Overpayment for any acquisition – either by Wataniya or by Qtel using Wataniya as acquisition vehicle – could be value dilutive for Wataniya's shareholders.

Wataniya P&L summary

In KWD m	2006a	2007e	2008e	2009e	2010e	2011e	2012e
Revenue	428	420	452	502	549	590	627
Change	21%	-2%	8%	11%	9%	8%	6%
EBITDA	178	148	166	197	222	245	265
Change	46%	-17%	12%	19%	13%	10%	8%
Margin	42%	35%	37%	39%	40%	41%	42%
Capex	-89	-108	-83	-75	-71	-71	-72
Capex/sales	20.8%	25.6%	18.4%	15.0%	13.0%	12.0%	11.5%
TFA	345	362	385	398	407	414	423
Depreciation	-48	-54	-60	-62	-63	-63	-64
Depn/opening TFA	0	0	0	0	0	0	0
Amortisation	-14	-14	-14	-14	-14	-14	-14
Operating profit	115	73	92	121	145	167	187
Non-op exceptional	2	17	0	0	0	0	0
Associate	-4	-1	0	0	0	0	0
PBIT	113	89	92	121	145	167	187
Interest paid	-16	-18	-16	-16	-16	-16	-16
Interest received	3	4	6	7	10	13	17
Interest	-12	-15	-9	-8	-6	-2	1
PBT	101	74	82	112	140	165	189
Tax	-3	-4	-3	-4	-5	-5	-6
Tax rate	2.8%	5.0%	3.5%	3.4%	3.3%	3.3%	3.2%
Minorities	-25	8	-2	-4	-7	-8	-9
Net profit	73	78	78	104	128	152	174
Number of shares	451	456	456	456	456	456	456
EPS	0.16	0.17	0.17	0.23	0.28	0.33	0.38
Change	39%	6%	-1%	34%	23%	18%	14%
DPS	0.11	0.12	0.12	0.16	0.19	0.23	0.26
Change	38%	6%	-1%	34%	23%	18%	14%

Source: HSBC estimates

Balance Sheet summary

In KWD m	2006a	2007e	2008e	2009e	2010e	2011e	2012e
Intangible assets	162	150	135	121	107	92	78
Tangible assets	345	362	385	398	407	414	423
Investments	78	48	48	48	48	48	48
Fixed assets	585	559	568	567	562	555	549
Stocks	5	5	6	8	11	13	15
Debtors	68	81	83	88	92	96	100
Investments + cash	59	120	146	200	267	343	427
Current assets	132	206	235	296	370	452	541
Loans & borrowings	-28	-75	-75	-75	-75	-75	-75
Other creditors	-172	-211	-212	-234	-255	-274	-292
Creditors < 1 year	-200	-286	-287	-309	-329	-349	-367
Net current assets	-68	-79	-52	-13	40	104	174
Assets less current liabs	516	480	516	554	602	659	723
Creditors > 1 year	185	150	150	150	150	150	150
Provisions	2	3	13	13	13	13	13
Minority interests	62	23	13	17	23	31	40
Equity shareholder funds	268	304	341	375	416	465	521
Total	516	480	516	554	602	659	723
Total Assets	716	766	803	863	931	1,007	1,090

Source: HSBC estimates

Cash flow summary

In KWD m	2006a	2007e	2008e	2009e	2010e	2011e	2012e
Op profit excl depre + amort	179	158	166	197	222	245	265
C/f from ops	169	151	175	193	219	242	262
Dividends received	2	1	0	0	0	0	0
Interest + minrtly divs	-3	-50	-9	-8	-6	-2	1
Tax	0	-1	-3	-3	-4	-5	-5
Capex	-89	-108	-83	-75	-71	-71	-72
Fixed assets sold	1	60	0	0	0	0	0
Investments net	-25	17	0	0	0	0	0
Intangibles net	-6	-1	0	0	0	0	0
Capex + investment	-119	-32	-83	-75	-71	-71	-72
Acqns + disposals	-4	-2	0	0	0	0	0
Dividends paid	-34	-50	-53	-53	-71	-87	-103
Net c/f pre financing	10	17	26	53	67	77	83
Loans new	9	9	0	0	0	0	0
Loans repaid	-9	-19	0	0	0	0	0
Financing	0	-10	0	0	0	0	0
Change in cash	9	30	26	53	67	77	83

Source: HSBC estimates

Notes

Disclosure appendix

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Company	Ticker	Recent price	Price Date	Disclosure
QATAR TELECOM	QTEL.QA	286.60	06-Feb-2008	2

Source: HSBC

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