

20 October 2009

Etisalat

3Q09 earnings – better than expected

Etisalat reported better-than-expected 3Q09 earnings, albeit lower on a q/q basis. EPS reached AED 0.31, in line with consensus but 7.4% higher than the CICRe of AED 0.29. Revenues declined 3% q/q despite higher-than-expected UAE mobile subscribers. We believe this is due to lower ARPU. Etisalat's EBITDA margin narrowed q/q. Though such a slip was expected, this was >300 bps higher than consensus. Etisalat continued its ambitious growth plans with capex heightened during the quarter to 25% of revenues (16% in 9M09), driven it seems by the FTTH network roll-out and Etisalat's Indian operation. 3Q09 results are more or less in line with our estimates for the full year, hence we maintain our target price of AED 20/share (+61%) and reiterate our Strong BUY.

Lower earnings q/q, in line with consensus, better than CICRe:

Etisalat reported a 3Q09 EPS of AED 0.31 (2Q09 AED 0.34, -7%), in line with consensus (median) EPS of AED 0.31 though 7.4% better than the CICRe of AED 0.29. Net earnings after royalty fees reached AED 2.25bn in 3Q09 (2Q09 AED 2.41bn), again beating our estimates of AED 2.10bn by 7.4%. Median consensus was for net earnings to reach AED 2.22bn.

Driven by lower revenues and ARPU: Unsurprisingly, Etisalat's total revenue slipped in 3Q09 by 3% q/q (-0.5% y/y) to AED 7.36bn. We believe this stems from the combination of economic slowdown and lower usage. While Etisalat's total UAE subs (mobile and fixed) increased q/q by 1.8% to 8.3mn, we believe lower revenue is due to weaker ARPU, influenced in part by lower usage in Ramadan and free airtime promotions offered to both post- and prepaid subs.

Despite higher UAE subs: Assuming an activity ratio of 94%, we estimate that UAE's mobile subs beat our expectations by 3% (6.99mn vs. CICRe of 6.76mn). We had expected the end of the school year and significant nationwide layoffs to negatively impact mobile net additions (i.e. net deactivations of 63,000 vs. reported net additions of 169,000). Internet subs grew by 3.3% q/q to 1.27mn. Meanwhile, UAE's fixed-line segment continued to be the hardest hit by the economic crisis, contracting for the third consecutive quarter by 2%, down 20,000 (vs. CICRe -3,000) to 1.31mn, slightly lower than the CICRe of 1.33mn.

AED mn	2007 A	2008 A	2009 F	2010 F	2011 F
Revenues	21,340	26,119	29,620	32,027	34,456
Growth rate		22.4%	13.4%	8.1%	7.6%
EBITDA	15,488	17,257	19,703	21,998	23,124
Growth rate		11.4%	14.2%	11.6%	5.1%
EBITDA margin	72.6%	66.1%	66.5%	68.7%	67.1%
Net income	7,297	8,665	8,958	9,920	10,363
Growth rate		18.8%	3.4%	10.7%	4.5%
Net margin	34.2%	33.2%	30.2%	31.0%	30.1%
PER	12.3x	10.3x	10.0x	9.0x	8.6x
P/BV	3.7x	2.8x	3.4x	2.8x	2.4x
EV/EBITDA	N/A	4.2x	3.9x	3.4x	3.2x
Net debt/EBITDA	-0.3x	-0.5x	-0.4x	-0.4x	-0.4x
Dividend yield	3.3%	4.0%	4.8%	5.3%	5.6%

Note: EV/EBITDA is proportionate; forecast does not include recently-acquired Tigo (Sri Lanka)

Source: Etisalat and CICR estimates

STRONG BUY (MAINTAINED)
LT FAIR VALUE | AED 24.2
TARGET PRICE | AED 20.0

COMPANY SYNOPSIS

Emirates Telecommunications Corporation (Etisalat) was established in 1976 as UAE's sole telecommunications service provider, under UAE Federal Government decree No.78 which was finally amended by Decretal Federal Code No.3/2003 stipulating the liberalization of the telecom sector. Etisalat's monopoly came to an end in 2005, when Emirates Integrated Telecommunications Company (du) won the second integrated telecom license. Despite the end of its service monopoly, Etisalat continues to submit 50% of its earnings to the UAE's government as royalties, making it a major contributor to the UAE's budget.

Etisalat established itself as a regional pioneer by introducing advanced technologies: mobile phone services (1982); GSM technology (1994); 3G and MMS (2003) and most recently BlackBerry service (2006). Driven by the vision to become one of the top 10 global telecom operators in 2010 and supported by a cash-generating saturated telecom market in the UAE, Etisalat expanded its service footprint to the global market. Currently, Etisalat possessed a portfolio of investments in West Asia, South Asia, and Africa markets in 18 countries with an aggregate subscriber base of around 85mn. Etisalat stands 140th among the Financial Times Top 500 Corporations in the world in terms of market capitalization, and is ranked by The Middle East magazine as the 6th largest company in the Middle East in terms of capitalization and revenues.

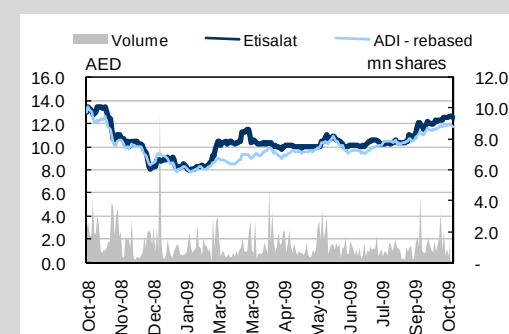
SHAREHOLDER STRUCTURE

Government of UAE	60.0%
Free float	40.0%
Total	100.0%

STOCK DATA

Reuters; Bloomberg	ETEL.AD; ETISALAT DH
Recent price as of 19-Oct-09	AED 12.45
No. of O/S shares	7,187.4 mn
Market cap	AED 89,483 mn
52-wk high / low	AED 13.54/ AED 7.75
Avg. daily volume / turnover	1.15 mn / AED 12 mn

STOCK PERFORMANCE | 52 WEEKS



Source: Bloomberg

AMR HUSSEIN ELALFY, CFA
AMR.ELALFY@CICH.COM.EG

NORAN ALI
NORAN.ALI@CICH.COM.EG

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Lower EBITDA margin q/q, but also beating expectations: We estimate that Etisalat's consolidated EBITDA margin narrowed slightly q/q to 67.6% (2Q09 69.5%) vs. CICRe of 64.5%. We attribute this to lower ARPU during the third quarter and higher opex of a number of subsidiaries still picking up speed on the revenue side. Given the lack of disclosure for some subsidiaries, we think the list could include Afghanistan, Tanzania, Nigeria and India.

Higher capex spent q/q, likely because of FTTH and India: Etisalat continued to ramp-up its capex spending during the quarter, reaching AED 1.85bn in 3Q09 or 25% of revenues (2Q09 AED 1.39bn/18%; 1Q09 AED 270mn/4%). 3Q09 capex came in AED 500mn higher than our expectations, probably due to (1) the continued roll-out of the FTTH network and (2) timing differences in gearing up India (expected to be launched in 4Q09). Total 9M09 capex is now AED 3.51bn or a more normalized 16% of revenue.

Valuation and recommendation: Etisalat achieved positive 3Q09 results, more or less in line with our estimates for the full year. Traded at a proportionate EV/EBITDA 2010e of 3.4x, we believe Etisalat is undervalued. We remain bullish on its stock and reiterate our sum-of-the-parts long-term fair value (LTFV) of AED 24.2/share with a target price (TP) of AED 20/share. This target price implies a 61% upside potential and, as a result, we maintain our Strong BUY.

Recent developments

Etisalat's expansionary measures are in line with its strategy to boost its current c.85mn subscribers' base to 100mn 2010 and 200mn 2012. The operator also aims to enlarge its International revenue contribution from a current c.11% to 30% by 2011. The company is reportedly evaluating a number of overseas investments including Iraq (currently in talks with Korek Telecom), Syria, Lebanon, and Algeria. Etisalat could also still be interested in the Iranian market.

On October 18, 2009, Etisalat announced its plan to offer 1 bn Libyan Riyal (US\$825mn) to bid for Libya's third mobile operator. The company is expected to receive a final decision from the Libyan authorities by the end of this year. In 2008, mobile subscribers reached 4.8mn subscribers with a 76% penetration rate. This market has attracted other operators such as Turkcell - Turkey's largest mobile operator.

On October 16, 2009, Etisalat purchased 100% of Millicom's Sri Lanka operations (Tigo Sri Lanka) for an enterprise value of US\$207mn or 7.4x 2009e EBITDA. Tigo Sri Lanka is the second largest mobile operator in Sri Lanka with 2.25mn subscribers and a 21% market share at end of September 2009.

The UAE telecom market is expected to undergo significant regulatory reform. In October 2009, the TRA announced its approval of Mobile Number Portability (MNP). This facility will enable subscribers (after spending at least one year with an operator) to retain their respective codes when shifting to a different operator. MNP is expected to be offered by 2010. On a different note, the TRA is currently holding talks with Etisalat and du to introduce VoIP.

Etisalat in expansionary mode

Bidding for Libya

Sri Lanka, Etisalat's last frontier in Asia

Expected regulatory reforms

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Figure 1: Etisalat's major KPIs (3Q09 actual vs. forecasts)

(All figures in AED mn, unless otherwise noted)	1Q09 a Mar-09	2Q09 a Jun-09	3Q09 a Sep-09	CICRe		Consensus (median)		
				3Q09 e Sep-09	Variance a vs. e	3Q09 e Sep-09	Variance a vs. e	No. of analysts
UAE subscribers (mn)	8.25	8.15	8.30	8.09	3%	8.07	3%	3
UAE mobile subscribers (mn)	6.90	6.82	6.99	6.76	3%	6.76	3%	3
UAE fixed subscribers (mn)	1.35	1.33	1.31	1.33	-1%	1.31	0%	3
UAE subscriber growth rate	0.5%	-1.2%	1.8%	-0.8%	263 bps	-1.0%	284 bps	
UAE mobile subscriber	0.8%	-1.1%	2.5%	-0.9%		-0.9%		
UAE fixed subscribers	-0.6%	-1.5%	-1.5%	-0.2%		-1.5%		
UAE net adds (mn)	0.04	(0.10)	0.15	(0.07)		(0.08)		
UAE mobile subscribers (mn)	0.05	(0.08)	0.17	(0.06)		(0.06)		
UAE fixed subscribers (mn)	(0.01)	(0.02)	(0.02)	(0.00)		(0.02)		
Revenues	7,119	7,625	7,364	7,467	-1.4%	7,367	0.0%	5
Growth rate q/q	34%	7%	-3%	-2%		-3%		
Growth rate y/y			-0.5%	1%		0%		
EBITDA	4,600	5,299	4,980	4,814	3.5%	4,760	4.6%	4
Growth rate q/q	32%	15%	-6%	-9%		-10%		
EBITDA margin %	64.6%	69.5%	67.6%	64.5%	316 bps	64.6%	302 bps	
Net income (after royalty fees)	2,178	2,415	2,254	2,099	7.4%	2,219	1.6%	6
Growth rate q/q	48%	11%	-7%	-13%		-8%		
Growth rate y/y			5%	-2%		3%		
Net margin %	30.6%	31.7%	30.6%	28.1%	250 bps	30.1%	49 bps	
No. of O/S Shares (mn)	7,187	7,187	7,187	7,187		7,187		
EPS	0.30	0.34	0.31	0.29	7.4%	0.31	1.6%	6
Capex	270	1,388	1,849	1,340	38.0%			
Capex/revenues	4%	18%	25%	18%	716 bps			
Simple FCF (EBITDA less capex)	4,330	3,911	3,131	3,473	-9.9%			
Growth rate q/q	97%	-10%	-20%	-11%				

Source: Etisalat reports & CICR estimates

Contacts and Disclaimer:

CI CAPITAL RESEARCH

Mark Rorison | Group Director, Head of Research
Mark.Rorison@cich.com.eg

Amr Hussein Elalfy, CFA | Director
Amr.Elalfy@cich.com.eg

Mona Mansour | Director
Mona.Mansour@cich.com.eg



CI CAPITAL SECURITIES BROKERAGE (EGYPT & UAE)

Amr Mostafa | Managing Director
Amr.Mostafa@cich.com.eg

DYNAMIC SECURITIES

Ahmed Roushdy | Managing Director
Ahmed.Roushdy@cich.com.eg

CI CAPITAL HOLDING

8, Nadi El-Seid Street, Third Floor
Dokki, Giza
Egypt

Reuters pages: COIW, COIX, COIY, and
COIZ

Bloomberg page: COIB <GO>

For more information,
please contact CI Capital Research on +2
(02) 33 38 62 59,
send e-mail to Research@cich.com.eg
or visit our website at www.cich.com.eg

RATING SYSTEM

In February 2009, CI Capital Research (CICR) launched a new rating system to give analysts more freedom to be market responsive. This is to make one element of our research more dynamic, namely the advertising of target prices and recommendations. What we did not change is our assessment of the Long Term Fair Value (LTFV), nor have we stopped our detailed industry and company research. What we did is changing the target price to trade in the balance of where a share should trade and where we think it will trade.

LTFV: As before we continue to estimate a fundamental valuation, largely DCF and/or NAV based.

Target Price: The target price, which is not necessarily the LTFV, is where the analyst, given all (qualitative as well as financial) information available, thinks the share price can get to within the next 3-12 months. This can be changed at any time on changing facts, and perceptions.

Recommendations: Our new rating system falls out from the total return relating to the share price performance to the target price, and including any distributions as may not be included in the target price calculation. This is shown in the table below, and to be BUY must return over 19%, an arbitrary hurdle rate we think reasonable given prevailing interest rates and risks. (Please see table below.)

Recommendation structure:

	Change to Target Price	
Strong BUY	> 30%	Strong Conviction
BUY	> 20% < 30%	
Hold	> 10% < 20%	
Underweight	> 0% < 10%	
SELL	< 0%	

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