

Aiming Higher

Buy

Emirates Telecommunications Corporation (Etisalat) is the oldest and largest company in the two-player UAE telecom market, ahead of Emirates Integrated Telecom Company (EITC). Etisalat's has 6.63 mn mobile subscribers which account for nearly 79% of the UAE's mobile market. In addition, the Company's fixed line and Internet subscriber base stands at 1.33 mn and 0.94 mn in Q1'08. While the mobile subscriber market is likely to grow only steadily due to increasing population, the broadband market holds immense growth potential for the Company. Since 2005, Etisalat has been aggressively expanding in Africa, Asia and Middle East markets in order to achieve exponential growth. We initiate coverage on the stock with a Buy rating.

Domestic markets: favourable demographics and an under-penetrated broadband market

The population of the UAE has been growing by 6.8% since 1995 due to large inflows of young expatriate professionals. Etisalat's target market is growing as the UAE economy is expected to remain robust due to a continued influx of expatriates. Also, low Internet penetration and migration of dial-up subscribers to broadband represent significant opportunities for the Company. Moreover, it plans to enter the Quad Play market with bundled services offerings capable of being delivered over an IP network. Combining its wide coverage and an innovative service portfolio, and given the absence of tariff-based competition, we believe Etisalat is well positioned to increase its mobile subscriber base at a CAGR of 4.4% and its Internet subscriber base at an impressive CAGR of 17.9% between 2008–2015.

International Market: a mantra for faster growth

Etisalat is aggressively expanding in Arab, African, and Asian markets in order to achieve faster growth. Although these markets are characterised by low average revenue per user (ARPU) and high initial operating costs compared to the UAE, the Company has a strong balance sheet with low leverage and huge operating cash flows capable of sustaining initial losses until international operations achieve significant scale.

Reduction in royalty will improve profitability

In 2007, EITC entered the UAE telecommunications market, ending Etisalat's 31-year monopoly. As a result, the Government is likely to reduce its royalty from the currently 50% of pre-tax profits level to 40% in the next few years, leading to improvement in profitability.

INITIATING COVERAGE

Share Data

Market Cap	AED 128.5 bn
Price	AED 21.45
Abu Dhabi Index	5,026.1
Reuters	ETELAD
Bloomberg	ETISALAT UH
Avg. Volume (52 Week)	2.0 mn
52-Week High/Low	AED 22.2 / 14.17
Shares Outstanding	5,990
Fair Value Estimate	AED 26.5

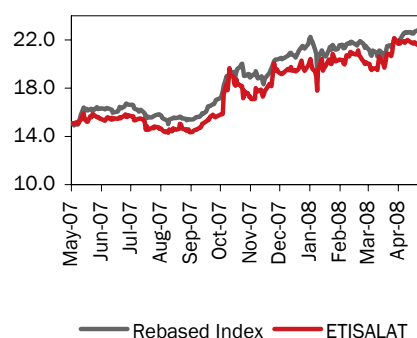
Key Figures

Year to 31 Dec	2007	2008
Revenue (mn)	21,339.9	25,746.2
Operating Profit (mn)	6,609.6	7,940.6
EBITDA (mn)	8,571.5	10,335.3
Net Profit (mn)	7,296.6	8,814.1
EPS (AED)	1.22	1.47
Operating Margin (%)	31.0%	30.8%
RoA (%)	13.7%	14.7%
RoE (%)	31.1%	30.7%
EV/Revenue	5.7x	4.8x
EV/EBITDA	14.3x	12.0x
P/E	17.6x	14.6x

Shareholding Pattern (%)

Government of UAE	60
Public & Others	40

Relative Performance



Valuation

We have valued Etisalat using SOTP-based Discounted Cash Flow (DCF) and Peer-Based Multiple methods. Our fair value estimate of Etisalat is AED 26.5. 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.

Weighted Average Value per Share		
Valuation Method	Value (AED)	Weight (%)
Valuation based on SOTP	27.5	70%
Peer-based multiple valuation	24.2	30%
Weighted Average Fair Value	26.5	100%

Source: ADCB research

Discounted Cash Flow (DCF) model

In our SOTP-based DCF valuation, we have valued Etisalat's consolidated business with its subsidiaries. We have discounted the explicit values of free cash flows from the UAE Stand alone business to 2015 at a WACC of 10.52% assuming a cost of equity of 10.76%, gearing of 5% and a terminal growth rate of 3.5%. Free cash flow (FCF) is defined as Operating Profit + Depreciation + Amortization – Capex – Changes in Working Capital. Operating profit is calculated after charging royalty fees.

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:	4.79% (Avg. 10 yr. US Treasury Bond Rate for three years)
Country Risk Premium:	0.9%
Equity Premium:	6.0%
Beta:	0.85 (Sector beta for emerging markets)
Cost of equity:	10.76%
WACC:	10.52%
Terminal growth rate:	3.5%

Based on these assumptions, our estimate of the fair value of equity is AED 147,542mn. Current outstanding shares total 5,990 mn. For the valuation of Etisalat's investments in associates and joint ventures, we have used the market value for listed companies like Pakistan Telecommunication Company, Qatar Telecom, and Sudan Telecom. For the valuation of Etihad Etisalat, we have used the average of analyst target price as we believe the current price of Etihad Etisalat is depressed mainly due to mandatory disposal of founder's shares. Besides, we have used the book value for unlisted companies. On this basis, our SOTP-based DCF model yields a fair value per share of AED 27.5.

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	50.0	0.01
Pakistan Telecommunication Company Ltd (PTCL)	26.00%	Market Value	3,200.5	0.53
Etihad Etisalat Company, KSA	26.25%	Analyst Target Price	10,096.6	1.69
Thuraya Satellite Telecommunications Company PJSC	28.04%	Book Value	509.1	0.08
PT Excelcomindo TBK	15.97%	Book Value	1,614.8	0.27
MDC-NG B.V., Netherlands	40.00%	Book Value	957.2	0.16
Other Investments		Market Value/Book Value	785.7	0.13
				2.87
DCF Valuation of Stand-alone Business				24.63
Valuation based on SOTP (In AED)				27.51

Source: ADCB research

Emirates Telecommunications Corporation PJSC

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

		Terminal cost of capital				
		9.5%	10.0%	10.5%	11.0%	11.5%
Terminal Growth	2.5%	24.5	23.4	22.4	21.6	20.8
	3.0%	25.8	24.6	23.4	22.5	21.6
	3.5%	27.4	25.9	24.6	23.5	22.5
	4.0%	29.3	27.5	26.0	24.7	23.6
	4.5%	31.5	29.4	27.6	26.1	24.8

Source: ADCB research

Sensitivity of fair value estimate of Stand-alone Business, using different mobile ARPU and market share for 2015

We have performed a sensitivity analysis based on mobile market share and ARPU as the mobile segment makes a significant contribution to the Company's revenue. Consequently, the valuation of the company is highly sensitive towards these two mobile business drivers.

		Market share in 2015				
		60.0%	62.5%	65.0%	67.5%	70.0%
Expected ARPU in 2015	125	23.3	23.5	23.8	24.0	24.2
	130	23.7	24.0	24.2	24.4	24.6
	135	24.2	24.4	24.6	24.9	25.1
	140	24.6	24.8	25.1	25.3	25.6
	145	25.0	25.3	25.5	25.8	26.0

Source: ADCB research

Sensitivity of fair value estimate of Stand-alone Business, using different Royalty Percentages

We believe that with the end of the Company's monopoly in the UAE telecom sector, the Government is likely to gradually reduce its royalty fee to 40% from currently 50% of pre-tax profit before cutting it further to 35% by 2015. We have analysed a number of different scenarios concerning the royalty fee as our DCF value is highly sensitive to it. According to the pessimistic scenario, the value falls by 21.1% to AED 19.4, while based on the optimistic scenario, the value increases by 19% to AED 29.3.

Scenario Summary			
Current Values:		Sensitivity to changes in Royalty %	
Percentage of Royalty:	Base case	Optimistic scenario	Pessimistic scenario
2008	50%	50%	50%
2009	45%	45%	50%
2010	40%	40%	50%
2011	40%	35%	50%
2012	40%	30%	50%
2013	35%	25%	50%
2014	35%	20%	50%
2015	35%	15%	50%
Value per share	24.6	29.3	19.4

Source: ADCB research

Peer-based Valuation method

In our peer-based valuation, we believe that in the case of Etisalat, a comparison based on P/E multiples is superior to one using EV/EBITDA ratios as our selected peer group companies do not have any comparable operating royalty expense similar to that paid by Etisalat to the Federal Government. Based on a peer-group average estimated P/E multiple of 14.1x 2009 earnings, our forecast 2009 EPS for Etisalat of AED 1.72 per share implies a value of AED 24.2.

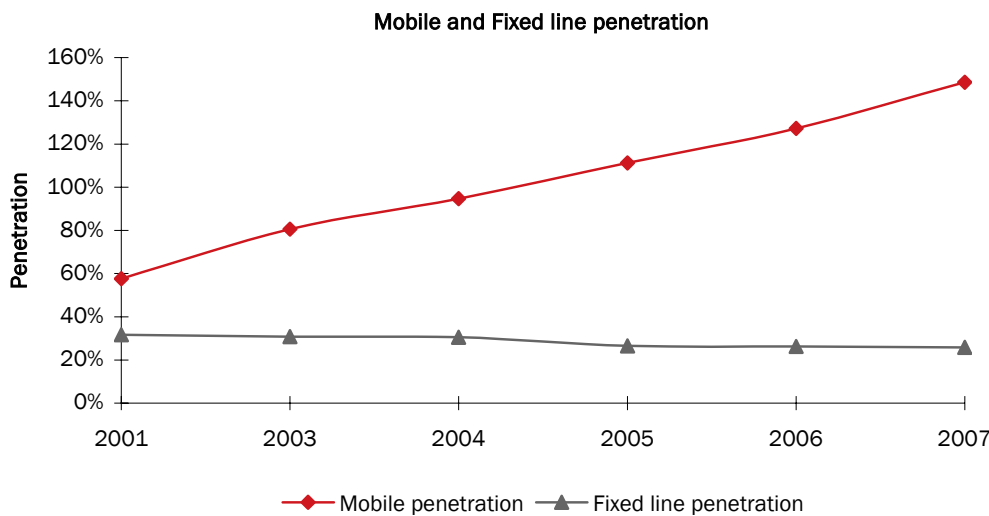
Comparable Company Trading Analysis												
Company	Stock Price	Fully Diluted		P/E			Fully Diluted			ROCE		
	14-May-08 (Local Ccy)	Market Cap (AED m)	Enterprise Value (AED m)	Dec-07	Dec-08	Dec-09	Dec-07	Dec-08	Dec-09	FY07	FY08	FY09
Saudi Telecom Co.	66.00	129,277	135,131	11.0x	10.4x	10.0x	8.3x	8.1x	7.7x	34%	34%	35%
Mobile Telecommunications Company (Zain)	1.70	98,684	124,405	22.5x	16.7x	13.8x	13.1x	10.3x	8.6x	19%	22%	25%
Turkcell Iletisim Hizmetleri AS	9.25	58,401	52,029	15.0x	8.2x	7.4x	6.9x	6.5x	5.6x	33%	16%	38%
Orascom Telecom Holding	79.62	56,012	73,971	28.7x	15.1x	12.9x	9.2x	7.6x	6.7x	26%	28%	30%
Etihad Etisalat Co	54.25	26,566	34,616	15.5x	12.3x	9.4x	12.0x	8.9x	7.5x	20%	24%	26%
Qatar Telecom QSC	219.00	24,300	51,798	12.0x	10.9x	9.2x	10.3x	7.5x	6.9x	18%	24%	25%
Telecom Egypt SAE	18.88	22,091	24,574	11.5x	10.8x	9.5x	6.9x	6.1x	6.0x	17%	19%	18%
Emirates Integrated Telecommunications Com	6.04	24,160	24,071	NM	NM	50.3x	NM	NM	20.5x	(21%)	0%	45%
Egyptian Company for Mobile Services	180.29	12,337	14,553	10.2x	10.4x	9.4x	5.6x	5.0x	4.4x	58%	69%	68%
Oman Telecommunications Co	2.14	15,320	14,399	14.3x	14.0x	13.0x	7.8x	7.6x	7.3x	55%	69%	NA
Bahrain Telecommunications Co BSC	0.83	11,574	11,454	11.7x	11.0x	9.9x	8.9x	8.0x	7.3x	22%	NA	NA
Mean				15.2x	12.0x	14.1x	8.9x	7.6x	8.0x	25%	30%	35%
Median				13.2x	11.0x	9.9x	8.6x	7.6x	7.3x	22%	24%	30%
P/E multiple (Peer-group average)	14.1x											
EPS09E	1.72											
Equity Value	24.2											

Source: ADCB research, Reuters, Company data

Industry Overview

In recent years, the telecommunications industry in the Middle East has expanded rapidly due to continuously rising crude oil prices, the introduction of new competition, and increasing numbers of construction projects. The UAE is one of the most developed telecommunications markets with a technologically advanced telecom infrastructure. It is ranked first amongst MENA countries on the Networked Readiness Index (NRI), according to the Global Information Technology Report produced by the World Economic Forum.

The UAE has one of the highest fixed and mobile penetration rates amongst MENA countries. Driven by a continuous inflow of expatriates, mobile penetration has increased from 45.4% in 2000 to 148.5% in 2007 taking the total mobile subscriber base to 7.9 mn. However fixed line penetration has stagnated at around 26% due to high fixed line to mobile substitution and an expatriate preference for mobile over fixed line technology.



Source: TRA, UAE

Etisalat was the sole telecom service provider in the UAE for over 30 years until May 2005, when the Government granted EITC a 20-year license to provide telecommunication services across the UAE in order to liberalise the telecom market as required by World Trade Organization (WTO) policy. Moreover, the Government is expected to fully liberalize the Country's telecommunication market by 2015, allowing the entry of foreign players.

Company Overview

Emirates Telecommunications Corporation (Etisalat) enjoyed exclusive rights of operation in the UAE telecommunications sector for over three decades. Etisalat's monopoly within the country was formalised by a Federal Act that guaranteed the Company exclusive rights concerning the telecom sector in exchange for the payment of a 50% royalty to the Government based on net profits. The Act also defined Etisalat's shareholding structure vesting a minimum 60% of total shares in the Government and banning foreign ownership in the Company.

During its thirty-one years of operations, the Company established a sound operational base in fixed line, mobile, and Internet services markets with its 3G & 3.5G network covering over 97% of the UAE population. At present, Etisalat has around 6.63 mn mobile and 1.33 mn fixed line subscribers. The Company's national and international traffic has increased at a CAGR of 15.4% since 2003 to 17,770 mn and 3,989 mn minutes, respectively. In international connectivity, Etisalat has become the largest voice traffic carrier in the Middle East, terminating calls at over 600 destinations and with 118 direct connections worldwide.

The Company has also capitalized on the opportunity presented by the under-penetrated domestic Internet market by increasing subscribers during Q1 2008 by 34.3% y-o-y to 0.94 mn. Its portfolio of services also includes enterprise solutions provided to customers

across eleven industry segments, including banking & finance, transportation & logistics, health care, and airlines.

In order to sustain its long term growth and achieve its ambition to become a top 10 telecom operator worldwide by 2010, Etisalat has in recent years focused on overseas expansion.

Financial Overview

Financial Analysis					
Profit & Loss (AED mn)	Q1'07	Q4'07	Q1'08	q-o-q%	y-o-y%
Net Revenue	4,809.4	5,954.0	6,059.7	1.8%	26.0%
Operating profit	1,762.4	1,471.4	1,805.1	22.7%	2.4%
Margin %	36.6%	24.7%	29.8%		
EBITDA	2,087.1	2,021.4	2,394.9	18.5%	14.7%
Margin %	43.4%	33.9%	39.5%		
PAT	1,837.4	1,760.2	2,122.4	20.6%	15.5%
Margins	38.2%	29.6%	35.0%		
EPS	0.31	0.29	0.35	20.6%	15.5%
Subscribers (In Mn)					
Fixedline	1.30	1.33	1.33	0.4%	2.3%
Mobile	5.78	6.37	6.63	4.1%	14.7%
Internet	0.70	0.88	0.94	7.4%	34.3%

Source: Company data

Etisalat continued strong financial performance in Q1 2008 with a 26.0% y-o-y increase in operating revenue to AED 6.0bn, largely due to a 34.3% growth in Internet and 14.7% increase in mobile subscribers. Despite competition from EITC, the Company has been successful in adding domestic subscribers to its base due to wide coverage of population, the continuous launch of new services, and the unique demographic profile of the UAE market. On the international front, although the Company does not disclose its geographical breakdown of revenue, we expect Etisalat Egypt to start contributing significantly to revenue over the next 3–4 years.

EBITDA and net profit increased by 14.7% and 15.5% y-o-y to AED 2.4bn and AED 2.1bn, respectively in Q1 2008. However, during the same period both EBITDA and net profit margins dipped 387bps and 318bps y-o-y to 39.5% and 35.0%, respectively, due to high network & establishment charges and increasing investments in international operations. We believe that margins will improve 2009 onwards as international operations begin to confer benefits from economies of scale and royalty is reduced.

During Q1 2008, the Company made capital expenditure and associate investments totalling AED 1.87bn. With ambitious international expansion plans across Asia and Africa, such spending is likely to remain high in the coming years. All capital expenditure and associate investments will be financed through internal cash flows and borrowing.

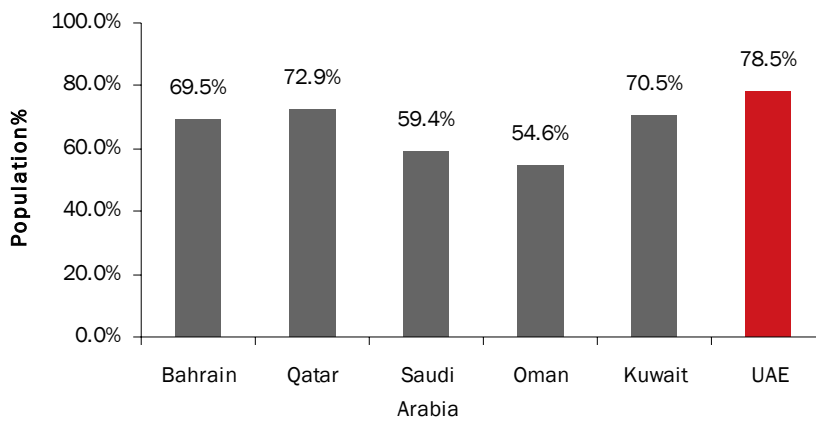
Investment Rationale

Domestic markets- favourable demography and under penetrated Internet Market

High population growth would continue to fuel growth

Since 1995, the population of the UAE has been growing at a CAGR of 6.8% to 5.3 mn due to the influx of expatriates from other Arab countries, the Indian subcontinent, the Far East, and Europe. As a result expatriates comprise nearly 80% of the total population. Moreover, as most are young professionals, the addressable population for the telecom companies (i.e. the age group between 15–64 years) comprises more than 78.5% of the total population, the highest proportion amongst all MENA countries. As real GDP growth is expected to remain robust at around 7% p.a., the population is likely to continue to grow at around high rate with the inflow of young expatriates further increasing the addressable population for telecom operators.

Addressable Population⁽¹⁾⁽²⁾



⁽¹⁾ Data indicated is as of December 31, 2007

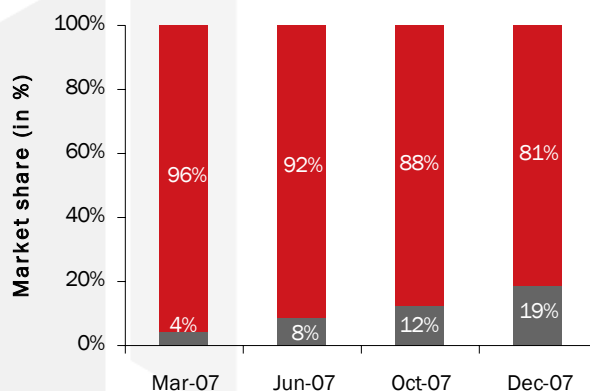
⁽²⁾ Addressable population represents the age-group of 15-64 years

Source: CIA - The world factbook

EITC has been a tough competitor

EITC has provided stiff competition for Etisalat based on the strong initial response to EITC's services. In under a year EITC accumulated nearly 1.5 mn mobile and 46,000 fixed line subscribers. EITC has steadily eroded Etisalat's mobile market share by capturing around 63% of incremental subscribers and around 19% of the overall mobile market by end of 2007.

Competition leading to loss of market share



Source: Company Data & ADCB Research

■ DU ■ Etisalat

Emirates Telecommunications Corporation PJSC

There is no price war

Price competition is limited in the UAE telecom market as both Etisalat and EITC are owned by the Government. A strategy aimed at reducing tariffs would impact exchequer revenues from royalty. Moreover, EITC is unlikely to embark on price competition, considering Etisalat's ability to more than match any tariffs it sets based on its substantial financial strength and scale of operations. Consequently, tariff plans for both companies are generally comparable.

Charges (AED)	EITC	Etisalat
Prepaid (Monthly Plan)		
Validity	365 days	365 days
Connection Fee	155	165
Annual Renewal	100	100
Postpaid (Monthly Plan)		
Connection Fee	125	185
Monthly charges	30	20
Call Charges for both Prepaid and Postpaid		
All mobiles and National landlines	0.005/sec	0.3/min
National SMS(per SMS)	0.18	0.18
International SMS(per SMS)	0.6	0.6

Source: Company data & ADCB Research

Innovative product offerings are vital

Etisalat focuses on delivering a strong and innovative service portfolio to its subscribers. With a network covering 97% of the UAE population, it provides technologically advanced services including High speed mobile Data Modem, MobileCAM, Mobile TV, Mobile Map, Video Call, and BlackBerry services. Moreover, the Company targets the country's substantial expatriate population through specific offerings including:

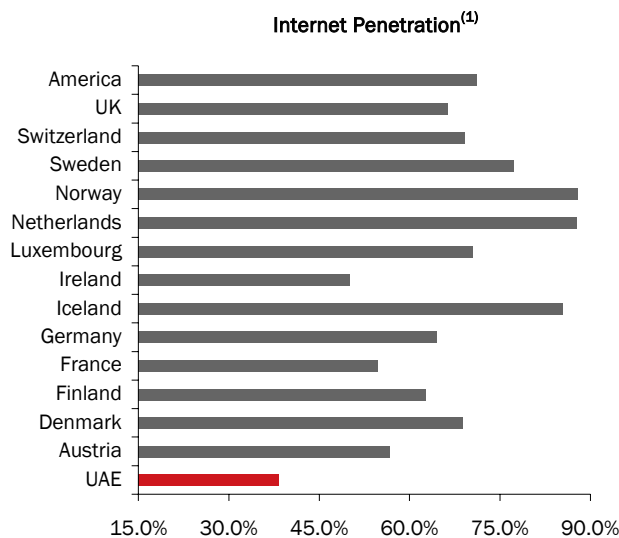
- ▶ Favourite Country Plan and Global Friends & Family packages, which offer preferential call rates to selected international destinations
- ▶ International Money Remittance using mobile phones
- ▶ 123 Mobile Banking, which allows customers to perform banking transactions and services for free through a menu-driven user interface.

We believe that Etisalat's strong product portfolio combined with the continuous launch of innovative services and presence of 3G and 3.5G services across the country should help it to maintain market leadership in the UAE market. Although EITC will increase its market share in the early years following launch of its services, we still expect Etisalat's market share to stabilize at around 65–70% by 2012.

While the Broadband market provides major opportunities

The UAE Internet market offers significant commercial scope with Internet penetration at a low 38.4% compared to countries with high per capita GDP. Evidently total Internet subscribers have been increasing at a CAGR of around 18% since 2001. With a continuous influx of young expatriate professionals to the UAE and the country's

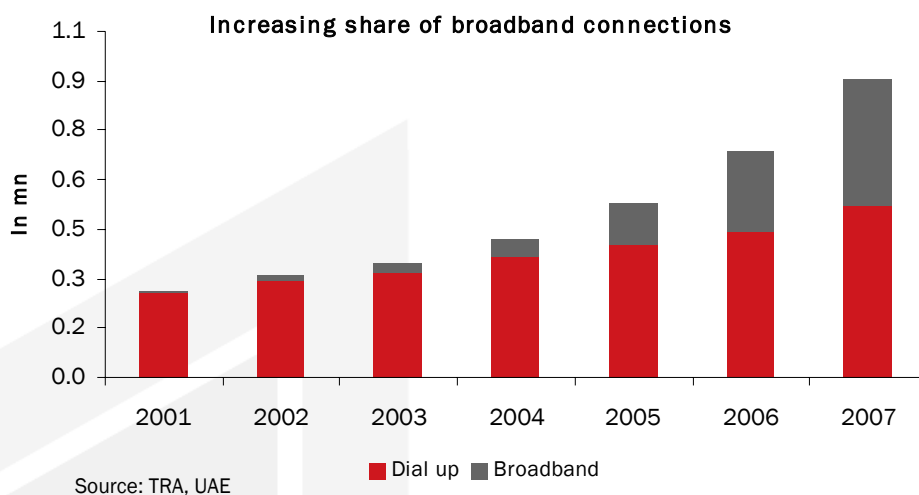
increasing literacy, Internet subscribers are expected to increase at a CAGR of around 24.4% between 2008–2015.



⁽¹⁾ Latest data as per the source

Source: Internet world stats

We expect broadband technology to result in substantial growth in Internet subscribers as customers prefer using broadband to dial-up access technology. Moreover, the increasing popularity of bulky multimedia downloads will support subscriber additions using broadband systems. As a result, we believe the total subscription mix will continue to shift gradually in favour of broadband.



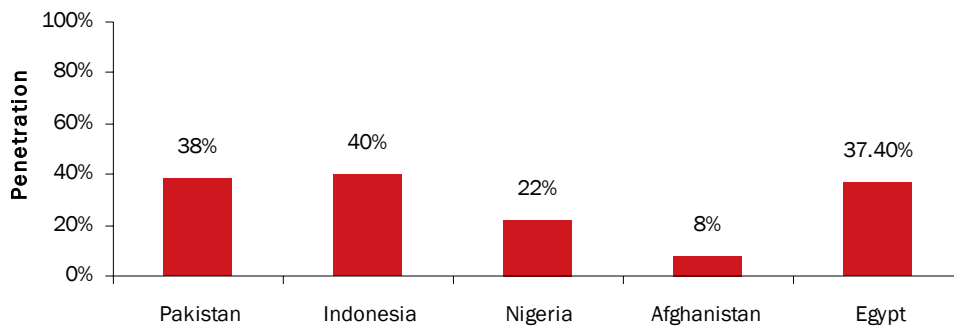
Etisalat has strong product offerings to cater to the increasing bandwidth demand from its subscribers. Currently the Company provides Ethernet to Home (ETTH) services, which have been instrumental in increasing broadband subscription in the UAE since their launch in 2006. ETTH supports IPTV, video on demand and many other 'bandwidth hungry' applications. In addition, the Company also provides various broadband packages (Al Shamil) including one which offers speeds of up to 4Mbps, the highest in the UAE.

Etisalat recently announced completion of the first phase of its Fibre-to-the-Home (FTTH) deployment, which provides last-mile connectivity for homes and businesses to enable them to meet the high bandwidth requirement. With the continued rollout of Next Generation Networks (NGN) across the UAE, we expect Etisalat to venture into Quad Play technology with bundled services offerings delivered over an IP network.

International Market: a mantra for faster growth

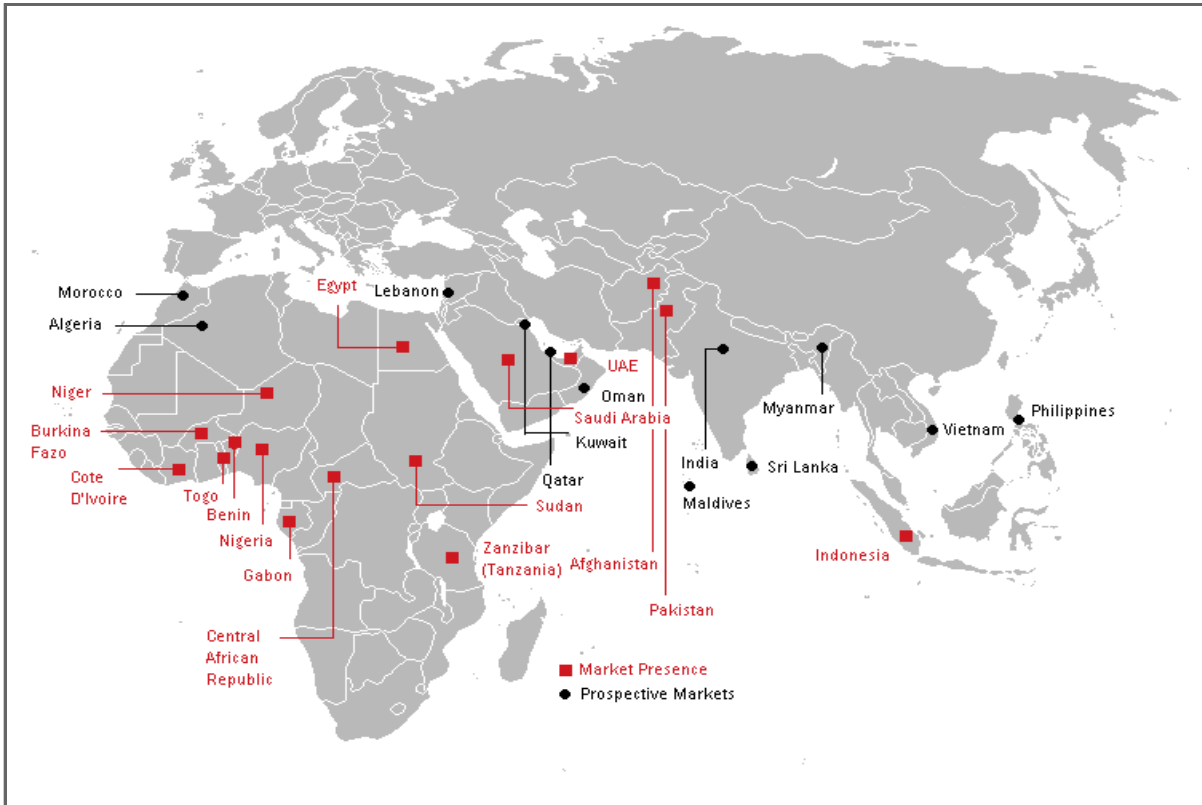
Having developed the UAE telecom market for more than three decades, Etisalat's revenues increased at a CAGR of 21.7% between 2002-2007 to exceed AED 21bn. However, we do not expect the Company to sustain such high growth as the UAE is now one of the highest penetrated markets in the world. Also, the entry of EITC will result in a loss of market share. As a result, Etisalat is now focusing on Greenfield licenses and inorganic growth in Arab and African markets with low penetration and high populations. The Company can easily finance its international operations with healthy cash flows generated through domestic operations.

Penetration levels in markets targeted



Source: ADCB research

Etisalat's investment in associates and joint-ventures and in international Greenfield licenses increased from AED 2.2bn in 2005 to AED 25.6bn in 2007. It has 63 mn subscribers across 16 countries. With its increased presence throughout Africa and the Middle East and with plans to enter the Indian market, Etisalat has the potential in the coming years to become one of the largest operators in the world with activities in Asia, Africa and the Middle East.

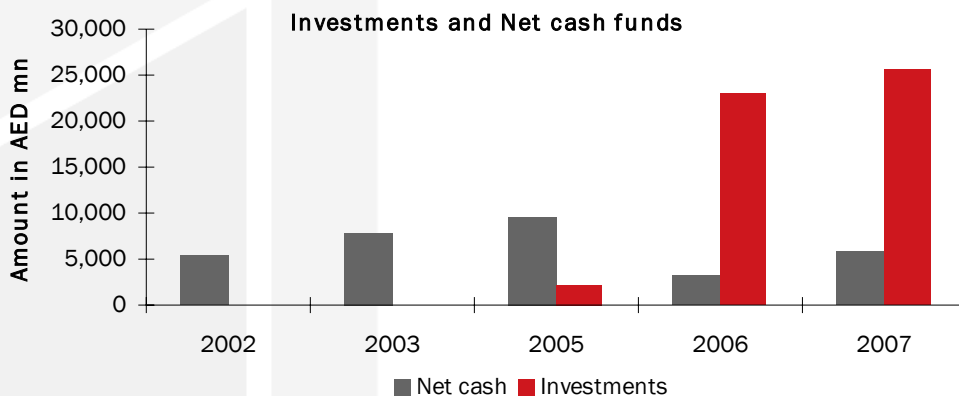


Source: Company data

Strong balance sheet and cash flows to help sustain initial losses

Currently, Etisalat is targeting several less developed nations with low GDP per capita. As a result, we expect its mobile ARPU to fall because the ARPU of the targeted countries is inferior to Etisalat's own domestic ARPU of USD 51. Also, in the initial stages, international operations may make losses due to high network and establishment charges.

In spite of heavy investments in international markets, the Company enjoys low leverage in its balance sheet and a healthy cash position as domestic operations are generating strong operating cash flows. We expect the Company to weather initial losses from its international operations fairly easily and to improve margins once they become better established.

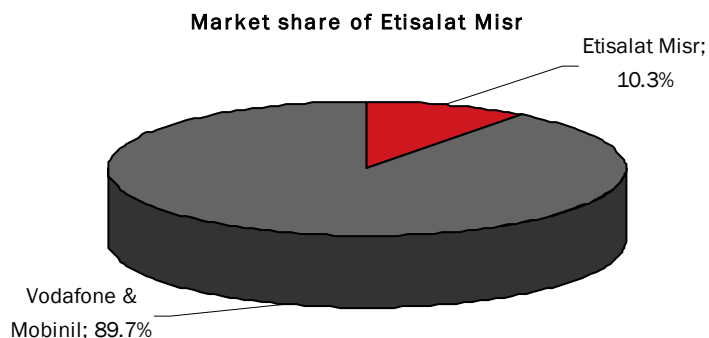


Source: Company Data

International basket

Etisalat Misr coming out of infancy

Etisalat Misr is Egypt's third largest mobile operator (after Mobinil and Vodafone Egypt). It commenced operations on May 1, 2007, based on its GSM and Internet services. Etisalat Misr was established through a consortium after Etisalat won the license to operate 3G and 2G services for EGP 16.7bn (USD 2.9bn) in July 2006. By the end of 2007, Etisalat Misr had attracted 3.1 mn subscribers, representing a 10.3% mobile market share in Egypt.

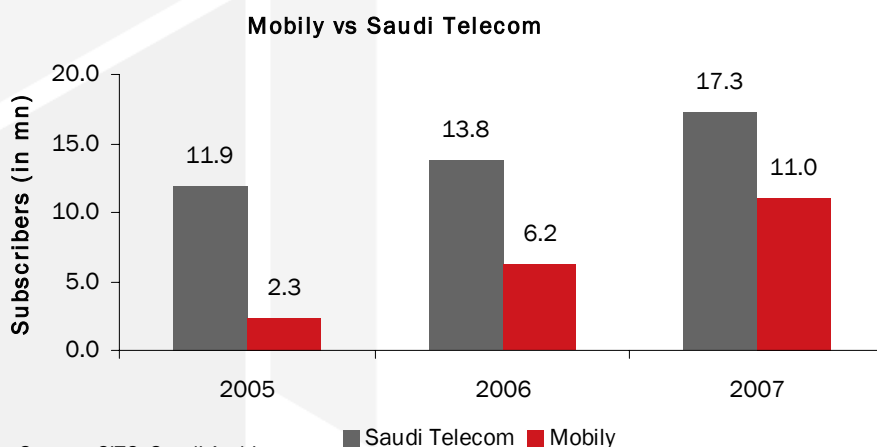


Source: NTRA, Egypt

Currently, the Company's investment in Etisalat Misr is value dilutive due to losses incurred by the latter as a result of high network development costs. However, we expect Etisalat Misr to capitalize on strong growth prospects for Egypt's telecom market (i.e. based on a population exceeding 80 mn and mobile penetration of 37.4%) with its integrated voice and data offerings and by leveraging roaming synergies available from the Group's presence in West and Central Africa and the Middle East. Moreover, Etisalat Misr is likely to bid in the auction for a second fixed line license and has acquired 27.7% and 16.6% stakes in Nile Online and The Egyptian Company for Networks, respectively, positioning itself as an all-round telecom service provider. Given its strong performance since the launch of its services and existing product offerings, we believe the Company is well positioned to acquire a market share of nearly 25% and contribute almost 15% of Etisalat's revenues by 2012.

Mobily (Etihad Etisalat) business is a huge success

We regard Etisalat's investment in Mobily, one of two operators in Saudi Arabia, as the flagship investment of its international business. Mobily commenced its operations in mid-2005. Subsequently, it has steadily eroded Saudi Telecom's mobile market share by capturing around 38.9% of the total market, equal to 11 mn mobile subscribers.

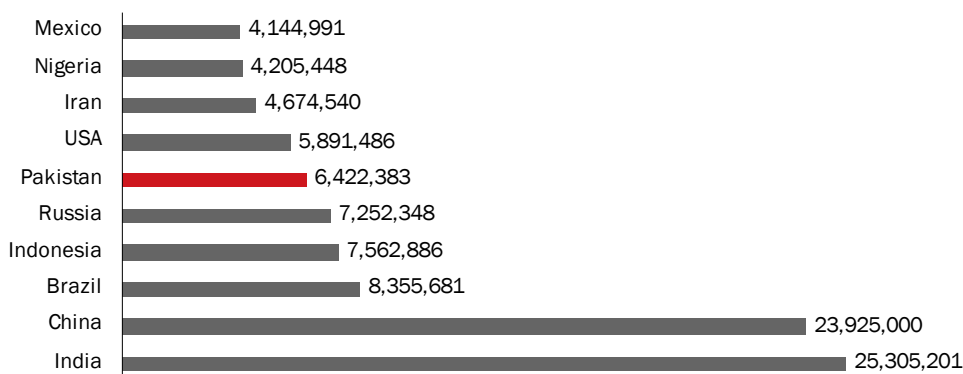


With penetration of 116%, an addressable population of 60%, and GDP per capita (PPP) of USD 20,700, the Saudi Arabian market offers steady growth opportunities with Mobily expected to provide quality services and increased network coverage to its customers. The launch of High Speed Packet Data Access (HSPDA) and the expansion of Mobily's network as a result of deploying the latest fibre optic network will further help the Company strengthen its product portfolio. However, the entry of a third operator, Kuwait's Zain, to the Kingdom will result in a loss of market share as well as a lower ARPU. Etisalat recently diluted its stake in Mobily from 35% to 26.25% in response to a regulatory requirement.

Looking for controlling stake in PTCL to consolidate

In 2006, the Etisalat bought a 26% stake in Pakistan Telecommunications Company Limited (PTCL) for USD 2.6bn. The holding comprises of Class B shares, which provide Etisalat 53% of the voting power and thus a majority say on the decision-making panel. It operates its mobile business through its mobile subsidiary, Ufone.

World Top Ten Countries with Highest Net Additions



Subscribers net additions per annum⁽¹⁾

⁽¹⁾Data: 2007

Source: Wireless Intelligence

Pakistan is a growing telecommunications market with a population base of 164.7 mn and a 38.3% mobile penetration level. The country ranks sixth in terms of net additions of subscribers worldwide. In addition to its 98% share of the fixed-line market amounting to 5.1 mn subscribers, PTCL has improved its mobile market share from 16% in 2004 to 22% in 2007.

Currently, Etisalat is seeking to acquire a controlling stake in PTCL. Should it do so, we expect its profitability to be adversely affected.

Other international operations

Etisalat owns a 70% stake in **Atlantique Telecom (AT)**, which covers 7 regions of West Africa (Benin, Burkina Faso, Togo, Niger, Central African Republic, Côte d'Ivoire and Gabon). At the end of 2007, AT had 2.9 mn mobile subscribers with 107% y-o-y growth.

- ◀ In August 2007, Etisalat launched its mobile operations in **Afghanistan**, covering most of the major cities. With a population of 31 mn but only 8% mobile penetration, Afghanistan offers significant growth and development opportunities.
- ◀ In December 2007, Etisalat acquired a 15.97% stake in Indonesian mobile service provider **Excelcomindo Pratama TBK** (Excelcomindo), the third largest mobile operator in that country. Excelcomindo claims 15 mn mobile subscribers, representing 16% of the total market. Indonesia is one of the largest and fastest growing mobile markets with a population of 234.7 mn (addressable population: 65.7%) and a penetration level of 40%.
- ◀ Etisalat has a 40% stake in MDC-NG B.V, the holding company of **Emerging Markets Telecommunications Services Limited (EMTS)**. EMTS has acquired a Unified Access Service License to provide integrated telecommunication services in Nigeria. With a mobile penetration level of 22% and strong nominal GDP growth of 13% in 2007, the Nigerian market lies largely untapped.
- ◀ Etisalat recently increased its stake in Zantel from 34% to 51%. **Zantel** provides mobile services in the Tanzanian market and covers nearly 65% of the local population. It has secured almost 9% of the mobile market with 684,000 subscribers in 2007. Again, the market has strong growth potential with low penetration of 20%.
- ◀ On September 2007, Etisalat has raised its stake in Canar from 37% to 82%. **Canar** controls 58% of the fixed line market in Sudan. With the commissioning of Port Sudan's FLAG/FALCON Cable Landing Station in 2007, Canar is well positioned to become a major international carrier in Sudan.

Reduction in royalty would improve profitability

Currently, Etisalat pays 50% of its pre-tax profits to the Government as a royalty under the terms of the Federal Act, which guaranteed the company its position as sole service provider in the UAE telecom sector. However, with EITC's entry to the market, the Government looks likely to reduce the royalty to 40% of pre-tax profits in the next few years. Such a move should improve Etisalat's profitability. Moreover, royalty levels should decline further as the market opens up to more foreign players by 2015.

Conclusion

Despite competition from EITC, Etisalat is well positioned to maintain its clear market leadership over the coming years. A favourable demographic profile and buoyant economic scenario in the UAE should enable the Company to continue to add mobile subscribers at a CAGR of 4.4% between 2008–2015. In addition, with low penetration, the UAE Internet market is a key growth driver. The rollout of NGN and FTTH services across the UAE will enable Etisalat to capture a large proportion of broadband

subscribers. Moreover, the proposed launch of converged services through advance networks will also enable it to provide bundled services of mobile, voice, video, and data.

We expect international operations to add significant numbers of subscribers given common characteristics of low penetration and high population growth rates in targeted countries. Also, Etisalat Misr should contribute nearly 15% of Group revenues by 2012 while other operations should begin to impact after 2012. However, low ARPU in these countries may be a concern.

Our Buy rating is based on several assumptions, any deviation from which could result in a change in our rating. The key risks to our rating include:

- ❖ Continuation of the royalty at 50% of pre-tax profit or less than a 15% reduction in the royalty by the Government before 2015
- ❖ Lower-than-expected population growth in the UAE
- ❖ A slowdown in the UAE economy
- ❖ Aggressive pricing by EITC and a larger-than-expected loss of market share to EITC
- ❖ Erosion of market capitalization of PTCL

Income Statement					Key Ratios				
(AED M,Yr. ending Dec. 31)	2007	2008	2009	2010		2007	2008	2009	2010
Revenue	21,340	25,746	28,623	30,417	Per share data (AED)				
Operating costs	(5,852)	(7,544)	(8,959)	(10,129)	Shares outstanding (mn)	5,990	5,990	5,990	5,990
Royalty	(7,297)	(8,360)	(8,123)	(7,426)	EPS	1.22	1.47	1.72	1.88
Depreciation & Amortisation	(1,962)	(2,395)	(2,585)	(2,775)	Book value per share	4.02	4.93	6.00	7.16
Share in profits of associates	380	492	590	658					
Operating Profit	6,610	7,941	9,547	10,746	Operational Metrics				
Operating margin	31.0%	30.8%	33.4%	35.3%	Mobile Subscribers (mn)	6.37	7.21	7.44	7.66
EBITDA	8,571	10,335	12,131	13,520	Fixed line Subscribers (mn)	1.33	1.56	1.62	1.58
YoY Growth (%)	22.6%	20.6%	17.4%	11.5%	Internet Subscribers (mn)	0.88	1.32	1.68	1.92
Finance cost	(503)	(332)	(385)	(388)	Mobile ARPU (AED)	188	175	165	160
Other income	736	751	766	781	Fixedline ARPU (AED)	191	195	190	190
Deferred Tax Liability	(122)	(122)	(122)	(122)	Internet ARPU (AED)	162	155	155	150
PAT	6,720	8,238	9,806	11,018					
Minority Interest	576	577	490	220	Valuation ratios (x)				
Net Income	7,297	8,814	10,296	11,238	EV/Revenue	5.7x	4.8x	4.4x	4.1x
Net Margin	34.2%	34.2%	36.0%	36.9%	EV/EBITDA	14.3x	12.0x	10.3x	9.1x
YoY Growth (%)	24.5%	20.8%	16.8%	9.1%	P/E	17.6x	14.6x	12.5x	11.4x
EPS	1.22	1.47	1.72	1.88					
Balance Sheet									
Non-Current Assets	39,547	45,250	50,720	53,425	Performance ratio (%)				
YoY Growth (%)	22.2%	14.4%	12.1%	5.3%	Return on avg. assets	13.7%	14.7%	15.6%	16.0%
Cash & cash equivalents	9,433	9,052	9,630	11,718	Return on avg. net worth	31.1%	30.7%	30.0%	28.0%
Other current assets	3,468	5,012	6,002	6,627	Return on Capital Employed	29.5%	29.7%	28.8%	27.4%
Total Current Assets	12,901	14,064	15,632	18,346	Operating ratios (%)				
YoY Growth (%)	(4.8%)	9.0%	11.1%	17.4%	Revenue Growth	31.0%	20.6%	11.2%	6.3%
Total Assets	52,448	59,314	66,351	71,770	EBITDA Margin	40.2%	40.1%	42.4%	44.4%
					EBIT Margin	31.0%	30.8%	33.4%	35.3%
Short Term Borrowings	343	1,000	1,000	750	Net Profit Margin	34.2%	34.2%	36.0%	36.9%
Other current Liabilities	17,322	18,337	19,252	18,309					
Total Current Liabilities	17,665	19,337	20,252	19,059	Balance Sheet ratios (%)				
Long Term Borrowings	3,141	4,000	5,500	6,000	Non-Current Assets Turnover Ratio	59.4%	60.7%	59.7%	58.4%
Other non-current Liabilities	5,746	5,170	3,905	3,294	Total Assets Turnover Ratio	43.4%	46.1%	45.6%	44.0%
Total Liabilities	26,553	28,507	29,657	28,354	Debt/Equity Ratio	14.5%	16.9%	18.1%	15.7%
Minority Interest	1,838	1,261	771	551	Net Debt/Equity Ratio	(24.7%)	(13.7%)	(8.7%)	(11.6%)
Total Shareholders' Equity	24,057	29,545	35,923	42,866					
Total Equity & Liabilities	52,448	59,314	66,351	71,770					

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.

Other Disclosures:

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