

19 October 2011

## Hold

**Target price**  
Dh3.07 (from Dh2.86)

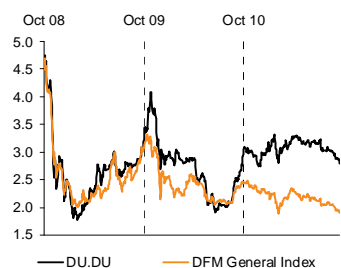
**Price**  
Dh2.80

**Short term (0-60 days)**  
n/a

**Market view**  
No Weighting

### Price performance

	(1M)	(3M)	(12M)
Price (Dh)	3.04	3.15	3.05
Absolute (%)	-7.9	-11.1	-8.2
Rel market (%)	-0.4	0.4	17.6
Rel sector (%)	-0.0	0.0	0.0



**Market capitalisation**  
Dh12.80bn (€2.54bn)

**Average (12M) daily turnover**  
Dh8.14m (US\$2.25m)

Sector: DFM Telecoms  
RIC: DU.DU, DU UH  
Priced Dh2.80 at close 18 Oct 2011.  
Source: Bloomberg

### Analyst

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# Du

## 3Q11 earnings preview

**We update our forecasts for Du, following its continued healthy performance in the UAE telecommunications market, thus increasing our target price by 7.3% to Dh3.07. We maintain Hold.**

### Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (Dhm)	5,339	7,074	8,851	9,920	10,612
EBITDA (Dhm)	1,063	2,018	2,607 ▲	3,273	3,714
Reported net profit (Dhm)	264.1	1,310	802.5 ▲	1,092	1,317
Normalised net profit (Dhm)	264.1	1,310	802.5 ▲	1,092	1,317
Normalised EPS (Dh)	0.06	0.29	0.18	0.24	0.29
Dividend per share (Dh)	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
Normalised PE (x)	48.46	9.77	15.95	11.73	9.72
EV/EBITDA (x)	14.00	6.97	5.09	3.90	3.25
EV/invested capital (x)	3.03	2.21	2.09	1.84	1.59
ROIC - WACC (%)	-4.73	2.64	2.22	6.56	8.20

Use of ▲ ▼ indicates that the line item has changed by at least 5%.

Accounting standard: IAS

Source: Company data, Rasmala forecasts

year to Dec, fully diluted

### 3Q11 forecasts scheduled to be released on 31 October

Du is scheduled to release its 3Q11 results on the 31 October. We expect Du to have continued strong performance from 1H11 into 3Q11, on the back of stronger subscriber acquisition and more resilient mobile ARPU performance. We forecast net income of Dh197m for 3Q11, or an increase of 20% compared with 3Q10.

### We upgrade our full-year forecasts

We also revise our 2011 forecasts following last week's updated management guidance. We increase our revenue estimates by 4% for FY11F, 4% for FY12F and 1% for FY13F, due to better usage and subscriber mix. We lower our capex estimate from Dh1.8bn to Dh1.7bn in line with Du's new guidance for FY11. We raise our EBITDA estimates by 10% for FY11, 3% for FY12 and 1% for FY13, as a result of higher revenue forecast and slightly increased EBITDA margin (due to better post-paid subscriber mix).

### Nothing new on federal royalty rate and TV not in infrastructure sharing deal

As of yet, there has been no official word on the final federal royalty rate, which currently stands at 50%. We maintain the 50% royalty rate for 2011 and beyond until further notice, despite the implied reduction of the royalty rate in future. Besides, an infrastructure-sharing agreement allowing rival UAE telecom operators to compete in home services will not include television, a move which could deter consumers from switching providers. Both Du and Etisalat already offer fixed-line, broadband and television services in the UAE, but not in the same districts. Meanwhile, Du expects an agreement to be finalised by end-2011, but which would only include broadband and voice. Since the two operators' networks are not yet IPTV compatible, television via the same fibre optic cables that provide fixed broadband would not be part of the initial agreement.

### We raise our target price to Dh3.07, and maintain our Hold recommendation

Our higher revenue and EBITDA forecasts, in addition to a lower capex for FY11, have led us to raise our target price by 7.3% to Dh3.07 from Dh2.86. We maintain Hold.

**Important disclosures can be found in the Disclosures Appendix.**

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**Table 1 : Updated forecasts**

Dhm unless stated otherwise	(Old forecasts)			(New Forecasts)			Change		
	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Revenue	8,499	9,543	10,521	8,851	9,920	10,612	4%	4%	1%
EBITDA	2,360	3,192	3,682	2,607	3,273	3,714	10%	3%	1%
EBITDA margin (%)	28%	33%	35%	29%	33%	35%			
Net profit	706	1,073	1,310	802	1,092	1,317	14%	2%	1%
EPS (Dh per share)	0.15	0.23	0.29	0.18	0.24	0.29	14%	2%	1%

Source: Rasmala estimates

**Table 2 : 1H11 performance and 3Q11 forecast**

Dhm unless stated otherwise	1H11	1H10	growth	2Q11	3Q11F	9M FY11F	9M FY10	growth
	Revenue	4,210	3,283	28%	2,172	2,220	6,433	5,028
EBITDA	1,310	820	60%	689	644	1,954	1,343	45%
EBITDA margin (%)	31%	25%		32%	29%	30%	27%	
Net profit	413	235	76%	207	197	610	398	53%
EPS (Dh per share)	0.09	0.05	76%	0.05	0.04	0.13	0.09	53%

Source: Company data and Rasmala estimates

**Table 3 : Rasmala estimates vs consensus**

Dhm unless stated otherwise	Ours	Consensus	Variance	Ours	Consensus	Variance
	3Q11F		3Q11F	FY11F	FY11F	
Revenue	2,220	2,193	1.2%	8,851	8,666	2.1%
EBITDA	644	671	-4.1%	2,607	2,663	-2.1%
EBITDA margin (%)	29%	31%		29%	31%	
EBIT	397	456	-12.9%	1,620	1,894	-14.4%
Net profit	197	219	-9.8%	802	877	-8.4%
EPS (Dh per share)	0.04	0.05	-9.8%	0.18	0.19	-8.4%

Source: Bloomberg and Rasmala estimates

## Income statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	5339	7074	8851	9920	10612
Cost of sales	-1831	-2474	-3098	-3422	-3661
Operating costs	-2444	-2582	-3147	-3224	-3237
<b>EBITDA</b>	<b>1063</b>	<b>2018</b>	<b>2607</b>	<b>3273</b>	<b>3714</b>
DDA & Impairment (ex gw)	-600.6	-724.2	-986.3	-1105	-1114
<b>EBITA</b>	<b>462.9</b>	<b>1294</b>	<b>1620</b>	<b>2168</b>	<b>2600</b>
Goodwill (amort/impaird)	0.00	0.00	0.00	0.00	0.00
<b>EBIT</b>	<b>462.9</b>	<b>1294</b>	<b>1620</b>	<b>2168</b>	<b>2600</b>
Net interest	-6.72	-51.3	-45.5	-24.8	-6.03
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	72.1	-16.3	30.0	40.0	40.0
<b>Reported PTP</b>	<b>528.2</b>	<b>1226</b>	<b>1605</b>	<b>2183</b>	<b>2634</b>
Taxation	-264.1	84.3	-802.5	-1092	-1317
Minority interests	0.00	0.00	0.00	0.00	0.00
Other post-tax items	0.00	0.00	0.00	0.00	0.00
<b>Reported net profit</b>	<b>264.1</b>	<b>1310</b>	<b>802.5</b>	<b>1092</b>	<b>1317</b>
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised EBITDA	1063	2018	2607	3273	3714
Normalised PTP	528.2	1226	1605	2183	2634
<b>Normalised net profit</b>	<b>264.1</b>	<b>1310</b>	<b>802.5</b>	<b>1092</b>	<b>1317</b>

Source: Company data, Rasmala forecasts

year to Dec

## Balance sheet

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	869.3	2785	2785	1336	1365
Other current assets	1356	1886	1507	1754	1801
Tangible fixed assets	6107	6689	7562	8341	9137
Intang assets (incl gw)	1200	1159	1159	1159	1159
Oth non-curr assets	0.00	-0.00	-0.00	0.00	-0.00
<b>Total assets</b>	<b>9532</b>	<b>12520</b>	<b>13013</b>	<b>12590</b>	<b>13461</b>
Short term debt (2)	0.00	0.00	1756	0.00	0.00
Trade & oth current liab	3677	6441	3982	4891	4638
Long term debt (3)	3000	904.7	1299	630.7	438.3
Oth non-current liab	63.5	77.7	77.7	77.7	77.7
<b>Total liabilities</b>	<b>6740</b>	<b>7424</b>	<b>7114</b>	<b>5600</b>	<b>5154</b>
Total equity (incl min)	2792	5096	5898	6990	8307
<b>Total liab &amp; sh equity</b>	<b>9532</b>	<b>12520</b>	<b>13013</b>	<b>12590</b>	<b>13461</b>
Net debt	2131	1273	457.4	-38.1	-734.0

Source: Company data, Rasmala forecasts

year ended Dec

## Cash flow statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	1063	2018	2607	3273	3714
Change in working capital	-90.6	-919.6	885.4	183.2	174.9
Net interest (pd) / rec	-6.72	-51.3	-45.5	-24.8	-6.03
Taxes paid	0.00	84.3	-802.5	-1092	-1317
Other oper cash items	-4.90	250.8	-297.8	-340.6	-340.5
<b>Cash flow from ops (1)</b>	<b>961.2</b>	<b>1382</b>	<b>2346</b>	<b>2000</b>	<b>2226</b>
Capex (2)	-1624	-1575	-1859	-1885	-1910
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-111.6	-41.2	0.00	0.00	0.00
<b>Cash flow from invest (3)</b>	<b>-1735</b>	<b>-1616</b>	<b>-1859</b>	<b>-1885</b>	<b>-1910</b>
Incr / (decr) in equity	0.00	1078	0.00	0.00	0.00
Incr / (decr) in debt	0.00	0.00	0.00	0.00	0.00
Ordinary dividend paid	0.00	0.00	0.00	0.00	0.00
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	367.9	1073	-815.4	-1945	-667.3
<b>Cash flow from fin (5)</b>	<b>367.9</b>	<b>2150</b>	<b>-815.4</b>	<b>-1945</b>	<b>-667.3</b>
Forex & disc ops (6)	0.00	0.00	0.00	0.00	0.00
<b>Inc/(decr) cash (1+3+5+6)</b>	<b>-406.3</b>	<b>1916</b>	<b>-327.8</b>	<b>-1830</b>	<b>-351.9</b>
Equity FCF (1+2+4)	-662.6	-193.0	487.6	114.9	315.4

Source: Company data, Rasmala forecasts

year to Dec

Standard ratios	Du					Mobily			Etisalat		
Performance	FY09A	FY10A	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Sales growth (%)	35.1	32.5	25.1	12.1	6.98	25.9	15.3	7.28	2.03	5.56	4.74
EBITDA growth (%)	188.5	89.8	29.2	25.6	13.5	19.4	15.3	7.28	-0.75	3.53	19.6
EBIT growth (%)	n/a	179.5	25.2	33.8	19.9	17.6	14.6	5.81	-8.52	8.82	30.4
Normalised EPS growth (%)	6305	396.1	-38.8	36.0	20.6	15.6	14.9	7.28	-8.48	5.16	27.0
EBITDA margin (%)	19.9	28.5	29.5	33.0	35.0	36.5	36.5	36.5	30.4	29.8	34.1
EBIT margin (%)	8.67	18.3	18.3	21.9	24.5	25.4	25.2	24.9	19.6	20.3	25.2
Net profit margin (%)	4.95	18.5	9.07	11.0	12.4	24.2	24.1	24.1	21.4	21.4	25.9
Return on avg assets (%)	2.67	12.2	6.35	8.47	9.98	14.7	15.8	15.6	8.75	9.44	11.7
Return on avg equity (%)	9.96	33.2	14.6	16.9	17.2	28.1	26.9	24.7	17.5	17.4	20.3
ROIC (%)	5.77	13.1	12.7	17.1	18.7	22.8	26.3	24.2	8.27	8.70	11.7
ROIC - WACC (%)	-4.73	2.64	2.22	6.56	8.20	0.00	0.00	0.00	0.00	0.00	0.00
				year to Dec			year to Dec			year to Dec	
<b>Valuation</b>											
EV/sales (x)	2.80	1.99	1.50	1.29	1.14	2.03	1.75	1.61	2.28	2.05	1.79
EV/EBITDA (x)	14.0	6.97	5.09	3.90	3.25	5.55	4.79	4.40	7.51	6.88	5.25
EV/EBITDA @ tgt price (x)	15.2	7.58	5.56	4.28	3.58	7.95	6.87	6.35	9.82	9.12	7.12
EV/EBIT (x)	32.3	10.9	8.18	5.89	4.64	7.98	6.92	6.45	11.6	10.1	7.09
EV/invested capital (x)	3.03	2.21	2.09	1.84	1.59	1.88	1.62	1.43	1.86	1.82	1.74
Price/book value (x)	4.59	2.51	2.17	1.83	1.54	2.00	1.69	1.46	1.93	1.81	1.64
Equity FCF yield (%)	-5.18	-1.51	3.81	0.90	2.46	7.58	7.73	9.48	9.84	11.2	15.0
Normalised PE (x)	48.46	9.77	15.95	11.73	9.72	7.83	6.82	6.36	11.31	10.75	8.47
Norm PE @ tgt price (x)	53.1	10.7	17.5	12.9	10.7	11.5	9.98	9.31	14.6	13.9	10.9
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00	5.50	6.42	6.87	6.01	6.01	6.01
				year to Dec			year to Dec			year to Dec	
<b>Per share data</b>						<b>Solvency</b>					
Tot adj dil sh, ave (m)	4571	4571	4571	4571	4571	Net debt to equity (%)	76.3	25.0	7.76	-0.54	-8.84
Reported EPS (AED)	0.06	0.29	0.18	0.24	0.29	Net debt to tot ass (%)	22.4	10.2	3.52	-0.30	-5.45
Normalised EPS (AED)	0.06	0.29	0.18	0.24	0.29	Net debt to EBITDA	2.00	0.63	0.18	-0.01	-0.20
Dividend per share (AED)	0.00	0.00	0.00	0.00	0.00	Current ratio (x)	0.61	0.73	0.75	0.63	0.68
Equity FCF per share (AED)	-0.14	-0.04	0.11	0.03	0.07	Operating CF int cov (x)	144.1	26.3	70.2	125.8	588.3
Book value per sh (AED)	0.61	1.11	1.29	1.53	1.82	Dividend cover (x)	0.00	0.00	0.00	0.00	0.00
				year to Dec						year to Dec	

Priced as follows: DU.DU - Dh2.80; 7020.SE - SR54.50; ETEL.DU - Dh9.99  
Source: Company data, Rasmala forecasts

### Valuation methodology – Approach (Dhm)

2011	861	854
2012	520	481
2013	702	605
2014	135	109
2015	760	655
Terminal Value	16,868	12,619
Enterprise value		15,323
Minus: net debt		1,273
Equity value		14,050
Number of shares (000)		4,571
12-month fair value per share		3.07

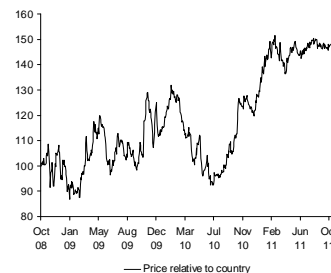
Source: Company data, Rasmala forecasts

**Company description**

**Hold**

**Price relative to country**

Emirates Integrated Telecommunications Company, otherwise known as Du, was incorporated at end-2005 with investments by the UAE federal government (50%), Mubadala Development Company (25.0%) and Emirates Communications and Technology Company (25.0%) and became the second telecom operator in the UAE. Du offers fixed and mobile telephony, broadband connectivity and IPTV services to individuals, homes and businesses, and carrier services for businesses.



**Strategic analysis**

**Average SWOT company score: 4**

**4**

**Shareholder structure**

**Strengths**

**4**

Since its operational launch in February 2007, Du has accounted for most net subscriber additions in the UAE, acquiring almost 70% of total net mobile additions during 2009, thanks to its ability to roll out innovative services.

**Weaknesses**

**3**

The main concern is a price war with Etisalat, which could put ARPUs and EBITDA margins under pressure.

**Opportunities**

**4**

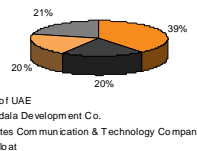
The UAE's Telecommunications Regulatory Authority (TRA) has decided to lift fixed-line and internet area restrictions and allow nationwide access to both operators. We believe there is an opportunity for operators to exploit VOIP after regulations change.

**Threats**

**3**

Du will continue to face increasing competition from Etisalat in a more saturated market.

*Scoring range is 1-5 (high score is good)*



Source: Company data

**Market data**

**Headquarters**

Building 14, Media City, P.O. Box 502666, Dubai, United Arab Emirates

**Website**

www.du.ae

**Shares in issue**

4571.4m

**Free float**

20%

**Majority shareholders**

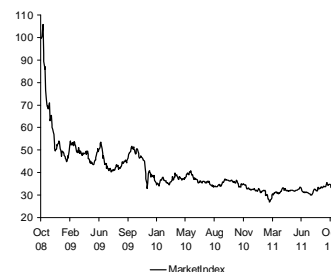
Gov't of UAE (40%), Mubadala Development Co. (20%), Emirates Communication & Technology Company (20%)

**Country view: United Arab Emirates**

**Country rel to M East & Africa**

MENA markets are showing characteristics of a text book case of loss aversion. This is expected given the magnitude of losses investors experienced since 2008, with 2009 lagging emerging markets by a fairly wide margin. Rising oil prices and budget surpluses drove asset prices across the region higher resulting in a real-estate bubble that has negatively impacted speculators and the banking system. Bubbles do pop and recover over time if there is a legal system in place that enables the transfer of assets. The bad news is such a mechanism did not exist. The good news is that with the creation of RERA and the possibility of Strata Law, this could change and facilitate the transfer of properties from speculators to real investors.

*The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.*



**Competitive position**

**Average competitive score: 3+**

**3+**

**Broker recommendations**

**Supplier power**

**4+**

Du is not overly reliant on any one key supplier.

**Barriers to entry**

**4+**

With high mobile penetration rates, we do not foresee additional mobile licences being offered in the UAE.

**Customer power**

**2+**

Customers in the UAE have only one alternative operator: Etisalat.

**Substitute products**

**4+**

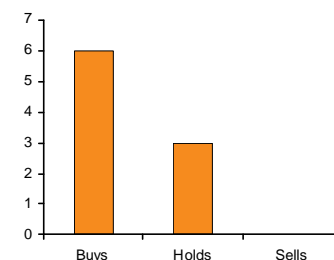
There are very few substitute products for mobile voice and broadband.

**Rivalry**

**3-**

The company's main competitor is Etisalat in the UAE. Du is in the early stages of its business plan and will take some time before it achieves Etisalat's scale.

*Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse*



Source: Bloomberg

## Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

## Valuation and risks to target price

**Du (RIC: DU.DU, Rec: Hold, CP: Dh2.80, TP: Dh3.07):** To derive our target price, we use a DCF valuation. The main risk to our target price is increased pricing competition from Etisalat, Du's main and only rival in the UAE telecom market. Upside risks include a better-than-expected share of broadband market and post paid subscriber base, and a reduction in the federal royalty rate.

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