12 August 2010

Du

Solid 2Q10 results

Hold

Target price
Dh2.06 (from Dh2.35)

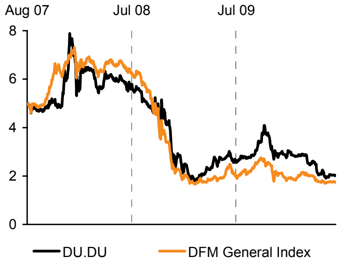
Price
Dh2.01

Short term (0-60 days)
n/a

Market view
No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (Dh)	1.97	2.55	2.80
Absolute (%)	2.0	-21.2	-28.2
Rel market (%)	2.3	-8.3	-7.4
Rel sector (%)	-1.0	-5.1	-5.1



Market capitalisation
Dh9.28bn (US$2.5bn)

Average (12M) daily turnover
Dh4.68m (US$1.29m)

Sector: DFM Telecoms
RIC: DU.DU, DU UH
Priced Dh2.03 at close 10 Aug 2010.
Source: Bloomberg

Dubai-based Emirates Integrated Telecommunications Company (Du) has reported that 1H10 net profit more than doubled to Dh137.4m in 2Q10, from Dh57.7m in 2Q09, as the company added more subscribers.

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue (Dhm)	3,951	5,339	6,290	7,188	8,101
EBITDA (Dhm)	399.7	1,108	1,540	2,294	2,921
Reported net profit (Dhm)	4.12	264.1	468.8	826.2	1,126
Normalised net profit (Dhm)	4.12	264.1	468.8	826.2	1,126
Normalised EPS (Dh)	0.00	0.06	0.10	0.18	0.25
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)	2,250	35.10	19.80	11.20	8.24
EV/EBITDA (x)	27.00	10.30	7.01	4.74	3.40
EV/invested capital (x)	2.69	2.32	1.87	1.63	1.45
ROIC - WACC (%)	-12.7	-4.73	-2.20	2.67	5.28

Accounting standard: IAS
Source: Company data, Rasmala forecasts
year to Dec, fully diluted

Revenue growth driven by strong mobile performance

Revenue grew 30% to Dh1.7bn in 2Q10, from Dh1.3bn in 2Q09. The key driver was 35% yoy growth in mobile revenue on the back of strong growth to 3.9m active mobile subscribers at the end of June 2010 from 3.7m at the end of March 2010.

Cost efficiency translates into enhanced EBITDA margin

Amid management's ongoing efforts to enhance efficiency, overheads relative to revenues decreased to 40% in 2Q10, from 43% in 1Q10. Accordingly, EBITDA for 2Q10 remained strong, increasing 24% qoq and 87% yoy, equivalent to an EBITDA margin of 27% for 2Q10 vs 23% for 1Q10 and 18% for 2Q09.

Net profit before royalties more than doubles

Thanks to the revenue growth and enhanced efficiency, net profit before royalties reached Dh275m in 2Q10, up 138% yoy and 42% qoq.

We maintain our Hold Recommendation

Du's strong 2Q10 results were in line with our expectations and so we maintain our Hold recommendation. We have adjusted our previous target price of Dh2.35 to Dh2.06 to reflect the company's new total outstanding shares following its capital increase.

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Key takeaways

Du's 2Q10 net profit result beat the Bloomberg consensus estimate of Dh110m on strong growth in mobile subscribers. Management has also said it does not expect the UAE's ban on certain BlackBerry services to impact its net profit or revenue for 2010.

Total revenues in 2Q10 grew 30% yoy to Dh1.7bn, from Dh1.3bn in 2Q09, with a healthy mobile performance during the quarter driving overall growth. Total active mobile subscribers rose to 3.9m at the end of June 2010, accounting for a 35% market share, according to Du's CEO, Osman Sultan. Mobile ARPU remained steady at Dh111 for 2Q10, compared to Dh108 in 1Q10 and Dh104 in 2Q09.

Revenues from Du's fixed-line business, including telephony, TV and broadband, amounted to Dh290m in 2Q10, up 20% yoy, with the fixed-line subscriber base up 52% yoy with 43,200 lines added during the quarter. The CEO said: "We are confident that our fixed-line business, which remains one of the most developed and technically advanced in the region, will enable us to acquire further market share."

With regard to the infrastructure-sharing agreement between Du and Abu Dhabi-based Emirates Telecommunications Corporation (Etisalat), which would enable Du to expand its fixed-line arm of operations to other emirates beyond its primary market in Dubai, management said it expected to start offering services during 4Q10 and that the agreement should start affecting its revenues in 2011.

Earlier this month, the UAE's telecom regulator, the Telecommunications Regulatory Authority (TRA), had announced its intention to suspend certain BlackBerry services from 11 October 2010 due to security concerns. Both Du and Etisalat, the UAE's two telecom operators, had been informed of the TRA's decision and subsequently announced that BlackBerry Email, BlackBerry web browsing, social networking and instant messaging services on BlackBerry devices that are supported as part of the BlackBerry service would be suspended. Du had stated that it was not in direct talks with Blackberry maker Research In Motion (RIM).

However, at its 1H10 results announcement, Du – which has a total BlackBerry subscriber base of between 75,000 and 80,000 – said it did not expect the ongoing ban on key BlackBerry services to impact its 2010 profits or revenues, given that the company is working hard on offering customers alternative solutions. Mr Sultan said Du was targeting revenue growth of over 25% for 2010 and an EBITDA margin in the high 20s.

Management said its capex programme remains on track, with capex of Dh341m in 2Q10 and an expected 2010 total of less than Dh2bn, down from its original guidance of Dh2.2bn, given the ongoing review of its expansion plans. The accelerated capex programme is aimed at building up Du's fixed and mobile telecommunications infrastructure to meet its goal of becoming the preferred integrated telecoms provider in the UAE as it competes with Etisalat. It has been partly boosted by funds from a Dh1bn rights issue, which was launched in April 2010 and completed in June.

Income statement

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue	3951	5339	6290	7188	8101
Cost of sales	-1440	-1831	-2158	-2372	-2592
Operating costs	-2112	-2399	-2593	-2522	-2588
EBITDA	**399.7**	**1108**	**1540**	**2294**	**2921**
DDA & Impairment (ex gw)	-504.0	-645.4	-722.7	-771.3	-814.9
EBITA	**-104.3**	**462.9**	**817.1**	**1523**	**2106**
Goodwill (amort/impaired)	0.00	0.00	0.00	0.00	0.00
EBIT	**-104.3**	**462.9**	**817.1**	**1523**	**2106**
Net interest	3.34	-6.72	-8.80	7.13	-5.28
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	109.2	72.1	129.4	122.5	152.3
Reported PTP	**8.25**	**528.2**	**937.7**	**1652**	**2253**
Taxation	-4.12	-264.1	-468.8	-826.2	-1126
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
Reported net profit	**4.12**	**264.1**	**468.8**	**826.2**	**1126**
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised EBITDA	399.7	1108	1540	2294	2921
Normalised PTP	8.25	528.2	937.7	1652	2253
Normalised net profit	**4.12**	**264.1**	**468.8**	**826.2**	**1126**

Source: Company data, Rasmala forecasts year to Dec

Balance sheet

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
Cash & market secs (1)	1276	869.3	1483	1416	400.0
Other current assets	1027	1356	1707	1956	2271
Tangible fixed assets	4314	6107	7688	8572	9205
Intang assets (incl gw)	1160	1200	1055	904.2	750.3
Oth non-curr assets	0.00	0.00	0.00	0.00	0.00
Total assets	**7776**	**9532**	**11934**	**12848**	**12625**
Short term debt (2)	4.90	0.00	0.00	0.00	1056
Trade & oth current liab	2436	3677	4608	7696	5291
Long term debt (3)	2775	3000	3000	0.00	0.00
Oth non-current liab	50.0	63.5	63.5	63.5	63.5
Total liabilities	**5266**	**6740**	**7671**	**7760**	**6410**
Total equity (incl min)	2510	2792	4262	5089	6215
Total liab & sh equity	**7776**	**9532**	**11934**	**12848**	**12625**
Net debt	1504	2131	1517	1584	655.9

Source: Company data, Rasmala forecasts year ended Dec

Cash flow statement

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA	399.7	1108	1540	2294	2921
Change in working capital	108.3	-135.5	578.9	-159.5	279.7
Net interest (pd) / rec	-7.97	-6.72	-8.80	7.13	-5.28
Taxes paid	0.00	0.00	-468.8	-826.2	-1126
Other oper cash items	24.9	-4.90	65.2	51.0	65.0
Cash flow from ops (1)	**525.0**	**961.2**	**1706**	**1367**	**2134**
Capex (2)	-2033	-1624	-2097	-1438	-1215
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-60.8	-111.6	0.00	0.00	0.00
Cash flow from invest (3)	**-2094**	**-1735**	**-2097**	**-1438**	**-1215**
Incr / (decr) in equity	0.00	0.00	1078	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	2755	367.9	-73.9	0.00	-1944
Cash flow from fin (5)	**2755**	**367.9**	**1004**	**0.00**	**-1944**
Forex & disc ops (6)	0.00	0.00	0.00	0.00	0.00
Inc/(decr) cash (1+3+5+6)	**1186**	**-406.3**	**613.5**	**-71.1**	**-1026**
Equity FCF (1+2+4)	-1508	-662.6	-390.4	-71.1	918.6

Source: Company data, Rasmala forecasts year to Dec

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: Dh2.01, TP: Dh2.06): To derive our target price, we use equally weighted peer multiple and DCF valuations. The two main downside risks to the company's valuation are a prolonged pricing war with Etisalat and capex catchup given its late entry into the market. The upside risks are capturing a higher mobile market share from Etisalat through the implementation of mobile number portability and an increased ability to manage operational costs without damaging the service quality.

Disclaimer