Equity | United Arab Emirates | Telecommunications

RASMALA

9 November 2010

# Du

## 9M10 results remain strong

**Dubai-based Emirates Integrated Telecommunications Company (Du) reported its 9M10 results, beating consensus expectations.**

**Change of recommendation**

**Sell** (from Hold)

**Target price**
Dh2.15 (from Dh2.06)

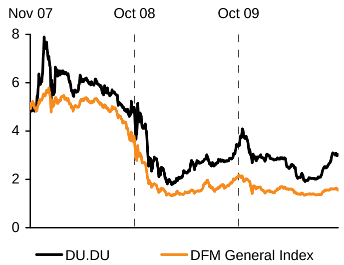
**Price**
Dh3.03

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

**Market view**
No Weighting

### Price performance

| | (1M) | (3M) | (12M) |
|---|---|---|---|
| Price (Dh) | 2.68 | 2.04 | 3.71 |
| Absolute (%) | 13.1 | 48.5 | -18.3 |
| Rel market (%) | 15.0 | 33.1 | 1.2 |
| Rel sector (%) | -0.0 | 0.0 | -4.1 |




**Market capitalisation**
Dh13.85bn (€2.71bn)

**Average (12M) daily turnover**
Dh6.32m (US$1.83m)

Sector: DFM Telecoms
RIC: DU.DU, DU UH
Priced at close of business 8 Nov 2010.
Source: Bloomberg

### Key forecasts

| | FY08A | FY09A | FY10F | FY11F | FY12F |
|---|---|---|---|---|---|
| Revenue (Dhm) | 3,951 | 5,339 | 6,808 | 8,228 | 9,253 |
| EBITDA (Dhm) | 399.7 | 1,108 | 1,788 % | 2,469 % | 3,146 % |
| Reported net profit (Dhm) | 4.12 | 264.1 | 603.0 % | 793.5 | 1,098 |
| Normalised net profit (Dhm) | 4.12 | 264.1 | 603.0 % | 793.5 | 1,098 |
| Normalised EPS (Dh) | 0.00 | 0.06 | 0.13 | 0.17 | 0.24 |
| Normalised PE (x) | 3,359 | 52.40 | 23.00 | 17.50 | 12.60 |
| EV/EBITDA (x) | 38.40 | 14.40 | 8.38 | 6.27 | 4.63 |
| EV/invested capital (x) | 3.83 | 3.25 | 2.71 | 2.27 | 2.08 |
| ROIC - WACC (%) | -12.7 | -4.73 | -0.28 | 3.84 | 5.76 |

Use of %& indicates that the line item has changed by at least 5%. year to Dec, fully diluted
Accounting standard: IAS
Source: Company data, Rasmala forecasts

### Revenue growth still driven by strong mobile performance

Revenue grew 31% to Dh1.745bn in 3Q10 from Dh1.333bn in 3Q09, beating the Bloomberg consensus estimate of Dh1,704m on the back of stronger-than-expected growth in mobile market share. According to management, Du now has a 37% market share of total active mobile subscribers in the UAE as it acquired 159,800 net active subscribers in 3Q10 to reach a total of 4.1m at the end of 9M10. Etisalat reported a 7.81m subscriber base at the end of 9M10, which, we calculate, implies that Du has captured 90% of total net subscriber additions ytd in the UAE. On Du's 9M10 conference call, management said it was targeting 30% top-line growth by year-end 2010.

### Net profit more than doubles yoy, beating consensus estimates

Net profit before royalty was Dh326m in 3Q10 vs Dh157m in 3Q09, ie an 108% annual increase and a 19% increase compared to Dh275m in 2Q10. Du beat the Bloomberg consensus estimate of Dh171m, as a result of the stronger-than-expected top-line growth and a Dh69m reversal in provisions (a one-time favourable adjustment of Dh104m as a result of a regulatory decision in favour of Du, of which Dh69m relates to 2009).

### Target price increased to Dh2.15 but downgrade to Sell

We have raised our year-end 2010 forecasts to reflect Du's better-than-expected performance during 9M10 – our revenue estimate by about 8% and our net profit for the one-off adjustment of Dh69m, which increase our net profit by about 28%. However, despite the company's better-than-expected performance, Du remains expensive relative to its Asian telecom peers, in our view. The stock trades at 17x for 2011, on Bloomberg consensus estimates, a 40% premium to the peers' average of about 12x. Our DCF/PE-blended target price has risen to Dh2.15 per share (from Dh2.06), implying about 30% downside, hence we downgrade our recommendation to Sell (from Hold).


**Analysts**

**Shrouk Diab**
United Arab Emirates
+971 552 248 033
shrouk.diab@rasmala.com

Dubai International Financial Centre,
The Gate Village, Building 10, Level 1,
P.O. Box 31145, Dubai, United Arab Emirates

**www.rasmala.com**

# Key takeaways

**By the end of September 2010, Du had an estimated 37% market share of active mobile subscribers, while management expects to increase this further to 40% by year-end 2010.**

**Highlights for the third quarter**

- 159,800 net active mobile subscribers added during the quarter, taking the total at quarter end to 4,080,900, which is equivalent to a 37% market share of active subscribers.
- Record revenues of Dh1,745m achieved, a 31% increase compared to 3Q09 (Dh1,333m) and a 2% increase vs 2Q10 (Dh1,703m).
- Gross margin grew by 29% yoy to Dh1,126m (3Q09: Dh876m) and remained flat qoq (2Q10: Dh1,127m).
- EBITDA grew 76% yoy to Dh523m and 15% compared to Dh454m in 2Q10.
- Net profit before royalty increased yoy to Dh326m vs Dh157m in 3Q09, representing a 19% increase over Dh275m in the previous quarter.
- Sustained momentum for post-paid active mobile subscriber additions with 15,300 added during the quarter, bringing the total to 209,400, up 91% vs 3Q09 and 8% vs 2Q10, equal to 5% of the total mobile subscriber base.
- Growth of 44% in Du's fixed-line subscriber base from 358,000 lines in 3Q09 to 515,400 in 3Q10, with 15,500 lines added during the quarter.

On a different note, Du stated last month that it had obtained US$255 million in financing from the Export-Import Bank of China as it seeks to repay debts and upgrade its network. The loan will be used to pay back a short-term facility of US$85m and purchase equipment for expanding the company's 3G network.

Capital expenditure for 2010 should reach around Dh1.8bn, management said during the 9M10 conference call. Du plans to spend between Dh1.8bn to Dh2.2bn during 2011. Most of the investment will go into the mobile network to provide faster services, such as music downloads and internet connections.

In September 2010, Du also obtained a US$207m export credit facility backed by the German export credit agency, Euler Hermes, to help roll out 2G and 3G networks.

Du will start offering services through a network-sharing arrangement with Emirates Telecommunications (also known as Etisalat), in the first half of 2011 after a delay, management said in the 9M10 conference call.

According to management, there is still no development on a reduction in royalty fees.

## Valuation

**Discounted cash flow valuation**

Du's DCF valuation yields a 12-month fair value of Dh2.50 per share. The assumptions underlying our DCF valuations are a 10.5% cost of equity, based on a risk-free rate of 4.5% and an equity-risk premium of 6.00%. We also use a 2.0% terminal growth, a WACC of 10%, a 6.5% cost of debt and a beta of 1x.

**Table 1 : DCF valuation**

| (Dhm) | Free cash flow | PV of FCF |
|---|---|---|
| 2010 | -150 | -150 |
| 2011 | -666 | -735 |
| 2012 | 742 | 611 |
| 2013 | 950 | 700 |
| 2014 | 917 | 611 |
| 2015 | 1,598 | 964 |
| Terminal value | 19,178 | 11,570 |
| Enterprise value | | 13,571 |
| Minus: net debt | | 2,131 |
| Equity value | | 11,440 |
| Number of shares (m) | | 4,571 |
| **12-month fair value per share** | | **2.50** |

Source: Company data, Rasmala estimates

### Peer valuation

The peer group valuation, which comprises average PE multiples for FY10 of 13.6x and FY11 of 12.3x (Table 2) gives us a fair value of Dh1.79 per share (using an average PE).

**Table 2 : Estimated PE 2010 and 2011 for telecom peers**

| Peers | PE 2010 | PE 2011 |
|---|---|---|
| Telefonos de Mexico | 9.62 | 9.24 |
| Reliance Industries | 16.69 | 13.93 |
| Telekom Malaysia | 22.47 | 20.30 |
| Globe Telecom Inc | 10.99 | 10.75 |
| Advanced Info Service | 14.97 | 14.38 |
| MTN Group | 13.26 | 10.97 |
| Excelcomindo Pratama | 18.48 | 14.05 |
| Turkcell Iletisim Hizmet | 9.02 | 9.48 |
| Vodacom Group | 10.64 | 10.02 |
| Bharti Airtel | 16.75 | 14.11 |
| America Movil SAB de C | 15.27 | 13.17 |
| China Telecom Corp | 17.76 | 14.95 |
| Jordan Telecom | 12.35 | NA |
| Telecom Egypt | 9.65 | 10.01 |
| Mobily | 10.39 | 9.41 |
| Saudi Telecom | 9.17 | 9.22 |
| **Average** | **13.59** | **12.27** |

* Prices as of 8 November 2010.
Source: Bloomberg

## Income statement

| Dhm | FY08A | FY09A | FY10F | FY11F | FY12F |
|---|---|---|---|---|---|
| Revenue | 3951 | 5339 | 6808 | 8228 | 9253 |
| Cost of sales | -1440 | -1831 | -2335 | -2715 | -2961 |
| Operating costs | -2112 | -2399 | -2685 | -3044 | -3146 |
| **EBITDA** | **399.7** | **1108** | **1788** | **2469** | **3146** |
| DDA & Impairment (ex gw) | -504.0 | -645.4 | -782.2 | -882.9 | -930.8 |
| **EBITA** | **-104.3** | **462.9** | **1006** | **1586** | **2215** |
| Goodwill (amort/impaired) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| **EBIT** | **-104.3** | **462.9** | **1006** | **1586** | **2215** |
| Net interest | 3.34 | -6.72 | -8.80 | 1.44 | -19.5 |
| Associates (pre-tax) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other pre-tax items | 109.2 | 72.1 | 209.0 | 0.00 | 0.00 |
| **Reported PTP** | **8.25** | **528.2** | **1206** | **1587** | **2196** |
| Taxation | -4.12 | -264.1 | -603.0 | -793.5 | -1098 |
| 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** | **603.0** | **793.5** | **1098** |
| Tot normalised items | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Normalised EBITDA | 399.7 | 1108 | 1788 | 2469 | 3146 |
| Normalised PTP | 8.25 | 528.2 | 1206 | 1587 | 2196 |
| **Normalised net profit** | **4.12** | **264.1** | **603.0** | **793.5** | **1098** |

Source: Company data, Rasmala forecasts year to Dec

## Balance sheet

| Dhm | FY08A | FY09A | FY10F | FY11F | FY12F |
|---|---|---|---|---|---|
| Cash & market secs (1) | 1276 | 869.3 | 1870 | 1378 | 400.0 |
| Other current assets | 1027 | 1356 | 1723 | 1981 | 2302 |
| Tangible fixed assets | 4314 | 6107 | 7812 | 9400 | 10122 |
| Intang assets (incl gw) | 1160 | 1200 | 1043 | 870.4 | 694.6 |
| Oth non-curr assets | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| **Total assets** | **7776** | **9532** | **12447** | **13629** | **13518** |
| Short term debt (2) | 4.90 | 0.00 | 0.00 | 0.00 | 1124 |
| Trade & oth current liab | 2436 | 3677 | 4987 | 8376 | 6043 |
| 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** | **8051** | **8439** | **7230** |
| Total equity (incl min) | 2510 | 2792 | 4397 | 5190 | 6288 |
| **Total liab & sh equity** | **7776** | **9532** | **12447** | **13629** | **13518** |
| Net debt | 1504 | 2131 | 1130 | 1622 | 723.8 |

Source: Company data, Rasmala forecasts year ended Dec

## Cash flow statement

| Dhm | FY08A | FY09A | FY10F | FY11F | FY12F |
|---|---|---|---|---|---|
| EBITDA | 399.7 | 1108 | 1788 | 2469 | 3146 |
| Change in working capital | 108.3 | -135.5 | 943.0 | 130.3 | 346.5 |
| Net interest (pd) / rec | -7.97 | -6.72 | -8.80 | 1.44 | -19.5 |
| Taxes paid | 0.00 | 0.00 | -603.0 | -793.5 | -1098 |
| Other oper cash items | 24.9 | -4.90 | 65.2 | 51.0 | 65.0 |
| **Cash flow from ops (1)** | **525.0** | **961.2** | **2184** | **1858** | **2440** |
| Capex (2) | -2033 | -1624 | -2262 | -2222 | -1388 |
| 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** | **-2262** | **-2222** | **-1388** |
| 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 | 0.00 | -127.6 | -2030 |
| **Cash flow from fin (5)** | **2755** | **367.9** | **1078** | **-127.6** | **-2030** |
| Forex & disc ops (6) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| **Inc/(decr) cash (1+3+5+6)** | **1186** | **-406.3** | **999.7** | **-491.6** | **-978.0** |
| Equity FCF (1+2+4) | -1508 | -662.6 | -78.1 | -364.0 | 1052 |

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: Sell, CP: Dh3.03, TP: Dh2.15)**: 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