RASMALA

20 October 2010

Etisalat

Etisalat reports 9M10 results

Buy

Target price
Dh13.60

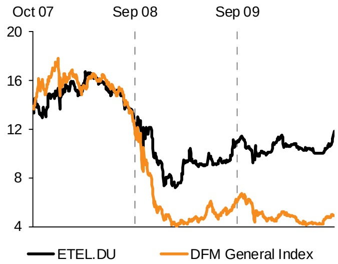
Price
Dh11.85

Short term (0-60 days)
n/a

Market view
No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (Dh)	10.35	10.35	11.32
Absolute (%)	14.5	14.5	4.7
Rel market (%)	8.1	-0.3	39.4
Rel sector (%)	-6.6	-23.5	21.4



Market capitalisation
Dh93.69bn (€18.49bn)

Average (12M) daily turnover
Dh11.29m (US$3.06m)

Sector: DFM Telecoms
RIC: ETEL.DU, ETISALAT UH
Priced at close of business 19 Oct 2010.
Source: Bloomberg

Etisalat reported disappointing 9M10 results, posting declines in both revenue and net profit. Meanwhile, plans are still ongoing to buyout a 46% stake in Kuwait's Zain Group.

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue (Dhm)	29,360	30,831	32,017	33,399	35,050
EBITDA (Dhm)	9,036	11,349	11,660	12,206	12,695
Reported net profit (Dhm)	8,511	8,836	8,361	9,055	9,875
Normalised net profit (Dhm)	8,511	8,836	8,361	9,055	9,875
Normalised EPS (Dh)	1.08	1.12	1.06	1.15	1.25
Dividend per share (Dh)	0.45	0.55	0.60	0.60	0.60
Dividend yield (%)	3.84	4.60	5.06	5.06	5.06
Normalised PE (x)	11.00	10.60	11.20	10.30	9.49
EV/EBITDA (x)	9.49	7.65	7.01	6.51	5.70
EV/invested capital (x)	3.10	2.59	2.54	2.31	2.21
ROIC - WACC (%)	0.00	0.00	0.00	0.00	0.00

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

Reported net profit for the period lags behind analysts' expectations

Etisalat announced its interim consolidated financial results for the 3Q10 period ending 30 September 2010, in which net profit for the period reached Dh1,733m, lagging behind Bloomberg's analysts' expectations of Dh2,018m. Overall consolidated net profit reached Dh5,505m at the end of 9M10, an annual drop of 19.5%. In addition to lacklustre revenue performance, a worsening operating expenses-to-revenue ratio for the reported period largely resulted in the discouraging net profit performance. That noted, operating expenses (before royalties) to revenue deteriorated to 56% at the end of 9M10 compared to 45% at the end of 9M09.

Revenues fall on both a quarterly and annual basis

Revenues for 9M10 amounted to Dh23,325m compared to Dh23,706m for the same period last year, an annual decline of 2%. Revenues for 3Q10 reached Dh7,315m compared to Dh7,996m for the same period last year, and compared to Dh8,605m recorded in 2Q10, which is equivalent to an 8.5% yoy decline and a 15% qoq drop.

We will revisit our 2010 year-end forecasts

In light of Etisalat's 9M10 performance and continued pressure in its major UAE market, we expect to revise our year-end estimates for 2010. However, we believe the main driver for the share price in the short term to be the potential acquisition of the stake in Zain.

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Key takeaways

The UAE market remains under pressure, while we expect Etisalat's share price in the short to medium term, to be mostly affected by expectations of Zain's potential 46% stake acquisition, while no final agreement has been reached to buy a Zain stake, as per Etisalat.

On 30 September 2010, Etisalat made a preliminary conditional offer to buy 46% of Kuwait's Mobile Telecommunications Company (Zain Group) in a deal worth about US$11.7bn, equivalent to a price of KWD1.70 per share, making it potentially one of the biggest corporate transactions of recent times in the Middle East and fuelling Etisalat's regional expansion strategy. However, as yet no final agreement has been reached to buy a Zain stake, according to Etisalat.

According to Etisalat’s Group Senior Vice President, Corporate Communications, Ahmed bin Ali, "We would like to emphasise that no final agreement has been reached at this point in time as this offer depends on the fulfilment of specific requirements and conditions that must be met to finalise the deal."

In our flash note dated 5 October 2010, we considered the dynamics behind the potential deal and justified the high price offered by Etisalat, given that the combination of assets under negotiation are all within one geographical umbrella, that of the MENA region, in addition to the scarcity of both greenfield and brownfield operations.

Etisalat’s decline in its 9M10 consolidated revenue, was mainly driven by a deteriorating performance in the UAE market, which is the company’s major revenue and operating profit contributor. Total revenue from the UAE reached Dh18,287m (a 78% revenue contribution) for the period ending 9M10, compared to a previous Dh20,278m (an 86% revenue contribution), reflecting an annual drop of 10%. Moreover, in terms of operating profit, proceeds from the UAE market reached Dh4,715m at the end of 9M10, equivalent to a 26% margin, versus a reported Dh6,952m, at the end of 9M09, equivalent to a 34% margin.

"We incurred multiple financial and operational costs during this period in order to carry out the deployment of the fibre-optics network. We have allocated over Dh5bn for transitioning to this new and advanced fibre-optic network," Nasser Bin Obood, the acting CEO of Etisalat, said.

"Investment in the telecom sector is typically middle and long-term investment but today Etisalat is generating revenue from many of its international operations ahead of forecasts, validating our growth and investment strategy", Mohammed Hassan Omran, Chairman of Etisalat, said in an e-mailed statement to the *Khaleej Times*.

Etisalat reported mobile, telephone and internet lines in service at the end of 30 September 2010 were at 7.81m, 1.25m and 1.35m, respectively.

Income statement

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue	29360	30831	32017	33399	35050
Cost of sales	-3319	-3840	-3988	-4160	-4366
Operating costs	-17004	-15642	-16370	-17033	-17989
EBITDA	**9036**	**11349**	**11660**	**12206**	**12695**
DDA & Impairment (ex gw)	-2484	-2535	-3353	-3245	-2987
EBITA	**6552**	**8815**	**8307**	**8961**	**9708**
Goodwill (amort/impaired)	0.00	0.00	0.00	0.00	0.00
EBIT	**6552**	**8815**	**8307**	**8961**	**9708**
Net interest	-148.4	11.6	388.2	453.9	519.1
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	1784	0.00	0.00	0.00	0.00
Reported PTP	**8187**	**8827**	**8695**	**9415**	**10228**
Taxation	-187.0	-243.8	-173.9	-141.2	-102.3
Minority interests	510.6	253.6	-159.8	-218.6	-249.9
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	**8511**	**8836**	**8361**	**9055**	**9875**
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised EBITDA	9036	11349	11660	12206	12695
Normalised PTP	8187	8827	8695	9415	10228
Normalised net profit	**8511**	**8836**	**8361**	**9055**	**9875**

Source: Company data, Rasmala forecasts year to Dec

Balance sheet

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
Cash & market secs (1)	11295	11309	16927	18034	21847
Other current assets	6128	8253	8095	8161	8194
Tangible fixed assets	13101	17585	19245	20903	21359
Intang assets (incl gw)	16204	16778	15818	14816	13764
Oth non-curr assets	16190	17452	17061	16873	16831
Total assets	**62918**	**71379**	**77145**	**78787**	**81995**
Short term debt (2)	722.3	1079	0.00	0.00	0.00
Trade & oth current liab	20694	22409	25427	25575	23261
Long term debt (3)	2644	3422	3802	574.8	337.7
Oth non-current liab	3237	4079	3750	3940	4318
Total liabilities	**27298**	**30989**	**32978**	**30090**	**27917**
Total equity (incl min)	35620	40389	44167	48697	54078
Total liab & sh equity	**62918**	**71379**	**77145**	**78787**	**81995**
Net debt	-7928	-6808	-12010	-14232	-21272

Source: Company data, Rasmala forecasts year ended Dec

Cash flow statement

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA	9036	11349	11660	12206	12695
Change in working capital	1319	-153.6	2061	852.7	642.7
Net interest (pd) / rec	12.2	193.4	388.2	453.9	519.1
Taxes paid	-87.9	-86.0	-173.9	-141.2	-102.3
Other oper cash items	329.0	-985.1	-159.8	-218.6	-249.9
Cash flow from ops (1)	**10609**	**10318**	**13776**	**13153**	**13505**
Capex (2)	-3908	-6798	-4052	-3902	-2391
Disposals/(acquisitions)	3869	0.00	0.00	0.00	0.00
Other investing cash flow	-2875	-166.0	391.0	188.8	42.0
Cash flow from invest (3)	**-2914**	**-6964**	**-3661**	**-3713**	**-2349**
Incr / (decr) in equity	0.00	0.00	117.6	811.4	1632
Incr / (decr) in debt	-2397	485.9	225.1	-4030	-3112
Ordinary dividend paid	-3244	-3893	-4744	-4744	-4744
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	0.00	0.00	-96.3	-370.3	-1119
Cash flow from fin (5)	**-5642**	**-3407**	**-4497**	**-8332**	**-7343**
Forex & disc ops (6)	-190.2	67.7	0.00	0.00	0.00
Inc/(decr) cash (1+3+5+6)	**1862**	**14.3**	**5618**	**1108**	**3813**
Equity FCF (1+2+4)	6701	3520	9724	9251	11114

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

Etisalat (RIC: ETEL.DU, Rec: Buy, CP: Dh11.85, TP: Dh13.60): To arrive at our target price, we use an equal weighting of valuations based on multiples, sum of the parts and DCF. The company's two main risks are a prolonged pricing war with Du and overpaying for licences and acquisitions.

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