

Buy

TP E£16.72 (from E£20.15)

Telecom Egypt

Persevering through

In light of the continued economic and political turbulence, we revise our forecasts for Telecom Egypt. We raise our discount rate from 10.5% to 14.5% in view of the political risk in the country. Hence, we cut our target price for Telecom Egypt to E£16.7, maintaining our Buy recommendation.

RBS Refiner

Price (close 12 Jan)	E£13.66
3M high/low	E£15.13/11.99
Market cap	E£23.32bn
Av (12M) turnover	E£11.84m
Freefloat	19%
Reuters	ETEL.CA
Bloomberg	ETEL.EY
Net debt (cash) FY10	E£(4100.73)m
3yr EPS CAGR 11-13F	(3.7)%
Income (2012F div yield)	10.3%

Source: Bloomberg

RBS vs consensus

NPBT	RBS	Cons	%
2011	3,527	3,624	-3%
2012	3,439	3,695	-7%
2013	3,610	3,894	-7%

Source: RBS forecasts, Bloomberg

Price performance

	(1M)	(3M)	(12M)
Price (E£)	13.69	14.50	18.75
Absolute (%)	-0.2	-5.8	-27.1
Rel to mkt*(%)	2.5	1.0	37.5

*EGX30

Source: Bloomberg

Key events

Date	Event
Jan-12	Annual results announced
Apr-12	Interim results announced
Jul-12	Interim results announced

Source: Bloomberg

Event: Political and economic risks take their toll on 12M performance

In Egypt, there is still much uncertainty regarding the economic outlook and the political direction the country may take, and popular measures by the government may result in a deteriorating environment for businesses operating in the country. The Egyptian-based Telecom Egypt was among the worst performers in the region on a 12M basis, falling by 27.1%.

Forecasts: Local economic turbulence to negatively affect retail revenue

The wider economic downturn has taken its toll on household incomes in Egypt, which in turn, has had a negative impact on overall active subscribers for Telecom Egypt and retail revenue. Retail revenue dropped by an annual 13% at the end of 3Q11. We lower our revenue forecasts for FY11, FY12 and FY13 by 8%, 4% and 4%, respectively, because of increased pressure from the retail revenue side of operations, as economic volatility may remain a factor throughout 2012. On the other hand, proceeds from Telecom Egypt's submarine cable projects (TE North) and growth from TE Data seem to be unaffected, for the most part, by the turbulence in the local economy. We lower our EBITDA marginally through 2013F, as a result of our lower top-line forecasts. Thus, we lower our EBITDA forecasts for FY11, FY12 and FY13 by 5%, 0.9% and 0.3%, respectively.

Valuation: We lower our target price by 17% to E£16.7 per share

We believe short-term volatility may remain at least until the first half of 2012, or until the presidential elections are over. Accordingly, we take a cautious stance towards Egyptian telecoms under our coverage and raise our discount rate from 10.5% to 14.5% to adjust for the higher political risk in the country. We value Telecom Egypt based on our sum-of-the-parts and DCF valuation model, revising our target price downwards by 17% to E£16.71 compared to our previous target price of E£20.15 and reiterating our Buy recommendation on the stock. Telecom Egypt is currently trading at PE multiples of 8.1x and 8.3x for FY11F and FY12F, which are 22% and 20%, respectively, below our average MENA peers multiple of 10.4x for 2011 and 2012. We believe Telecom Egypt retains some value despite current local volatility, as we believe the economic risk has been fully priced in the stock price and estimated dividend yields for 2011F and 2012F are attractive, with an average yield above 9% compared to our average MENA dividend yields of 5%. The main downside risks are continued political and economic instability, which could directly affect subscriber spending habits, and a more aggressive fixed-to-mobile substitution trend.

Key forecasts

year to Dec	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (E£m)	9,960	10,318	9,870	9,990	10,211
EBITDA (E£m)	4,526	5,107	4,598 ▼	4,595	4,697
Normalised PTP (E£m)	3,370	3,804	3,527	3,439	3,610
Norm fully diluted EPS (E£)	1.71	1.94	1.69 ▼	1.65 ▼	1.73
Normalised PE	8.01	7.05	8.07	8.28	7.88
Dividend per share (E£)	0.75	1.30	1.27 ▼	1.40 ▼	1.56
Dividend yield (%)	5.49	9.52	9.29	10.30	11.40

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

Source: Company data, Rasmala forecasts

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Important disclosures can be found in the Disclosures Appendix.

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RBS Equities Forecasts: Telecom Egypt

Income statement

E£m, year to December	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	9960	10318	9870	9990	10211
Cost of sales	-3252	-3358	-3479	-3546	-3651
Operating costs	-2182	-1853	-1793	-1848	-1864
EBITDA	4526	5107	4598	4595	4697
DDA & Impairment (ex gw)	-2475	-2487	-2095	-2148	-2093
EBITA	2051	2620	2503	2448	2604
Goodwill (amort/impaird)	0.00	0.00	0.00	0.00	0.00
EBIT	2051	2620	2503	2448	2604
Net interest	10.5	-160.1	39.5	59.9	61.3
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	1309	1344	984.2	931.6	944.9
Reported PTP	3370	3804	3527	3439	3610
Taxation	-453.4	-491.7	-634.8	-619.0	-649.8
Minority interests	-5.35	-2.45	-2.35	-2.29	-2.44
Other post-tax items	-0.00	0.00	0.00	-0.00	0.00
Reported net profit	2912	3309	2890	2818	2958
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised EBITDA	4526	5107	4598	4595	4697
Normalised PTP	3370	3804	3527	3439	3610
Normalised net profit	2912	3309	2890	2818	2958

Balance sheet

E£m, year ended December	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	2453	4976	5789	7021	8392
Other current assets	4769	4149	4692	4549	4355
Tangible fixed assets	17036	16312	14917	13668	12494
Intang assets (incl gw)	128.2	109.9	100.9	93.9	87.9
Oth non-curr assets	7644	7657	8215	8797	9384
Total assets	32030	33204	33715	34129	34712
Short term debt (2)	0.00	0.00	0.00	0.00	0.00
Trade & oth current liab	4271	4345	4449	4669	4687
Long term debt (3)	872.5	725.2	459.1	0.00	0.00
Oth non-current liab	372.1	146.2	146.2	146.2	146.2
Total liabilities	5516	5216	5054	4815	4834
Total equity (incl min)	26514	27988	28661	29314	29879
Total liab & sh equity	32030	33204	33715	34129	34712
Net debt	-1373	-4101	-5223	-6889	-8392

Cash flow statement

E£m, year to December	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	4526	5107	4598	4595	4697
Change in working capital	197.6	859.3	-394.9	338.2	344.3
Net interest (pd) / rec	-208.7	-160.1	39.5	59.9	61.3
Taxes paid	-1250	-491.7	-634.8	-619.0	-649.8
Other oper cash items	1008	2074	984.2	931.6	944.9
Cash flow from ops (1)	4272	7388	4592	5306	5398
Capex (2)	-980.8	734.5	-691.0	-892.1	-913.0
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	1046	-12.8	-558.9	-581.3	-586.8
Cash flow from invest (3)	65.2	721.7	-1250	-1473	-1500
Incr / (decr) in equity	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in debt	0.00	0.00	0.00	0.00	0.00
Ordinary dividend paid	-2367	-2219	-2219	-2167	-2395
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	-2049	-3258	-309.6	-434.1	-131.9
Cash flow from fin (5)	-4415	-5477	-2529	-2601	-2527
Forex & disc ops (6)	-290.0	0.00	0.00	0.00	0.00
Incr/(decr) cash (1+3+5+6)	-367.8	2632	813.0	1231	1371
Equity FCF (1+2+4)	3292	8122	3901	4414	4485

Source: Company data, Rasmala forecasts

Key assumptions

We revise our target price slightly downwards to E£20.12, maintaining our Buy recommendation. Based on our forecasts, Telecom Egypt is currently trading at a PE of 8.1x for 2011, which is 22% below our average MENA peers multiple for 2011 of 10.4x.

In our valuation of Telecom Egypt, our base-case scenario assumptions include: cost of equity of 19%, based on a risk-free rate of 14.5% and a premium of 5%, cost of debt of 15%, a terminal growth rate of 1.5% and a beta of 0.83x.

Valuation and target price

Sum-of-the-parts and discounted cash flow

TE's sum-of-the-parts/DCF valuation yields a 12-month fair value of E£16.71, which is more than 20% higher than the current price of E£13.66.

Table 1: DCF valuation

Operation	Assumptions
Telecom Egypt	DCF (risk-free rate: 14.5%, risk premium: 5%, cost of debt: 15%, beta : 0.83x, LTG: 1.5%)
Vodafone Egypt	DCF (risk-free rate: 14.5%, risk premium: 5%, cost of debt: 15%, beta : 0.91x, LTG: 3.0%)

Source: Rasmala estimates

Table 2: SOTP valuation

Operation (all figures in E£m, unless stated otherwise)	Enterprise value	Stake	Proportionate EV
Telecom Egypt	17,051	100%	17,051
Vodafone Egypt	16,403	44.95%	7,373
Total enterprise value			24,424
Less: net debt/(net cash)			(4,101)
Total equity value			28,525
Total outstanding shares (m)			1,707
Total SOTP (E£ per share)			16.7

Source: Rasmala estimates

Table 3: Forecast changes

E£m	(Old forecasts)			(New forecasts)			Change		
	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Revenue	10,692	10,377	10,599	9,870	9,990	10,211	-8%	-4%	-4%
EBITDA	4,863	4,637	4,712	4,598	4,595	4,697	-5%	-1%	0%
EBITDA margin (%)	45%	45%	44%	47%	46%	46%	1%	1%	2%
Net profit	3,015	2,910	2,968	2,890	2,818	2,958	-4%	-3%	0%

Source: Rasmala estimates

Disclosure Appendix

Recommendation structure

Absolute performance, short term (trading) recommendation (Australian coverage only): A Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and, except as follows, only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For research on Australian listed property trusts (LPT) or real estate investment trusts (REIT), the recommendation is based upon total return, ie, the estimated total return of capital gain, dividends and distributions received for any particular stock over the investment horizon.

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.

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.

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