Q3 UPDATE: Emirates Integrated Telecom Company PJSC

November 13, 2008

Fair value estimate: AED 5.4
Recommendation: BUY

Maintaining Growth Momentum

Emirates Integrated Telecom Company PJSC (DU) performed well in Q3 2008 maintaining strong growth momentum. Revenue increased 157% y-o-y to over AED 1bn, due mainly to robust active mobile subscriber growth of 215% y-o-y. The Company reported EBITDA of AED 101mn following a loss of AED 186mn in Q3 2007, while EBITDA margins continued to improve as the Company reaped the benefits of economies of scale. In addition, DU has sufficient liquidity to finance its capital expenditure plans for 2008-09 with an undrawn credit facility of AED 2bn. Based on the strong growth in subscriber additions, we expect the Company to report a profit in 2008, and to post a positive free cash flow in 2010.

Result Highlights

Net revenue: DU reported net revenue of AED 1,059.6mn in Q3 2008, up 157% y-o-y, due to robust mobile and fixed-line subscriber additions.

Subscribers: DU's mobile and fixed-line subscribers increased by 12.3% q-o-q and 12.7% q-o-q, respectively. Despite adjusting its mobile subscriber data to discount inactive users, growth was sufficient to boost mobile market share to 22.8% in Q3 from 21.3% in Q2 2008. In addition, fixed-line services were well received by customers with DU adding 30,000 in Q3 2008 (compared with 10,000 by Etisalat), to end the quarter with 248,000 subscribers. We forecast an increase in the Company's domestic mobile subscribers at a CAGR of 24.6% to 2010, and expect it to expand its mobile market share to 27.5% by 2010. In addition, we estimate that DU's fixed-line market share will exceed 25% by 2011.

EBITDA and Net profit: DU reported EBITDA of AED 101mn in Q3 2008 compared to a loss of AED 186mn in Q3 2007. The Company also continued to improve its EBITDA margin which increased to 9.6% from 3.2% in the previous quarter due to lower network operations and maintenance costs. The Company posted positive net profits of AED 31.5mn in Q3 compared to a loss of AED 43.8mn in Q2 2008. However, net profits totalled AED 16.4mn after adjustment for AED 35.6mn in compensation received as a result of an agreement to vacate an operational site, and AED 20.5mn in depreciation charged for the site itself.

We forecast improved EBITDA and net profit margins of 24.3% and 9%, respectively in 2010 due to economies of scale reflecting a larger subscriber base. In addition, we expect a two stage reduction in royalties to 45% in 2009, and to 40% in 2010 which will support better margins.

Capital expenditure: The Company has announced aggressive capital expenditure plans for the rest of this year and 2009, most of which will be applied for capacity expansion,

RESULT UPDATE

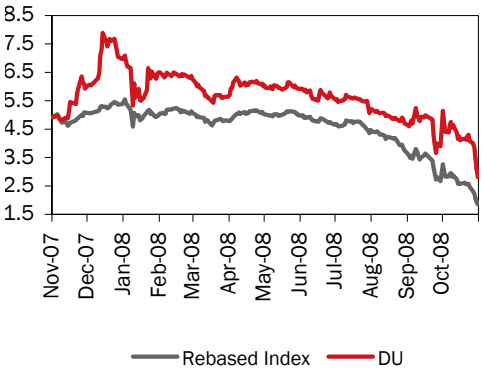
Share Data	
Market Cap	AED 11.3 bn
Price	AED 2.82
Dubai Financial Market General Index	2,106.1
Reuters	DU.DU
Bloomberg	DU UH
Avg. Volume (52 Week)	7.3 mn
52-Week High/Low	AED 8.42 / 2.82
Shares Outstanding	4,000
Fair Value Estimate	**AED 5.4**
Rating	**BUY**

Key Figures

Year to 31 Dec	2007	2008
Revenue (mn)	1,537.4	3,963.9
Gross Profit (mn)	858.5	2,507.1
EBITDA (mn)	(706.0)	411.9
Net Profit (mn)	(885.3)	22.7
EPS (AED)	(0.22)	0.01
GPM (%)	55.8%	63.3%
RoA (%)	(20.9%)	0.4%
RoE (%)	(30.0%)	0.9%
EV/Revenue	7.3x	3.2x
EV/EBITDA	nm	30.6x

Shareholding Pattern (%)	
Government of UAE	40
Institutions	39
Public & Others	21

Relative Performance



and increased coverage and improvement of service quality across the UAE. Also, DU will invest in internet and roaming infrastructure facilities. Capital expenditure in Q3 was AED 347mn, and so far this year AED 1,235mn. We forecast capital investments of AED 1.8bn in both 2008 and 2009 in line with management guidance, to be financed through internal accruals and an undrawn credit facility. However, we expect substantially lower capital expenditure from 2010.

Outlook

We expect DU to improve its mobile market share to 27.5% by 2010 as the Company continues to increase its share of net mobile subscriber additions. We believe DU is well placed to grow its mobile subscribers at a CAGR of 24.6% to 2.9 million by the end of 2010, supported by its innovative and client focused product offerings, and the absence of direct price competition with Etisalat.

In addition, we expect DU to have secured a 25% internet market share by the end of 2010 due to the Company's competitive product offering in the UAE's relatively immature internet market. We expect internet business to contribute around 10% of total revenues by 2010.

DU has adequate liquidity to meet its capital expenditure requirements for the next two to three years based on positive operating cash flows from 2008 and an undrawn credit facility of AED 2bn. Furthermore, the TRA announced that it is working on a new legislation that will boost competition through shared telecom infrastructure. The new legislation will require that developers emplace the telecom infrastructures and lease them out to telecom operators. We believe that overall, if implemented ,this new legislation will further improve telecom companies' liquidity position and further advantage DU given its lagging position in terms of infrastructure development and market share, however given the embryonic stage of the legislative project we do not explicitly account for it in our valuation model.

Eventually, we expect the Company's balance sheet to strengthen as operations expand. We believe its financial leverage will decline as it repays debt supported by positive free cash flows. Consequently, we expect DU's net debt to EBITDA ratio to decline from 3.1x in 2008 to 0.4x by 2010.

Key Figures

Quarterly Data	Q3'07	Q2'08	Q3'08	YoY %	QoQ%
(Figures in AED mn, except per share and Subscribers data)					
Net Revenue	412	908	1,060	157.0%	16.7%
EBITDA	(186)	29	101	nm	246.8%
EBITDA Margins	(45.1%)	3.2%	9.6%		
PAT	(242)	(44)	31	nm	nm
PAT Margins	(58.7%)	(4.8%)	3.0%		
Per Share Data (AED)					
EPS	(0.06)	(0.01)	0.01	nm	nm
Subscribers (In mn)					
Fixedline	-	0.22	0.25	na	12.7%
Mobile[(1)]	0.66	1.85	2.08	215.2%	12.3%

[(1)] Active Mobile Subscribers

Valuation

We have valued DU using Discounted Cash Flow (DCF) and Peer-Based Multiple methods. Our weighted DCF (90%) and peer-based multiple (10%) valuations allocate a higher weight to our DCF model because it discounts firm-specific cash flows. In addition, we have restricted our peer valuation weighting to 10% and used the EV/Revenue multiple in our relative valuation as the Company has yet to achieve significant operational scale. Our fair value estimate of DU is AED 5.4 for 2008 representing a premium of 91% to the current share price. We maintain our Buy rating.

Weighted Average Value per Share		
Valuation Method	Value (AED)	Weight (%)
Discounted Cash Flow (DCF)	5.6	90%
Peer-based multiple valuation	3.0	10%
Weighted Average Fair Value	5.4	100%

Source: ADCB research

Cost of equity is derived by using the Capital Asset Pricing Model (CAPM). We make the following key assumptions in our model:

Risk free rate:	4.79% (Avg. 10 yr. US Treasury Bond Rate for three years)
Country Risk Premium:	0.9%
Equity Premium:	6.0%
Beta:	1.03 (Avg. beta for new players in emerging markets)
Cost of equity:	11.87%
WACC:	11.42%
Terminal growth rate:	3.5%
Terminal WACC:	11.64%

We have revised our cost of equity from 11.09% to 11.87% to reflect the increase in average beta for new players in emerging markets from 0.90 to 1.03.

Sensitivity of fair value estimate, using different rates for terminal cost of capital and terminal growth rates:

	Terminal cost of capital					
Terminal Growth	5.65	10.6%	11.1%	11.6%	12.1%	12.6%
	2.5%	5.9	5.5	5.1	4.8	4.5
	3.0%	6.3	5.8	5.4	5.0	4.7
	3.5%	6.7	6.1	5.6	5.2	4.9
	4.0%	7.1	6.5	6.0	5.5	5.1
	4.5%	7.6	6.9	6.3	5.8	5.4

Source: ADCB research

Sensitivity of fair value estimate, using different mobile ARPU and market share for 2015

	Market share in 2015					
Expected ARPU in 2015	165	27.5%	32.5%	35.0%	37.5%	42.5%
	125	4.5	4.9	5.1	5.4	5.8
	130	4.7	5.2	5.4	5.6	6.1
	135	4.9	5.4	5.6	5.9	6.4
	140	5.1	5.6	5.9	6.2	6.7
	145	5.4	5.9	6.2	6.4	7.0

Source: ADCB research

Comparable Company Trading Analysis											
		Stock	Fully Diluted		Fully Diluted						
		Price	Market	Enterprise	Enterprise Value / Revenue			ROCE			
Company	Local Currency	13-Nov-08 (Local Ccy)	Cap (AED m)	Value (AED m)	Dec-07	Dec-08	Dec-09	FY07	FY08	FY09
Saudi Telecom Co	SAR	58.00	113,607	119,461	3.5x	2.9x	2.7x	34%	41%	42%
Mobile Telecommunications Co KSC	KWD	1.00	58,048	83,769	3.6x	2.9x	2.5x	19%	21%	24%
Emirates Telecommunications Corporation	AED	13.05	65,136	62,668	2.9x	2.4x	2.1x	54%	67%	68%
Turkcell Iletisim Hizmetleri AS	TRY	8.25	52,087	45,716	2.5x	2.2x	2.0x	33%	15%	36%
Orascom Telecom Holding	EGP	32.29	22,716	40,675	2.2x	2.0x	1.8x	26%	26%	27%
Etihad Etisalat Co	SAR	27.50	13,466	21,517	2.6x	2.1x	1.9x	20%	23%	24%
Qatar Telecom QSC	QAR	134.70	14,946	42,444	4.1x	2.6x	2.2x	16%	28%	32%
Telecom Egypt SAE	EGP	15.45	18,078	20,561	3.0x	2.9x	2.8x	17%	17%	17%
Egyptian Company for Mobile Services	EGP	122.37	8,373	10,590	1.9x	1.6x	1.4x	58%	69%	66%
Oman Telecommunications Co	OMR	1.72	12,308	11,386	3.3x	2.9x	2.7x	55%	76%	NA
Bahrain Telecommunications Co BSC	BHD	0.57	7,996	7,877	2.8x	2.4x	2.1x	22%	NA	NA
Mean					2.9x	2.4x	2.2x	32%	38%	37%
Median					2.9x	2.4x	2.1x	26%	27%	32%
EV/Revenue (Peer-group average)		2.2								
EV		13,164								
Net Debt		1,009								
Equity Value		12,155								
No of shares		4,000								
Value per share		3.0								

Source: ADCB research, Reuters, Company Data

Income Statement				
(AED M,Yr. ending Dec. 31)	2007	2008	2009	2010
Revenue	1,537	3,964	6,019	7,198
COGS	(679)	(1,457)	(2,107)	(2,303)
Gross Profit	858	2,507	3,913	4,895
Gross Profit margin	55.8%	63.3%	65.0%	68.0%
Other Operating Expenses	(1,564)	(2,095)	(2,777)	(3,146)
Royalty	0	(23)	(259)	(433)
Post Royalty EBITDA	(706)	389	877	1,316
YoY Growth (%)	11%	(155.1)%	125.2%	50%
Depreciation & Amortisation	(224)	(461)	(608)	(678)
Post Royalty EBIT	(930)	(72)	268	638
YoY Growth (%)	27.2%	(92.3)%	(473.2)%	nm
Net finance income	45	5	(72)	(58)
Total Net Income	(885)	23	316	650
YoY Growth (%)	45.4%	(102.6%)	1290.8%	nm
EPS	(0.22)	0.01	0.08	0.16

Balance Sheet				
Non-Current Assets	3,593	4,932	6,124	6,146
YoY Growth (%)	64.7%	37.3%	24.2%	0.4%
Cash & cash equivalents	89	304	550	1,077
Other current assets	666	1,151	1,442	1,600
Total Current Assets	755	1,456	1,992	2,678
YoY Growth (%)	(61.4%)	92.9%	36.8%	34.4%
Total Assets	4,348	6,388	8,115	8,823
Current liabilities	1,692	2,214	3,202	3,501
Borrowings	0	1,600	2,000	1,750
Other Non-Current Liabilities	150	45	69	78
Total Non-Current Liabilities	150	1,645	2,069	1,828
YoY Growth (%)	(26.5%)	998.5%	25.7%	(11.6%)
Total Liabilities	1,842	3,859	5,271	5,329
Total Equity	2,506	2,529	2,845	3,494
Total Equity & Liabilities	4,348	6,388	8,115	8,823

Key Ratios				
	2007	2008	2009	2010
Per share data (AED)				
Shares outstanding (mn)	4,000	4,000	4,000	4,000
EPS	(0.22)	0.01	0.08	0.16
Book value per share	0.63	0.63	0.71	0.87
Operational Metrics				
Mobile Subscribers (mn)	1.50	2.28	2.48	2.90
Fixedline Subscribers (mn)	0.05	0.26	0.35	0.44
Internet Subscribers (mn)	0.00	0.20	0.34	0.51
Mobile ARPU (AED)	123	140	150	150
Fixedline ARPU (AED)	170	160	190	190
Internet ARPU (AED)	0	140	140	135
Valuation ratios (x)				
EV/Revenue	7.3x	3.2x	2.1x	1.7x
EV/EBITDA	nm	30.6x	11.2x	6.8x
P/E	nm	nm	35.7x	17.4x
Performance ratio (%)				
Return on avg. assets	(20.9%)	0.4%	4.4%	7.7%
Return on avg. net worth	(30.0%)	0.9%	11.8%	20.5%
Return on Capital Employed	(28.2%)	10.0%	23.4%	33.4%
Operating ratios (%)				
Revenue Growth	254.2%	157.8%	51.9%	19.6%
EBITDA Margin	(45.9%)	10.4%	18.9%	24.3%
EBIT Margin	(60.5%)	(1.2%)	8.8%	14.9%
Net Profit Margin	(57.6%)	0.6%	5.2%	9.0%
Balance Sheet ratios (%)				
Non-Current Assets Turnover Ratio	53.2%	93.0%	108.9%	117.3%
Total Assets Turnover Ratio	36.2%	73.8%	83.0%	85.0%
Debt/Equity Ratio	na	63.3%	70.3%	50.1%
Net Debt/Equity Ratio	(3.6%)	51.2%	51.0%	19.2%

Source: Company data, ADCB research

Investment Ratings:

Buy: More than 15% potential return. We recommend that investors buy the stock based on the annualised return to the shareholders over 6-24 months time horizon (percentage change from current price to the projected target price).
Sell: Negative potential return. We recommend that investors sell the stock based on the annualised return to the shareholders over the 6-24 months time horizon.
Hold: Between 0 and 15% potential return. We take a neutral view on the stock over the 6-24 months period.

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