Etihad Etisalat Company

Telecom –Industrial
EEC AB: Saudi Arabia
08 May 2011

الراجحي المالية
Al Rajhi Capital

US$9.61bn	55.3%	US$27.43mn
Market cap	Free float	Avg. daily volume

Target price	74.00	43.69% over current
Consensus price	70.00	35.9% over current
Current price	51.50	as at 7/5/2011

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Underweight | Neutral | **Overweight**

Mobily

Consistently solid

This report follows our Flash View of 11th April. Mobily announced Q1 results with yet another set of remarkable growth, featuring 25% year-on-year sales growth and 40% net profit growth. However, gross margins were below our expectations due to the high handset sales and intense promotions. We expect revenue and profits growth to moderate from now on after surging in recent quarters, but to remain strong. Reflecting our expectations of lower prices (ARPU), we have trimmed our long term estimates for sales and margins slightly. Thus, we have marginally lowered our target price to SAR74.0, implying 43.6% upside potential. We remain Overweight.

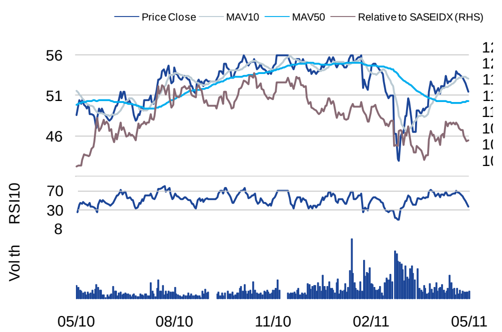
Key themes

Our preferred stock in the Saudi telecoms sector is Mobily, which we rate as Overweight. Mobily is performing well operationally and offers strong growth in the near term at a reasonable valuation.

Implications

Our preferred stock in the Saudi telecoms sector is Mobily, which we rate as Overweight. Mobily is performing well operationally and offers strong growth in the near term at a reasonable valuation.

Performance



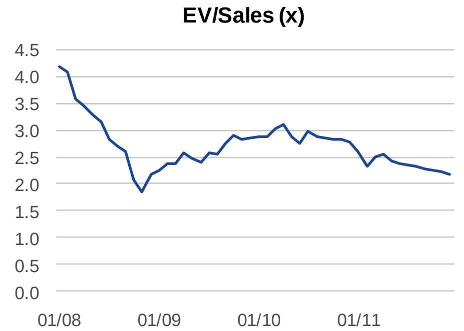
Source: Bloomberg

Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	16,013	18,782	21,239	23,501
Revenue Growth	22.6%	17.3%	13.1%	10.6%
EBITDA (mn)	6,165	7,195	8,000	8,813
EBITDA Growth	27.5%	16.7%	11.2%	10.2%
EPS	6.02	6.86	7.70	8.33
EPS Growth	39.7%	14.0%	12.3%	8.2%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Revenue increase by 25% year-on-year: Mobily's Q1 revenues grew by 25% y-o-y to reach SAR4.4bn and exceeding our forecast by roughly 3.3%. According to Mobily, handsets and pads sales were the main driver of this remarkable growth. We believe mobile data will continue to grow and offset the slow growth in voice revenues despite that penetration level is considerably high. We now forecast data revenue to reach 21.5% of sales by the end of 2011.

Load on gross margin: Gross profit increased year-on-year by 25%. As mentioned above, Q1 witnesses high handsets and pads sales, which almost carry no profit. This increase in handset sales coupled with intense competition from all the operators had its impact on gross margin. Although gross margin of 51% is similar to that in Q1 2010, it was far below that of 57.5% in Q4 2010 and 57.9% in Q3 2010. For Mobily, the second half of the year is usually better than the first one in terms of margins, however, we believe that the expected launch of new handsets and pads this year coupled with continuous aggressive promotions will continue to pressure Mobily's margins.

EBITDA: Mobily showed an impressive EBITDA growth of more than 33% year-on-year and exceeding our forecasts by 4%. EBITDA margin increased year-on-year by more than 2% and this fed directly through to a 40% increase in net profit. This can be mainly attributed to the decline in SG&A cost as a proportion of sales which shrank from 18% in Q1 2010 to 16% in Q1 2011. This shows the strong control that Mobily has over its SG&A costs.

Strong balance sheet: At the end of Q1, net debt was SAR6, 837mn, above our forecasts by 17%. Although net debt/EBITDA increase from below 1.0x levels in Q4 to 1.1x, we still believe that gearing level is at very healthy level. With strong finances, Mobily can continue to invest in growth. In addition, Mobily can at ease pay higher dividends. Thus, we expect Mobily to raise its dividends payment for the year 2011 (dividends in 2010 was SAR2.0 per share). We further note that Mobily will pay its dividends for 2011 on a semi-annual basis.

Conclusion: Despite high penetration levels, we think the Saudi telecom market still has strong growth potential where mobile data will be the main driver. We think Mobily will continue to be the key beneficiary of strong demand for mobile broadband service. We expect revenue and profits growth to moderate from now on after surging in recent quarters, but to remain strong. We like Mobily's Q1 results; however, we have cut our earnings forecasts to reflect the pricing pressure. As a result, we have cut our target price from SAR78.2 to SAR74.0. The new price target implies 43.6% upside. We remain overweight.

Corporate summary

Etihad Etisalat (Mobily) is the second-placed telecoms operator in Saudi Arabia, with a market value of US$10bn. Mobily has a market share of mobile accounts of about 40%, although its revenue share is lower at 31%. Mobily has at least 50% of mobile broadband subscriptions; this is the fastest-growing segment of the Saudi telecoms market. Mobily's presence in fixed-line service is very limited, but should expand due to selective acquisitions. Mobily is an affiliate of Emirates Telecoms Corp., which owns 27% of its shares.

Share information

Market cap (SAR/US$)	36.05bn / 9.61bn
52-week range	43.00 - 56.00
Daily avg volume (US$)	27.43mn
Shares outstanding	700.0mn
Free float (est)	55.3%

Performance:	1M	3M	12M
Absolute	0%	-6.4%	2.5%
Relative to index	0%	-5.8%	6%

Major Shareholder:	
Emirates Telecoms Corp.	27.5%
Gen. Organisation for Social Insce.	11.2%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	16,013	18,782	21,239	23,501
EBITDA (SARmn)	6,165	7,195	8,000	8,813
Net Profit (SARmn)	4,211	4,800	5,392	5,833
EPS (SAR)	6.02	6.86	7.70	8.33
DPS (SAR)	2.00	2.66	3.46	4.08
EPS Growth	39.7%	14.0%	12.3%	8.2%
EV/EBITDA (x)	6.8	5.7	4.9	4.2
P/E (x)	8.6	7.5	6.7	6.2
P/B (x)	2.3	1.9	1.6	1.4
Dividend Yield	3.9%	5.2%	6.7%	7.9%

Source: Company data, Al Rajhi Capital

Figure 1. Mobily summery of Q1 2011 results

(SAR mn)	2010Q1A	2010Q4A	2011Q1A	% chg. y-y	2010Q2A	2011Q2E	% chg. y-y
Revenues	3,581	4,471	4,484	25.21%	3,972	4,586	15.5%
Gross profit	1,827	2,573	2,289	25.29%	2,074	2,385	15.0%
Gross margin	51.02%	57.54%	51.05%	0.03pp	52.21%	52.00%	(0.21)pp
EBITDA	1,180	1,948	1,577	33.68%	1,388	1,605	15.7%
EBITDA margin (%)	32.94%	43.58%	35.17%	2.2pp	34.94%	35.00%	0.06pp
Operating profit	763	1,465	1,054	38.11%	940	1,078	14.6%
Net profit	714	1,459	998	39.80%	901	1,025	13.8%
Capex	730	1,065	1,139	56.01%	739	688	-6.9%
Capex/sales (%)	20.38%	23.81%	25.39%	5.0pp	18.61%	15.00%	(3.61)pp
Net debt	6,682	5,860	6,838	2.33%	7,133	7,605	6.6%
Net debt/annualised EBITDA (x)	1.4	0.8	1.1	n/a	1.3	1.2	n/a

Source: Company data, Al Rajhi Capital

We expect a revenue growth of 17% for 2011

We expect Mobily to increase its dividends this year

We expect gross margin to stay around 54%

Mobily's ROIC is well above the its WACC

Mobily is trading on a PE of 7.6x and EV/EBITDA of 5.8x

Income Statement (SARmn)	**12/09A**	**12/10A**	**12/11E**	**12/12E**	**12/13E**
Revenue	**13,058**	**16,013**	**18,782**	**21,239**	**23,501**
Cost of Goods Sold	(5,512)	(7,230)	(8,582)	(9,750)	(10,810)
Gross Profit	**7,547**	**8,783**	**10,200**	**11,489**	**12,690**
Government Charges					
S.G. & A. Costs	(2,710)	(2,619)	(3,005)	(3,488)	(3,878)
Operating EBIT	**3,208**	**4,355**	**5,042**	**5,630**	**6,059**
Cash Operating Costs	(8,222)	(9,849)	(11,587)	(13,238)	(14,688)
EBITDA	**4,837**	**6,165**	**7,195**	**8,000**	**8,813**
Depreciation and Amortisation	(1,629)	(1,810)	(2,153)	(2,370)	(2,754)
Operating Profit	**3,208**	**4,355**	**5,042**	**5,630**	**6,059**
Net financing income/(costs)	(204)	(146)	(137)	(100)	(77)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	41	70	7	-	-
Other Expenses	-	-	-	-	-
Net Profit Before Taxes	**3,045**	**4,279**	**4,912**	**5,530**	**5,982**
Taxes	(31)	(67)	(112)	(138)	(150)
Minority Interests	-	-	-	-	-
Net profit available to shareholders	**3,014**	**4,211**	**4,800**	**5,392**	**5,833**
Dividends	(875)	(1,400)	(1,862)	(2,421)	(2,858)
Transfer to Capital Reserve	-	-	-	-	-

	12/09A	**12/10A**	**12/11E**	**12/12E**	**12/13E**
Adjusted Shares Out (mn)	700.0	700.0	700.0	700.0	700.0
CFPS (SAR)	6.63	8.60	9.93	11.09	12.27
EPS (SAR)	4.31	6.02	6.86	7.70	8.33
DPS (SAR)	1.250	2.000	2.660	3.458	4.083

Growth	**12/09A**	**12/10A**	**12/11E**	**12/12E**	**12/13E**
Revenue Growth	21.0%	22.6%	17.3%	13.1%	10.6%
Gross Profit Growth	25.2%	16.4%	16.1%	12.6%	10.5%
EBITDA Growth	27.5%	27.5%	16.7%	11.2%	10.2%
Operating Profit Growth	28.5%	35.8%	15.8%	11.7%	7.6%
Net Profit Growth	44.1%	39.7%	14.0%	12.3%	8.2%
EPS Growth	16.8%	39.7%	14.0%	12.3%	8.2%

Margins	**12/09A**	**12/10A**	**12/11E**	**12/12E**	**12/13E**
Gross profit margin	57.8%	54.9%	54.3%	54.1%	54.0%
EBITDA margin	37.0%	38.5%	38.3%	37.7%	37.5%
Operating Margin	24.6%	27.2%	26.8%	26.5%	25.8%
Pretax profit margin	23.3%	26.7%	26.2%	26.0%	25.5%
Net profit margin	23.1%	26.3%	25.6%	25.4%	24.8%

Other Ratios	**12/09A**	**12/10A**	**12/11E**	**12/12E**	**12/13E**
ROCE	17.2%	20.6%	20.2%	19.7%	19.0%
ROIC	18.4%	22.2%	23.0%	22.8%	23.1%
ROE	27.4%	30.3%	27.8%	26.0%	24.1%
Effective Tax Rate	1.0%	1.6%	2.3%	2.5%	2.5%
Capex/Sales	25.2%	21.2%	18.5%	21.0%	20.0%
Dividend Payout Ratio	29.0%	33.2%	38.8%	44.9%	49.0%

Valuation Measures	**12/09A**	**12/10A**	**12/11E**	**12/12E**	**12/13E**
P/E (x)	12.0	8.6	7.5	6.7	6.2
P/CF (x)	7.8	6.0	5.2	4.6	4.2
P/B (x)	2.9	2.3	1.9	1.6	1.4
EV/Sales (x)	3.3	2.6	2.2	1.8	1.6
EV/EBITDA (x)	8.9	6.8	5.7	4.9	4.2
EV/EBIT (x)	13.4	9.6	8.2	6.9	6.1
EV/IC (x)	2.2	2.0	1.7	1.5	1.4
Dividend Yield	2.4%	3.9%	5.2%	6.7%	7.9%

Source: Company data, Al Rajhi Capital

We expect Mobily to have net cash by 2014

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	1,533	2,111	4,000	6,047	7,915
Current Receivables	5,481	5,736	7,190	8,024	8,460
Inventories	132	297	459	513	353
Other current assets	1,277	1,271	1,198	1,198	1,198
Total Current Assets	**8,577**	**9,415**	**12,847**	**15,781**	**17,926**
Fixed Assets	10,370	12,457	14,087	16,705	19,177
Investments	-	-	-	-	-
Goodwill	1,530	1,530	1,530	1,530	1,530
Other Intangible Assets	10,450	10,028	9,550	9,024	8,498
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**22,349**	**24,015**	**25,167**	**27,259**	**29,205**
Total Assets	**30,926**	**33,430**	**38,014**	**43,040**	**47,131**
Short Term Debt	2,147	2,442	3,107	3,107	3,107
Trade Payables	9,831	9,533	10,985	12,481	13,160
Dividends Payable	-	-	(1,400)	(1,400)	(1,400)
Other Current Liabilities	211	281	267	267	267
Total Current Liabilities	**12,189**	**12,256**	**12,960**	**14,455**	**15,135**
Long-Term Debt	6,448	5,529	6,000	6,000	6,000
Other LT Payables	-	-	-	-	-
Provisions	47	66	74	74	74
Total Non-current Liabilities	**6,495**	**5,595**	**6,074**	**6,074**	**6,074**
Minority interests	-	-	-	-	-
Paid-up share capital	7,000	7,000	7,000	7,000	7,000
Total Reserves	5,243	8,580	11,980	15,510	18,922
Total Shareholders' Equity	**12,243**	**15,580**	**18,980**	**22,510**	**25,922**
Total Equity	**12,243**	**15,580**	**18,980**	**22,510**	**25,922**
Total Liabilities & Shareholders' Equity	**30,926**	**33,430**	**38,014**	**43,040**	**47,131**

Net debt/EBITDA is low; Mobily can invest for growth

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	7,062	5,860	5,107	3,060	1,192
Net Debt/EBITDA (x)	1.46	0.95	0.71	0.38	0.14
Net Debt to Equity	57.7%	37.6%	26.9%	13.6%	4.6%
EBITDA Interest Cover (x)	23.7	42.1	52.7	80.2	115.2
BVPS (SAR)	17.49	22.26	27.11	32.16	37.03

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	3,045	4,279	4,912	5,530	5,982
Depreciation & Amortisation	1,629	1,810	2,153	2,370	2,754
Decrease in Working Capital	(388)	(774)	(27)	609	403
Other Operating Cashflow	(40)	156	(2)	(138)	(150)
Cashflow from Operations	**4,246**	**5,470**	**7,037**	**8,372**	**8,989**
Capital Expenditure	(3,288)	(3,392)	(3,480)	(4,462)	(4,700)
New Investments	-	-	-	-	-
Others	(51)	16	6	-	-
Cashflow from investing activities	**(3,339)**	**(3,376)**	**(3,474)**	**(4,462)**	**(4,700)**
Net Operating Cashflow	**907**	**2,094**	**3,563**	**3,909**	**4,289**
Dividends paid to ordinary shareholders	(525)	(875)	(2,800)	(1,862)	(2,421)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	-	-	-	-	-
Cashflow from financing activities	**(1,687)**	**(1,516)**	**(1,675)**	**(1,862)**	**(2,421)**
Total cash generated	(781)	578	1,888	2,047	1,869
Cash at beginning of period	2,314	1,533	2,111	4,000	6,047
Implied cash at end of year	**1,533**	**2,111**	**4,000**	**6,047**	**7,915**

We are expecting CAPEX for 2011 of SAR3.4bn

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	25.2%	21.2%	18.5%	21.0%	20.0%

Source: Company data, Al Rajhi Capital

Disclaimer and additional disclosures for Equity Research

Disclaimer

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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"Overweight": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"Neutral": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"Underweight": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"Time horizon": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"Fair value": We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

"Target price": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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