

Etiad Etisalat Company

Telecom Sector

EEC AB: Saudi Arabia

17 August 2011

الراجحي المالية
Al Rajhi Capital



US\$9.71bn Market cap
55.3% Free float
US\$12.55mn Avg. daily volume

Target price **72.90** 40.9% over current
Consensus price **72.70** 40.5% over current
Current price **51.75** as at 16/8/2011

Research Department
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Underweight **Neutral** **Overweight**

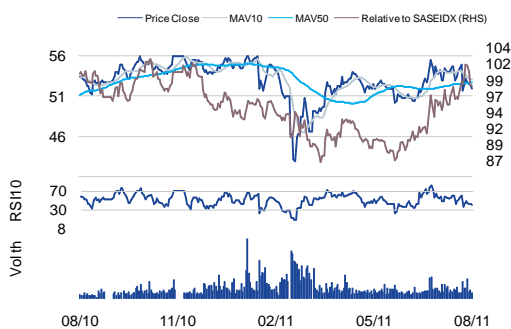
Key themes

We expect mobile to continue to outperform fixed-line telecoms in Saudi Arabia over the next few years. Mobily has taken a clear lead in 3.5G mobile data, which is the fastest-growing segment of the market. While Mobily's strong focus on mobile is a clear positive, it is also making selective investments in fixed-line service.

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 an attractive valuation.

Performance

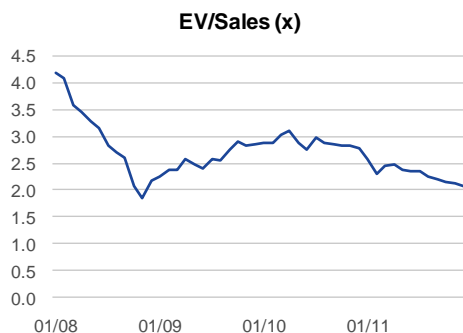


Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	16,013	20,345	23,900	25,883
Revenue Growth	22.6%	27.1%	17.5%	8.3%
EBITDA (mn)	6,165	7,563	8,708	8,930
EBITDA Growth	27.5%	22.7%	15.2%	2.5%
EPS	6.02	7.41	8.55	8.23
EPS Growth	39.7%	23.2%	15.4%	-3.8%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Mobily

Growth maintained; margins slipping

Mobily again recorded a double digit y-o-y growth in revenues and net profit, both registering 29% increase. This top and bottom line growth can be mainly attributed to increased data revenues, higher MOU, and strong smartphones sales. Gross margin, nevertheless, contracted by roughly 390bps y-o-y but this decline was slightly offset by a fall in SG&A costs as a proportion of sales. In our view, gross margins have shrunk due to the rapidly maturing voice market (penetration rate 180%), resulting in an intense competition among operators to capture market share. Accelerating handsets sales has also squeezed gross profit as they carry very low margins. As a result, we expect pressure on margins to preserve and estimate a gross margin of 52% for year 2011 (down from 58% and 55% in 2009 and 2010). We have adjusted our forecasts incorporating the recent trends in the telecoms market. Our target price has thus slightly fallen to SAR72.9, implying 41% upside from the current price. We remain Overweight.

High sales growth continues, but margins under pressure: After rising by 25% y-o-y in Q1, revenue rose by 29% in Q2 to SAR5.1bn, compared to our forecast of SAR4.6bn. In our view, expansion in broadband business and strong smartphone sales drove top line growth. Driven by broadband, data comprises now around 20% of total revenues and we expect it to grow further. On the other hand, although Mobily's gross margin stands at a healthy level of around 49% in H1 2011, they have noticeably shrunk by 2-3% in the last couple of quarters. This contraction is as a result of increasing reliance on handset sales which carries very low margins. With the telecoms market moving to a matured stage close to 200% penetration, companies have started bundling various packages in an attempt to stimulate sales. Several packages involving blackberry, iphone and other smartphones were launched in Q2 which boosted sales but weighed on margins.

Higher dividend payout will favour the stock: Mobily paid a dividend of SR1.25 for the first half of 2011. It is worth noting that Mobily board has approved a dividend payout ratio of not less than 40% of its net profits in 2011. On that basis, we estimate H2 dividend to be higher (SAR1.75 per share), indicating a full year dividend of SAR3.0. This implies an attractive dividend yield of 5.8% and close to STC's dividend yield of 5.9%.

Outlook positive for remaining quarters: We expect remaining quarters to be equally strong for mobily as it coincides with Ramadan and the Hajj season. More than 4.3mn Umrah visas were issued by the Saudi Hajj Ministry which is 1.1mn more than the visas issued last year; this will definitely support H2 results. For 2011 as a whole, we now predict 27% growth in sales and 23% growth in net profits.

Conclusion: Mobily remains the market leader of the surging mobile broadband market in Saudi Arabia. With the broadband market still growing, we think Mobily will continue its robust growth for at least another 12-15 months. Though margins have slipped, robust revenue growth will continue to drive profitability. We have therefore cut our target price to incorporate falling margins in our model. Our new target price is now SAR72.9 from earlier SAR74.0, implying 41% upside. Mobily now trades at a PE of 7.0x which makes it one of the most attractive investment in the market.



Corporate summary

Etiihad 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\$) 36.40bn / 9.71bn
52-week range 43.00 - 56.00
Daily avg volume (US\$) 12.55mn
Shares outstanding 700.0mn
Free float (est) 55.3%

Performance: 1M 3M 12M
Absolute -3.3% 0% -1.9%
Relative to index 2.8% 8.9% -1.8%

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

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	16,013	20,345	23,900	25,883
EBITDA (SARmn)	6,165	7,563	8,708	8,930
Net Profit (SARmn)	4,211	5,189	5,988	5,760
EPS (SAR)	6.02	7.41	8.55	8.23
DPS (SAR)	2.00	3.00	3.53	4.03
EPS Growth	39.7%	23.2%	15.4%	-3.8%
EV/EBITDA (x)	6.9	5.6	4.5	4.2
P/E (x)	8.6	7.0	6.1	6.3
P/B (x)	2.3	2.0	1.6	1.4
Dividend Yield	3.8%	5.8%	6.8%	7.8%

Source: Company data, Al Rajhi Capital

Below we present our forecasts for Q3 2011:

Figure 1. Mobily summary of Q2 & Q3 2011 (actual vs. our estimates)

(SAR mn)	2010Q2A	2011Q2E	2011Q2A	% chg. y-y	2010Q3A	2011Q3E	% chg. y-y
Revenues	3,972	4,586	5,127	29.1%	3,989	5,007	25.5%
Gross profit	2,074	2,385	2,478	19.5%	2,310	2,754	19.2%
Gross margin	52.2%	52.0%	48.3%	(3.88)pp	57.9%	55.0%	(7.71)pp
EBITDA	1,388	1,605	1,760	26.8%	1,648	1,953	18.5%
EBITDA margin (%)	34.9%	35.0%	34.3%	(0.62)pp	41.3%	39.0%	(5.23)pp
Operating profit	940	1,078	1,223	30.1%	1,187	1,424	20.0%
Net profit	901	1,025	1,164	29.2%	1,138	1,370	20.5%
Capex	739	688	1,302	76.1%	858	1,152	34.2%
Capex/sales (%)	18.6%	15.0%	25.4%	6.78pp	21.5%	23.0%	1.49pp
Net debt	7,133	7,605	6,753	-5.3%	6,530	6,616	1.3%
Net debt/annualised EBITDA (x)	1.3	1.2	1.0	n/a	1.0	0.8	n/a

Source: Company data, Al Rajhi Capital



We expect a revenue growth of 30% for 2011; powered by handset sales and broadband growth

We expect Mobily to increase dividends to SAR3.5 next year

We expect gross margin to fall gradually on account of increasing share of mobile sales carrying low margins

Mobily's ROIC is well above the its WACC

Mobily is trading on a PE of 7.0x and EV/EBITDA of 5.6x

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	13,058	16,013	20,345	23,900	25,883
Cost of Goods Sold	(5,512)	(7,230)	(9,731)	(11,692)	(12,683)
Gross Profit	7,547	8,783	10,614	12,208	13,200
Government Charges					
S.G. & A. Costs	(2,710)	(2,619)	(3,052)	(3,500)	(4,271)
Operating EBIT	3,208	4,355	5,420	6,250	5,911
Cash Operating Costs	(8,222)	(9,849)	(12,783)	(15,192)	(16,954)
EBITDA	4,837	6,165	7,563	8,708	8,930
Depreciation and Amortisation	(1,629)	(1,810)	(2,142)	(2,459)	(3,019)
Operating Profit	3,208	4,355	5,420	6,250	5,911
Net financing income/(costs)	(204)	(146)	(164)	(187)	(75)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	41	70	49	72	72
Other Expenses	-	-	-	-	-
Net Profit Before Taxes	3,045	4,279	5,305	6,135	5,908
Taxes	(31)	(67)	(117)	(147)	(148)
Minority Interests	-	-	-	-	-
Net profit available to shareholders	3,014	4,211	5,189	5,988	5,760
Dividends	(875)	(1,400)	(2,100)	(2,468)	(2,822)
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	10.47	12.07	12.54
EPS (SAR)	4.31	6.02	7.41	8.55	8.23
DPS (SAR)	1.250	2.000	3.000	3.525	4.032
	12/09A	12/10A	12/11E	12/12E	12/13E
Growth					
Revenue Growth	21.0%	22.6%	27.1%	17.5%	8.3%
Gross Profit Growth	25.2%	16.4%	20.8%	15.0%	8.1%
EBITDA Growth	27.5%	27.5%	22.7%	15.2%	2.5%
Operating Profit Growth	28.5%	35.8%	24.5%	15.3%	-5.4%
Net Profit Growth	44.1%	39.7%	23.2%	15.4%	-3.8%
EPS Growth	16.8%	39.7%	23.2%	15.4%	-3.8%
	12/09A	12/10A	12/11E	12/12E	12/13E
Margins					
Gross profit margin	57.8%	54.9%	52.2%	51.1%	51.0%
EBITDA margin	37.0%	38.5%	37.2%	36.4%	34.5%
Operating Margin	24.6%	27.2%	26.6%	26.1%	22.8%
Pretax profit margin	23.3%	26.7%	26.1%	25.7%	22.8%
Net profit margin	23.1%	26.3%	25.5%	25.1%	22.3%
	12/09A	12/10A	12/11E	12/12E	12/13E
Other Ratios					
ROCE	17.2%	20.6%	22.1%	22.0%	18.7%
ROIC	18.4%	22.2%	24.7%	24.8%	22.7%
ROE	27.4%	30.3%	30.5%	29.3%	24.0%
Effective Tax Rate	1.0%	1.6%	2.2%	2.4%	2.5%
Capex/Sales	25.2%	21.2%	22.2%	21.8%	20.0%
Dividend Payout Ratio	29.0%	33.2%	40.5%	41.2%	49.0%
	12/09A	12/10A	12/11E	12/12E	12/13E
Valuation Measures					
P/E (x)	12.1	8.6	7.0	6.1	6.3
P/CF (x)	7.8	6.0	5.0	4.3	4.1
P/B (x)	3.0	2.3	2.0	1.6	1.4
EV/Sales (x)	3.3	2.6	2.1	1.6	1.5
EV/EBITDA (x)	9.0	6.9	5.6	4.5	4.2
EV/EBIT (x)	13.5	9.7	7.8	6.3	6.4
EV/IC (x)	2.3	2.0	1.7	1.6	1.4
Dividend Yield	2.4%	3.8%	5.8%	6.8%	7.8%

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	3,011	6,122	7,864
Current Receivables	5,481	5,736	5,630	6,392	9,318
Inventories	132	297	518	613	388
Other current assets	1,277	1,271	1,450	1,450	1,450
Total Current Assets	8,577	9,415	10,609	14,575	19,019
Fixed Assets	10,370	12,457	15,233	18,506	21,190
Investments	-	-	-	-	-
Goodwill	1,530	1,530	1,530	1,530	1,530
Other Intangible Assets	10,450	10,028	9,579	9,053	8,527
Total Other Assets	-	-	-	-	-
Total Non-current Assets	22,349	24,015	26,341	29,089	31,247
Total Assets	30,926	33,430	36,950	43,665	50,266
Short Term Debt	2,147	2,442	3,111	3,111	3,111
Trade Payables	9,831	9,533	9,234	11,186	14,495
Dividends Payable	-	-	-	875	875
Other Current Liabilities	211	281	33	33	33
Total Current Liabilities	12,189	12,256	12,378	15,205	18,514
Long-Term Debt	6,448	5,529	6,000	6,000	6,000
Other LT Payables	-	-	-	-	-
Provisions	47	66	79	79	79
Total Non-current Liabilities	6,495	5,595	6,079	6,079	6,079
Minority interests	-	-	-	-	-
Paid-up share capital	7,000	7,000	7,000	7,000	7,000
Total Reserves	5,243	8,580	11,493	15,381	18,674
Total Shareholders' Equity	12,243	15,580	18,493	22,381	25,674
Total Equity	12,243	15,580	18,493	22,381	25,674
Total Liabilities & Shareholders' Equity	30,926	33,430	36,950	43,665	50,266

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	6,100	2,990	1,248
Net Debt/EBITDA (x)	1.46	0.95	0.81	0.34	0.14
Net Debt to Equity	57.7%	37.6%	33.0%	13.4%	4.9%
EBITDA Interest Cover (x)	23.7	42.1	46.1	46.6	119.5
BVPS (SAR)	17.49	22.26	26.42	31.97	36.68

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	3,045	4,279	5,305	6,135	5,908
Depreciation & Amortisation	1,629	1,810	2,142	2,459	3,019
Decrease in Working Capital	(388)	(774)	(850)	1,096	607
Other Operating Cashflow	(40)	156	(20)	(147)	(148)
Cashflow from Operations	4,246	5,470	6,577	9,542	9,386
Capital Expenditure	(3,288)	(3,392)	(4,521)	(5,207)	(5,177)
New Investments	-	-	250	-	-
Others	(51)	16	-	-	-
Cashflow from investing activities	(3,339)	(3,376)	(4,270)	(5,207)	(5,177)
Net Operating Cashflow	907	2,094	2,306	4,336	4,209
Dividends paid to ordinary shareholders	(525)	(875)	(2,275)	(1,225)	(2,468)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	-	-	(250)	-	-
Cashflow from financing activities	(1,687)	(1,516)	(1,408)	(1,225)	(2,468)
Total cash generated	(781)	578	899	3,111	1,742
Cash at beginning of period	2,314	1,533	2,111	3,011	6,122
Implied cash at end of year	1,533	2,111	3,010	6,122	7,864

We are expecting CAPEX for 2011 of SAR4.5bn

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	25.2%	21.2%	22.2%	21.8%	20.0%

Source: Company data, Al Rajhi Capital

Disclaimer and additional disclosures for Equity Research

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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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