

Etiad Etisalat Company

Telecoms – Integrated

EEC AB: Saudi Arabia

17 July 2010

الراجحي المالية
Al Rajhi Capital



US\$9.50bn Market cap
55.3% Free float
US\$9.90mn Avg. daily volume

Target price **71.00** 39.2% over current
Consensus price **64.00** 25.5% over current
Current price **51.00** as at 14/7/2010

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

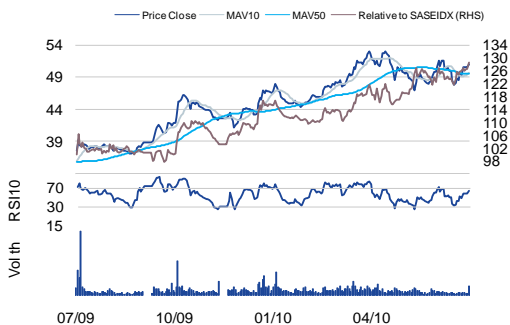
Key themes

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 a reasonable valuation.

Performance

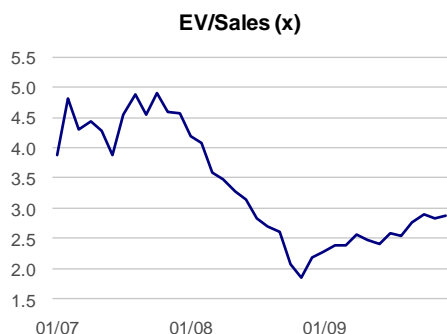


Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	13,058	15,638	17,887	19,641
Revenue Growth	21.0%	19.8%	14.4%	9.8%
EBITDA (SARmn)	4,837	5,744	6,513	7,130
EBITDA Growth	27.5%	18.8%	13.4%	9.5%
EPS	4.31	5.33	5.91	6.30
EPS Growth	16.8%	23.9%	10.8%	6.5%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Mobily

Strong results, strong outlook

This report follows our Flash View of 13th July. Mobily's results for Q2 2010 were again excellent. Sales and profits exceeded our forecasts and we now predict 24% net profit growth for 2010. With strong growth, healthy finances and a vision for the future, Mobily is our key pick in Saudi telecoms. We remain Overweight with a new target price of SAR71.0, implying 39% upside.

High sales growth continues: After rising by 27% year-on-year in Q1, revenues rose by 24% year-on-year in Q2 to SAR3,972mn, compared to our forecast of growth of 16%. Q1 2009 was a rather weak quarter, but Q2 was not, so we had not expected Mobily to maintain sales growth of over 20%. In the event, further expansion in broadband business and postpaid users and lower price pressure compared to Q1 all helped drive top-line growth. Driven by broadband, data now stands at 18% of revenues, and we expect this ratio to rise further.

Margin stays steady: After rising by 30% year-on-year in Q1, EBITDA rose by 23% in Q2. This is similar to the growth in sales, so Mobily held its EBITDA margin at close to 35%. Besides expansion in broadband and postpaid service, EBITDA benefited from an improvement in international call business. Unlike Q1, in which Mobily staged a major low-price promotion, promotions did not impact international call revenues in Q2, whereas international interconnection costs stayed the same. The profit margin on international calls thus increased.

Net profit well above our estimate: After surging by 49% in Q1 compared to a weak Q1 2009, net profit rose by 33% in Q2. Net profit of SAR901mn was 15% above our forecast of SAR785mn. Besides the boost from higher EBITDA, net profit benefited from a 13% year-on-year reduction in interest charges (although interest charges rose slightly compared to Q1) and a jump in "other income" from SAR11.1bn to SAR31.0bn. This item is volatile, and we are not sure that it is sustainable. However, if other income had been zero, net profit would have been SAR870mn, which would still have represented growth of 29% year-on-year.

Balance sheet strengthens further: Net debt was SAR7.13bn at the end of Q2, up from Q1 due to payment of the annual dividend of SAR875mn in Q2 but down sharply from SAR8.28bn one year previously. Higher EBITDA pushed the net debt/EBITDA ratio down to 1.3x at the end of Q2, versus 1.8x one year ago. We consider a net debt/EBITDA ratio of 2x as optimal for a mature telecoms operator. With its finances very healthy, Mobily can afford to invest for growth.

Near-term outlook positive: Mobily has launched a new international calls promotion in Q3 with a price of 77 halala per minute from the second minute on. While this may adversely affect the EBITDA margin in Q3, the promotion is less aggressive than that staged in Q1. We continue to expect a strong year-on-year improvement in Q4, given that the Saudi Hajj season was weak in Q4 2009. For 2010 as a whole, we now predict growth in sales of 20% and in net profit of 24%.

Our top pick in the sector: Mobily dominates the surging mobile broadband market in Saudi Arabia. While in the near term trends in mobile will drive the company, Mobily's new GED ("Growth, Efficiency and Differentiation") strategy should prepare it for a future of likely greater fixed and mobile integration. Following the strong results, we have raised our target price by 5% to SAR71.0. Mobily trades on a PE of 9.7x and yields 2.7%. We remain Overweight.



Corporate summary	Share information	Valuation																																																							
Etiihad Etisalat (Mobily) is the second-placed telecoms operator in Saudi Arabia, with a market value of US\$9bn. 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.	Market cap (SAR/US\$) 35.70bn / 9.50bn 52-week range 37.10 - 53.00 Daily avg volume (US\$) 9.90mn Shares outstanding 700.0mn Free float (est) 55.3%	<table border="1"> <thead> <tr> <th>Period End</th> <th>12/09A</th> <th>12/10E</th> <th>12/11E</th> <th>12/12E</th> </tr> </thead> <tbody> <tr> <td>Revenue (SARmn)</td> <td>13,058</td> <td>15,638</td> <td>17,887</td> <td>19,641</td> </tr> <tr> <td>EBITDA (SARmn)</td> <td>4,837</td> <td>5,744</td> <td>6,513</td> <td>7,130</td> </tr> <tr> <td>Net Profit (SARmn)</td> <td>3,014</td> <td>3,734</td> <td>4,138</td> <td>4,408</td> </tr> <tr> <td>EPS (SAR)</td> <td>4.31</td> <td>5.33</td> <td>5.91</td> <td>6.30</td> </tr> <tr> <td>DPS (SAR)</td> <td>1.25</td> <td>1.40</td> <td>1.64</td> <td>1.97</td> </tr> <tr> <td>EPS Growth</td> <td>16.8%</td> <td>23.9%</td> <td>10.8%</td> <td>6.5%</td> </tr> <tr> <td>EV/EBITDA (x)</td> <td>8.8</td> <td>7.3</td> <td>6.2</td> <td>5.3</td> </tr> <tr> <td>P/E (x)</td> <td>11.8</td> <td>9.6</td> <td>8.6</td> <td>8.1</td> </tr> <tr> <td>P/B (x)</td> <td>2.9</td> <td>2.4</td> <td>2.0</td> <td>1.7</td> </tr> <tr> <td>Dividend Yield</td> <td>2.5%</td> <td>2.7%</td> <td>3.2%</td> <td>3.9%</td> </tr> </tbody> </table>	Period End	12/09A	12/10E	12/11E	12/12E	Revenue (SARmn)	13,058	15,638	17,887	19,641	EBITDA (SARmn)	4,837	5,744	6,513	7,130	Net Profit (SARmn)	3,014	3,734	4,138	4,408	EPS (SAR)	4.31	5.33	5.91	6.30	DPS (SAR)	1.25	1.40	1.64	1.97	EPS Growth	16.8%	23.9%	10.8%	6.5%	EV/EBITDA (x)	8.8	7.3	6.2	5.3	P/E (x)	11.8	9.6	8.6	8.1	P/B (x)	2.9	2.4	2.0	1.7	Dividend Yield	2.5%	2.7%	3.2%	3.9%
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	Performance: 1M 3M 12M Absolute 2.4% -3.3% 39.7% Relative to index 5% 7.1% 29%	Source: Company data, Al Rajhi Capital																																																							
	Major Shareholder: Emirates Telecoms Corp. 27.5% Gen. Organisation for Social Insc. 11.2%	Source: Bloomberg, Al Rajhi Capital																																																							

Details of Q1 results: another strong performance

Below we present the key details of Mobily's Q1 2010 results, together with our comments.

Figure 1. Mobily: summary of Q2 2010 results

(SAR mn)	Q2 09 actual	Q1 10 actual	Q2 10 actual	% chg. y-y	Q2 10 ARC est.	Comment
Revenues	3,199	3,581	3,972	24.2%	3,696	Sales were 7% above our estimate; this was an impressive outcome
Gross profit	1,833	1,827	2,073	13.1%	2,070	Close to our forecast although the gross margin was well below our estimate due to competitive pressures
Gross margin	57.3%	51.0%	52.2%	-5.1pp	56.0%	As above
EBITDA	1,130	1,180	1,388	22.8%	1,331	Very strong given pressure on gross margin; combined SG&A costs fell by 4% year-on-year
EBITDA margin (%)	35.3%	33.0%	34.9%	-0.4pp	36.0%	EBITDA margin was held at around 35%. We believe that Mobily is correctly focusing more on revenue growth than on boosting the margin
Depn. & amortisation	-403	-417	-448	11.2%	-490	Well under control
Operating profit	727	763	940	29.3%	841	Reflects strong EBITDA and lower depreciation than our forecast
Financial costs	-49	-40	-42	-14.3%	-36	Interest costs are falling as financial position strengthens
Other	11	6	31	181.8%	0	Up threefold year-on-year; we do not know the reason for this
Net income before tax	689	729	929	34.8%	805	Reflects strong EBITDA, control of depreciation, lower financial expenses and higher other income
Tax and zakat	-15	-14	-28	86.7%	-20	Above our estimate
Net profit	674	715	901	33.7%	785	15% above our forecast, and would have been 11% higher even if other income had been zero
Capex	704	730	739	5.0%	739	Close to our forecast. Network coverage is now very high, but think capacity needs will prevent capex from falling significantly in the near term
Capex/sales (%)	22.0%	20.4%	18.6%	-3.4pp	20.0%	As above
Net debt	8,280	6,682	7,133	-13.9%	7,490	Below our forecast, and down sharply year-on-year
Net debt/annualised EBITDA (x)	1.8	1.4	1.3	n/m	1.4	This is a very healthy gearing level

Source: Company data, Al Rajhi Capital



We have raised our estimate of revenue growth for 2010 from 17% to 20%

Rising earnings give scope to boost dividend

Growth rates set to moderate from now on, but to remain high

We are more optimistic about sales growth than about margin progression

Mobily achieves returns well above cost of capital

Mobily offers solid value, notably on EV/sales and PE; it also has a tangible prospective dividend yield of 2.7%

Income Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue	10,795	13,058	15,638	17,887	19,641
Cost of Goods Sold	(4,766)	(5,512)	(7,070)	(8,060)	(8,937)
Gross Profit	6,028	7,547	8,568	9,827	10,704
Government Charges					
S.G. & A. Costs	(2,234)	(2,710)	(2,823)	(3,314)	(3,575)
Operating EBIT	2,496	3,208	3,931	4,336	4,630
Cash Operating Costs	(7,000)	(8,222)	(9,893)	(11,374)	(12,511)
EBITDA	3,794	4,837	5,744	6,513	7,130
Depreciation and Amortisation	(1,298)	(1,629)	(1,813)	(2,177)	(2,500)
Operating Profit	2,496	3,208	3,931	4,336	4,630
Net financing income/(costs)	(438)	(204)	(138)	(92)	(109)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	41	41	37	-	-
Other Expenses	-	-	-	-	-
Net Profit Before Taxes	2,099	3,045	3,830	4,244	4,521
Taxes	(7)	(31)	(96)	(106)	(113)
Net Profit	2,092	3,014	3,734	4,138	4,408
Dividends	-	(875)	(980)	(1,147)	(1,376)
Transfer to Capital Reserve	-	-	-	-	-
	12/08A	12/09A	12/10E	12/11E	12/12E
Adjusted Shares Out (mn)	700.0	700.0	700.0	700.0	700.0
CFPS (SAR)	5.98	6.63	7.92	9.02	9.87
EPS (SAR)	3.69	4.31	5.33	5.91	6.30
DPS (SAR)	0.000	1.250	1.400	1.638	1.966
Growth	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue Growth	27.9%	21.0%	19.8%	14.4%	9.8%
Gross Profit Growth	29.7%	25.2%	13.5%	14.7%	8.9%
EBITDA Growth	17.2%	27.5%	18.8%	13.4%	9.5%
Operating Profit Growth	13.1%	28.5%	22.6%	10.3%	6.8%
Net Profit Growth	51.6%	44.1%	23.9%	10.8%	6.5%
EPS Growth	39.8%	16.8%	23.9%	10.8%	6.5%
Margins	12/08A	12/09A	12/10E	12/11E	12/12E
Gross profit margin	55.8%	57.8%	54.8%	54.9%	54.5%
EBITDA margin	35.1%	37.0%	36.7%	36.4%	36.3%
Operating Margin	23.1%	24.6%	25.1%	24.2%	23.6%
Pretax profit margin	19.4%	23.3%	24.5%	23.7%	23.0%
Net profit margin	19.4%	23.1%	23.9%	23.1%	22.4%
Other Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
ROCE	15.2%	17.2%	18.5%	17.8%	16.7%
ROIC	16.8%	16.2%	18.4%	18.0%	17.0%
ROE	26.7%	27.4%	27.3%	24.8%	22.2%
Effective Tax Rate	0.3%	1.0%	2.5%	2.5%	2.5%
Capex/Sales	27.4%	25.2%	20.8%	21.0%	20.5%
Dividend Payout Ratio	0.0%	29.0%	26.2%	27.7%	31.2%
Valuation Measures	12/08A	12/09A	12/10E	12/11E	12/12E
P/E (x)	13.8	11.8	9.6	8.6	8.1
P/CF (x)	8.5	7.7	6.4	5.7	5.2
P/B (x)	3.7	2.9	2.4	2.0	1.7
EV/Sales (x)	3.2	3.3	2.7	2.2	1.9
EV/EBITDA (x)	9.2	8.8	7.3	6.2	5.3
EV/EBIT (x)	14.0	13.3	10.7	9.2	8.2
EV/IC (x)	2.2	2.1	1.8	1.5	1.3
Dividend Yield	0.0%	2.5%	2.7%	3.2%	3.9%

Source: Company data, Al Rajhi Capital



We expect Mobily to have net cash by 2013

Annualised net debt/EBITDA was 1.3x at the end of Q2 2010; this is a healthy gearing level

We expect capex to remain relatively high due to capacity requirements for data

Balance Sheet (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Cash and Cash Equivalents	2,314	1,533	1,864	3,987	6,143
Current Receivables	3,389	5,481	6,223	7,001	7,169
Inventories	108	132	246	276	295
Other current assets	4,200	1,277	2,043	2,043	2,043
Total Current Assets	6,621	8,577	10,376	13,307	15,649
Fixed Assets	8,117	10,370	12,523	14,625	16,677
Investments	-	-	-	-	-
Goodwill	1,530	1,530	1,530	1,530	1,530
Other Intangible Assets	10,923	10,450	9,962	9,436	8,910
Total Other Assets	-	-	-	-	-
Total Non-current Assets	20,570	22,349	24,014	25,591	27,117
Total Assets	27,192	30,926	34,390	38,899	42,767
Short Term Debt	3,148	2,147	2,205	2,205	2,205
Trade Payables	7,523	9,831	10,809	12,160	12,767
Dividends Payable	-	-	-	-	-
Other Current Liabilities	78	211	79	79	79
Total Current Liabilities	10,749	12,189	13,092	14,443	15,050
Long-Term Debt	6,642	6,448	6,140	6,140	6,140
Other LT Payables	-	-	-	-	-
Provisions	46	47	56	56	56
Total Non-current Liabilities	6,688	6,495	6,196	6,196	6,196
Minority interests	-	-	-	-	-
Paid-up share capital	7,000	7,000	7,000	7,000	7,000
Total Reserves	2,754	5,243	8,102	11,259	14,520
Total Shareholders' Equity	9,754	12,243	15,102	18,259	21,520
Total Equity	9,754	12,243	15,102	18,259	21,520
Total Liabilities & Shareholders' Equity	27,192	30,926	34,390	38,899	42,767

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Net Debt (SARmn)	7,476	7,062	6,481	4,358	2,202
Net Debt/EBITDA (x)	1.97	1.46	1.13	0.67	0.31
Net Debt to Equity	76.6%	57.7%	42.9%	23.9%	10.2%
EBITDA Interest Cover (x)	8.7	23.7	41.6	70.9	65.4
BVPS (SAR)	13.93	17.49	21.57	26.08	30.74

Cashflow Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Net Income before Tax & Minority Interest	2,099	3,045	3,830	4,244	4,521
Depreciation & Amortisation	1,298	1,629	1,813	2,177	2,500
Decrease in Working Capital	(39)	(388)	(1,030)	542	421
Other Operating Cashflow	(3,358)	(4,286)	(4,613)	(6,963)	(7,442)
Cashflow from Operations					
Capital Expenditure	(2,954)	(3,288)	(3,250)	(3,754)	(4,026)
New Investments	-	-	-	-	-
Others	(1,580)	(51)	1	-	-
Cashflow from investing activities	(4,533)	(3,339)	(3,249)	(3,754)	(4,026)
Net Operating Cashflow	(987)	907	1,466	3,103	3,302
Dividends paid to ordinary shareholders	(250)	(525)	(875)	(980)	(1,147)
Proceeds from issue of shares	2,000	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	12	-	-	-	-
Cashflow from financing activities	2,598	(1,687)	(1,135)	(980)	(1,147)
Total cash generated	1,611	(781)	331	2,123	2,156
Cash at beginning of period	703	2,314	1,533	1,864	3,987
Implied cash at end of year	2,314	1,533	1,864	3,987	6,143

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Capex/Sales	27.4%	25.2%	20.8%	21.0%	20.5%

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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