

Emirate Integrated Telecommunications Company PJSC (DU) - Outlook

TP: AED 5.91/ share

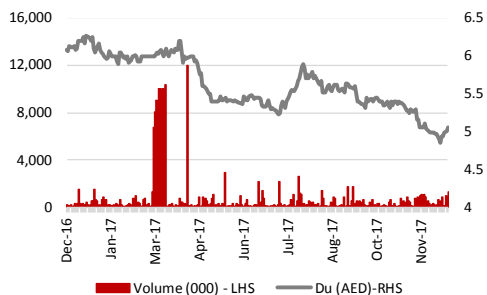
December 19, 2017

Recommendation	ACCUMULATE
Bloomberg Ticker	DU UH EQUITY
Current Market Price (AED)	5.000
52wk High / Low (AED)	6.32/4.79
12m Average Vol. (000)	679.15
Mkt. Cap. (AED/USD mn)	6223/2395.9
Shares Outstanding (mn)	4,571.4
Free Float (%)	41%
3m Avg Daily Turnover (000)	2,150
6m Avg Daily Turnover (000)	2,253
PE 2018e (x)	12.6
PBv 2018e (x)	3.2
Dividend Yield '18e (%)	6.8%

Price Performance:

1 month (%)	-2.91
3 month (%)	-10.71
12 month (%)	-17.76

Price Volmue Chart



Source: Bloomberg

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We maintain our recommendation of **ACCUMULATE** on **DU** with a target price of **AED 5.91/share**. TP offers an upside of 18.3% to CMP; implies PE'18e of 12.1x and PB'18e of 3.3x. The company provides one of the highest return on equity among regional telecom players 21.7% compared to sector mean of 11.1%. Its current dividend yield stands at 6.8% compared to peers average of 5.3%. We are positive on the UAE Telecom sector despite of challenges as we see growth in many segments particularly broadband services and wholesale business.

Top level: Sustainable growth to continue

The industry attractiveness and strong growth drivers to support the top level. Our positive view is supported by: 1) low penetration of broadband internet subscriptions at 15% (of inhabitants) in 8M'17, 2) on going mega projects such as Expo 2020, 3) the government commitment in achieving high ranks in telecom industry worldwide, 4) shift in preferences among subscribers towards digital services and 5) the favorable demographic outlook as youth represents 74% of total population. We expect total revenues to increase by 2.1% in 2018 and at CAGR of 2.9% over 2018 – 2022.

EBITDA margin: lower but remain above sector average

Average EBITDA margins are estimated at 41% over 2018 – 2022 down from 43% historically on higher operating expenses and upgrading the network towards fully digitalized services. Du EBITDA remains higher than regional telecom average of 39%.

Net earnings to register a CAGR of 2% during 2018 -2022

Considering that Royalty rate is unlikely to see further increase in addition to expected lower finance cost (as we expect loans to decline over the forecast period in favor of other internal sources), we forecast a CAGR of 2% for profit after royalty during 2018 – 2022. For 2018, we expect AED 1.8bn of net earnings, a growth of 1.7% on yearly basis.

Dividends stability to persist

DU enjoys strong cash position with high retained earnings for any business expansion without impacting the dividends. We estimate dividend pay-out of 87% in 2017, resulting in total DPS of AED 0.34/share. In spite of continuous CAPEX, the company is likely to maintain the payout ratio of 85% over the forecasted period resulting in average yield of 7% on the current market price.

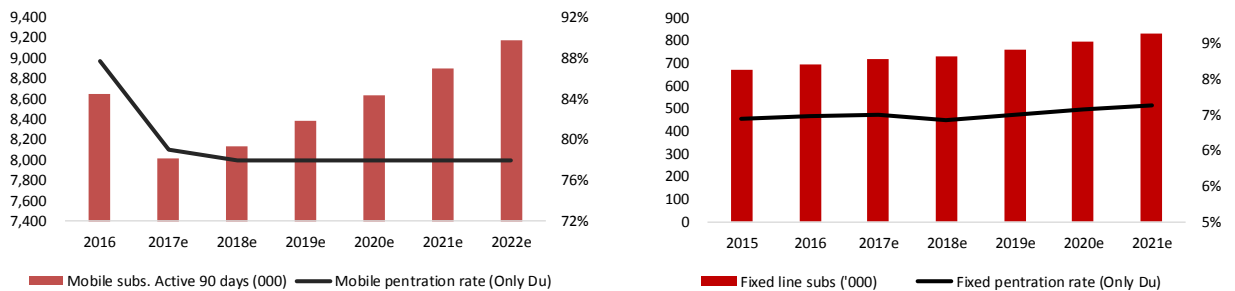
The implementation of VAT will not result in notable impact on the business

Starting from the 1st of January 2018, DU and Etisalat will add 5% as value added tax (VAT) to most of their products and services. In our view, as DU represents "tax collector" in the VAT process, there will be no significant impact on its net earnings as the company role will be collecting the VAT on the government behalf. We have not applied VAT in our model waiting for more clarity about the accounting treatment by the companies.

Rise in quality subscribers, data and digital services to support top level

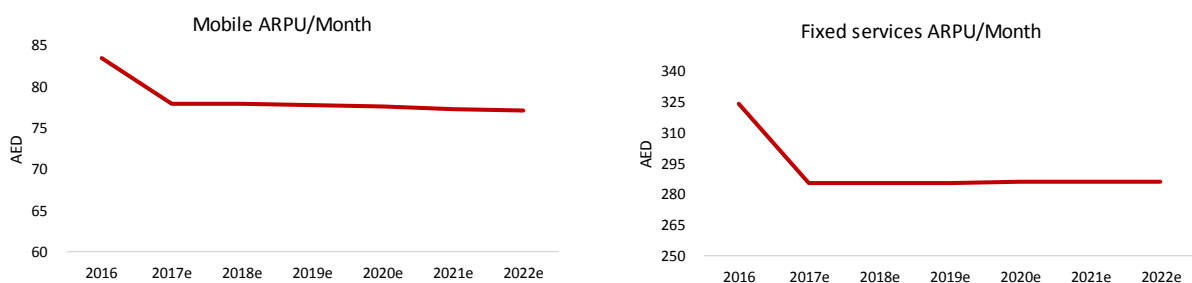
DU saw drop in subscribers' number especially mobile subscribers "Active" 90 days in 9M'17 by 7.8% YTD mainly on competition and restructuring of services. However, we expect recovery to occur in the coming years based on the introduction of Virgin Mobile in 3Q'17, increasing number of visitors to the UAE, major events such as upcoming EXPO 2020 and the successful implementation of digital transformation vision. DU has recently introduced three new divisions mainly 1) Digital Lifestyle and Innovation division (which will focus on the development of innovative products and services), 2) Infrastructure Division (with focus on consolidation all infrastructure, network and data center operations) and 3) Information and Communications Technology (ICT) Solutions Division.

We observed that the company was successful in getting more postpaid mobile subscribers in 3Q'17, (+14% yoy) thus partially mitigating the volatility in pre-paid movements and revenue. Furthermore, we believe data will continue to dominate mobile revenue (was 33.2% in 2016 and we expect to reach 45% by 2022) and shall play role in attracting new customers. We forecast a CAGR of 2.8% over 2018 – 2022 in mobile subscribers and 3.9% in fixed line subscribers which will be supported by demand for business internet services. In terms of market share, we believe the ratio to remain 45: 55 in favor of Etisalat.



Source: Company's financials, U Capital

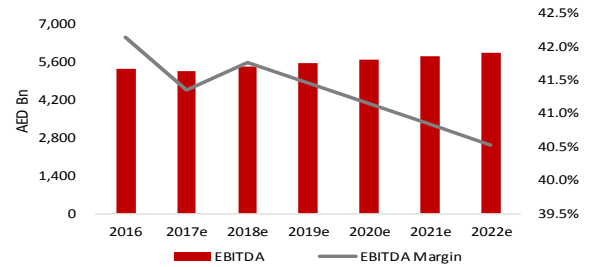
We estimate a CAGR of 8% and 3% for wholesale and broadcasting revenues in the forecasted years building on DU vision of being a fully integrated ICT player with strong Public Private Partnership (PPP) and online broadcasting applications. We expect Du to continue to offer attractive packages with notable discounts, which will slightly pressurize the mobile ARPUs in the coming period and thus lower the enhancement in mobile subscribers. Moreover, due to tougher competition we expect challenges in transferring better data usage to higher revenue. We expect mobile ARPUs to drop slightly further by 0.5% in 2018 before registering a stable performance over the coming years. We expect average mobile ARPU to stand at AED 77.6 during the forecasted period compared to 9M'17 average of AED 78. On the other hand, we forecast stable fixed Line ARPU mainly on the popularity of broadband services. Accordingly, we see total revenues up by 2.1% in 2018 with a CAGR of 2.9% over 2018 – 2022.



Source: Company's financials, U Capital

Healthy EBITDA margins despite challenges

Average EBITDA margins are estimated at 41% over 2018 – 2022 compared to 43% over the past two years due to increasing cost of some operating and general expenses such as network maintenance, staff, product costs, rent and utilities and continues investment in adjacent business areas to transition to its next phase of growth. However, Du EBITDA remains higher than regional telecom average of 39%.



Source: Company's financials, U Capital

Depreciation and Amortization to remain within their historical frame

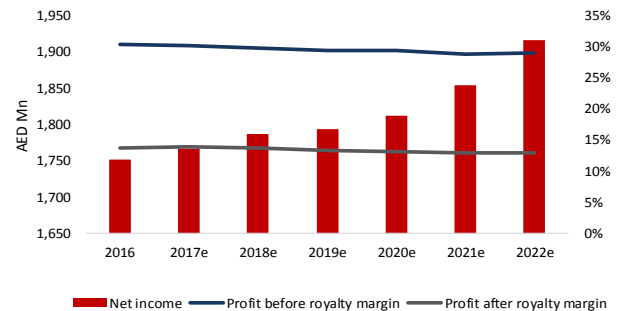
Due to continuity of investment, we estimate both depreciation and amortization to be within their historical percentage as of revenues at 11.8%. We expect them to be at AED 1.6bn in 2018.

The stability of Royalty rates to lesser pressures on net earnings

After increasing royalty rates in 2016, there was no change since then. We do not expect further increase as the introduction of VAT from 2018 will eliminate any urgent need for further taxes bearing in mind the negative impact on telecom sector attractiveness in case of applying additional taxes.

	2012	2013	2014	2015	2016
On regulated revenue	5%	7.5%	10%	12.5%	15%
On regulated profit after deducting royalty on licensed revenue	17.5%	20%	25%	30%	30%

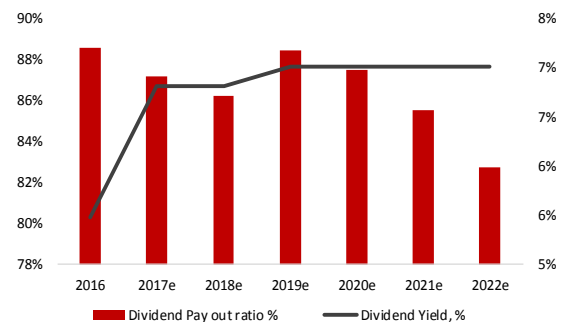
Accordingly, we estimate profit before royalty to register a CAGR of 2.4% over 2018 – 2022 while we see a CAGR of 2% for profit after royalty in the same period. For 2018, we expect profit after royalty at AED 1.8bn, i.e. a yearly increase of 1.7%. We also see support from lower finance cost as we expect loans to be minimized over the forecasted period in favour of other internal sources such as short investments. In terms of margins, we expect profit before royalty margin to post an average of 29.5% over 2018 – 2022 while profit after royalty margin at 13.4% assuming no change in current royalty percentage.



Source: Company's financials, U Capital

Sound financial position and dividends stability

As for 2018, we expect CAPEX at AED 1.4bn and project CAPEX/ revenue ratio at an average of 12.4% over 2018 – 2022 with more focus on digitization of services. Du enjoys strong cash position with suitable retained earnings for any business expand without impacting the dividends policy. Currently, Du provides one of the highest return on equities among regional telecom players at 21.7% compared to mean of 11.1%. The current dividend yield stands at 6.7% compared to peers' average of 5.3%. We estimate dividend pay-out of 85% over the forecast period resulting in average yield of 7%.

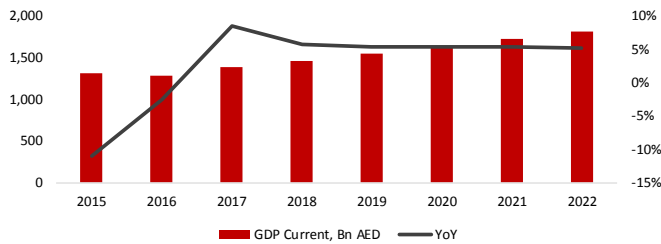


Source: Company's financials, U Capital

Macro and Industry Key drivers

Recovery in GDP

IMF estimates that the UAE GDP will record a CAGR of 6.9% over 2018 – 2022. This comes after drops in 2015 and 2016 due to lower oil prices. The expectations for a gradual rise in oil prices coupled with measures taken by the GCC governments to reduce expenditure and raise revenue, shall improve the situation.



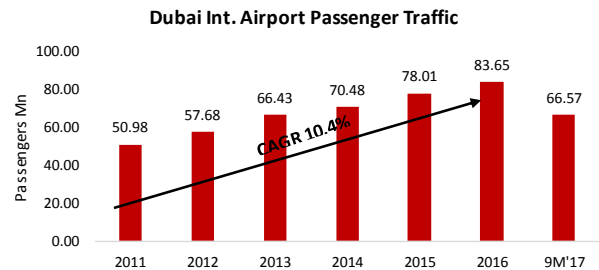
Source: IMF

Tourism growth is critical for pre-paid mobile segment

As per the World Travel and Tourism Council “Economic Impact 2017 report”, the direct contribution of travel and tourism to GDP in 2016 in the UAE was AED 68.5bn i.e. 5.2%, and it is forecasted to rise by 3.2% in 2017 with annual average growth of 5.1% afterwards till 2027 to reach AED 116.1bn. In terms of passengers’ traffic, Dubai airports alone has recorded 66.6mn passengers in 9M’17, an increase of 5.8% over the same period last year. In 2016, Dubai International Airport ranked 3rd behind Hartsfield Jackson Atlanta International airport and Beijing Capital International airport in the top 30 busiest airports in the World for 2016 list. The airport passenger traffic data showed a CAGR of 10.4% during 2011 – 2016 at 83.65mn.

Top 10 busiest airports 2016	Country	Passengers
Hartsfield Jackson Atlanta International	USA	104,171,935
Beijing Capital International	China	94,393,454
Dubai International	UAE	83,654,250
Los Angeles International Airport	USA	80,921,527
Tokyo International	Japan	79,699,762
Chicago O’Hare International	USA	78,327,479
London Heathrow	United Kingdom	75,715,474
Hong Kong International Kai Tak	China	70,314,462
Shanghai Pudong International Airport	China	66,002,414
Charles de Gaulle International	France	65,933,145
Dallas Fort Worth International	USA	65,670,697

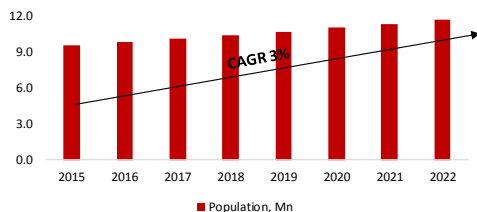
Source: World Airport Codes



Source: Dubai Airports

Population growth expected to continue at CAGR of 3.8% over 2018 – 2022

IMF estimates UAE population to grow by 3.8% p.a. during the coming five years. Bearing in mind that over 74% of populations is represented by youth, key users of smart devices and data. Hence, we believe the demand for data to remain solid.



Source: IMF

Spending on infrastructure to continue

Dubai announced its largest budget ever with total budgeted spending of AED 56.6bn and focus on infrastructure projects led by Expo 2020. Such investments will create demand for telecom services taking into account that both local telecom players are looking to support the long-term vision of the government in developing smart infrastructure and providing customers an opportunity to select their operator of choice for telecom services. Moreover, the focus on Internet of Things (IoT), smart homes, machine to machine (M2M) in addition to the increasing demand for Information and communications technology (ICT) shall boost telecom players business. Both Du and Etisalat are investing more than USD 1.34bn on network and infrastructure developments and upgrades.

The entry of the 3rd operator is unlikely to happen soon

Although the UAE telecom sector is limited in terms of number of telecom players, we do not see any need currently for the 3rd operator as the market is very competitive and has a high level of mobile penetration (228% as of Aug'17).

New legal VoIP service to mitigate the pressures from over-the-top (OTT) providers

VoIP services are still in the list of prohibited Internet content as per the UAE's Telecommunications Regulatory Authority (TRA). However, in a move to make it "legal", Etisalat and DU launched new legal VoIP service for monthly fee of AED50 and AED100 for one user and for each member of the family, respectively. Such step was crucial in facing competition from illegal apps and over-the-top providers who adds pressures on the traditional markets in the telecom sector.

No major impact to result from the implementation of value-added tax (VAT) starting next year

Starting from the 1st of January 2018, DU and Etisalat will add 5% as value added tax (VAT) to most of their products and services. Du, for instance, said that "postpaid customers, 5% VAT will be reflected on their total monthly bill, while prepaid customers will continue to recharge as normal with More Time, More International and More Credit". The company added that the 5% VAT will apply on the usage of their credit towards its services with the exception of More Data where the credit received will be after the 5% VAT deduction. In our view, as DU represents "tax collector" in the VAT process, there will be no significant impact on its net earnings as the company role will be collecting the VAT on the government behalf.

Nevertheless, there are some concerns to be addressed:

- Performing an extra function, i.e. tax collector, could result in additional hiring and costs such as implementing VAT systems, customers awareness, renegotiation of supply contracts and training of their staff
- Change of customers' behaviors. Telecom providers will try to offer attractive rates to attract customers which shall result in tougher competition and pressures on ARPUs.

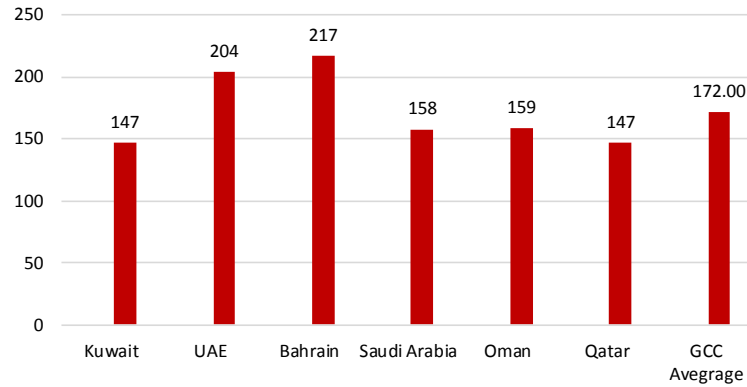
We have not applied VAT in our model waiting for more clarity about the accounting treatment by the companies. However, even when we will implement it, the impact will be insignificant to the company earnings as it will be a passed on to the end consumers

Challenges include but not limited to ...

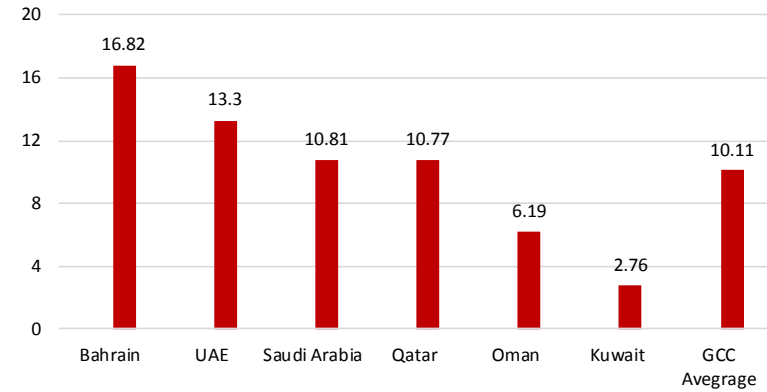
Competition, pricing pressures, increasing number of subscribers in view of VAT implementation and the need to introduce new products.

Telecom Services penetration across GCC - 2016

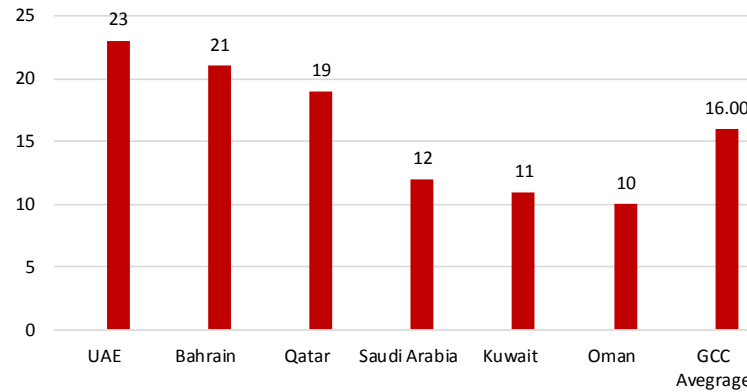
GCC Mobile Penetration, %



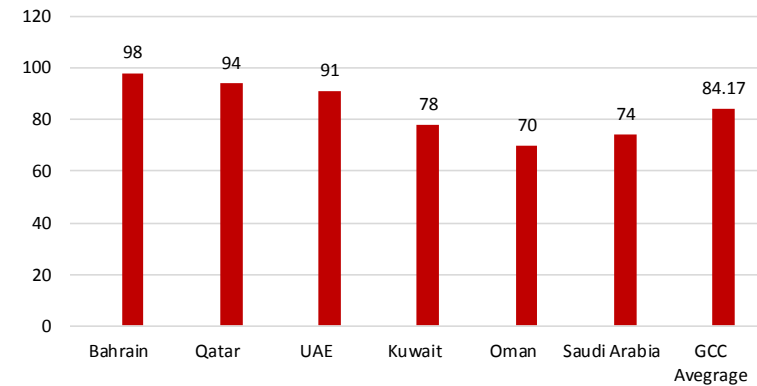
GCC Fixed broadband Penetration, %



GCC Fixed telephone Penetration, %



GCC Internet Users Penetration, %



Financial Statements

AED Mn	2015	2016	2017e	2018e	2019e	2020e	2021e
Income Statement							
Revenues	12,337	12,727	12,703	12,974	13,388	13,856	14,261
Cost of sales	(5,003)	(5,236)	(5,183)	(5,397)	(5,584)	(5,795)	(5,980)
Gross profit	7,334	7,491	7,520	7,577	7,804	8,062	8,281
G&A exp	(1,918)	(2,177)	(2,318)	(2,212)	(2,310)	(2,418)	(2,517)
Other income	3	50	52	54	56	58	60
EBITDA	5,419	5,363	5,254	5,419	5,551	5,702	5,824
DD&A	(1,557)	(1,528)	(1,474)	(1,583)	(1,633)	(1,621)	(1,669)
EBIT	3,862	3,836	3,780	3,836	3,917	4,080	4,156
Finance income	113	143	162	121	104	79	68
Finance expenses	(116)	(118)	(116)	(89)	(90)	(90)	(89)
Share of profit of investment	3	3	10	15	20	25	30
Profit before royalty	3,862	3,864	3,836	3,883	3,951	4,094	4,165
Royalty	(1,921)	(2,111)	(2,068)	(2,085)	(2,142)	(2,262)	(2,284)
Net income	1,941	1,753	1,767	1,797	1,809	1,832	1,881
Balance Statement							
Property, plant and equipment	8,333	8,449	8,449	8,449	8,543	8,806	9,177
Intangible assets	1,201	1,173	1,187	1,180	1,184	1,182	1,183
Investments in associates	111	114	130	122	126	124	125
Available for sale financial asset	0	18	18	18	18	18	18
Derivative financial instruments	3	6	8	7	8	7	7
Trade and other receivables	0	32	60	62	64	66	68
Total Non Current Assets	9,648	9,794	9,852	9,839	9,942	10,204	10,578
Inventories	83	40	61	50	56	53	55
Trade and other receivables	1,448	1,969	1,965	2,007	2,071	2,143	1,997
Due from a related party	397	220	200	210	205	208	206
Short term investments	6,200	6,150	4,137	3,945	3,384	3,375	3,303
Cash and bank balances	163	239	943	837	1,465	1,400	918
Total Current Assets	8,292	8,618	7,306	7,050	7,181	7,179	6,478
Total Assets	17,940	18,411	17,158	16,888	17,123	17,383	17,056
Trade and other payables	5,327	5,838	5,827	5,952	6,142	6,356	5,990
Due to related parties	28	13	24	25	25	26	26
Borrowings	134	783	1,160	892	901	902	887
Total Current Liabilities	5,489	6,634	7,012	6,868	7,067	7,284	6,903
Borrowings	4,358	3,596	2,708	2,676	2,702	2,706	2,662
Provision for employees' end of service ben	187	226	230	228	229	228	229
Other provisions	88	102	120	111	116	113	114
Total Non Current Liabilities	4,633	3,924	3,058	3,015	3,047	3,048	3,005
Total Liability	10,122	10,558	10,069	9,883	10,114	10,332	9,908
Share Capital	4,571	4,571	4,533	4,533	4,533	4,533	4,533
Share premium	394	394	232	232	232	232	232
Other reserves, net of treasury shares	1,988	2,003	1,414	1,276	1,261	1,262	1,269
Retained Earnings	866	885	910	964	983	1,024	1,114
Total Equity	7,819	7,853	7,089	7,005	7,009	7,051	7,148
Total Equity and Liability	17,940	18,411	17,158	16,888	17,123	17,383	17,056
Cash Flow Statement							
Cash Flow from Operating Activities		3,497	3,238	3,451	3,572	3,592	3,329
Cash Flow from Investing Activities		(1,591)	509	(1,376)	(1,174)	(1,872)	(1,969)
Cash Flow from Financing Activities		(1,830)	(3,043)	(2,181)	(1,770)	(1,785)	(1,843)
Change in Cash		76	703	(106)	628	(65)	(482)
Net Cash at End		239	943	837	1,465	1,400	918

Source: U Capital Research, Company Financials

	2015	2016	2017e	2018e	2019e	2020e	2021e
Key Ratios							
EBITDA Margin	43.9%	42.1%	41.4%	41.8%	41.5%	41.1%	40.8%
Profit Before Royalty Margin	31.3%	30.4%	30.2%	29.9%	29.5%	29.5%	29.2%
Net Profit Margin	15.7%	13.8%	13.9%	13.9%	13.5%	13.2%	13.2%
ROAA	10.8%	9.6%	9.9%	10.6%	10.6%	10.6%	10.9%
ROAE	24.8%	22.4%	23.7%	25.5%	25.8%	26.1%	26.5%
Current Ratio (x)	1.51	1.30	1.04	1.03	1.02	0.99	0.94
Price AED	5.10	6.20	5.00	5.00	5.00	5.00	5.00
Debt / Equity (x)	0.57	0.56	0.55	0.51	0.51	0.51	0.50
EV/EBITDA (x)*	4.02	4.99	4.44	4.27	4.39	4.26	4.09
Dividend Yield	8.4%	5.5%	6.8%	6.8%	7.0%	7.0%	7.0%
P/E Ratio (x)*	12.01	16.15	12.82	12.61	12.53	12.37	12.05
P/BV Ratio (x)*	2.98	3.60	3.20	3.24	3.23	3.21	3.17

Source: U Capital Research, Company Financials

*Market price for 2017 and subsequent years based on closing price of Dec 19, 2017

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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