


Rating UNDER REVIEW

Target price Under Review

Current price SAR22.70

Share information

Market cap (SAR/US\$) 17.48bn / 4.661bn

52-week range 17.05 - 31.86

Shares outstanding 770.0mn

Free float (est) 61%

Performance 1M 3M 12M

Absolute 4.1% 10.6% -27.6%

Relative to index 3.8% 9.3% -35.7%

Major Shareholder:

Emirates Telecoms Corp. 27.56%

Gen. Organisation for Social Insc. 11.85%

Performance


Source: Bloomberg, Company data, Al Rajhi Capital

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Etihad Etisalat (Mobily)

Looking beyond profits

After Zain KSA reported its first ever quarterly net profit in Q1, investor focus in the telecom sector is back on Etihad Etisalat which previously reported five quarterly losses in eight quarters. We are less convinced of a quick turnaround as we believe meaningful growth and material costs savings are hard to come by. Even if the company manages to save an additional SAR50mn a quarter, it could at best add ~SAR2.5/share to its fair price as per our analysis. Moreover 2017 will see additional cost pressure (~SAR110mn as per our estimate) due to increased financial expenses post its debt restructuring that can offset cost savings. The company seems to face constrained cash flows that is likely to lower ability to spend on capex in the next couple of years. We note that the company's total liabilities now stand at SAR25bn. Excluding total debt which is ~SAR15bn, the remaining is not all related to typical working capital because a large chunk of it is related to capex payables, accrued selling & marketing expenses etc. which are not sustainable at the current rate. Thereby with constrained cash flows, even if we are to forecast capex at 60% of past capex, its fair value could range between SAR17-20 per share depending on a range of variables for growth, margins used in our DCF valuation model. We believe there may be variation from this range depending on its cash flow position over the next few quarters and hence for now we place Mobily "Under review".

No material cost savings: One of the key areas of interest for investors in the company is the return to profitability through cost savings. However, we believe that potential cost saving for Mobily may be not material. While Mobily may be able to lower its provisions (non-cash) and wage expense slightly, we note that selling & marketing expenses and general & admin expenses have already significantly declined. Thus, scope for further cost savings may not be significant. Even if the company manages to save an additional SAR50mn a quarter (cancellation of some contracts), it could at best add SAR2.5/share to the fair price, assuming all of these savings flow directly as free cash flows to equity. We also note that additional financing expenses, amounting to an ~SAR110mn as per our estimates, could offset most of the possible cost savings in 2017.

Significant level of liabilities over and above debt: While the reported debt is SAR15.2bn there is a significant chunk of liabilities on the balance sheet reported as accrued expenses and liabilities (SAR5.6bn) and accounts payable

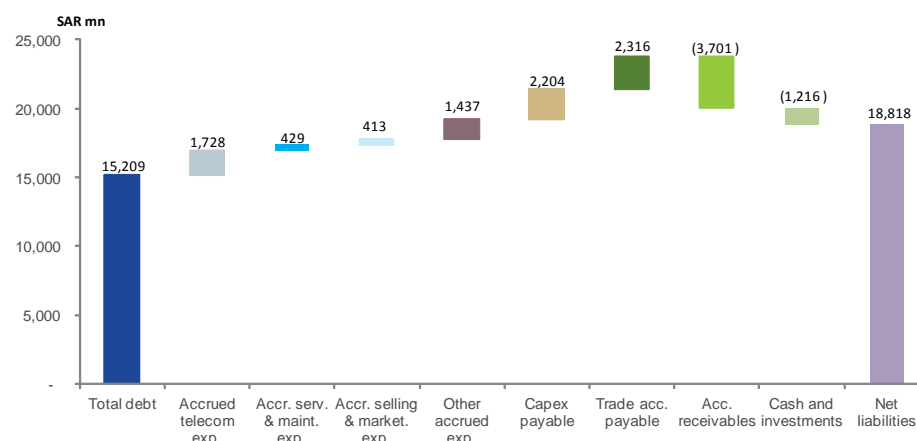
Period End (SAR)	12/14A	12/15A	12/16A	12/17E	12/18E
Revenue (mn)	14,004	14,424	12,569	11,800	11,942
Revenue Growth	-27.0%	3.0%	-12.9%	-6.1%	1.2%
Gross profit margin	48.4%	55.2%	59.1%	60.1%	60.6%
EBITDA margin	16.0%	20.4%	31.9%	33.5%	34.7%
Net profit margin	-11.3%	-7.6%	-1.6%	-1.6%	3.4%
EPS	(2.05)	(1.42)	(0.26)	(0.25)	0.52
EPS Growth		-30.6%	-81.4%	-4.5%	
ROE	-8.3%	-6.8%	-1.3%	-1.3%	2.6%
ROCE	-7.7%	-2.8%	1.0%	1.5%	3.2%
Capex/Sales	33.7%	24.4%	44.3%	17.0%	17.0%

Source: Company data, Al Rajhi Capital



(SAR4.5bn), most of which do not classify as typical working capital for a telecom firm in our view. In the case of Mobily, these liabilities relate to accrued expenses of selling, marketing and even capex payable which will have to be paid back and is not sustainable at the current run rate. Even if we exclude deferred revenues of SAR1.6bn, net out accounts receivables of SAR3.7bn (as some of the receivables and payables could be offset due to interconnection charges) and cash, the net liabilities other than debt comes to ~4bn (See Figure 1).

Figure 1 Mobily: Net liabilities calculation*



Source: Company data, Al Rajhi Capital (* We have excluded deferred revenues from accrued expenses)

Constrained cash flow: Over the last few quarters, the company has been generating operating cash flow of SAR900mn on average (which has been declining over time). The gross capex for 2016 and 2015 have been SAR3.2bn and SAR3.4bn respectively. Even if the company manages to invest just SAR1.4-1.7bn capex (12-15% of sales) and operating cash flows improve to SAR4bn (and grow topline by 2% thereafter with improving margins), this could imply an EV of, at best SAR32bn. With net debt and liabilities at SAR18.8bn, the fair value of the stock could range from SAR17-20/share over the next one year.

Valuation and risks: We are less convinced about any meaning cost savings that can possibly revive the stock. We place the stock “Under Review” to observe an improvement in cash flows, which could constrain capex and thereby future growth for the company. We use a discount rate of 9.2% based on a cost of equity of 12.55% for our calculations. We believe the key upside risk could be related to sale of towers – however it depends on the price received for its towers.



Income Statement (SARmn)	12/14A	12/15A	12/16A	12/17E	12/18E
Revenue	14,004	14,424	12,569	11,800	11,942
Cost of Goods Sold	(7,225)	(6,466)	(5,144)	(4,710)	(4,706)
Gross Profit	6,779	7,958	7,425	7,090	7,236
Government Charges					
S.G. & A. Costs	(4,532)	(5,017)	(3,416)	(3,141)	(3,096)
Operating EBIT	(1,287)	(684)	235	450	969
Cash Operating Costs	(11,758)	(11,483)	(8,560)	(7,851)	(7,802)
EBITDA	2,246	2,941	4,009	3,949	4,140
Depreciation and Amortisation	(3,533)	(3,625)	(3,775)	(3,499)	(3,170)
Operating Profit	(1,287)	(684)	235	450	969
Net financing income/(costs)	(269)	(361)	(556)	(669)	(593)
Forex and Related Gains					
Provisions	(63)	-	-	-	-
Other Income	83	121	75	71	72
Other Expenses					
Net Profit Before Taxes	(1,535)	(924)	(246)	(149)	448
Taxes	(41)	(169)	43	(45)	(45)
Minority Interests					
Net profit	(1,576)	(1,093)	(203)	(194)	403
Dividends	(1,925)	-	-	-	-
Transfer to Capital Reserve					
	12/14A	12/15A	12/16A	12/17E	12/18E
Adjusted Shares Out (mn)	770.0	770.0	770.0	770.0	770.0
CFPS (SAR)	2.54	3.29	4.64	4.29	4.64
EPS (SAR)	(2.05)	(1.42)	(0.26)	(0.25)	0.52
DPS (SAR)	2.50	-	-	-	-
Growth	12/14A	12/15A	12/16A	12/17E	12/18E
Revenue Growth	-27.0%	3.0%	-12.9%	-6.1%	1.2%
Gross Profit Growth	-44.4%	17.4%	-6.7%	-4.5%	2.0%
EBITDA Growth	-73.4%	30.9%	36.3%	-1.5%	4.8%
Operating Profit Growth	-121.6%	-46.8%		91.5%	115.6%
Net Profit Growth	-126.5%	-30.6%	-81.4%	-4.5%	
EPS Growth		-30.6%	-81.4%	-4.5%	
Margins	12/14A	12/15A	12/16A	12/17E	12/18E
Gross profit margin	48.4%	55.2%	59.1%	60.1%	60.6%
EBITDA margin	16.0%	20.4%	31.9%	33.5%	34.7%
Operating Margin	-9.2%	-4.7%	1.9%	3.8%	8.1%
Pretax profit margin	-11.0%	-6.4%	-2.0%	-1.3%	3.8%
Net profit margin	-11.3%	-7.6%	-1.6%	-1.6%	3.4%
Other Ratios	12/14A	12/15A	12/16A	12/17E	12/18E
ROCE	-7.7%	-2.8%	1.0%	1.5%	3.2%
ROIC	-4.0%	-2.6%	0.7%	2.1%	3.0%
ROE	-8.3%	-6.8%	-1.3%	-1.3%	2.6%
Effective Tax Rate	-2.6%	-18.3%	17.6%	-30.2%	10.0%
Capex/Sales	33.7%	24.4%	44.3%	17.0%	17.0%
Dividend Payout Ratio	-122.2%	0.0%	0.0%	0.0%	0.0%
Valuation Measures	12/14A	12/15A	12/16A	12/17E	12/18E
P/E (x)	na	na	na	na	43.4
P/CF (x)	8.9	6.9	4.9	5.3	4.9
P/B (x)	1.0	1.1	1.1	1.1	1.1
EV/Sales (x)	1.2	1.2	1.4	1.5	1.5
EV/EBITDA (x)	7.8	5.9	4.4	4.4	4.2
EV/EBIT (x)	na	na	74.5	38.9	18.0
EV/IC (x)	0.6	0.6	0.6	0.6	0.6
Dividend Yield	11.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital



Balance Sheet (SARmn)	12/14A	12/15A	12/16A	12/17E	12/18E
Cash and Cash Equivalents	1,964	498	866	471	811
Current Receivables	5,629	4,711	4,121	3,542	3,028
Inventories	818	486	200	204	208
Other current assets	5,247	3,009	2,119	2,010	2,010
Total Current Assets	12,502	7,416	6,886	5,808	5,637
Fixed Assets	24,073	24,466	24,406	23,254	22,455
Investments	24	1,001	913	913	913
Goodwill	1,467	1,467	1,467	1,467	1,467
Other Intangible Assets	8,578	8,026	7,521	7,227	6,933
Total Other Assets	-	-	-	-	-
Total Non-current Assets	34,142	34,960	34,307	32,860	31,768
Total Assets	46,644	42,376	41,193	38,668	37,405
Short Term Debt	16,993	5,766	7,608	-	-
Trade Payables	12,638	12,012	10,151	7,788	7,082
Dividends Payable	-	-	-	-	-
Other Current Liabilities	159	289	193	180	174
Total Current Liabilities	29,790	18,067	17,952	7,968	7,256
Long-Term Debt	-	8,509	7,601	15,209	14,209
Other LT Payables	-	-	-	-	-
Provisions	200	240	282	283	283
Total Non-current Liabilities	200	8,748	7,883	15,491	14,492
Minority interests	2	2	2	2	2
Paid-up share capital	-	-	-	-	-
Total Reserves	16,652	15,559	15,356	15,207	15,655
Total Shareholders' Equity	16,652	15,559	15,356	15,207	15,655
Total Equity	16,654	15,561	15,358	15,209	15,657
Total Liabilities & Shareholders' Equity	46,644	42,376	41,193	38,668	37,405
Ratios	12/14A	12/15A	12/16A	12/17E	12/18E
Net Debt (SARmn)	13,929	12,527	13,993	14,388	13,048
Net Debt/EBITDA (x)	6.20	4.26	3.49	3.64	3.15
Net Debt to Equity	83.6%	80.5%	91.1%	94.6%	83.3%
EBITDA Interest Cover (x)	8.3	8.1	7.2	5.9	7.0
BVPS (SAR)	21.63	20.21	19.94	19.75	20.33
Cashflow Statement (SARmn)	12/14A	12/15A	12/16A	12/17E	12/18E
Net Income before Tax & Minority Interest	(1,535)	(924)	(246)	(149)	448
Depreciation & Amortisation	3,533	3,625	3,775	3,499	3,170
Decrease in Working Capital	3,015	916	(605)	(1,693)	(200)
Other Operating Cashflow	1,159	1,626	1,241	(45)	(45)
Cashflow from Operations	6,171	5,244	4,164	1,613	3,373
Capital Expenditure	(4,714)	(3,515)	(5,573)	(2,006)	(2,030)
New Investments	(240)	(58)	(31)	(47)	(48)
Others	(1,065)	(122)	900	0	0
Cashflow from investing activities	(6,019)	(3,695)	(4,704)	(2,053)	(2,078)
Net Operating Cashflow	153	1,549	(540)	(440)	1,295
Dividends paid to ordinary shareholders	(2,888)	-	-	-	-
Proceeds from issue of shares	-	-	-	-	-
Increase in Loans	5,512	216	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(2,383)	(2,946)	-	-	-
Cashflow from financing activities	241	(2,730)	-	-	-
Total cash generated	394	(1,181)	(540)	(440)	1,295
Cash at beginning of period	1,570	1,964	498	866	471
Implied cash at end of year	1,964	783	(42)	426	1,766
Ratios	12/14A	12/15A	12/16A	12/17E	12/18E
Capex/Sales	33.7%	24.4%	44.3%	17.0%	17.0%

Source: Company data, Al Rajhi Capital



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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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