Zain KSA
Telecom – Industrial
ZAINKSA AB: Saudi Arabia
30 July 2017

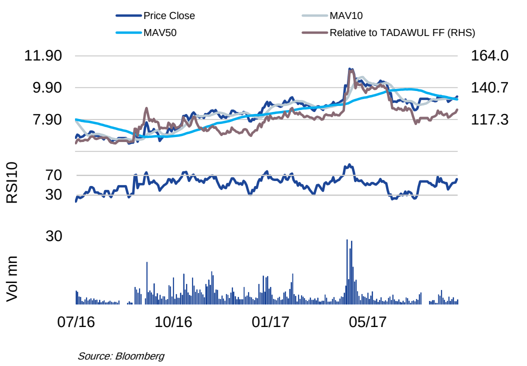
US$1.454bn	48%	US$5.19mn
Market cap	Free float	Avg. daily volume

Target price	9.00	2% over current
Current price	8.82	as at 30/7/2017

Existing rating

Underweight	**Neutral**	Overweight

Performance



Earnings

(SARmn)	2016	2017	2018
Revenue	6926.7	7550.1	7776.6
Gross Profit	4400.7	5088.7	5272.5
EBITDA	1795.0	2661.4	2830.7
EBITDA margin	25.9%	35.3%	36.4%
Net profit	-980	154	170
EPS (SAR)	nm	0.26	0.29

Source: Company data, Al Rajhi Capital

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Zain KSA

N: Lower than expected results. Revise TP to SAR9/sh.

Zain reported SAR8mn net profit for Q2 2017 as compared to our estimate of SAR30mn and consensus estimate of SAR37mn. Revenue also came below our expectation due to Ramadan weakness, while we had expected market share gains to offset this seasonality. Though we believe it would be unreasonable to expect the company to show continuous quarterly improvement in performance considering the overall weak environment, where total market size is shrinking, its sequential decline in top-line as compared to Mobily's flattish top-line is noteworthy. However, we forecast gradual market share gains for Zain in the coming quarters given down-trading and its portfolio of products, which we believe to be the best in terms of value in the Kingdom. Based on our DCF valuation model, we arrive at a TP of SAR9.0/share and continue to remain Neutral on the stock. Downside risks are related to lower than expected gains in market share, unfavourable regulations, faster than expected decline in overall market size. Upside risks are related to value accretive tower sale, positive outcome from Zakat / other litigations.

- **Financial performance in Q2:** Revenue improved 8% y-o-y while gross profit improved 13% and EBITDA improved 70%. On a sequential basis, revenue, gross profit and EBITDA declined by around 3-5% mainly owing to Ramadan seasonality and summer holidays. Notably, the q-o-q performance was lower than Mobily's flattish top-line performance in Q2. We do not believe it yet to be a cause of major concern as we expect the overall weak market environment to lead to down-trading and this, coupled with Zain's product portfolio could in turn help Zain KSA to achieve gradual increase in market share. Overall operating costs declined as decrease in general and admin costs offset increase in marketing costs. The accumulated deficit at SAR2.2bn is at 38% of share capital and hence we believe it is imperative for the company to maintain profitability. The importance of deficit implies that a tower sale will have to be carefully balanced as it would likely result in higher tower lease costs (higher than tower operating costs) despite lower interest costs. Hence a tower sale may not always be positive and depends on valuation of towers sold.

- **Valuation:** We revise our TP to SAR9/share (implied Ev/2018 EBITDA 8.6x) based on DCF valuation methodology. We forecast a 4.5% CAGR top-line growth till 2020 and an improvement in EBITDA margin to 37.5% by 2020. We apply a WACC of 7.2%, which increases to 9.2% by terminal year as debt decreases.

Figure 1 Q2 results

(SARmn)	2Q16	1Q17	2Q17	y-o-y	q-o-q	ARCe	vs ARCe
Revenue	1727	1919	1865	8.0%	-2.8%	1948	-4.3%
Gross profit	1113	1291	1259	13.1%	-2.5%	1305	-3.5%
EBITDA	372	665	632	69.8%	-4.9%	660	-4.3%
EBITDA margin	21.5%	34.6%	33.9%			33.9%	
Net profit	-329	45	8	-102.4%	-82.4%	30	-73.5%

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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