الراجحي المالية
Al Rajhi Capital

Research Department
Pritish K Devassy, CFA
Tel +966 11 211 9370, devassyp@alrajhi-capital.com

Saudi Telecoms

Q4: New trends may be emerging

Saudi telecom sector's Q4 earnings was better than consensus and our expectations. At the net profit level, STC came inline while Mobily and Zain came above our expectations. However, a closer look at the numbers reveal a few emerging trends for the sector as Q4 was a period of normalized performance without one-offs after last two quarters of uncertainty post the fingerprint exercise, reduction in interconnection rates, Hajj season etc. STC's top line declined 9 % q-o-q (SAR1.2bn below consensus expectation) while both Zain and Mobily grew top-line 10% q-o-q. As this was the first quarter after cut on allowances and cap on mobile payments for some Govt employees (mostly STC customers in our view), this could be the new base for STC. Secondly, after a few quarters of revenue declines, Mobily may have started to follow Zain's approach of gaining market share by incurring higher customer acquisition costs. As a result, Mobily grew its revenue by double digits sequentially but saw its gross profit decline 4% q-o-q. Zain's performance was above peers as gross profit grew 7.6% q-o-q. In our view, Mobily is likely to focus on maintaining its market share at higher customer acquisition costs but its priority will be on operating cost savings. Overall, we revise STC's TP to SAR68 per share (N) while we maintain Mobily's TP at SAR27 per share (OW), and raise Zain's TP to SAR8.5 (N) on improving financials.

STC – Top-line miss, bottom-line inline: STC announced a mixed set of results for Q4 2016 with revenue declining 11% q-o-q, missing our estimate, but EBITDA and net profit coming in flat, as per our expectations. The fall in revenue may be attributable to lower allowances for some public sector employees (mostly STC customers in our view) and regulations that capped mobile bill payments for some Govt. employees. The revenue decline for STC (11% q-o-q vs. Mobily/Zain up +10% q-o-q) may also suggest that consumers may be looking to down-trade in the current backdrop of lower disposable incomes. We believe the company is now looking for acquisitions to drive growth. It acquired 10% in UAE-based Careem, acquired the remaining 40% stake in Sale Advanced Co. Ltd (Saleco) and also acquired the remaining stake in Gulf Digital Media Company (Intigral) last quarter. In addition, the company is also looking to raise its stake in OTAS (which holds 55% stake in Turk Telekom) and has also offered a loan of SAR160mn to OTAS. STC maintained its quarterly dividend of SAR1 per share, which was below our expectations likely due to its recent acquisitions. We lower our TP on STC on weak top-line performance to SAR68 per share, and remain Neutral on the stock.

Mobily – Beats estimates on cost savings: Mobily reported a better-than-expected bottom line on the back of cost savings and reversal of some accruals. Top line performance (+10.2% q-o-q) was largely in line with our estimates, on the back of aggressive customer acquisition, which also resulted in lower gross profit margin. However, cost saving at the operating level and the lower amortization charge helped the company reduce its net loss by more than half. Mobily's net loss came in at SAR70.7mn (-57.8% q-o-q), beating our (SAR160mn) and consensus (SAR106mn) estimates. The stock has fallen around 16% since November 2016 despite better than expected numbers. We believe the company has some scope to lower operating costs in the coming quarters partially offset by higher acquisition costs. However, stock trajectory will continue to be dependent on topline growth which continues to be weak. As the stock has recently dropped, the upside on our TP of SAR27 changes our rating to Overweight.

Key themes

Post Q4 earnings, we notice a few emerging trends in the sector: a) STC's topline declined 9% q-o-q while Mobily and Zain grew 10% q-o-q. As this was the first quarter after cut on allowances and cap on mobile payments for some Govt employees (mostly STC customers in our view), this could be the new base for STC b) Mobily may have started to follow Zain's approach of gaining market share by incurring high customer acquisition costs c) We believe Mobily has some more scope to cut operating costs to help it claw back into profits gradually

What do we think?

Stock	Rating	Price Target
STC	Neutral	SAR68.0
Mobily	Overweight	SAR27.0
Zain	Neutral	SAR8.5

Zain posts an impressive quarter: Zain KSA reported its best quarterly result since inception with net loss coming in at SAR135mn, ahead of our estimate of SAR171mn loss. The beat was mainly driven by higher than expected revenue and lower financing costs, the impact of which was partially offset by one-off jump in 'General and Administrative' expenses (one time consultancy fees). At the more important EBITDA level, the company reported only a 1% q-o-q increase. The lower EBITDA margins could imply higher customer acquisition costs, which likely supported subscriber addition of ~200,000 q-o-q in Q4. Apart from its attractive mobile plans and packages, Zain's pricing range maybe more appealing in the current scenario of falling disposable income, where consumers may be looking to down trade. Overall, though we believe the company may continue to outperform its peers in the sector, the saturated state of the sector (FY2016 revenue growth is less than 3% y-o-y) and intense competition may be less appealing in a broader market context. The stock has some upside triggers – 1) The company is looking to sell its tower business 2) possibility of synergies by working with Atheeb by leveraging its fixed line infrastructure which could lead to quick gains in the fixed business 3) reversal of some of its liabilities (Zakat/withholding etc.) which may boost equity capital and valuations for the company . Despite ample near term triggers, fundamentally we have a Neutral rating on the stock with a TP of 8.5/share.

Figure 1 STC: Summary of Q4 2016 results

(SAR mn)	Q4 2015	Q3 2016	Q4 2016	% chg y-o-y	% chg q-o-q	ARC est
Revenue	13,246	13,498	12,012	-9.3%	-11.0%	13,494
Gross profit	8,011	7,067	7,417	-7.4%	5.0%	7,038
Gross profit margin	60.5%	52.4%	61.7%			52.2%
Operating profit	2,554	2,361	2,231	-12.6%	-5.5%	2,227
Net profit	1,950	2,148	2,150	10.3%	0.1%	2,134

Source: Company data, Al Rajhi Capital

Figure 2 Mobily: Summary of Q4 2016 results

(SAR mn)	Q4 2015	Q3 2016	Q4 2016	% chg y-o-y	% chg q-o-q	ARC est
Revenue	3,488.0	2,638.7	2,908.0	-16.6%	10.2%	3,025.2
Gross profit	2,134.0	1,741.0	1,671.0	-21.7%	-4.0%	1,790.9
Gross profit margin	61.2%	66.0%	57.5%			59.2%
Operating profit	133.0	(136.8)	86.9	-34.7%	NM	(28.2)
Net profit	10.6	(167.7)	(70.7)	NM	-57.8%	(160.3)

Source: Company data, Al Rajhi Capital

Figure 3 Zain KSA: Summary of Q4 2016 results

(SAR mn)	Q4 2015	Q3 2016	Q4 2016	% chg y-o-y	% chg q-o-q	ARC est
Revenue	1,672.0	1,633.8	1,801.0	7.7%	10.2%	1,692.6
Gross profit	1,065.0	1,061.0	1,142.0	7.2%	7.6%	1,104.9
Gross profit margin	63.7%	64.9%	63.4%			65.3%
Operating profit	(82.0)	(2.0)	87.0	NM	NM	103.3
Net profit	(291.0)	(267.0)	(135.0)	-53.6%	-49.4%	(170.8)

Source: Company data, Al Rajhi Capital

IMPORTANT DISCLOSURES FOR U.S. PERSONS

This research report was prepared by Al Rajhi Capital (Al Rajhi), a company authorized to engage in securities activities in Saudi Arabia. Al Rajhi is not a registered broker-dealer in the United States and, therefore, is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. This research report is provided for distribution to "major U.S. institutional investors" in reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act").

Any U.S. recipient of this research report wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided in this research report should do so only through Rosenblatt Securities Inc, 40 Wall Street 59th Floor, New York NY 10005, a registered broker dealer in the United States. Under no circumstances should any recipient of this research report effect any transaction to buy or sell securities or related financial instruments through Al Rajhi. Rosenblatt Securities Inc. accepts responsibility for the contents of this research report, subject to the terms set out below, to the extent that it is delivered to a U.S. person other than a major U.S. institutional investor.

The analyst whose name appears in this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA") and may not be an associated person of Rosenblatt Securities Inc. and, therefore, may not be subject to applicable restrictions under FINRA Rules on communications with a subject company, public appearances and trading securities held by a research analyst account.

Ownership and Material Conflicts of Interest

Rosenblatt Securities Inc. or its affiliates does not 'beneficially own,' as determined in accordance with Section 13(d) of the Exchange Act, 1% or more of any of the equity securities mentioned in the report. Rosenblatt Securities Inc, its affiliates and/or their respective officers, directors or employees may have interests, or long or short positions, and may at any time make purchases or sales as a principal or agent of the securities referred to herein. Rosenblatt Securities Inc. is not aware of any material conflict of interest as of the date of this publication.

Compensation and Investment Banking Activities

Rosenblatt Securities Inc. or any affiliate has not managed or co-managed a public offering of securities for the subject company in the past 12 months, nor received compensation for investment banking services from the subject company in the past 12 months, neither does it or any affiliate expect to receive, or intends to seek compensation for investment banking services from the subject company in the next 3 months.

Additional Disclosures

This research report is for distribution only under such circumstances as may be permitted by applicable law. This research report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient, even if sent only to a single recipient. This research report is not guaranteed to be a complete statement or summary of any securities, markets, reports or developments referred to in this research report. Neither Al Rajhi nor any of its directors, officers, employees or agents shall have any liability, however arising, for any error, inaccuracy or incompleteness of fact or opinion in this research report or lack of care in this research report's preparation or publication, or any losses or damages which may arise from the use of this research report.

Al Rajhi may rely on information barriers, such as "Chinese Walls" to control the flow of information within the areas, units, divisions, groups, or affiliates of Al Rajhi.

Investing in any non-U.S. securities or related financial instruments (including ADRs) discussed in this research report may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the U.S. Securities and Exchange Commission. Information on such non-U.S. securities or related financial instruments may be limited. Foreign companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect within the United States.

The value of any investment or income from any securities or related financial instruments discussed in this research report denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related financial instruments.

Past performance is not necessarily a guide to future performance and no representation or warranty, express or implied, is made by Al Rajhi with respect to future performance. Income from investments may fluctuate. The price or value of the investments to which this research report relates, either directly or indirectly, may fall or rise against the interest of investors. Any recommendation or opinion contained in this research report may become outdated as a consequence of changes in the environment in which the issuer of the securities under analysis operates, in addition to changes in the estimates and forecasts, assumptions and valuation methodology used herein.

No part of the content of this research report may be copied, forwarded or duplicated in any form or by any means without the prior consent of Al Rajhi and Al Rajhi accepts no liability whatsoever for the actions of third parties in this respect. This research document has been prepared by Al Rajhi Capital Company ("Al Rajhi Capital") of Riyadh, Saudi Arabia. It has been prepared for the general use of Al Rajhi Capital's clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Al Rajhi Capital. Receipt and review of this research document constitute your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusion, or information contained in this document prior to public disclosure of such information by Al Rajhi Capital. The information contained was obtained from various public sources believed to be reliable but we do not guarantee its accuracy. Al Rajhi Capital makes no representations or warranties (express or implied) regarding the data and information provided and Al Rajhi Capital does not represent that the information content of this document is complete, or free from any error, not misleading, or fit for any particular purpose. This research document provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other investment products related to such securities or investments. It is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this document.

Investors should seek financial, legal or tax advice regarding the appropriateness of investing in any securities, other investment or investment strategies discussed or recommended in this document and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities or other investments, if any, may fluctuate and that the price or value of such securities and investments may rise or fall. Fluctuations in exchange rates could have adverse effects on the value of or price of, or income derived from, certain investments. Accordingly, investors may receive back less than originally invested. Al Rajhi Capital or its officers or one or more of its affiliates (including research analysts) may have a financial interest in securities of the issuer(s) or related investments, including long or short positions in securities, warrants, futures, options, derivatives, or other financial instruments. Al Rajhi Capital or its affiliates may from time to time perform investment banking or other services for, solicit investment banking or other business from, any company mentioned in this research document. Al Rajhi Capital, together with its affiliates and employees, shall not be liable for any direct, indirect or consequential loss or damages that may arise, directly or indirectly, from any use of the information contained in this research document.

This research document and any recommendations contained are subject to change without prior notice. Al Rajhi Capital assumes no responsibility to update the information in this research document. Neither the whole nor any part of this research document may be altered, duplicated, transmitted or distributed in any form or by any means. This research document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or which would subject Al Rajhi Capital or any of its affiliates to any registration or licensing requirement within such jurisdiction.

Disclaimer and additional disclosures for Equity Research

Disclaimer

This research document has been prepared by Al Rajhi Capital Company ("Al Rajhi Capital") of Riyadh, Saudi Arabia. It has been prepared for the general use of Al Rajhi Capital's clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Al Rajhi Capital. Receipt and review of this research document constitute your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusion, or information contained in this document prior to public disclosure of such information by Al Rajhi Capital. The information contained was obtained from various public sources believed to be reliable but we do not guarantee its accuracy. Al Rajhi Capital makes no representations or warranties (express or implied) regarding the data and information provided and Al Rajhi Capital does not represent that the information content of this document is complete, or free from any error, not misleading, or fit for any particular purpose. This research document provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other investment products related to such securities or investments. It is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this document.

Investors should seek financial, legal or tax advice regarding the appropriateness of investing in any securities, other investment or investment strategies discussed or recommended in this document and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities or other investments, if any, may fluctuate and that the price or value of such securities and investments may rise or fall. Fluctuations in exchange rates could have adverse effects on the value of or price of, or income derived from, certain investments. Accordingly, investors may receive back less than originally invested. Al Rajhi Capital or its officers or one or more of its affiliates (including research analysts) may have a financial interest in securities of the issuer(s) or related investments, including long or short positions in securities, warrants, futures, options, derivatives, or other financial instruments. Al Rajhi Capital or its affiliates may from time to time perform investment banking or other services for, solicit investment banking or other business from, any company mentioned in this research document. Al Rajhi Capital, together with its affiliates and employees, shall not be liable for any direct, indirect or consequential loss or damages that may arise, directly or indirectly, from any use of the information contained in this research document.

This research document and any recommendations contained are subject to change without prior notice. Al Rajhi Capital assumes no responsibility to update the information in this research document. Neither the whole nor any part of this research document may be altered, duplicated, transmitted or distributed in any form or by any means. This research document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or which would subject Al Rajhi Capital or any of its affiliates to any registration or licensing requirement within such jurisdiction.

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 10% above the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"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.

"Target price": We estimate target 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.

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.

Contact us

Jithesh Gopi, CFA
Head of Research and Financial Institutions
Tel : +966 1 211 9332
Email: gopij@alrajhi-capital.com

Al Rajhi Capital
Research Department
Head Office, King Fahad Road
P.O. Box 5561, Riyadh 11432
Kingdom of Saudi Arabia
Email: research@alrajhi-capital.com

Al Rajhi Capital is licensed by the Saudi Arabian Capital Market Authority, License No. 37/07068.