جلوبل Global

Mobily (Etihad Etisalat Company)

HOLD
TP SAR30.0
+9.5%

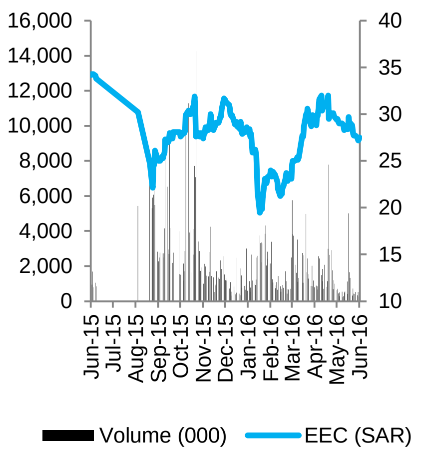
Market Data

Bloomberg Code	EEC AB
Reuters Code	7020.SE
CMP (02 June 2016)	SAR27.4
O/S (mn)	770
Market Cap (SAR mn)	21,098
Market Cap (USD mn)	5,626
52 Week High (SAR)	34.3
52 Week Low (SAR)	19.5
3m ADVT (USD mn)	12.5

Price Performance

	1m	3m	12m
Absolute (%)	-6.2	10.0	-20.0
Relative (%)	-3.8	5.7	13.0

Price Volume Performance



Source: Zawya

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- **Turnaround to be gradual; Revenues to grow from 2017e**
- **Possible tower sale unlikely to materialize soon**
- **Improvement in fundamentals priced in; HOLD recommended**

Successful negotiation with the banks eases concern over the going concern status. Mobily reached an agreement with the remaining lenders to reset the debt covenants which will allow it to raise further debt and reduce strain on the cash flows. At the end of 1Q16, current portion of long-term loans was SAR9.3bn. We believe a major part of it will be re-classified as long-term loans in the aftermath of the agreement.

A long road to recovery. Although Mobily posted a profit of SAR17mn in 1Q16 compared to a loss of SAR45mn in 1Q15, we believe, the road to recovery is a long one mainly due to (i) a saturated mobile market with a penetration rate of 170% (ii) tough competition as STC and Zain have become more assertive (iii) monetization of the fiber-optic network might be a slow process due to STC's dominance in the fixed-line segment.

Biometric verification through finger-printing to affect 2016 revenues. The law was passed in September 2015 and phase 1 got implemented from January 2016 and covers newly issued SIM cards. The next phase will cover existing subscribers. Due to this whole exercise, mobile subscribers in Saudi Arabia are expected to decline in 2016 as illegal expatriates might see their connections getting cancelled.

Tower sale still in the works. Recently the stock price has reacted to news flow on possible tower sale-and-leaseback transaction. In our conversation with Mobily's management, we have understood that the whole process will take time as the decision to sell the towers will have to go through a series of approvals including of the telecom regulator. Mobily is looking to sell 10,000 towers and in the process might raise up to USD1.5bn which will be around 37.0% of debt at the end of 1Q16.

Investment Indicators

SAR (mn)	2014	2015	2016e	2017e	2018e
Revenue	14,004	14,424	13,957	14,293	14,989
EBITDA	2,246	2,941	4,606	4,988	5,396
EBITDA margin	16.0%	20.4%	33.0%	34.9%	36.0%
Net Profit	(1,576)	(1,093)	250	646	1,045
EPS (SAR)	-2.05	-1.42	0.32	0.84	1.36
Dividend Yield	8.5%	0.0%	0.0%	0.0%	0.0%
P/E (x)	n/a	n/a	84.5	32.7	20.2
EV/EBITDA (x)	21.2	11.6	6.9	6.1	5.2

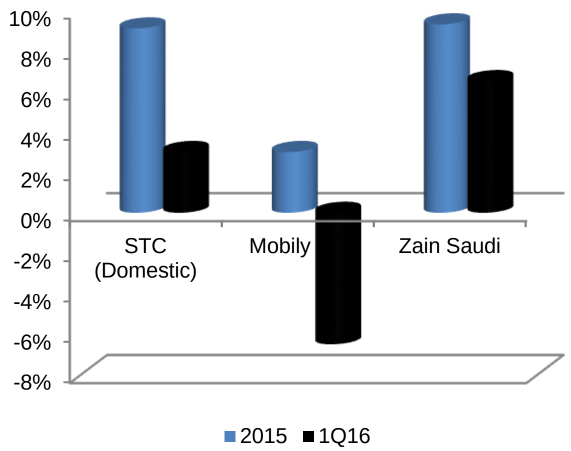
Source: Company financials & Global Research

Revenues: 2016 revenues to decline as Mobily cedes susbcriber market share

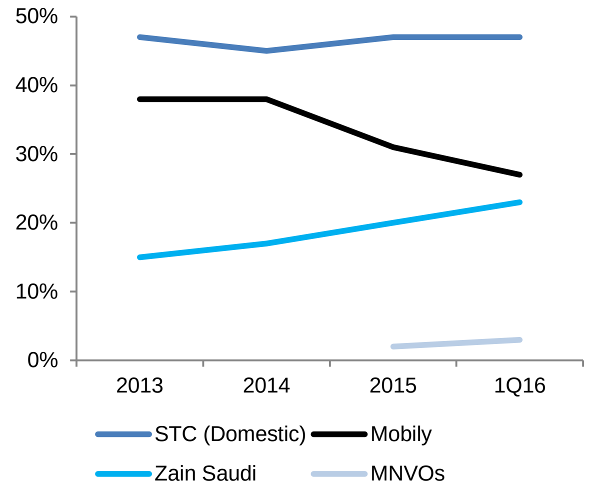
We expect 2016e revenues to decline by 3.2% to SAR13.96bn due to bio-metric verification. In addition, STC, Zain and MNVOs will continue to encroach on Mobily's subscriber market share as the latter deals with the fallout of the accounting scandal. Subscriber numbers are not revealed by STC and Mobily but based on the numbers disclosed by Zain, Mobily's market share fell by a massive 7pp to 31.0% in 2015 and then by a further 4pp to 27.0% in 1Q16 with STC and Zain along with the MNVOs capturing Mobily's market share.

We have also taken a look at the revenue growth figures for 2015 and 1Q16 in view of the contradiction in the subscriber numbers disclosed by the Saudi telecom regulator and Zain. Revenue growth figures also indicate that Mobily's drop in market share was significant with Mobily even lagging behind STC, the largest player, in terms of revenue growth.

Revenue growth YoY



Mobile subscriber market share



Source: Company financials, Zain Investor Presentation and Global Research

Recovery in 2017 to be led by uptick in ARPUs and monetization of fiber-optics

We expect Mobily's revenue to grow at a 2017-20e CAGR of 3.8% driven by (i) increase in ARPUs and subscribers in the mobile segment (ii) monetization of the fiber-optic network. We expect Mobily's mobile subscriber market share to stabilize from 2017 onwards while industry mobile subscriber growth to mirror population growth of 2.0% in view of the high mobile penetration rate. Telecom sector in general will also benefit from a planned increase in religious tourism as the NTP envisages inter-alia doubling of Umrah capacity by 2020.

We expect mobile ARPU's to increase to an estimated SAR78 by 2020e compared to an estimated SAR73 in 2015 driven by an increase in data consumption and tariffs. We are likely to see rise in data tariffs in Saudi Arabia as (i) data tariffs are one of the lowest in GCC (ii) telecom operators move to regulate data traffic to reduce congestion on the network. Mobily has already stopped provision of unlimited data packages.

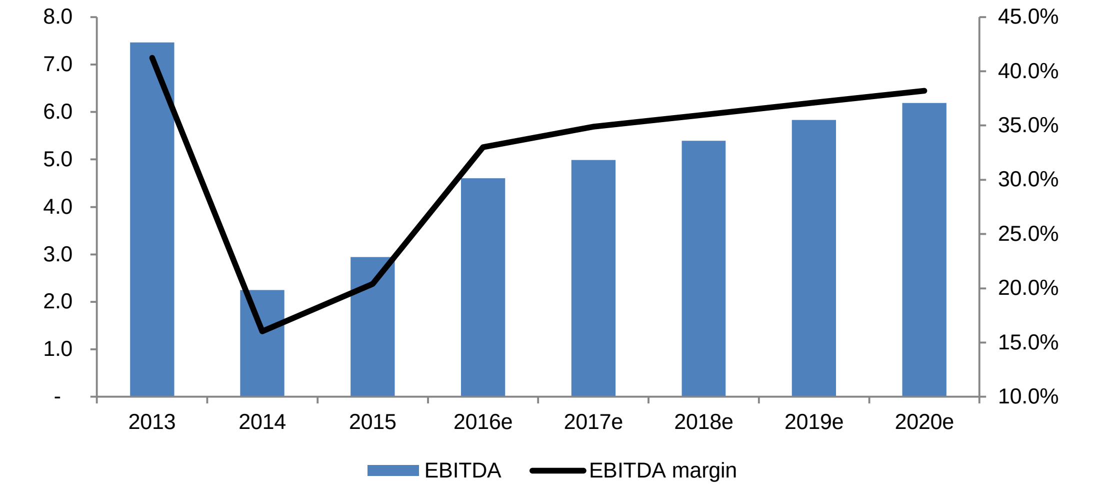
Just to get a sense of low tariffs in Saudi Arabia, we compare Mobily's 20GB wireless data-only plan with a one-month validity with Etisalat's. Mobily's plan costs SAR95 compared to AED449 for Etisalat in UAE which implies a discount of 80.0%.

Mobily currently does not disclose revenue breakdown but according to the management, the contribution from the fixed line segment (FTTH) is insignificant at the moment. Mobily has already invested heavily in fiber optic with around 24,000km of Metropolitan and FTTH fiber network. The company will seek to monetize this segment by utilizing the free capacity.

Focus on cost-control to improve margins

EBITDA margins improved to 32.4% in 1Q16 compared to 25.3% in 1Q15. This reflects cost-control on part of the company. The company is taking measures such as vacating some rented buildings and accommodating employees in a smaller number of buildings thereby saving on the rent costs. We expect EBITDA margins to increase to 38.2% by 2019e which is close to STC's EBITDA margin of 38.8% in 1Q16. The expansion in EBITDA margin will also be driven by an expected increase in ARPUs.

EBITDA (SAR bn) and EBITDA Margin



Source: Company financials & Global Research

Insignificant impact of MTR rate cut

The Saudi regulator, for the second time, reduced termination rates for mobile and landlines in March 2016 by 33-36%. The first cut of 30-40% happened in February 2015. The cut will have an insignificant impact as lower revenues will be offset by lower costs. However, the beneficiary will be Zain Saudi by courtesy of its lowest subscriber market share as the amount of revenues it generates from incoming calls is lower than the amount of charges it pays for outgoing calls.

Capex to be around SAR3.0bn per annum

We expect 2016e Capex/revenue of 24.0% and for 2017e-20e to be between 19-22%. In absolute terms, it will range from SAR2.9-3.2bn per annum. Majority of the capex will go towards upgradation and expansion of the mobile network. Meanwhile, capex will be minimal on the fiber-optic network as Mobily has already invested heavily in it in previous years.

Tower sale-and-leaseback transaction will reduce stress on the cash flows

Mobily is looking to sell 10,000 towers as part of sale-and-lease back transaction. Assessing the possible inflow is a difficult task as the sale price will be scaled by the magnitude of the lease payments. However, assuming a sale price of USD150,000 per tower which is close to the price estimated for the Zain Saudi towers, the company could see an inflow of USD1.5bn (SAR5.6bn) which is around 37.0% of 1Q16 debt.

However, there are still many unanswered questions regarding the tower sale for e.g. whether an independent tower company will buy the towers or a joint tower company will be set up by STC, Zain and Mobily. With STC recently also indicating its intention to sell the towers, the possibility of a joint tower company cannot be ruled out.

Reset of covenants to help liquidity position

Mobily had “cash & cash equivalents” and “short-term investments” of SAR2.2bn and net debt of SAR12.2bn at the end of 1Q16; SAR9.3bn of the debt was classified as short-term. However, post the recent reset of the covenants, a part of it will be re-classified as long-term. We believe, debt-repayments will likely happen in-line with the position as at the end of 2013 as indicated by the management. We are assuming debt repayments of SAR2.8bn in 2016 and SAR2.0bn every year till 2020e. If the company faces any shortfall or new issuance of debt becomes a problem then Mobily might have to resort to a cut in Capex.

Net debt/ EBITDA was at 4.3x at the end of 2015. Majority of the loan is owed to syndication of local banks with an outstanding amount of SAR7.5bn. There are semi-annual instalments with the last installment due in February 2019.

The effective interest rate on loans was 2.5% in 2015. We have assumed an increase in effective interest to 5.0% in view of the breach of covenants and their subsequent re-setting.

Valuation Update- HOLD with a TP of SAR30.0/share

We have derived a TP of SAR30.0/share for Mobily using the DCF method. The stock currently offers an upside of 9.5%, thus we recommend a HOLD. We assumed a risk-free rate (US 10-year Treasury yield) at 1.9% and US risk premium at 7.65%. On this we have added country-risk premium of 1.5%. We have also added company specific premium of 1.0% to account for higher risk attached to Mobily due to its tight liquidity position. The COE comes at 12.0% while WACC comes at 10.4%. We have assumed cost of debt of 5.0%.

The stock is trading at a 2017e P/E of 32.4x compared to GCC telcos average of 11.7x. We believe the earnings will reach a normalized level by 2020e. Meanwhile the stock is trading at 2017e EV/EBITDA of 6.1x compared to average of 4.7x for the GCC telecom companies indicating the stock is fairly valued.

We don’t expect any dividends during the forecast period

We don’t expect any payment of dividends during the forecast period as the first priority will be to meet the debt obligations and capex requirements.

Valuation risks

Upside risks

- Faster than expected monetization of fiber-optic network.
- Higher than expected increase in data prices and hence ARPUs.
- Winning the lawsuit against Zain Saudi can result in an inflow of SAR1-2bn which will add SAR1.29-2.59 or 4-9% to the TP.
- Sale of towers can unlock value by making operations more efficient. We have not incorporated any form of tower sale in our model or valuation.
- Resumption of dividend payouts can lead to a re-rating of the stock.

Downside risks

- Further rise in interest costs. We have assumed 5.0% for the forecast period.
- Deterioration of cash flows and inability to raise further capital can raise concerns over meeting debt obligations.
- Regulatory measures such as increase in taxation, royalty or imposition of VAT on mobile services.
- No increase in data tariffs leading to a decline in ARPUs.

Financial Statements

(SAR mn)	2013	2014	2015	2016e	2017e	2018e	2019e
Income Statement							
Revenue	18,103	14,004	14,424	13,957	14,293	14,989	15,715
Revenue Growth	-	-22.6%	3.0%	-3.2%	2.4%	4.9%	4.8%
Cost of services	(6,896)	(7,225)	(6,466)	(6,071)	(6,075)	(6,295)	(6,522)
SG&A	(3,742)	(4,532)	(5,017)	(3,280)	(3,230)	(3,298)	(3,363)
EBITDA	**7,465**	**2,246**	**2,941**	**4,606**	**4,988**	**5,396**	**5,830**
EBITDA growth	-	-69.9%	30.9%	56.6%	8.3%	8.2%	8.0%
Depreciation and amortization	(2,760)	(3,533)	(3,625)	(3,785)	(3,871)	(3,979)	(4,075)
EBIT	**4,705**	**(1,287)**	**(684)**	**821**	**1,117**	**1,417**	**1,755**
Financial Charges	(191)	(269)	(361)	(571)	(471)	(371)	(271)
Other income/expenses	257	20	121	-	-	-	-
Profit Before Taxation	**4,771**	**(1,535)**	**(924)**	**250**	**646**	**1,045**	**1,484**
Zakat/Taxation	(79)	(41)	(169)	-	-	-	-
Net Profit	**4,692**	**(1,576)**	**(1,093)**	**250**	**646**	**1,045**	**1,484**
Balance Sheet							
Cash and Bank Balance	1,570	1,964	498	816	149	379	1,159
Short-term investments	-	1,100	1,250	-	-	-	-
Receivables	7,505	4,529	3,461	3,344	3,424	3,589	3,761
Inventories	915	818	486	419	429	450	471
Prepayments & other current assets	4,730	4,091	2,704	2,094	2,144	2,248	2,357
Net property plant and equipment	20,320	24,073	24,466	24,627	24,498	24,117	23,631
Intangible assets	10,443	10,045	9,493	8,946	8,398	7,850	7,302
Other non-current assets	6	24	19	19	19	19	19
Total Assets	**45,488**	**46,644**	**42,376**	**40,264**	**39,061**	**38,652**	**38,700**
Trade & other payables	5,043	7,806	6,536	6,982	6,986	7,240	7,500
Current portion of LTD	3,080	16,993	5,849	2,000	2,000	2,000	2,000
Other current liabilities	5,575	4,991	5,765	5,794	5,928	6,207	6,497
Long-term debt	10,517	-	8,426	9,426	7,426	5,426	3,426
Employee end-of-service benefits	158	200	240	252	264	278	292
Share capital	7,700	7,700	7,700	7,700	7,700	7,700	7,700
Retained Earnings	10,767	6,303	5,210	5,460	6,106	7,151	8,635
Other reserves	2,649	2,649	2,649	2,649	2,649	2,649	2,649
Total Shareholders Equity incl. MI	21,116	16,654	15,561	15,810	16,456	17,502	18,986
Total Equity & Liability	**45,488**	**46,644**	**42,376**	**40,264**	**39,061**	**38,652**	**38,700**
Cash Flow							
Cash Flow from Operating Activities	5,591	6,171	5,198	5,887	4,999	5,651	6,092
Cash Flow from Investing Activities	(5,802)	(6,019)	(3,585)	(2,149)	(3,195)	(3,050)	(3,041)
Cash Flow from Financing Activities	479	241	(3,080)	(3,420)	(2,471)	(2,371)	(2,271)
Change in Cash	268	394	(1,467)	318	(667)	230	780
Net Cash at End	**1,570**	**1,964**	**498**	**816**	**149**	**379**	**1,159**
Ratio Analysis							
EBITDA Margin	41.2%	16.0%	20.4%	33.0%	34.9%	36.0%	37.1%
Net Profit Margin	25.9%	-11.3%	-7.6%	1.8%	4.5%	7.0%	9.4%
Return on Assets	10.3%	-3.4%	-2.6%	0.6%	1.7%	2.7%	3.8%
Return on Equity	22.2%	-9.5%	-7.0%	1.6%	3.9%	6.0%	7.8%
Net debt / EBITDA	1.6	6.2	4.3	2.3	1.9	1.3	0.7
EBITDA Interest coverage	39.2	8.3	8.1	8.1	10.6	14.5	21.5
Debt / Equity (x)	0.6	1.0	0.9	0.7	0.6	0.4	0.3
Capex as % of sales	31.0%	48.3%	23.8%	24.0%	22.0%	20.0%	19.0%
EV/EBITDA (x)	10.4	21.2	11.6	6.9	6.1	5.2	4.4
EV/Revenues (x)	4.3	3.4	2.4	2.3	2.1	1.9	1.6
FCFE Yield	5.4%	11.6%	-11.5%	-1.5%	-0.7%	3.1%	5.2%
EPS (SAR)	6.1	(2.0)	(1.4)	0.3	0.8	1.4	1.9
Book Value Per Share (SAR)	27.4	21.6	20.2	20.5	21.4	22.7	24.7
Market Price (SAR) *	85.5	43.9	28.2	27.4	27.4	27.4	27.4
Market Capitalization (SAR mn)	65,835	33,795	21,714	21,098	21,098	21,098	21,098
Dividend Yield	5.5%	8.5%	0.0%	0.0%	0.0%	0.0%	0.0%
P/E Ratio (x)	14.0	n/a	n/a	84.5	32.7	20.2	14.2
P/BV Ratio (x)	3.1	2.0	1.4	1.3	1.3	1.2	1.1

Source: Company Reports & Global Research

** Market price for 2016 and subsequent years as per closing prices on 02 June, 2016*

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The following is a comprehensive list of disclosures which may or may not apply to all our researches. Only the relevant disclosures which apply to this particular research has been mentioned in the table below under the heading of disclosure.

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Company	Recommendation	Bloomberg Ticker	Reuters Ticker	Price	Disclosure
Etihad Etisalat	HOLD	EEC AB	7020.SE	SAR27.4	1,10

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