

February 23, 2015

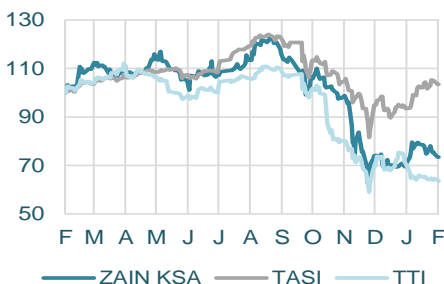
Expected Total Return

Price as of Feb-22, 2015	SAR 6.83
Upside to Target Price	61.1%
Expected Dividend Yield	-
Expected Total Return	61.1%

Market Data

52-Week H/L	SAR 11.70/5.45
Market Capitalization	SAR 7,377 mln
Enterprise Value	SAR 21,148 mln
Shares Outstanding	1,080 mln
Free Float	51.2%
12-Month ADTV (000's)	21,802
TASI Weight	0.4%
Reuters Code	7030.SE
Bloomberg Symbol	ZAINKSA AB

1-Year Price Performance



Source: Bloomberg

	Zain KSA	TASI	TTI
Feb-22-2015	6.83	9,301	1,811
Total Change			
6-months	(35.3%)	(13.2%)	(39.8%)
1-Year	(26.6%)	3.5%	(36.5%)
2-Year	(19.6%)	32.1%	(19.0%)

Huge Win for Zain KSA

The CITC's decision to lower the cap on network charges for mobile calls to 15 halalas per minute from 25 halalas is a major move in the industry following the decision to allow MVNOs. We have long held the view that survival of a third operator in this market is challenging given the substantial debt burden incurred for license acquisition. The regulator seems to agree and has taken steps to give breathing room to Zain KSA by deferring royalty charges in the past and now lowering usage costs. Perhaps the next step will be to reimburse some of the license fees to ease the operator's debt burden. Clearly, this decision is a huge win for Zain KSA and should pose a catalyst for shares (see our note of Nov-3, 2014). For now we maintain our Hold recommendation and SAR 11 target price, equating to 1.8x 2015E sales, while we review our forecasts.

Promoting competition by lowering interconnect charges

The Communication and Information Technology Commission (CITC) announced a major shift in network charges yesterday. In an effort to improve competition and lower tariffs for end users, network operators can charge a maximum of 15 halalas per minute, down from 25 halalas, for usage by other operators. In practical terms, this means that STC cannot charge Zain KSA more than 15 halalas per minute when a Zain KSA mobile customer calls STC mobile number. The idea is that cost savings from lower network charges will be passed onto the end customer. Secondly, the announcement capped network usage charges for landline at 7 halalas, down from 10 halalas, per minute. The announcement seems vague when it comes to MVNOs charges. Namely can STC charge its MVNO partner, Virgin Mobile, lower than what it charges a competing operator? Similarly, what do the reduced charges mean for non-partner MVNOs?

Lobbying efforts finally payoff

Zain KSA has been lobbying the CITC to lower network charges to level the playing field, while Mobily and STC have taken a counter position. Zain KSA argued that it is disproportionately penalized from higher network charges due to a lower customer base. Meaning that the likelihood of a Zain KSA customer making an offnet call is substantially higher than both Mobily and STC. This limits Zain KSA's pricing power for its customer base, while the competitors can enjoy greater flexibility. In the end, the announcement should not come as a surprise to the operators since the discussions with CITC have been ongoing for some time. In our view, this is a huge win for Zain KSA validating its position that the mobile landscape needs to be readjusted to make room for a third operator to survive. Additionally, with greater clarity on the pricing regime for MVNOs, we believe Zain KSA will be able to neutralize that threat.

Gross margins should improve

Gross margins for 2014 improved to 51.6% versus 48.1% in 2013, largely due to greater contribution from higher margin data revenues. With the new cap on network charges, we believe gross margins have scope for improvement. We estimate and each percentage point gain in gross margins could yield an additional SAR 60 million in gross profits. Secondly, Zain KSA's voice proposition will now look more appealing as customers can expect lower cost.

Possibly profitability within reach

Although Zain KSA made commendable strides in streamlining its cost structure, boosting network coverage and driving data penetration, we believe the status quo was not sustainable. Something had to change to facilitate competition and entry of MVNOs in the Saudi market. We believe lower network charges will bring relief to Zain KSA but also increase focus on management to revive voice revenues. We are reviewing our forecasts for the coming years and taking a deeper look at the path to profitability. We maintain our Hold recommendation and SAR 11 target price, equating to 1.8x 2015E sales.

Stock Rating

Strong Buy	Buy	Hold	Sell	Not Rated
Expected Total Return ≥ 25%	Expected Total Return ≥ 15%	Expected Total Return < 15%	Overvalued	Under Review/ Restricted

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