July 16, 2018

riyad capital

Rating	Buy
12- Month Target Price	SAR 9.50

ZAIN COMPANY

2Q2018 First Look

Expected Total Return	
Price as on July 15, 2018	SAR 6.34
Upside to Target Price	49.8%
Expected Dividend Yield	0.0%
Expected Total Return	49.8%

Market Data	
52 Week H/L	SAR 9.38/5.85
Market Capitalization	SAR 3,701 million
Shares Outstanding	584
Free Float	51.8%
12-Month ADTV	3,134,427
Blomberg Code	ZAINKSA

1-Year Price Performance

Source: Bloomberg

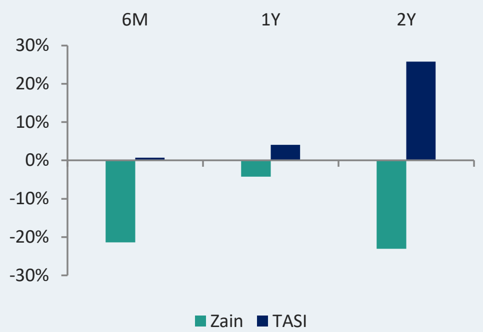

Fig in SAR mln	RC Est.	Actuals
Sales	1,837	1,846
Gross Profit	1,249	1,193
Net Income	(40)	(38)
EPS (SAR)	(0.07)	(0.64)

Net loss Meets Expectations

Zain posted a net loss of SAR (38) million, in line with our forecast of SAR (40) million but better than market consensus of SAR (52) million. The decline in losses Q/Q is attributed primarily to higher prices as the Company has reported stable subscribers over the preceding quarter. However, the number of subscribers in the industry has risen to 42 million by 1Q2018-end, according to data released by the CITC. Revenue increased by +10% Q/Q to reach SAR 1.8 billion, also in line with our estimates. However, gross margin shrunk to 65%, down 400 bps on a quarterly basis. Operating profit grew by +25% Q/Q while EBITDA margin fell to 33% from 34% in the previous quarter. We maintain our Buy recommendation but reduce the target price from SAR 12.00 to SAR 9.50 on a tougher operating environment going forward.

Revenue grows +10% Q/Q

The company's revenue grew by +10% Q/Q to SAR 1.8 billion primarily due to higher prices in 2Q versus 1Q, where promotions were offered. The CITC has reported a +4% Q/Q increase in the number of subscribers to 42 million by 1Q-end. While industry numbers are not yet available for 2Q, Zain has stated that their subscriber number remained stable Q/Q at 8.4 million by 2Q-end. On a Y/Y basis, topline declined slightly by -1% on the back of a decrease in interconnection rates. Overall, Zain benefits from lower interconnection charges as the proportion of incoming calls are much higher than outgoing calls.

Gross margins contract

Gross profit reached SAR 1.2 billion, up +3% Q/Q but down -5% Y/Y. Growth in revenues Q/Q helped but we have witnessed shrinking gross margins due to lower handset sales. Zain posted gross margins of 65% in 2Q2018, down from 69% in the preceding quarter and 67% last year. However, we believe 65% is a sustainable level for the Company and do not expect any major declines from here.

Operating profit up by +25% Q/Q

Operating profit came down -23% Y/Y to SAR 179 million but has increased by +25% Q/Q. On a quarterly basis, marketing and distribution costs have come down by -3% to SAR 525 million but administrative and general costs have risen by +15% with an increase in depreciation expenses by +2%.

Target price lowered to SAR 9.50

Zain achieved a net loss of SAR (38) million in line with our forecast of SAR (40) million, reducing its losses from SAR (77) million in the previous quarter. EBITDA margin decreased by 100bps Q/Q to 33%. Zain bottom line has improved on a quarterly basis on higher prices but the impact of VAT and the potential reduction in the subscribers as expats leave the country casts a shadow over the sector. We have moderated our forecasts going forward. While maintain our Buy recommendation, we have reduced the target price from SAR 12.00 to SAR 9.50. We believe finalization of capital restructuring would be a trigger for stock price.

Key Financial Figures

FY Dec31 (SAR mln)	2017A	2018E	2019E
Sales	7,305	7,448	7,598
Gross Profit	4,913	4,972	5,053
EBITDA	2,517	2,540	2,594
Net Profit	11	32	94
EPS (SAR)	0.02	0.05	0.16

Key Financial Ratios

FY Dec31	2017A	2018E	2019E
Gross Margin	67.2%	66.5%	66.0%
EBIT Margin	34%	34%	34%
Net Margin	0.2%	0.4%	1.0%
EV/EBITDA	5.69x	5.64x	5.52x
P/FCF	3.01x	1.76x	5.21x

Muhammad Faisal Potrik
muhammed.faisal@riyadcapital.com
+966-11-203-6807

Shaykhah A. AlDosari
Shaykhah.a.aldosari@riyadcapital.com
+966-11-203-6812

Stock Rating

Buy	Neutral	Sell	Not Rated
Expected Total Return Greater than 15%	Expected Total Return between -15% and +15%	Expected Total Return less than -15%	Under Review/ Restricted

** The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors*

For any feedback on our reports, please contact research@riyadcapital.com

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