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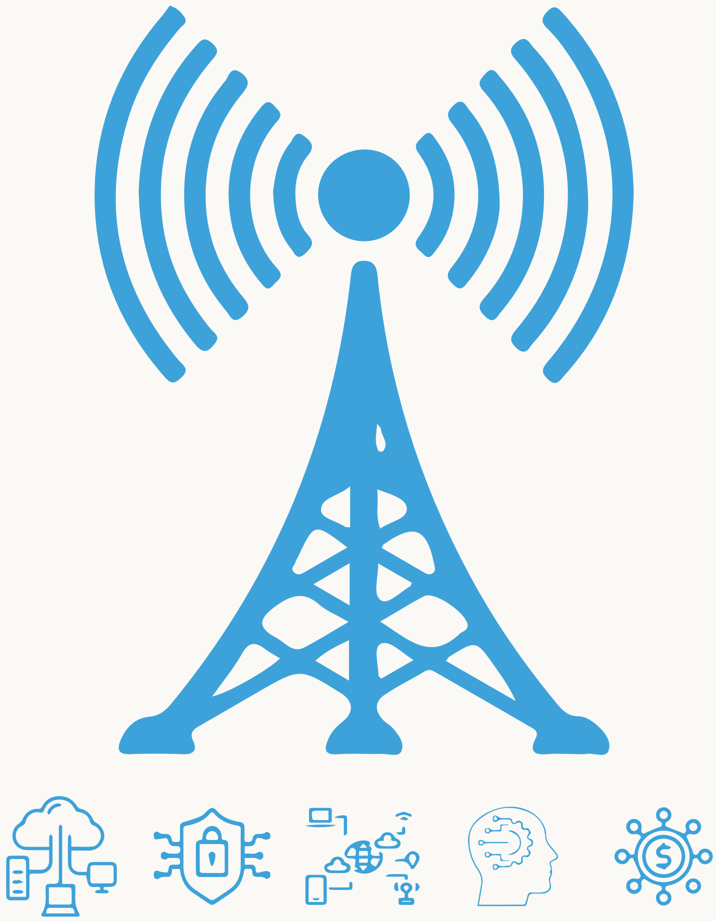

KSA Telecom Sector

B2B segment in focus, tapping all the avenues of ICT domain crucial for the operators

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The telecom sector in Saudi Arabia has expanded significantly over the past few years. Early deployment of 5G infrastructure compared to most global peers, government backed digitization drive in public as well as private enterprises and increasing adoption advanced technologies are key factors that are driving the growth of Saudi telecom industry. Currently, the sector is witnessing good traction in the B2B segment, as increasing need for digitization, data intensive operations and higher usage of internet are driving growth in this segment. Recently, not only large private and government enterprises but also small and medium enterprises (SMEs) are going digital. Furthermore, the government's plans to boost digital economy and increasing its contribution to the GDP would further accelerate demand for information communication technology (ICT) services. On the hand, the Consumer segment of KSA telecom industry is going through a phase of intense competition due to increased number of players (primarily 3 MNOs and 4 MVNOs). The mobile network penetration level is already high. Thus, the players operate in a limited space available now. However, in the long run, the increased adoption of 5G and changing consumer behavior are expected to drive incremental data usage that will drive the ARPUs higher. Moreover, the expected increase in tourist activity will provide scope for growth in visitor's packages and roaming services. Among the stock in the sector, we maintain our "Overweight" rating on STC and Mobily with TPs of SAR 45.5/share and SAR 62.6/share, respectively. We have a "Neutral" rating on Zain KSA with a TP of SAR 13.5/share.

Industry-level growth drivers, particularly in the B2B segment, to drive revenue growth for telecom companies: We expect the B2B segment to be key growth driver for the telecom sector over at least next two-three years. The proportion of establishments using internet related devices and systems reached 60.1%, while that of establishments purchasing cloud computing services was 48.0% in FY22. Thus, there has been good progress in terms of digitization in the last few years. However, there is still untapped potential in the segment. SMEs which contribute 50% of the GDP are increasingly digitalizing their businesses and they are likely to be key driver of B2B segment demand for telecom operators. Mobily and Zain KSA are experiencing strong growth in the segment and seem to have increased their market share recently. Mobily recorded 21.0% Y/Y growth in B2B revenue in FY23. Nevertheless, increasing digitization and growing use of technologies such as IoT, cloud computing, AI, ML, and M2M suggest potential expansion of overall B2B market itself. Thus, all three operators, having spread their spectrum across the ICT services, would benefit from the expected strong demand. Additionally, internet and data usage will also increase with adoption of modern technologies favoring their data revenue.

Saudi telecom operators looking for capital reallocation through liquidation of assets: Saudi telecom operators are emphasizing on freeing up their capital in passive assets such as towers. Zain KSA sold its tower assets to investors led by PIF. Through the deal Zain KSA realized a net gain of SAR 1.1bn. STC sold a piece of land generating net gain of SAR 1.3bn. In FY23, Zain KSA announced its first ever dividend of SAR 0.5 per share, while STC paid a special dividend of SAR 1 per share. However, in our view, Zain could have prioritized repaying debts or investing in growth over returning capital to shareholders. STC has also received an offer from PIF to buy a 51% stake in its tower subsidiary Tawal. We believe Mobily could also follow the same suit for its tower assets. Considering the interest shown by PIF in telecom tower assets, there is a possibility of consolidation of tower assets of all three operators under PIF. The consolidation of tower assets is likely to augur well for both the tower company as well as the operators. Furthermore, we also believe STC could provide more value unlocking opportunities through listing its subsidiaries.

KSA telecom sector expected post average mid-single digit topline growth and double-digit adjusted net income growth during FY24-25E: We forecast telecom sector topline to record average annual growth of 5.0% till FY25E. The increase in revenue will be primarily driven by B2B along with expansion of ICT services. The net income (adjusted for one-off gains in FY23) is expected to register an average annual growth of 10.2% during the same period. A decent revenue growth and improvement in operating efficiency are likely to support the healthy expansion of the bottom line, despite some pressure on the GP margin due to changing revenue mix. STC is expected to grow on the back of expansion of its subsidiaries' business and strong foothold in Consumer segment, while Mobily is expected to build on its ongoing momentum in the B2B segment. Zain KSA's revenue will be aided by a growing presence in B2B and growth in Tamam but higher OPEX are likely to weigh on profits. We recommend an "**Overweight**" rating on STC and Mobily with TPs of **SAR 45.5/share** and **SAR 62.6/share**, respectively; while we are "**Neutral**" on Zain KSA with a TP of **SAR 13.5/share**.

Downside risks to our view on the sector are: (1) Lower than expected demand from B2B business 2) longer than expected time taken by the market to adopt to 5G as well as other new technologies that are expected to drive data demand 3) delay infrastructure structure projects that are expected to generate higher demand for ICT service. 4) loss opportunities by telecom companies to software and technology companies where both are competing with each other.

Table 1. Price target and recommendation

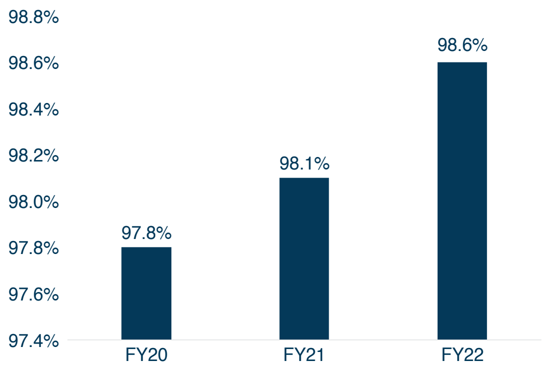
Company Name	TP (SAR per share)		Upside/ downside	Recommendation	Net income (SAR mn)		P/E FY24E	EV/EBITDA FY24E	DY FY24E
	Old	New			FY23	FY24E			
STC	47.0	**45.5**	14.5%	**Overweight**	13,295	12,992	15.2x	7.8x	4.0%
Mobily	50.0	**62.6**	13.8%	**Overweight**	2,232	2,541	16.7x	7.4x	2.6%
Zain KSA	12.8	**13.5**	4.6%	**Neutral**	1,267	295	39.4x	6.1x	3.9%

Source: Tadawul, Aljazira Capital Research; prices as of 14th March 2024

KSA's widespread internet access, favorable demographics and rising 5G adoption to increase data demand

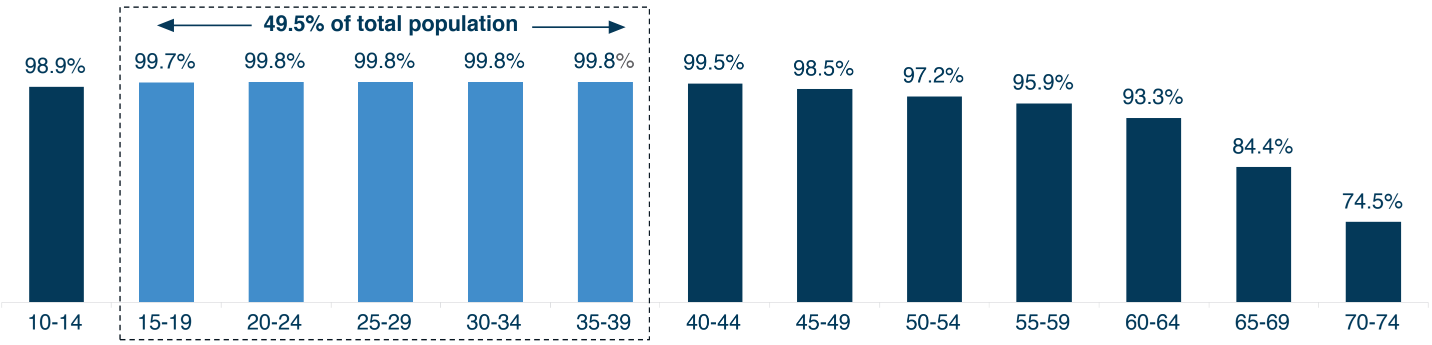
Saudi Arabia's internet penetration rate in higher than several advanced and emerging economies. The number of internet users in the country reached 98.6% of the total population. Internet penetration is widespread with all the regions clocking rate higher than 95%; with Najran being the lowest at 95.4%, while Riyadh being the highest at 99.9%. The young population aged between 15-39 forms almost half (49.5%) of the Saudi population. This age group has internet penetration levels close to 100% and they are key drivers of data demand. Moreover, the Kingdom is witnessing higher number of visitors both for religious and leisure tourism; the number is expected grow in coming years given governent's boost to tourism. The higher number of visitors will support growth in data usage through visitor's ans roaming packages. Additionally, expanding deployement and usage of 5G is expected to generate higher data demand.

Fig 1. Internet penetration in Saudi Arabia



Source: CST, Aljazira Capital

Fig 2. Internet penetration by age group (FY22)



Source: CST, GASTAT, Aljazira Capital

A surge in data traffic, transition to 5G expected to increase further: Internet traffic in KSA was 35.1mn TB in FY22, an increase of 17% over the previous year. Average monthly mobile data consumption per person stood at 37 GB. We beileve there is still a great scope for strong growth in internet traffic/data consumption because of change in life style and consumer preferences. Rising e-commerce website and application usage, greater exposure to social media, emergence of fintech, access to smart devices, growing usage of government e-services, avaibility of high speed mobile as well as fixed line internet, and further transition from 4G to 5G are the factors that will be responsible for robust growth in data consumption. Around 74% of mobile data traffic was still on 4G network as of FY22, while 5G network accounted for 22.5% of the mobile data traffic. Thus, there is further room for higher mobile data usage as more consumers transition to 5G. Moreover, in B2B segment also adoption of 5G and impletation of modern technologies will demand higher data consumption. For telecom operators incremental revenue from 5G will be directly dependent on incremental data consumption as pricing for 5G is same as 4G.

Fig 3. Internet traffic in KSA (in mn TB)

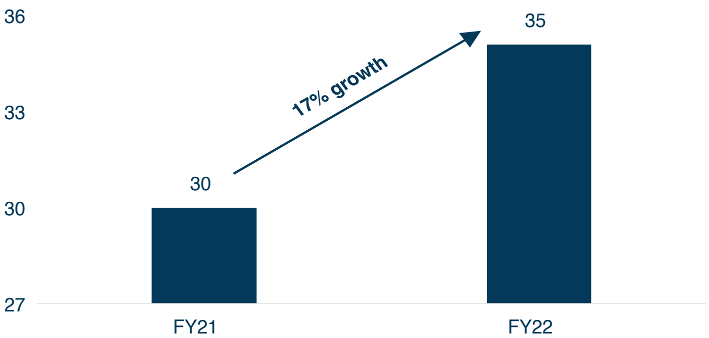
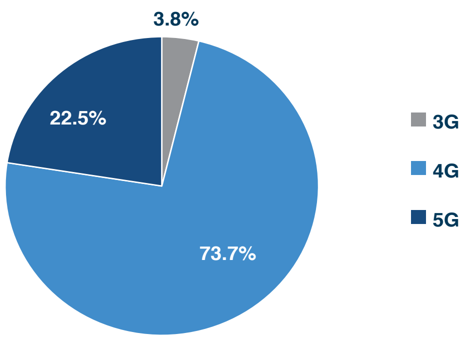


Fig 4. Mobile data traffic by technology (FY22)



Source: CST, Aljazira Capital

Deeper digitization level in public, private and SMEs to fuel B2B connectivity and data demand; government regulations supportive to domestic market growth

Digital economy's contribution to the GDP on par with global average; contribution expcted to increase significantly with higher number of enterprises going for digitization: In FY22, digital economy contributed 14.0% to the Kingdom's GDP. The digital economy makes up ~10% of the US GDP (FY22), according to US Bureau of Economic Analysis. As per the World Bank, digital economy's contribution is more than 15% to the global GDP. Hence, it can be concluded that KSA stands broadly on par with global peers as far as the digital economy's share is concern. Globally, digital economy has grown 2.5x faster than non-digital economy over the past decade. Saudi Arabia's ongoing digitization drive is reflecting in increased level of digitization across business activities. In FY22, establishments using internet related devices and systems was 60.1%, while it was at 48.0% for establishments purchasing cloud omputing services. However, purchases and offering of services through electronic medium is low. Nevertheless, there is definitely much more room for further digitization across the sectors.

Fig 5. Digital economy contribution to GDP (FY22)

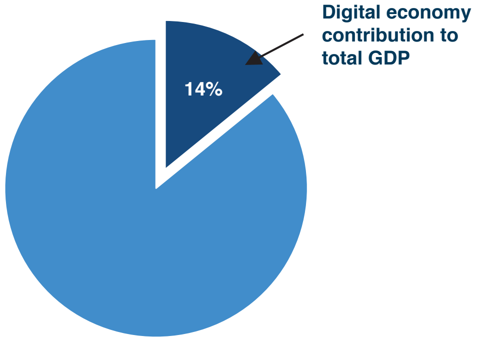
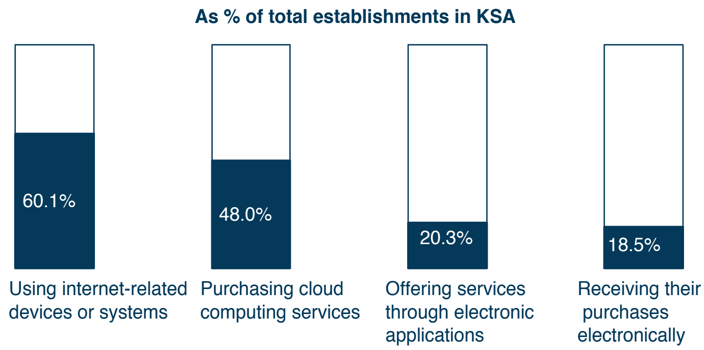


Fig 6. Digitization level among establishments (FY22)



Source: GASTAT, Aljazira Capital

Public entities form a larger share of B2B market for telecom operators but SMEs could also play an equally improtant role in growth going forward: The ongoing public sector transition to digitization will continue to generate demand for telecom operators. This segment witnessed a little stagnation recently owing cost optimization by government entities. This refelcted in decline in revenue from government enterprise business for STC, a dominant player in the segment. However, this is likely to be short term as upcoming new projects and expected higher spending from government will keep the demand intact. Nevertheless, currently SMEs seem to be driving the B2B segment. There is an increasing accepatnace by SMEs for digitization. Considering their size SMEs are more flexible technically. Saudi Arabia had 1.3mn SMEs operating as Decemeber 2023, as per Small & Medium Enterprises General Authority (Monshaat) and SMEs contribute more than 50% to the local GDP. Thus, B2B telecom segment in KSA certainly has a huge potential across large, small, public and private enterprises. This in turn will translate into higher internet usage, more demand for cloud services and other connectivity services.

Regional Headquarter Program and cloud computing regualtions favorable for domestic market growth: Saudi Arabia's Regional Headquarters Program requires multinational companies (MNCs) operating in the country to set up a regional headquarter in KSA. The program aims to attract 480 MNCs by 2030. In FY23, the Kingdom exceeded its target of 160 and attracted over 180 companies. The companies establishing their base in KSA will increase demand for ICT services. Saudi Arabia's cloud computing regulations require hosting and storage of data inside the Kingdom. Cloud service providers with infrastructure in KSA get advantage from this policy.

Ample of opportunities for Saudi telecom companies in ICT/non-conventional revenue streams

Saudi telecom companies which have already ventured into new business domains along with traditional telecommunication services are bound to benefit from expanding ICT market and increasing level of digitization. Based on Vision 2030's goal of digital transformation through e-commerce, digital education, digital health, smart cities, national data, and e-government; Ministry of Communication Information and Technology (MCIT) is focusig on developing a robust digital infrastructure. Government efforts along with growing need from enterprises to adopt modern technologies have open up multiple business subsegments within B2B segment for telecom operators.

Large upcoming projects to expand the ICT market: Saudi Arabia's ICT market size was estimated ~USD 40bn (SAR 150bn) in FY22, as per Communications, Space and Technology Commission (CST). The spending on ICT in the Kingdom was projected at USD 34.5bn by IDC. The spending on software (including cloud) and IT services is anticipated to increase at a CAGR of 11.4% and 8.7%, repectively, during FY22-26. Ongoing infrastrure development plans with a big governement push in terms of spending coupled with rising foreign direct investment are expected to reflect in higher spending on ICT sector. The value of upcoming giga projects in Saudi Arabia exceeds USD 900bn, accrding to MEED. These projects include NEOM City, Qiddiya Entertainmaint City and The Red Sea Project among others, which will require ICT infrasture and will act as key driver for demand of ICT services. Additionally, there are smart city projects initiated in Riyadh, Yanbu industrial city, Makkah, Jeddah, Madinah, and Al-Ahsa that will demand technological upgradation in areas such as IoT, AI systems, cloud computing and data centers.

ICT opportunities for Saudi Telcos and developments in the subsegments

Cloud Computing: Cloud services market in Saudi Arabia was estimated to reach USD 1.3bn in FY23, as per PwC. Further, the market size is forecasted to expand at CAGR of 25% to reach around USD 2.4bn in FY26. SAudi Arabia has strategic location to act as cloud service hub for MENA regions, attracting international player such as Alibaba, Google. STC set up a new firm focusing on cloud computing services in a joint venture with several companies including Alibaba Cloud, with an investment of around SAR 492mn. STC is establishing cloud and digital hub for the MENA region, investing USD 1bn. Google Cloud has officially announced the opening of its new cloud region in Dammam. The new cloud region is anticipated to contribute a cumulative USD 109bn to the Saudi economy between FY24 and FY30. Mobily has an agreement with Virtustream (owned by Dell) to develope of Saudi Arabia's cloud computing market. Zain KSA provides cloud services under under 'Zain Cloud'.

Internet of Things (IoT): According to IDC, Saudi Arabia's IoT market is expected to grow at 12.8% CAGR to be valued at USD 2.9bn by FY25. As mentioned earlier, IoT will play crucial role in upcoming smart cities in the country. Saudi Arabia leads in terms of IoT network coverage in MENA region. STC and PIF has a JV, "iot squared" that was estblished in FY22 with an initial capital of SAR 492mn.

Cybersecurity: Saudi Arabia is the largest cybersecurity market in the Middle East, according to the International Telecommunication Union. It was valued at USD 3.6bn in 2020 and is expected to grow at a CAGR of 18.0% to reach USD 9.8bn by FY26.

Artificial Intelligence (AI): AI is likely to contribute USD 135bn to KSA economy in FY30, making the Kingdom the biggest beneficiary of technology in the Middle East, according to a PwC report. Saudi Arabia ranked first globally in Tortoise Media's Government Strategy Index for Artificial Intelligence.

Fintech: All three Saudi telecom operators are active fintech space. STC is estblishing STC Bank, the first digital bank in the coutry, while Zain KSA is offering financial services including micro-financing through its platform, Tamam. Mobily offers financial services through Mobily Pay.

Sector witnessed helathy topline growth but margins contracted in FY23, margins likely to remain under pressure in FY24

Saudi Telecom sector's revenue grew 7.3% Y/Y to SAR 99.0bn in FY23, growth rate likely to moderate but average around mid-sigle digit till FY25E: Revenue growth for Mobily and Zain was driven by a strong growth rates in B2B segment along with increases in wholesale. Zain KSA's topline was also supported by 5G and Tamam growth. On the other hand, STC witnessed growth in the consumer segment. Within Consumer segment, Mobility and Fixed line business grew 4.3% and 9.7%, respectively. However, STC's Enterprise segment revenue declined due to slow down in government segment. We expect revenue growth to moderate a little in FY24E to 5.6% and to 4.5% in FY25E mainly due to higher base after two consecutive years of strong hrpwth, and lower B2B growth expected amid ongoing cost optimization efforts from government enterprises. Moreover, Consumer segment would continue to see stiff competition with prepaid market being subdued and MNOs and MVNOs competing among each other. We expect revenue growth to ease during FY23-25 for all three opertors with CAGR of 5.1%, 4.5% and 5.3% for STC, Mobily and Zain KSA, respectively

Fig 7. Telecom sector revenue (SAR bn) and growth rate

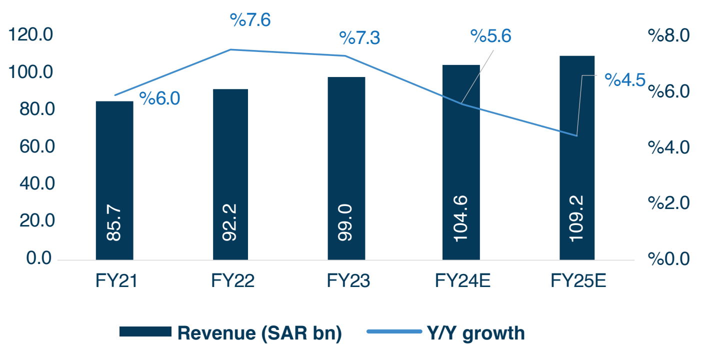
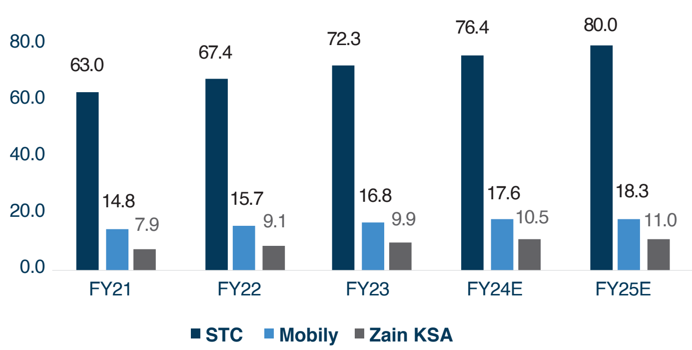


Fig 8. Revenue by company (SAR bn)



Source: Company reports, Aljazira Capital Research

Margin under pressure amid changing revenue mix; pressure expected to ease gradually: Gross margin of the sector contracted siginificantly during FY23, falling to 53.7% from 56.5% in FY22. The contraction in GP margin was led by STC due to higher contribution to the topline from subsidiaries which are low margin businesses and are currently in initial phases where cost is required. For Mobily, increasing share of topline from B2B segment might have weighed on GP margin. Whereas Zain KSA's GP margin improved in FY23. The contraction in operating margin (18.2% from 20.0%) was due to the effect of lower GP margin, higher Opex for Zain KSA due to leaseaback of towers; partially offset by operating efficiency of Mobily. We beileve margin pressure from revenue mix to persist till FY25 but gradual improvement can be expected with continous growth in revenue and controlled operating expenses. Thus, GP margin for the sector is forecasted be steady, while operating margin may show slight improvement. STC's GP margin is estimated to start improving from FY25E onwards as its new subsidiaries start becoming profitable, while Zain KSA is expcted to show decline in GP margin due to increasing share of B2B segment in coming years.

Fig 9. Sector margins

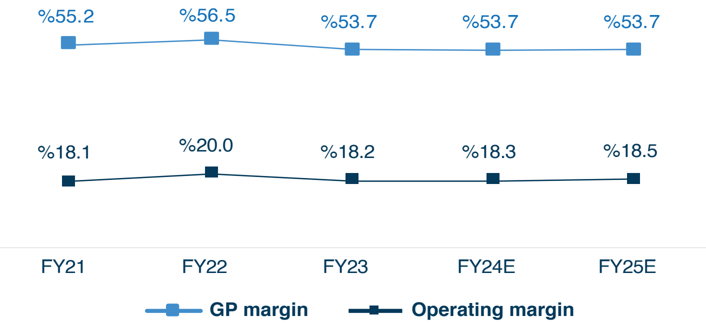
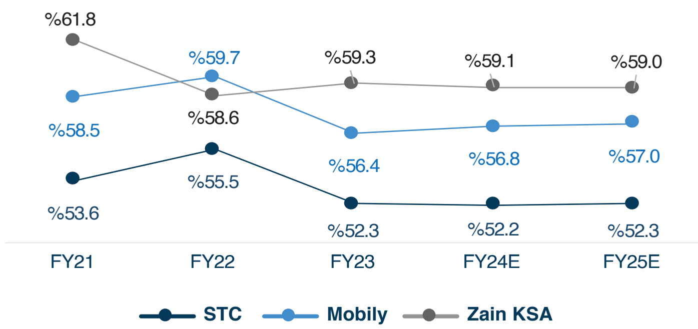


Fig 10. GP margins by companies



Source: Company reports, Aljazira Capital Research

One-off, non-operating incomes supported the bottoline in FY23, adjusted net income to post double digit growth till FY25E: Telecom sector's net profit jumped 16.8% Y/Y in FY23 to SAR 16.8bn. The bottom line growth outpaced that of the top line despite contraction of operating margin, as one-of gains supported the net profits. STC recorded an income of SAR 1.3bn from sale of a piece of land. Zain KSA posted net gain of SAR 1.1bn from completing the transfer of tower assets and gain on sale of remaining share in the tower company. We forecast net income for the sector to decline 5.8% Y/Y in FY24E due to absence of one-off items. After adjusting for above mentioned non-recurring items in FY23, net income is expected to grow 10.0% Y/Y this year. The net profit is expected to rise further by 10.4% Y/Y in FY25E. Net margin reached 17.0% in FY23, while adjusted net margin was 14.5% compared to 15.6% in FY22. Net margin is estimated at 15.1% in FY24E and improve further to 16.0% in FY25E.

Fig 11. Sector net income (SAR bn) and net margin

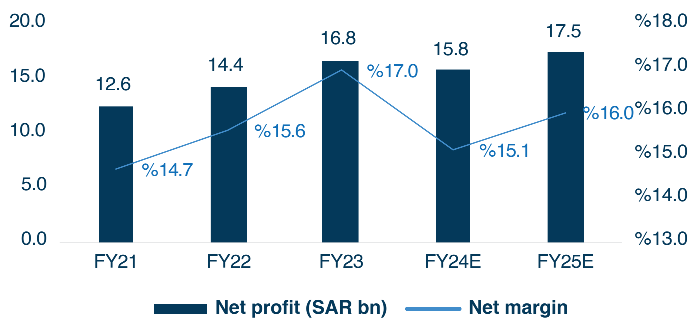
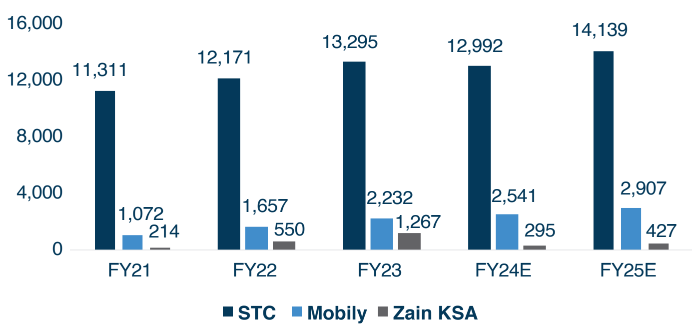


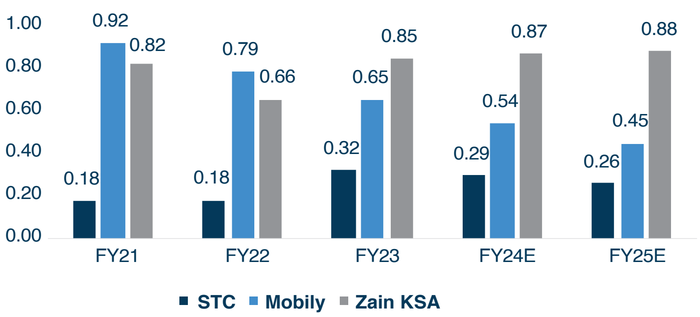
Fig 12. Net income by company (SAR mn)



Source: Company reports, Aljazira Capital Research

Zain KSA most leveraged company in the sector, sector leverage to ease gradually: Total debt in the sector spiked to SAR 46.6bn in FY23 from SAR 33.1bn a year earlier, implying an incrase of 41.1%, mainly driven by STC raising debt for its international acquisition. However, STC continues to be least levered company with leverage ration of 0.32x, while Zain KSA is the most levered company at 0.85x leverage. Mobily made significant progress in deleveragin its balance sheet from the leverage of 0.92x in FY21 to 0.65x in FY23. Overall, leverage level in the sector is expected to ease in next few years, as any large Capex does not appear to be requirment in forseable future except for any large acquisition.

Fig 13. Leverage (Debt/Equity) by company



Sources: Company reports, AlJazira Capital.

Key trends observed during FY23 across different revenue segment

- **B2B segment:** B2B segment delivered different performance for different operators. Mobily and Zain KSA saw a strong growth in B2B revenue. Mobily recorded 21.0% Y/Y growth in the segment. On the other hand, STC which is a leading player in this segment witnessed a decline in B2B revenue. It seems that Mobily and Zain KSA have gained market share in B2B segment. However, STC still continues to be dominant player. Cost optimization meassures by government enterprises hit the STC's business, while private and SMEs business continues to grow. B2B segment contribution to Mobily and Zain KSA seems to be increasing after change in government contract allocation process.
- **Consumer segment:** Consumer segment saw competitive pressure due to increased number of players with 3 MNOs and 4 MVNOs operating in the market. However, there was some improvement due to rise in tourism and good Hajj and Umrah season. The pricing pressure continues in the segment and it less likely that prices will be increased for the packages.
- **Wholesale:** Zain KSA and Mobily performed well in Wholesale segment. Mobily recorded 11% growth in wholesale revenue. Zain KSA seems to have gaining from agreement with the new MVNOs, the segment where it was lagging other operators earlier. We beilieve telcom operators will continue to cater pre-paid users through MVNOs, while they will focus on gaining high value post-paid subscribers' business.
- **5G:** The adoption of 5G cotinues to increase but at gradual pace. We believe that incremental revenue from 5G in both B2B and Consumer segment is growing but it has not yet reached a substantial level. Going forward we see higher transition from 4G to 5G and incremental revenue from 5G is expcted to be mainly due to higher data demand it will generate.

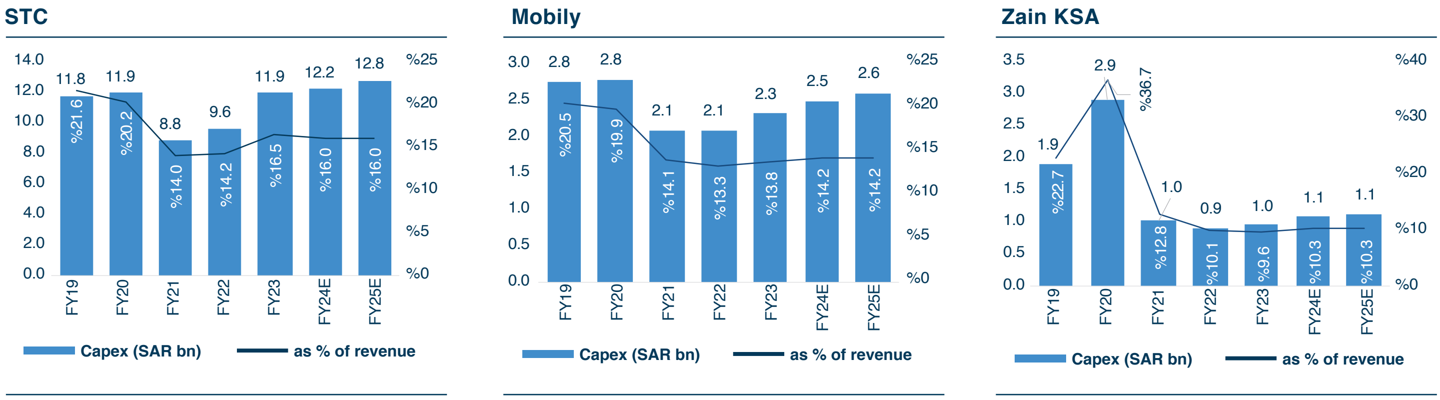
Telcos going for capital reallocation through monetization of assets; cash inflows to support organic and non-organic growth, deleveraging; Capex intensity normalized expected to remain steady

Asset monetization: In FY23, Zain KSA transferred its 8,069 towers to GLI (Tower Co.) realizing a gain of SAR 1.1bn. This included gain on sale of remaining 20% stake in GLI. STC sold a piece of land recognizing a gain of SAR 1,296mn. STC has received a non-binding offer from PIF to buy 51% stake for an amount of SAR 22bn. However, there is no further development on the offer yet. Moreover, there are other subsidiaries of STC where the company can look for unlocking the value through sale of stake or listing. The cash inflows from sale of assets will help the companies to fund their expansion plans and growth initiatives. Also, companies can use this cash for lowering their leverage.

M&As: STC expanded its international footprints through large international acquisitions. STC's subsidiary TAWAL acquired portfolio of tower assets from United Group in Europe for around SAR 5bn. TAWAL fully acquired AWAL Telecom, a tower company, in Pakistan. STC acquired 9.9% stake in Telefonica in Spain for 8.5bn and is reportedly bidding for acquisition of Altice Portugal.

Capex expected to remain rangebound in the medium term for all the operators: Saudi telecom sector has completed its major chunk of 5G rollout, thus capex levels in the sector have normalized now. In FY23, capex was almost flat in absolute terms, while it eased as % of revenue. Capex as % of revenue has declined from a high of ~22% during the peak 5G rollout period in FY20 to ~13% in FY23. Although there is no major spike in capex is expected in the coming period, there will be continous requirement for investment in different kind of infrastructure and technologies. Thus, the capex is expected to continue to remain moderate in future and will be focused on investment in modern technologies, further expansion of 5G network and expansion of the business into integrated ICT service. As a % of revenue, capex is likely to be in the range of 10-16% across all the three operators

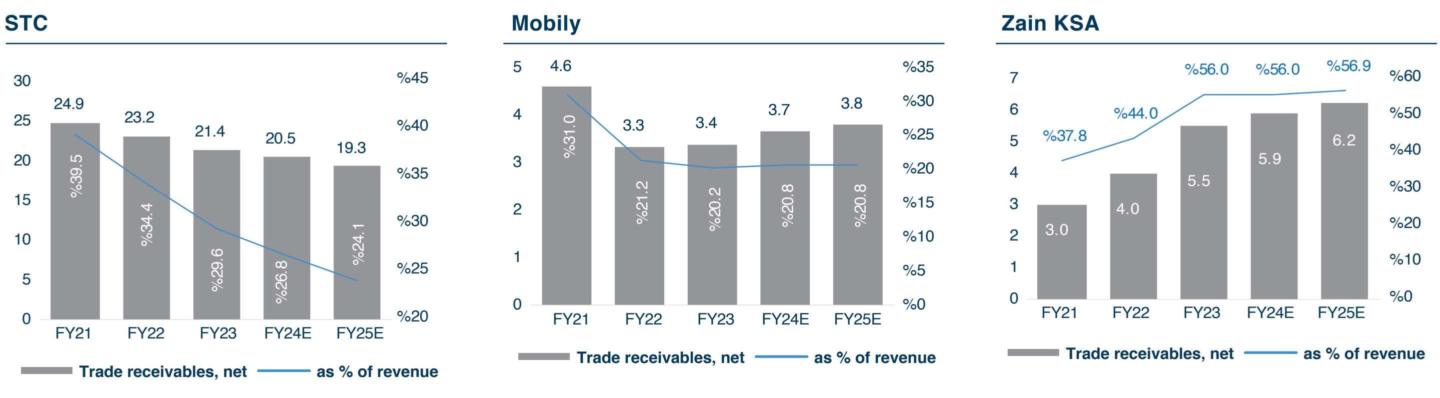
Fig 14. Capex* and capex intensity



Source: Company reports, Aljazira Capital Research
*Capex = Additions to PPE and intangible assets

Receivables collection improved for STC and Mobily, could potentially be a challenge for Zain KSA: STC, in the past, faced issues relateding to spike in trade receivable owing delay in collection from government sector client but the situation has improved significantly over the past two years. Given the recent trend of good collection rates we expcted further easing of recevables as % of revenue. For Mobily, trade receivables are expcted to increase gradually keeping them wothin manageable levels. However, Zain KSA has seen a spike in trade receivables in the last two years and receivable now stand at 56% of the revenue. We expect the growth in receivable to slowdown with some collections in the coming years but they are likely to stay at alarming levels unless the company is able to collect a significant chunk of outstanding recceivables.

Fig 15. Net trade receivables (SAR bn)



Source: Company reports, Aljazira Capital Research

STC: The expansion of subsidiaries business to help top line but at the cost of margins; maintain "Overweight" with a lower TP

Saudi Telecom Company (STC)'s continued its strong revenue growth in FY23 (+7.3%) with Solutions and Channels being the major contributors to the growth along with other subsidiaries, while the parent company's top line was flattish. We expect STC to maintain healthy revenue growth on the back of its expansion across multiple segments of the ICT sector in addition to a leading position in Telecom. However, the company's revenue in the Enterprise business segment is under pressure due to optimization of expenses by government entities. Nevertheless, growing digitization demand from SMEs and STC's leadership in Consumer business would support the revenue growth. Whereas changing revenue mix towards low margin subsidiary business is likely to keep pressure on margins in FY24E with gradual improvement FY25E onwards with more subsidiaries turning profitable. Additionally, we are positive on potential value unlocking through sale of stake in TAWAL to PIF or possibilit y listing of subsidiaries in the medium term. Moreover, there is a chance of a higher dividend with the expected announcement of a new dividend policy by the end of FY24. We maintain our "Overweight" rating on STC but lower TP to SAR 45.5/share due to downward revision to earnings given ongoing margin pressure.

Net income in Q4-23 was impacted by the weak GP margin and slowdown in revenue growth: STC posted a net profit of SAR 2.3bn (-17.5% Y/Y) in Q4-23, missing our estimate of SAR 2.7bn. Revenue of SAR 17.7bn (+2.7% Y/Y) was below our estimate of SAR 18.4bn. The company's gross profit was down 1.1% at SAR 8.9bn in Q4-23, as GP margin contracted to 50.4% from 52.3% in Q4-22 (AJC estimate: 52.0%). Operating profit decreased 4.0% Y/Y to SAR 2.9bn, recording operating margin of 16.1% (vs. 17.2% in Q4-22). Finance costs increased sharply to SAR 480mn from SAR 186mn due to increased borrowings for acquisition but was partially offset by higher finance income. The topline for FY23 grew 7.3% Y/Y to SAR 72.3bn with revenue from subsidiaries showing strong growth; mainly Channels (+24.0%) and Solutions (+25.4%). GP margin for FY23 was 52.3% vs. 55.5% in FY22. The change in revenue mix, lost business on connectivity in government segment impacted margins. However, the consumers segment provided the support with both Mobility and Fixed line businesses growing 4.3% Y/Y and 9.7% Y/Y, respectively. More contribution from ICT services hit EBITDA margins (34.1% vs. 37.2%), as 2-3 subsidiaries are still EBITDA negative. Net income at SAR 13.3bn (+9.2% Y/Y), including SAR 1.3bn gain on sale of land.

Mid-single digit topline growth expected in FY24E backed by ICT market expansion and leadership in Enterprise and Consumer businesses: STC has made huge investment in the ICT sector domains such as artificial intelligence, IoT, cloud computing, data centers, submarine cables, tower infrastructure, fintech and cybersecurity. The company recently entered the European market acquiring SAR 5bn telecom tower assets through TAWAL. STC's market leading position in KSA and its ability to invest in large amount new technologies and infrastructure bodes well for the company to establish itself as an integrated ICT services provider. In Enterprise business unit the company witness headwinds due to decline in revenue from government projects due to cost optimization measure by government companies and growing competition. However, we believe there is strong demand from SMEs in this space and with upcoming projects under Vision 2030, the government segment still has potential. STC being leader in this space will benefit from this. Additionally, STC's Consumer business unit is doing better than peers.

Recommendation	Overweight
Target Price (SAR)	45.5
Upside/(Downside)	14.5%

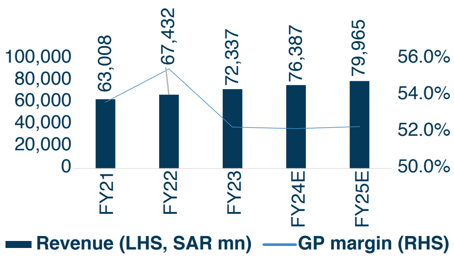
Source: Tadawul Prices as of 14th of March 2024

Key Financials

(in SAR mn, unless specified)	FY22	FY23	FY24E	FY25E
Revenues	67,432	72,337	76,387	79,965
Growth %	7.0%	7.3%	5.6%	4.7%
Gross Profit	37,393	37,804	39,862	41,810
Net Income	12,171	13,295	12,992	14,139
Growth %	7.6%	9.2%	-2.3%	8.8%
EPS	2.43	2.66	2.60	2.83

Source: Company reports, Aljazira Capital

Revenue (SAR mn) and GP margin



Source: Company reports, Aljazira Capital

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	55.5%	52.3%	52.2%	52.3%
Net Margin	18.0%	18.4%	17.0%	17.7%
ROE	16.0%	16.3%	14.9%	15.0%
ROA	9%	8.3%	7.8%	8.2%
P/E (x)	15.0	15.2	15.3	14.1
P/B (x)	2.4	2.5	2.3	2.1
EV/EBITDA (x)	7.6	7.8	7.5	7.4
Dividend Yield	4.4%	6.4%	4.0%	4.0%

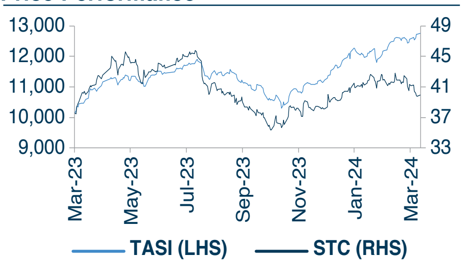
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	198.8
YTD%	-1.6%
52-week (High)/(Low)	46.0/35.0
Share Outstanding (mn)	5,000.0

Source: Company reports, Aljazira Capital

Price Performance

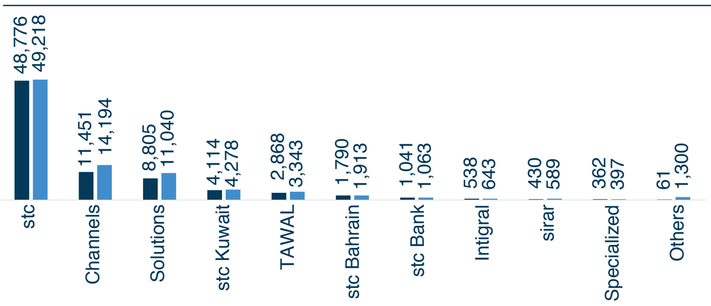


Source: Tadawul, Aljazira Capital

The company's mobile subscribers jumped 10.9% in FY23. We forecast STC's revenue to grow 5.6% to SAR 76.4bn in FY24E and 4.7% to SAR 80.bn FY25E.

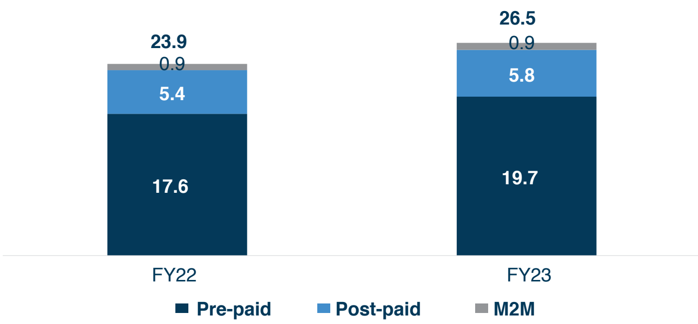
- **Margins to be under pressure FY24E, gradual improvement expected FY25E onwards:** As mentioned above STC's future topline growth is likely to be driven by its subsidiaries. As these subsidiaries are currently operating at a lower margin or some of them are yet to turn profitable, rising contributions from subsidiaries put pressure on margins. We expect the GP margin to ease slightly to 52.2% in FY24E from 52.3% in FY23. The operating margin is estimated to be stable at 19.6% in FY24E. Bothe GP margin and operating margin are expected to start improving gradually from FY25E onwards.
- **Potential value unlocking from the subsidiaries and hopes of a revised dividend policy are the positives in the long term:** PIF has made an offer to buy a 51% stake in TAWAL (valuation: SAR 21.9bn). Additionally, there is a possibility of STC coming up with IPOs of a few of its subsidiaries in the medium term. This may unlock value to shareholders. Moreover, STC's current dividend policy will end in FY24. Thus, a new dividend policy is likely to be announced by the end of this year, which may include an increase in the minimum dividend payment.

Fig.1 Revenue by subsidiaries (SAR mn)



Source: Company reports, AJC Research

Fig.2 Mobile subscribers (mn)



Source: Company reports, AJC Research

Valuation: We value the company with 50% weightage to DCF (2.5% terminal growth, 8.1% WACC) and 25% each to EV/EBITDA (7.8x) and P/E (16.3x) to arrive at a TP of SAR 45.5/share with a "Overweight" rating.

DCF

	FY24E	FY25E	FY26E	FY27E	FY28E
EBIT	13,755	14,482	15,427	16,177	16,996
Depreciation & Amortization	11,106	11,341	11,566	12,023	12,358
Change in working capital	(398)	324	379	460	608
Capex	(12,213)	(12,782)	(12,881)	(12,693)	(12,629)
FCFF	12,250	13,365	14,491	15,967	17,333
Present value of FCFF	**11,477**	**11,580**	**11,612**	**11,832**	**11,879**
Terminal Value					315,503
PV of terminal value					216,226
Enterprise Value					274,607
Net debt					12,743
Employee end of service benefits					5,469
FV to common shareholders					253,865
No outstanding shares (mn)					5,000
Fair value per share					**SAR 50.8**

Source: Aljazira Capital Research

Blended Valuation

Valuation Summary	Fair Value	Weight	Weighted Average
DCF	50.8	50%	25.4
EV/EBITDA	38.1	25%	9.5
P/E	42.4	25%	10.6
Weighted average 12-month TP			**45.5**
Current market price (SAR /share)			39.8
Expected Capital Gain			**14.5%**

Source: Aljazira Capital Research

Key Financial Data

Amount in SAR mn, unless otherwise specified	FY20	FY21	FY22	FY23	FY24E	FY25E
Income statement						
Gross Revenue	58,953	63,008	67,432	72,337	76,387	79,965
Y/Y	**8.4%**	**6.9%**	**7.0%**	**7.3%**	**5.6%**	**4.7%**
Cost of Revenue	(24,999)	(29,214)	(30,038)	(34,533)	(36,525)	(38,154)
Gross Profit	**33,954**	**33,794**	**37,393**	**37,804**	**39,862**	**41,810**
Selling & marketing	(6,054)	(5,586)	(6,110)	(5,914)	(6,399)	(7,034)
General & administrative	(5,811)	(5,368)	(6,204)	(7,206)	(7,406)	(7,694)
Operating Income	**12,731**	**13,128**	**15,088**	**14,200**	**14,952**	**15,741**
Y/Y	**2.0%**	**3.1%**	**14.9%**	**-5.9%**	**5.3%**	**5.3%**
Depreciation and amortization	(9,359)	(9,713)	(9,990)	(10,483)	(11,106)	(11,341)
EBITDA	**22,090**	**22,841**	**25,079**	**24,683**	**26,057**	**27,082**
Financial Income	414	378	602	1,513	1,551	1,170
Financial Charges	(624)	(619)	(697)	(1,271)	(1,663)	(1,028)
Other	(165)	(252)	(1,524)	353	(350)	(371)
Income before Zakat	**12,356**	**12,635**	**13,470**	**14,795**	**14,489**	**15,512**
Zakat	(1,170)	(1,040)	(1,083)	(1,375)	(1,376)	(1,241)
Non-controlling interests	(190)	(283)	(216)	(124)	(121)	(132)
Net income	**10,995**	**11,311**	**12,171**	**13,295**	**12,992**	**14,139**
Y/Y	**3.1%**	**2.9%**	**7.6%**	**9.2%**	**-2.3%**	**8.8%**
EPS	**5.50**	**5.66**	**2.43**	**2.66**	**2.60**	**2.83**
Balance sheet						
Assets						
Cash and cash equivalents	9,004	8,281	17,794	13,414	17,043	21,250
Accounts receivable, net	15,725	24,857	23,179	21,401	20,507	19,276
Other current assets	21,130	18,329	19,817	36,409	37,407	38,823
Total Current Assets	**45,859**	**51,468**	**60,790**	**71,224**	**74,957**	**79,349**
Property & Equipment	47,848	47,205	46,645	48,101	49,143	50,240
Intangbile assets	10,466	10,735	11,775	17,282	18,446	19,642
Other non-current assets	17,799	18,372	18,009	23,075	23,510	24,218
Total non-current assets	76,113	76,311	76,430	88,459	91,099	94,101
Total Assets	**121,972**	**127,779**	**137,220**	**159,683**	**166,056**	**173,450**
LIABILITIES						
Trade Payables	19,711	17,114	20,708	22,154	23,406	24,803
Murabahas and loans – current portion	318	1,457	277	8,316	8,555	7,996
Other current liabilities	12,861	14,990	15,415	17,602	17,602	17,603
Total current liabilities	32,891	33,561	36,400	48,071	49,564	50,403
Employees end of services benefits	5,239	5,467	4,871	5,258	5,469	5,687
Murabahas and loans	8,638	7,847	10,214	13,642	12,833	11,995
Other non -current liabilities	9,937	9,519	9,709	11,197	11,197	11,197
Total non-current liabilities	23,814	22,833	24,794	30,097	29,498	28,879
Total Liabilities	**56,705**	**56,393**	**61,194**	**78,168**	**79,062**	**79,282**
EQUITY						
Share Capital	20,000	20,000	50,000	50,000	50,000	50,000
Retained Earnings	37,508	37,985	10,954	27,472	31,165	35,890
Total Shareholder's Equity	**65,267**	**71,386**	**76,026**	**81,515**	**86,994**	**94,168**
Total Liabilities & Equity	**121,972**	**127,779**	**137,220**	**159,683**	**166,056**	**173,450**
Key fundamental ratios						
Liquidity ratios						
Current ratio (x)	1.4	1.5	1.7	1.5	1.5	1.6
Quick ratio (x)	1.4	1.5	1.6	1.4	1.5	1.5
Profitability ratios						
GP Margin	57.6%	53.6%	55.5%	52.3%	52.2%	52.3%
Operating Margins	21.6%	20.8%	22.4%	19.6%	19.6%	19.7%
EBITDA Margin	37.5%	36.3%	37.2%	34.1%	34.1%	33.9%
Net Margins	18.7%	18.0%	18.0%	18.4%	17.0%	17.7%
ROE	16.8%	15.8%	16.0%	16.3%	14.9%	15.0%
ROA	9.0%	8.9%	8.9%	8.3%	7.8%	8.2%
Leverage ratio						
Debt / equity (x)	0.2	0.2	0.2	0.3	0.3	0.3
Market valuation ratios						
EV	212,048	223,778	190,304	193,457	194,404	200,008
EV/sales (x)	3.6	3.6	2.8	2.7	2.5	2.5
EV/EBITDA (x)	9.6	9.8	7.6	7.8	7.5	7.4
EPS (SAR)	5.50	5.66	2.43	2.66	2.60	2.83
BVPS (SAR)	32.63	35.69	15.21	16.30	17.40	18.83
Market price (SAR*)	42.40	44.96	36.6	40.4	39.75	39.75
Market Cap (SAR mn)	212,000	224,800	183,000	202,000	198,750	198,750
DPS	2.0	1.6	1.6	2.6	1.6	1.6
Dividend yield	4.7%	3.6%	4.4%	6.4%	4.0%	4.0%
P/E (x)	19.3	19.9	15.0	15.2	15.3	14.1
P/BV (x)	3.2	3.1	2.4	2.5	2.3	2.1

Source: Company reports, Aljazira Capital Research

Mobily: Robust B2B performance, expanding subscriber base and better operating efficiency to keep the growth momentum; lift our TP to SAR 62.6 per share, maintain "Overweight" rating

Etihad Etisalat Company (Mobily) continues to deliver robust growth in the bottom line with a healthy revenue growth and improved profitability. The company is increasing its footprints in the B2B segment successfully, resulting in strong revenue growth. Given the expected continued demand in the B2B segment in KSA due to increasing digitization in private and public sector and ability shown by Mobily in the segment, we expect continued growth in B2B segment for the company. Moreover, in Consumer segment Mobily's subscriber base is expanding. However, due to intense competition revenue growth is likely to moderate. The company's operating efficiency has improved over the past few years, that would help profitability. We maintain our "Overweight" rating on Mobily win an increased TP of SAR 62.6/share.

One-off reversal of provisions supported net income in Q4-23, despite contraction of GP margin: Mobily's net profit jumped 23.1% Y/Y to SAR 746mn in Q4-23, beating our estimate of SAR 616mn. Revenue of SAR 4,364mn (+4.4% Y/Y) was broadly in line with our estimate. The company's GP margin contracted sharply to 53.8% from 60.1% in Q4-22. Operating profit increased 21.0% Y/Y to SAR 1,005mn, as GP margin contraction was more than offset by SAR 202mn reversal of provisions. For FY23, revenue grew 6.7% Y/Y to SAR 16.8bn driven strong growth in B2B segment (+21.0%), also aided by 11.1% increase in Wholesale revenue. GP margin decreased to 56.4% from 59.7% in FY22. The growing contribution from the B2B segment to the total revenue is likely to have weighed on the GP margin. However, the operating margin improved to 17.8% from 14.8% due to reversals in Q4-23, operating efficiency and lower depreciation and amortization. As a result, net income jumped to SAR 2.2bn (+34.7% Y/Y) in FY23.

B2B segment run expected to continue driving overall revenue growth: Mobily is expected to hold on its momentum in B2B business. The company seems to have expanded its market share in the segment. We believe Mobily befitted from 1) change in government contract allotment process 2) its strategic investment to improve B2B services and 3) inherent growing demand in the segment. Additionally, the company's plans to build 2 new data centers, its increasing 5G reach (although still behind peers), partnership with government entities (e.g Ministry of Helath), and agreements related to international connectivity (MoU with Telecom Egypt for a Red Sea crossing; laying of two new international cables to connect with Europe and Asia) will help the company emerge as in integrated ICT service provider. In the Consumer business segment, Mobily's subscriber base continues to expand for both mobile (4.4%) and FTTH (5.4%). The segment revenue is likely to remain under pressure due to increased competition but register growth in low single digit growth due to expansion in subscriber base. Overall, we expect Mobily's revenue growth to be driven mainly by the B2B segment. We forecast top line to growth at 5.2% and 3.8% in FY24E and FY25E, respectively.

Operating efficiency to help deliver healthy margins: We expect Mobily's GP margin to improve in FY24E, as we believe low margins in FY23, particularly Q4-23, are not sustainable. However, it is noteworthy that rising B2B segment contribution will put some pressure on margins. Thus, we forecast FY24E GP margin at 56.8% vs. 56.4% in FY23 (but lower than 59.7% in FY22) and improve further to 57.0% in FY25E. Furthermore, the company's improved operating efficiency in recent period will maintain the healthy profitability level. We expect operating margin to stand at 17.8% in FY24E (unchanged from FY23 that included reversal of SAR 202mn) and 18.1% in FY25E.

Recommendation	**Overweight**
Target Price (SAR)	**62.6**
Upside/(Downside)	**13.8%**

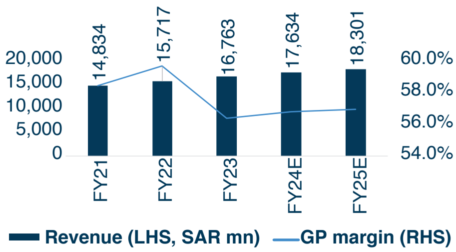
Source: Tadawul Prices as of 14th of March 2024

Key Financials

(in SAR mn, unless specified)	FY22	FY23	FY24E	FY25E
Revenues	15,717	16,763	17,634	18,301
Growth %	6.0%	6.7%	5.2%	3.8%
Gross Profit	9,381	9,452	10,016	10,424
Net Income	1,657	2,232	2,541	2,907
Growth %	54.6%	34.7%	13.9%	14.4%
EPS	2.15	2.90	3.30	3.78

Source: Company reports, Aljazira Capital

Revenue (SAR mn) and GP margin



Source: Company reports, Aljazira Capital

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	59.7%	56.4%	56.8%	57.0%
Net Margin	10.5%	13.3%	14.4%	15.9%
ROE	10.1%	12.7%	13.3%	14.2%
ROA	4.3%	5.7%	6.5%	7.3%
P/E (x)	16.1	16.9	16.7	14.6
P/B (x)	1.6	2.1	2.2	2.1
EV/EBITDA (x)	6.3	7.2	7.4	6.8
Dividend Yield	3.3%	3.0%	2.6%	3.6%

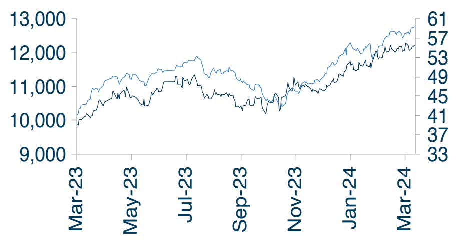
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	42.4
YTD%	12.1%
52-week (High)/(Low)	57.0/38.7
Share Outstanding (mn)	770.0

Source: Company reports, Aljazira Capital

Price Performance

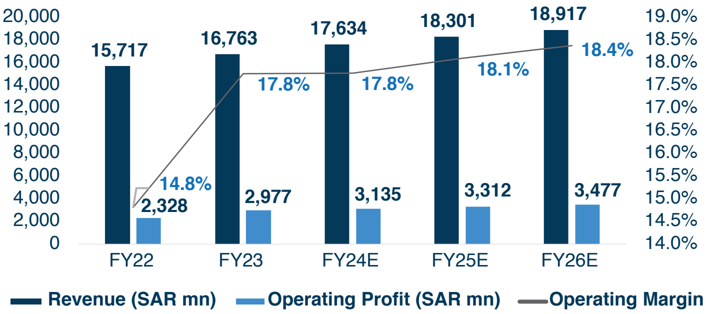


Source: Tadawul, Aljazira Capital

The company's strong operating performance is expected to translate into double-digit growth in net income for the next few years. The net income is anticipated to grow a CAGR of 13.1% during FY24-26E.

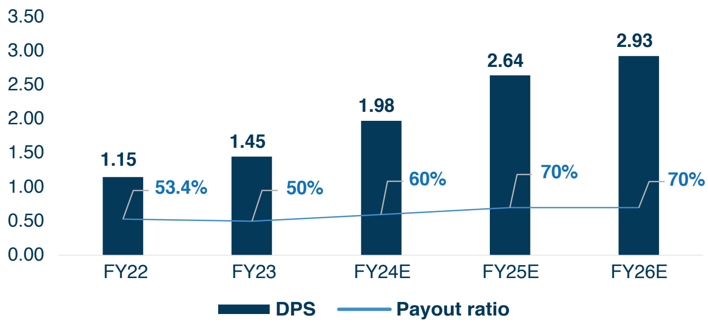
- **Increasing profitability and deleveraging of the balance sheet provide room for higher dividend payout:** Mobily is likely to deliver a healthy growth in its profits. The company is focused on deleveraging its balance sheet total gross debt decreased from SAR13.0bn in FY22 to SAR 11.7bn in FY23. Net debt/EBITDA eased to 1.2x from 1.7x during the same period. Thus, we see a scope for increased dividend payout by Mobily. We forecast the dividend payout ratio to increase from the current 50% to 70% by FY25E.

Fig.1 Revenue by subsidiaries (SAR mn)



Source: Company reports, AJC Research

Fig.2 DPS and dividend payout ratio



Source: Company reports, AJC Research

Valuation: We value the company with 50% weightage to DCF (2.5% terminal growth, 8.4% WACC) and 25% each to EV/EBITDA (6.8x) and P/E (18.0x) to arrive at a TP of SAR 62.6/share with an "Overweight" rating.

DCF

	FY24E	FY25E	FY26E	FY27E	FY28E
NOPAT	2,931	3,097	3,251	3,407	3,567
Depreciation & Amortization	3,717	3,840	3,960	4,078	4,199
Change in working capital	(185)	(109)	(97)	(201)	(117)
Capex	(3,062)	(3,166)	(3,288)	(3,291)	(3,403)
FCFF	3,402	3,662	3,827	3,993	4,246
Present value of FCFF	**3,180**	**3,158**	**3,044**	**2,930**	**2,873**
Terminal Value					73,602
PV of terminal value					49,812
Enterprise Value					64,998
Net debt					9,880
FV to common shareholders					55,118
No outstanding shares (mn)					770
Fair value per share					**SAR 71.6**

Source: Aljazira Capital Research

Blended Valuation

Valuation Summary	Fair Value	Weight	Weighted Average
DCF	71.6	50%	35.8
EV/EBITDA	47.7	25%	11.9
P/E	59.4	25%	14.9
Weighted average 12-month TP			**62.6**
Current market price (SAR /share)			55.0
Expected Capital Gain			**13.8%**

Source: Aljazira Capital Research

Key Financial Data

Amount in SAR mn, unless otherwise specified	FY20	FY21	FY22	FY23	FY24E	FY25E
Income statement						
Revenue	14,046	14,834	15,717	16,763	17,634	18,301
Y/Y	**4.4%**	**5.6%**	**6.0%**	**6.7%**	**5.2%**	**3.8%**
Cost of Revenue	(5,894)	(6,163)	(6,336)	(7,311)	(7,619)	(7,877)
Gross Profit	**8,152**	**8,672**	**9,381**	**9,452**	**10,016**	**10,424**
Selling & marketing	(1,391)	(1,390)	(1,463)	(1,467)	(1,552)	(1,605)
General & administrative	(1,407)	(1,558)	(1,628)	(1,175)	(1,499)	(1,550)
Operating Income	**1,367**	**1,654**	**2,328**	**2,977**	**3,135**	**3,312**
Y/Y	**41.3%**	**21.0%**	**40.8%**	**27.9%**	**5.3%**	**5.7%**
Financing costs	(561)	(505)	(607)	(690)	(638)	(423)
Zakat	(43)	(79)	(122)	(217)	(177)	(202)
Net income	**783**	**1,072**	**1,657**	**2,232**	**2,541**	**2,907**
Y/Y	**NM**	**36.8%**	**54.6%**	**34.7%**	**13.9%**	**14.4%**
EPS	**1.02**	**1.39**	**2.15**	**2.90**	**3.30**	**3.78**
Balance sheet						
Assets						
Cash and cash equivalents	929	1,051	828	1,654	2,115	2,792
Other current assets	5,547	7,034	7,298	7,846	8,322	8,762
Total Current Assets	6,476	8,085	8,125	9,500	10,438	11,554
Property & Equipment	21,321	20,380	19,508	19,012	18,683	18,339
Other non-current assets	10,611	10,899	10,545	10,305	10,073	9,838
Total Assets	**38,408**	**39,364**	**38,178**	**38,817**	**39,193**	**39,730**
LIABILITIES						
Total current liabilities	10,985	11,083	10,065	11,197	10,916	10,867
Total non-current liabilities	12,978	13,085	11,755	9,998	9,229	8,434
Paid -up capital	7,700	7,700	7,700	7,700	7,700	7,700
Retained earnings	4,206	4,884	5,919	7,247	8,672	10,055
Total Shareholder's Equity	**14,445**	**15,196**	**16,359**	**17,623**	**19,047**	**20,430**
Total Liabilities & Equity	**38,408**	**39,364**	**38,178**	**38,817**	**39,193**	**39,730**
Key fundamental ratios						
Liquidity ratios						
Current ratio (x)	0.6	0.7	0.8	0.8	1.0	1.1
Quick ratio (x)	0.6	0.7	0.8	0.8	0.9	1.0
Profitability ratios						
GP Margin	58.0%	58.5%	59.7%	56.4%	56.8%	57.0%
Operating Margins	9.7%	11.2%	14.8%	17.8%	17.8%	18.1%
EBITDA Margin	38.1%	37.6%	39.3%	39.5%	38.9%	39.1%
Net Margins	5.6%	7.2%	10.5%	13.3%	14.4%	15.9%
Return on assets	2.0%	2.7%	4.3%	5.7%	6.5%	7.3%
Return on equity	5.4%	7.1%	10.1%	12.7%	13.3%	14.2%
Leverage ratio						
Debt / equity (x)	0.9	0.8	0.7	0.6	0.4	0.3
Market/valuation ratios						
EV/EBITDA (x)	6.6	6.6	6.3	7.2	7.4	6.8
EPS (SAR)	1.02	1.39	2.15	2.90	3.30	3.78
BVPS (SAR)	18.8	19.7	21.2	22.9	24.7	26.5
Market price (SAR)*	28.7	31.2	34.8	49.1	55.0	55.0
Market-Cap (SAR mn)	22,061	23,986	26,758	37,769	42,350	42,350
DPS	0.50	0.85	1.15	1.45	1.98	2.64
Dividend yield	1.7%	2.7%	3.3%	3.0%	3.6%	4.8%
P/E ratio (x)	28.2	22.4	16.1	16.9	16.7	14.6
P/BV ratio (x)	1.5	1.6	1.6	2.1	2.2	2.1

Source: Company reports, Aljazira Capital Research

Zain KSA: Tower deal strengthens the balance sheet but leaseback to elevate OPEX; maintain "Neutral" with a revised TP

Mobile Telecommunication Company Saudi Arabia (Zain KSA) benefited from gains from sale of tower assets in FY23. The company's B2B segment expansion, incremental 5G revenue and rapidly growing Tamam business are expected to help continue topline growth. However, the company's key challenge would be increased costs in FY24 due to operating expenses related to the lease back of towers and higher finance expenses. Additionally, the rising revenue from the B2B segment is also likely to put slight pressure on the GP margin. We maintain our "Neutral" rating on Zain KSA but revise TP to SAR 13.5/share.

Gains from transfer of towers and 20% stake in GLI boosted Q4-23 net profit, core operating performance was weak: Zain KSA recorded a net profit of SAR 296mn (+18.2% Y/Y) in Q4-23, beating our estimate of SAR 79mn, due to recognition of SAR 368mn combined gain from transfer of remaining towers and gain on sale of 20% in the tower company, GLI. However, excluding these one-off gains Zain KSA recorded a net loss of ~SAR 73mn. The bottom line was weighed down by higher Opex, expected credit loss provisions and finance expenses. Revenue grew 5.8% Y/Y to SAR 2.5bn (in line with our estimate). The company's gross profit rose by a modest 1.7% Y/Y in Q4-23, as GP margin contracted to 58.1% from 60.4% in Q4-22. Operating profit plunged 78.0% Y/Y to SAR 78mn, recording an operating margin of just 3.1% (vs. 14.8% in Q4-22) an increase in operating expenses and higher credit loss provisions hit the operating margin. Finance costs increased sharply 31.1% Y/Y. In FY23, topline growth was strong at 8.9% Y/Y to SAR 9.9bn, driven B2B, 5G, digital products, wholesale and Tamam. GP margin for FY23 expanded to 59.3% from 58.6% in FY22. However, it was counteracted by lower operating margins of 8.8% vs. 11.7% in FY22, mainly due to higher Opex for leaseback of transferred towers. Additionally, higher interest rates elevated finance expenses by 27.1% Y/Y. The reported net income stood at SAR 1,267mn, including one-off gains worth SAR 1,136mn, indicating an adjusted net income of ~SAR 131mn in FY23.

B2B and Tamam to be key growth drivers: Zain KSA also benefitted from growing demand in the B2B segment of KSA. We expect the segment to continue to post strong growth for Zain KSA given the industry level demand-drivers and smaller base for Zain KSA. The company's subsidiary Tamam is also expected to contribute to its growth due to the exponential growth this business is experiencing. Tamam's revenue more than doubled in FY23 to SAR 284mn from SAR 127mn in FY22. Total loan book was SAR 609mn as of September 2023 and net profit in 9M-23 was SAR 45mn. Building on existing momentum in B2B and Tamam, and supported by growing wholesale business, we expect Zain KSA to post 6.6% and 4.4% revenue growth in FY 24E and FY25E to SAR 10.5bn and SAR 11.0bn

Lease back of towers to push Opex higher, finance expenses are also expected stay elevated: Zain KSA transferred all 8,069 towers during FY23. The company. As per the agreement the company is leasing back all these towers. The leasing of towers has increased operating expenses. In FY23, Opex to sales ratio (Opex: Dist. & marketing + Gen. & admin.) surged to 26.9% from 21.4% in FY22. FY24 will see the full year effect of transfer of all the tower. Thus, we expect Opex to increase further by 7.1% Y/Y, implying Opex to sale ratio of 27.0%. However, revenue growth and steady depreciation will support operating margins at 10.0% compared to 8.8% in FY22. The company's finance expenses are also forecasted to stay higher due to the high debt level and interest rates. Finance expenses increased in H2-23, perhaps due to the conversion of MoF outstanding amount into Murabaha facility. Hence, we expect higher finance expenses in FY24E, unless the company utilizes tower deal proceedings to repay some of the outstanding loans.

Recommendation	Neutral
Target Price (SAR)	13.5
Upside/(Downside)	4.6%

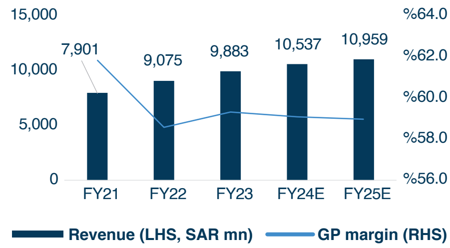
Source: Tadawul Prices as of 14th of March 2024

Key Financials

(in SAR mn, unless specified)	FY22	FY23	FY24E	FY25E
Revenues	9,075	9,883	10,537	10,959
Growth %	14.9%	8.9%	6.6%	4.0%
Gross Profit	5,315	5,857	6,224	6,466
Net Income	550	1,267	295	427
Growth %	156.5%	130.5%	-76.7%	44.8%
EPS	0.61	1.41	0.33	0.48

Source: Company reports, Aljazira Capital

Revenue (SAR mn) and GP margin



Source: Company reports, Aljazira Capital

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	58.6%	59.3%	59.1%	59.0%
Net Margin	6.1%	12.8%	2.8%	3.9%
ROE	5.6%	12.0%	2.8%	4.1%
ROA	1.9%	4.6%	1.1%	1.5%
P/E (x)	16.4	10.0	39.4	27.2
P/B (x)	0.9	1.2	1.1	1.1
EV/EBITDA (x)	4.8	6.9	6.1	5.8
Dividend Yield	0.0%	3.9%	3.9%	3.9%

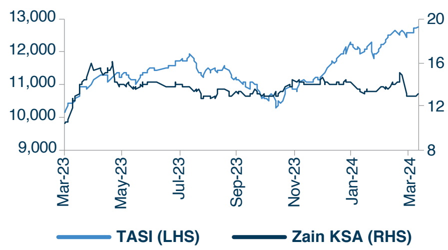
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	11.6
YTD%	-8.1%
52-week (High)/(Low)	16.3/10.4
Share Outstanding (mn)	899

Source: Company reports, Aljazira Capital

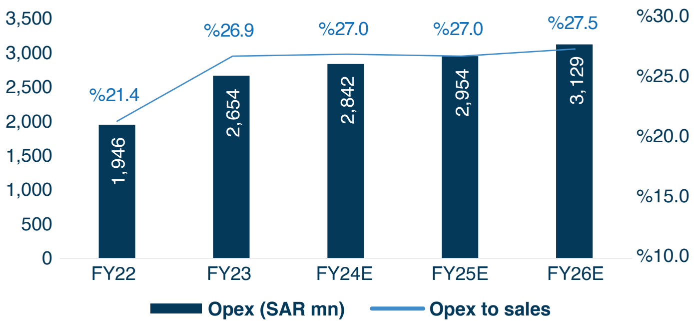
Price Performance



Source: Tadawul, Aljazira Capital

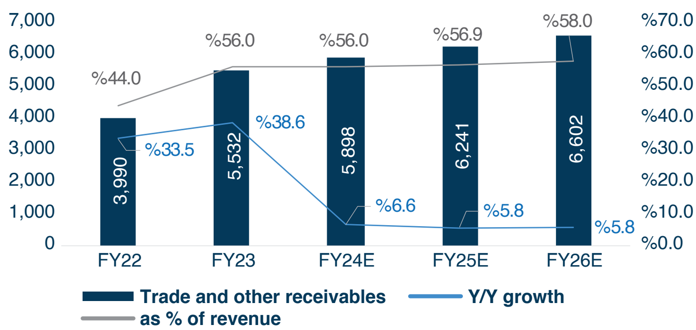
- **Sharp rise in trade receivable a concern, ECL may continue to hit P&L:** Zain KSA's net trade receivable increased 33.5% and 38.6% in FY22 and FY23, respectively. The increase in trade receivables coincided with a jump in expected credit losses (ECL, FY22: SAR 215mn and FY23: SAR 226mn). We estimate trade receivable to continue to grow further but at a slower pace compared to the last two years and thus ECL are also expected to remain higher weighing on the company's profitability.

Fig.1 Opex (SAR mn) and Opex to sales



Source: Company reports, AJC Research

Fig.2 Trade receivables (SAR mn)



Source: Company reports, AJC Research

Valuation: We value the company with 50% weightage each to DCF (2.5% terminal growth, 8.9% WACC) and EV/EBITDA (5.7x) to arrive at a TP of SAR 13.5/share with a "Neutral" rating.

DCF

	FY24E	FY25E	FY26E	FY27E	FY28E
NOPAT	991	1,062	1,117	1,211	1,307
Depreciation & Amortization	2,101	2,137	2,141	2,141	2,139
Change in working capital	-102	-168	-180	-175	-187
Capex	-1,507	-1,537	-1,575	-1,620	-1,672
FCFF	1,482	1,493	1,503	1,557	1,587
Present value of FCFF	**1,380**	**1,276**	**1,180**	**1,122**	**1,049**
Terminal Value					25,263
PV of terminal value					16,701
Enterprise Value					22,708
Net debt					8,007
FV to common shareholders					14,701
No outstanding shares (mn)					899
Fair value per share					**SAR 16.4**

Source: Aljazira Capital Research

Blended Valuation

Valuation Summary	Fair Value	Weight	Weighted Average
DCF	16.4	50%	8.2
EV/EBITDA	10.7	50%	5.4
Weighted average 12-month TP			**13.5**
Current market price (SAR /share)			**12.9**
Expected Capital Gain			**4.6%**

Source: Aljazira Capital Research

Key Financial Data

Amount in SAR mn, unless otherwise specified	FY20	FY21	FY22	FY23	FY24E	FY25E
Income statement						
Revenue	7,917	7,901	9,075	9,883	10,537	10,959
% Y/Y Growth	**-5.6%**	**-0.2%**	**14.9%**	**8.9%**	**6.6%**	**4.0%**
Cost of Services	(2,472)	(3,016)	(3,760)	(4,025)	(4,313)	(4,493)
Gross Profit	**5,445**	**4,885**	**5,315**	**5,857**	**6,224**	**6,466**
% Y/Y Growth	-8.8%	-10.3%	8.8%	10.2%	6.3%	3.9%
Operating and administrative expenses	(1,763)	(1,749)	(1,946)	(2,654)	(2,842)	(2,954)
EBITDA	**3,441**	**3,128**	**3,155**	**2,978**	**3,150**	**3,260**
Depreciation and amortization	(2,439)	(2,430)	(2,089)	(2,106)	(2,101)	(2,137)
Operating Profit	**1,002**	**699**	**1,066**	**871**	**1,049**	**1,123**
% Y/Y Growth	-33.7%	-30.3%	52.5%	-18.2%	20.4%	7.1%
Finance Charges	(898)	(489)	(566)	(719)	(834)	(754)
Net Income before Zakat	**104**	**210**	**500**	**152**	**215**	**369**
Zakat	(20)	(17)	(24)	(89)	(17)	(25)
Net Income	260	214	550	1,267	295	427
% Y/Y Growth	**-46.4%**	**-17.6%**	**156.5%**	**130.5%**	**-76.7%**	**44.8%**
Balance Sheet						
Assets						
Cash and Cash equivalents	1,103	168	375	946	1,342	1,746
Other current assets	2,280	3,269	7,106	5,807	6,203	6,558
Total Current Assets	3,383	3,437	7,481	6,753	7,544	8,305
Property and equipment	6,857	6,640	4,926	4,736	4,671	4,648
Intangible assets,net	16,280	15,561	14,967	14,245	13,563	12,887
Total Non Current Assets	24,775	24,302	20,980	20,625	19,996	19,444
Total Assets	**28,158**	**27,739**	**28,461**	**27,378**	**27,541**	**27,749**
Liabilities						
Total Current Liabilities	9,099	10,106	9,250	7,934	8,300	8,382
Long term loans	3,836	2,638	5,171	6,533	6,162	5,968
Total Non-Current Liabilities	10,330	8,593	9,408	8,853	8,803	8,952
Share Capital	8,987	8,987	8,987	8,987	8,987	8,987
Reserve	(204)	(87)	179	277	307	350
Retained earnings	(54)	139	636	1,327	1,143	1,078
Total Equity	**8,729**	**9,040**	**9,802**	**10,591**	**10,437**	**10,415**
Total Liabilities and Equity	**28,158**	**27,739**	**27,474**	**26,640**	**25,832**	**25,832**
Key fundamental ratios						
Liquidity ratios						
Current ratio (x)	0.4	0.3	0.8	0.9	0.9	1.0
Quick ratio (x)	0.4	0.3	0.8	0.8	0.9	1.0
Profitability ratios						
Gross Margin	68.8%	61.8%	58.6%	59.3%	59.1%	59.0%
Operating Margin	12.7%	8.8%	11.7%	8.8%	10.0%	10.3%
EBITDA Margin	43.5%	39.6%	34.8%	30.1%	29.9%	29.7%
Net Margin	3.3%	2.7%	6.1%	12.8%	2.8%	3.9%
ROE	3.0%	2.4%	5.6%	12.0%	2.8%	4.1%
ROA	0.9%	0.8%	1.9%	4.6%	1.1%	1.5%
Leverage ratio						
Debt / equity (x)	0.60	0.82	0.66	0.85	0.87	0.88
Market/ Valuation ratios						
EV/EBITDA (x)	3.9	5.8	4.8	6.9	6.1	5.8
PE (x)	35.9	50.5	16.4	10.0	39.4	27.2
PB (x)	1.4	1.2	0.9	1.2	1.1	1.1
EPS	0.38	0.24	0.61	1.41	0.33	0.48
Book Value Per Share (BVPS)	9.7	10.1	10.9	11.8	11.6	11.6
Market price (SAR)*	13.6	12.0	10.1	14.1	12.9	12.9
Market-Cap (SAR mn)	9,337	10,821	9,041	12,654	11,630	11,630
DPS	-	-	-	0.5	0.5	0.5
Dividend yield	0.0%	0.0%	0.0%	3.9%	3.9%	3.9%

Source: Company reports, Aljazira Capital Research

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

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1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

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