رياض المالية
riyad capital

November 12, 2019

Etihad Etisalat (Mobily)

Company Update

Rating	Neutral
12- Month Target Price	SAR 22.00

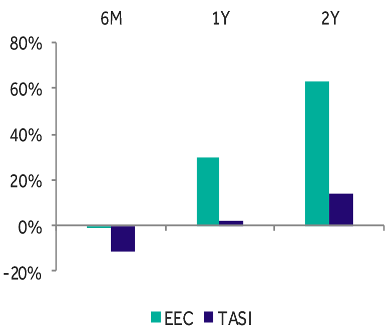
Price as on Nov-11, 2019	SAR 22.00
Upside to Target Price	0.0%
Expected Dividend Yield	0.0%
Expected Total Return	0.0%

Market Data

52 Week H/L	SAR 27.0/15.8
Market Capitalization	SAR 16,894 mln
Shares Outstanding	770 mln
Free Float	60.5%
12-Month ADTV	2,676,732
Bloomberg Code	EEC AB

1-Year Price Performance

Source: Bloomberg



Return to Profitability

We revise our estimates and raise Mobily's target price to SAR 22.00 from SAR 20.00, using a combination of the Discounted Cash Flows model & EV/EBITDA multiple. Mobily has shown that it seeks to implement its RISE strategy to raise profits while improving the quality of services provided in addition to consolidating its financial position. We expect the company to continue to stay in the green from now on. Mobily has achieved profits for the fourth quarter in a row and a strong topline growth, which stood at SAR 3.4 billion in 3Q 2019, up by +14% Y/Y, due to increased demand. The Company has stabilized its margins despite the regulatory changes that have had a negative impact. Revenue growth has provided support to Mobily while gross margin has expanded to 59% in a difficult environment. EBITDA has improved to reach SAR 1.3 billion for 3Q2019 compared to SAR 1.1 billion last year. 3Q2019 net profit positively surprised reaching SAR 51 million compared to a loss of SAR (31) million in 3Q2018.

Risks

We believe a delay in the launch of the 5G network, thus losing market share, in addition to high cost of implementing 5G service can be challenging. Also, investors should watch any further increase in leverage and higher provisions.

Financials and Forecasts

	2018	2019E	2020E	2021E
Income Statement (SAR mln)				
Revenue	11,865	13,390	13,615	13,800
Gross Profit	6,582	7,284	7,407	7,507
EBITDA	4,548	4,615	4,675	4,738
EBIT	603	845	816	793
Net Income	(123)	176	202	245
EPS	(0.16)	0.23	0.26	0.32
Balance sheet (SAR mln)				
Assets:				
Total Current Assets	7,103	8,339	8,119	8,649
Total Non-Current Assets	31,461	30,399	29,143	27,832
Total Assets	38,564	38,738	37,262	36,481
Liabilities:				
Total Current Liabilities	11,556	14,435	13,923	14,211
Total Non-Current Liabilities	13,139	10,258	9,091	7,777
Total Liabilities	24,695	24,693	23,014	21,988
Equity:				
Total Equity	13,869	14,045	14,248	14,493
Total Equity and Liabilities	38,564	38,738	37,262	36,481
Key Ratios				
Gross Margin	55%	54%	54%	54%
EBIT Margin	5%	6%	6%	6%
EBITDA Margin	38%	34%	34%	34%
Net Margin	(1%)	1%	1%	2%
EV/EBITDA	6.6x	6.6x	6.5x	6.4x
P/FCF	9.6x	11.0x	6.2x	12.7x

Source: Riyad Capital, Company Reports

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

Telecom Sector Advancing

The Saudi telecom sector occupies an important position in the Kingdom, as it is a key element in the Kingdom's Vision 2030. According to the latest report by CITC, the telecom sector regulator in the Kingdom, the number of mobile subscriptions reached 41.6 million in 1Q2019 compared to 41.3 million at the end of 2018. We expect an increase to 41.7 million by end of 2019.

Table 1: Number of Subscribers In The Sector (mln)

Million	2015	2016	2017	2018	2019E
Post-paid Subscriptions	7.9	8.8	10.1	12.9	12.9
Pre-Paid Subscriptions	44.9	39.1	30.1	28.4	28.8
Total Subscriptions	**52.8**	**47.9**	**40.2**	**41.3**	**41.7**

Source: Riyad Capital, CITC Reports

Demand for telecom services depends mainly on the population, which grew by 2% in 2018 to reach 33.41 million and is expected to reach 33.74 million by the end of 2019. Saudi Arabia has announced the issuance of tourist visas, which is expected to increase the number of tourists, subsequently increasing the number of subscribers in the future. This will also be reflected positively by supporting the tourism sector in the Kingdom in particular and the wheel of economic growth in general.

Table 2: Population & Number of Subscribers

Million	2015	2016	2017	2018	2019E
Population	31.5	31.7	32.6	33.4	33.7
Number of subscribers	52.8	47.9	40.2	41.3	41.7
Mobile Penetration %	**168%**	**151%**	**123%**	**124%**	**124%**

Source: Riyad Capital, CITC Reports, GASTAT

Subscriber Churn

The telecommunications sector is a highly competitive industry; therefore, the study of the telecom market should focus on the subscriber base because it represents the artery of operators' revenues. Subscriber churn is the loss of existing customers to another company or service provider, which causes pressure on the operator. We list some factors that influence the subscriber's decision to change between service providers:

Network coverage

Network coverage is one of the main factors affecting the subscriber's decision to switch operator, as the quality of service provided is greatly affected. As result of poor network coverage, unsuccessful call rate and call drop rate and low voice quality increases. To solve that, operators need to improve their radio coverage, expand the capacity of the network and optimize the performance of its elements. STC has the highest number of towers compared to other operators, followed by Mobily and then Zain KSA. While unsuccessful call rate in 3Q2018 for Mobily reached 0.77% and 0.46% for Zain, for STC it was 0.60% for 2G and 0.20% for 3G. Call Drop Rate attain 0.25% for STC and 0.33% for Mobily and Zain. Voice Quality reached 4.07 for Mobily and 3.75 for Zain, while STC Voice Quality reached 3.7 for 2G and 3.8 for 3G. However CITC Standards for Unsuccessful call rate and Call Drop Rate is to be less than 2% and higher than 3.5 for Voice Quality.

Rising prices

It is an indisputable fact that operators compete for price and quality of service in addition to providing innovative services to maintain and develop subscriber base. Note that the companies have raised the prices of the packages consecutively during the previous year and this year, but the prices of STC is the highest followed by Mobily and then Zain. This is in addition to the price war between STC and Zain for 5G services.

Seasonal promotions

It is important to note the marketing costs incurred by operators for promotional offers, especially during special seasons such as Hajj, Umrah and roaming services offered during summer holidays. This is in addition to new smartphone offers so as to attract new subscribers and to offer a new product or to improve the brand name.

Customer care

Customer services include all the services and means necessary to satisfy the customer, including pre and post-sale services, support services, complaint handling and others. According to CITC indicators for service quality for 3Q2018, the response time for operator service reached within 60 second, 95% for STC, 89% for Mobily and 81% for Zain while CITC Standards is 80%. According to rating indicator of service providers in 2Q2019 ,Zain has registered the highest number of complaints for Mobile Voice with 30 complaints per 100K subscriptions, while STC and Mobily registered 18 complaints. In terms of fixed Internet, Mobily recorded the lowest number of complaints amongst operators with 48 complaints while STC recorded 107 complaints as the highest number of complaints among operators. Zain achieved the highest rate of complaints for mobile Internet with 8 complaints per 100k subscribers, followed by 3 complaints at STC and one complaint to Mobily.

Mobily History

Etihad Etisalat (Mobily) is a Saudi company established in 2004. The Company's major shareholders are Etisalat Emirates Group (27.99%) and the General Organization for Social Insurance (11.85%). The remaining shares are owned by institutional and retail investors. As the winning bidder for Saudi Arabia's second license in 2004, Mobily ended a monopoly in the wireless industry to provide mobile telecommunications services nationwide. After a six-month preparatory phase, it launched commercially in 2005.

3Q2019 Results

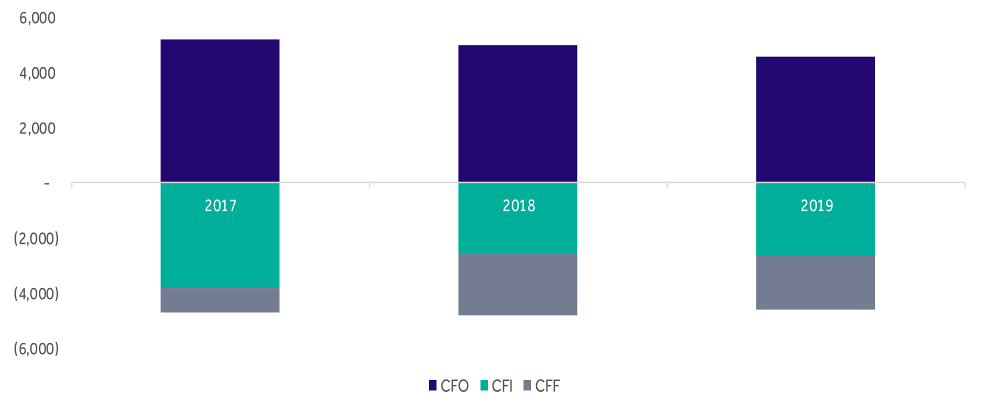
- Mobily has continued to grow its topline to reach SAR 3.4 billion, up by (+14% Y/Y, +2% Q/Q) on back of growth in FTTH revenue, as well as business unit and wholesale, in addition to the increase in subscribers base.
- The company was able to maintain its gross margin at 59%, despite the announcement of higher costs of government fees, mainly attributed to the improvement in revenues that absorbed the impact.
- Despite the improvement in revenues, EBIT remained flat Q/Q due to higher operating expenses.
- 3Q2019 earnings of SAR 51 million (+35% Q/Q) are below both our and market expectations due to higher operating expenses. Financial charges for 3Q2019 decreased to reach SAR 206 million versus SAR 217 million in 2Q2019 due to the decrease in SIBOR.

RISE Strategy execution

In 2017, Mobily developed a growth strategy for the company for 2019 and beyond, We can see that this strategy has been working towards its goals. Its 4 pillars are to regain commercial strength by offering value to customers and growth that supports Saudi Arabia's transformation agenda; to ignite customer experience, which includes customer care and digital excellence; to strive to increase their agility and operating efficiency; and to enable a level of execution that is world class, improving their organizational structure and their overall capabilities.

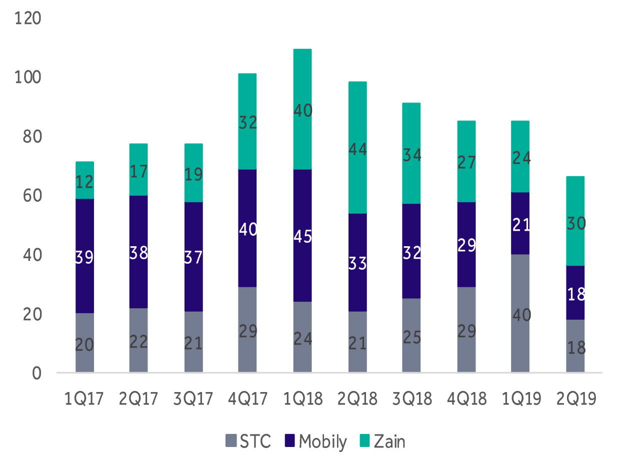
The company was able to increase its revenues in all segments despite market conditions. It also increased its operating cash flow by improving revenue and raising the level of collection, beside rationalizing its investment expenses and reducing its debt as we see in Exhibit 1. It also tended to improve the quality of services provided, it achieved a lower level of complaints in voice, fixed and mobile Internet services we see in Exhibits 2, 3, 4.

Exhibit 1: Cash Movement Over 9M Period (mln)



Source: Riyad Capital, Company Reports

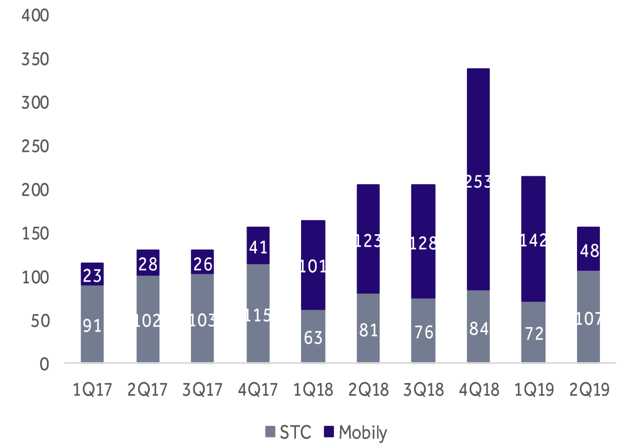
Exhibit 2: Mobile Voice Complaint



Source: CITC

- Complaints for Mobily's mobile voice calls dropped to 18 compared to 33 complaints last year.

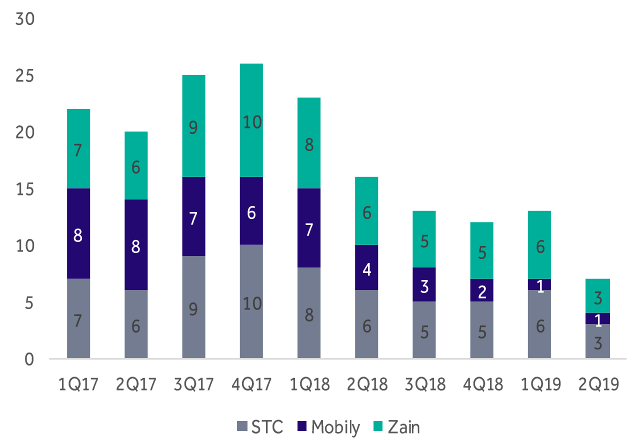
Exhibit 3: Fixed Internet Complaint



Source: CITC

- Mobily's fixed internet complaints were at 48 in 2Q19 versus 123 complaints last year.

Exhibit 4: Mobile Internet Complaint



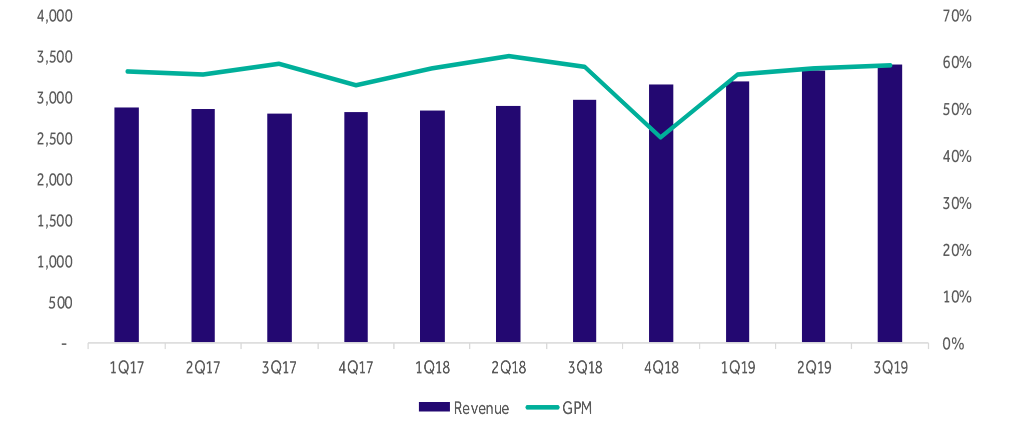
Source: CITC

- The number of complaints for mobile Internet dropped to 1 from 4 the previous year.

Topline grew by +14% Y/Y

Mobily has managed to grow its topline despite competition and market conditions, it achieved a revenue of SAR 9.9 billion for the current period compared to SAR 8.7 billion in the previous period with a growth rate of +14% Y/Y on the back of growth in FTTH revenue as well as business unit and wholesale, in addition to the increase in subscribers base. It is noteworthy that business segment participation in topline increased to 12% in this period compared to 11% in 9M period 2018 and 2017. While wholesale segment participation improved to 8% compared to 7% and 6% in 9M period 2018 and 2017 respectively.

Exhibit 5: Revenues Grow And Margins Are Stable (mln)

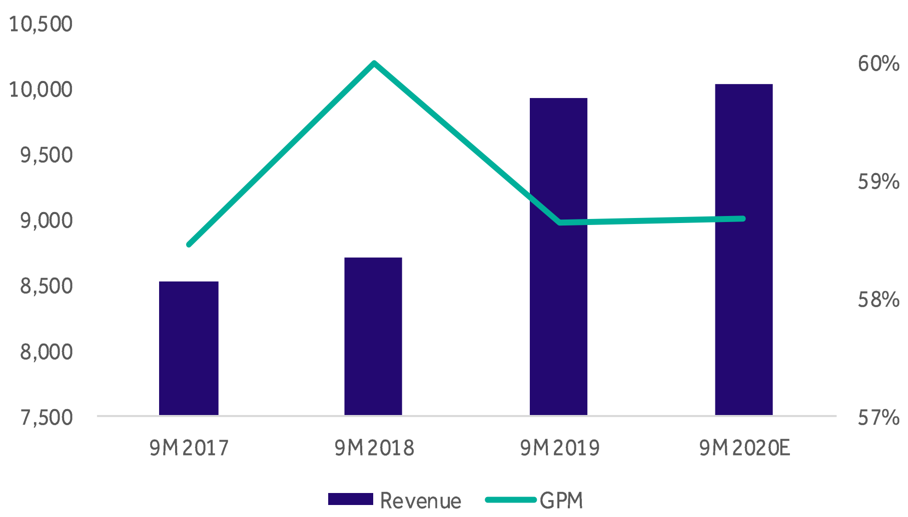


Source: Riyad Capital, Company Reports

Margins Intact

At the same time, the Company has managed to restore the gross margin to its previous levels even after the new calculation of the government fees mainly attributed to the improvement in revenues that absorbed the impact. The company previously announced that the new calculation of the government fees would increase costs by about SAR 450 million to SAR 600 million per year. The gross margin for 9M 2019 was 58% compared to 60% in 9M 2018 versus 58% in 9M 2017, however, 9M 2018 was compensated by the reversal of previous provisions related to the previous disputes. We expect further revenue growth with margins rising slightly.

Exhibit 6: Margin Is Settled (mln)

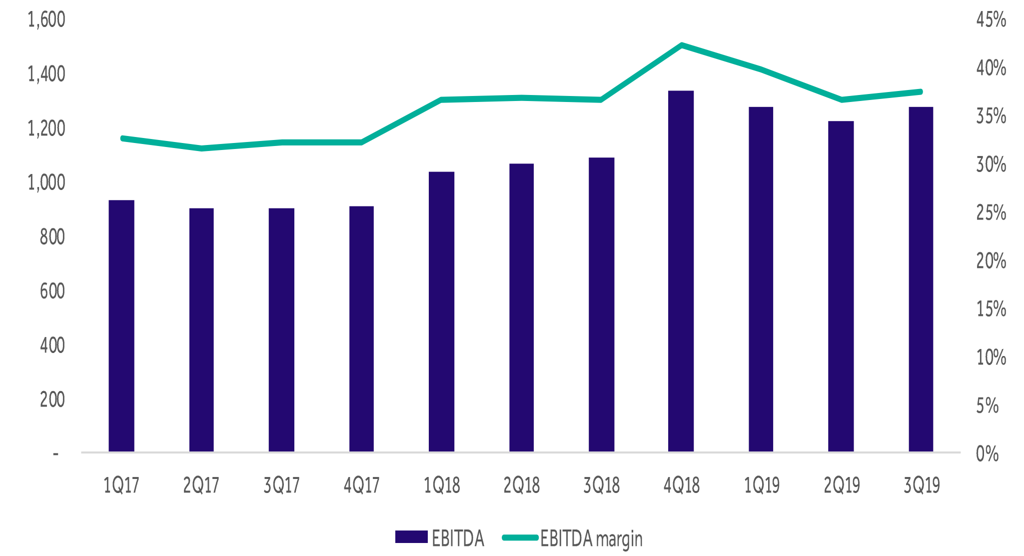


Source: Riyad Capital, Company Reports

Healthy EBITDA and EBITDA margin

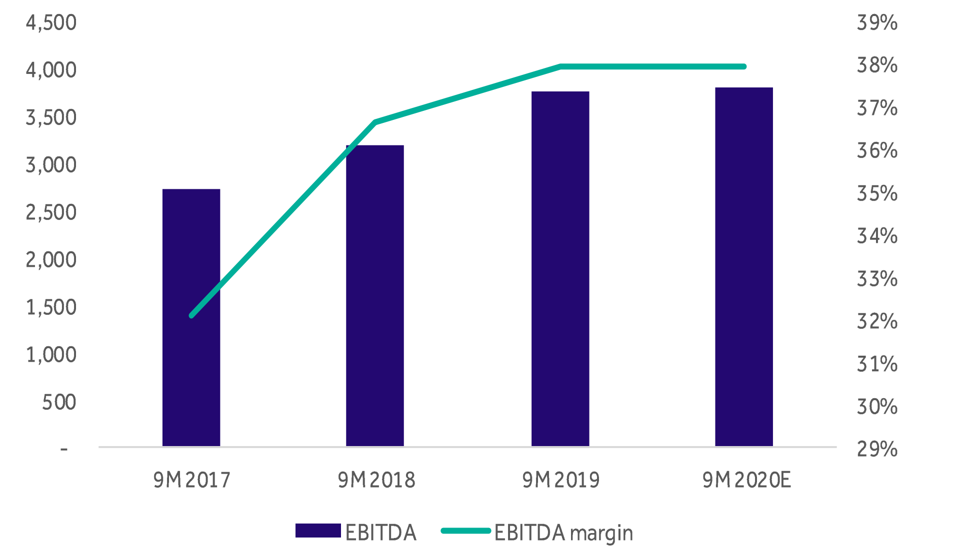
EBITDA has improved to reach SAR 3.7 billion for 9M 2019 compared to SAR 3.2 billion in the same period of the previous year, up +18% Y/Y while the EBITDA margin expanded by +100 bps to reach 38% in 9M 2019 versus 37% last period. This is mainly due to revenue growth and improved operating performance as well as the application of IFRS 16. We expect improvement to continue in the future as margin remains at the same level.

Exhibit 7: EBITDA and EBITDA Margin Growing (mln)



Source: Riyad Capital, Company Reports

Exhibit 8: EBITDA & EBITDA Margin Over The Period (mln)

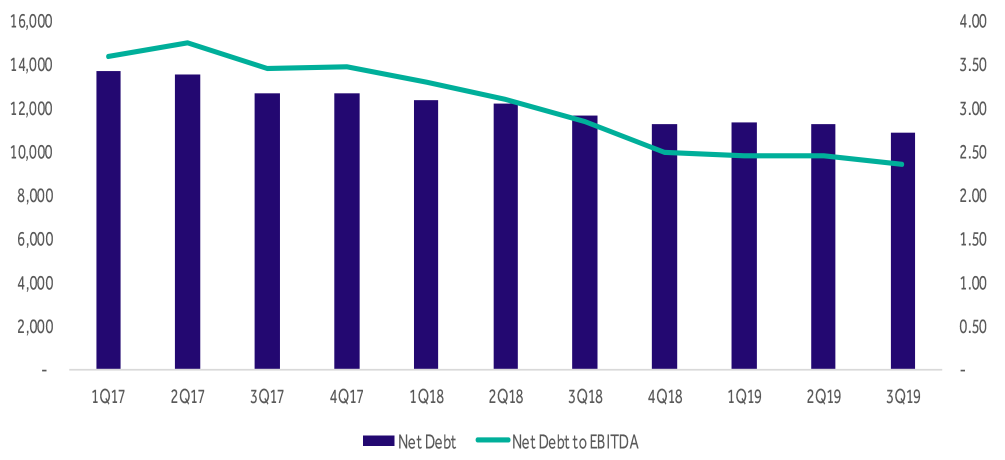


Source: Riyad Capital, Company Reports

Net Debt to EBITDA reach 2.43x

Usually Telecom companies are highly leveraged because of massive amounts of capital expenditure required to setup a network which includes the cost of equipment, the cost of spectrum and license acquisition because Companies strive to be proactive in launching the latest technologies. Mobily seeks to reduce its level of leverage as it reduced its Net Debt to SAR 10.8 billion by end of 3Q2019 from SAR 11.3 billion in 3Q2018, while Net Debt to EBITDA has reach 2.34x versus 2.84x in 3Q 2018. The company is expected to continue its debt reduction strategy.

Exhibit 9:Net Debt To EBITDA Shrinking (mln)

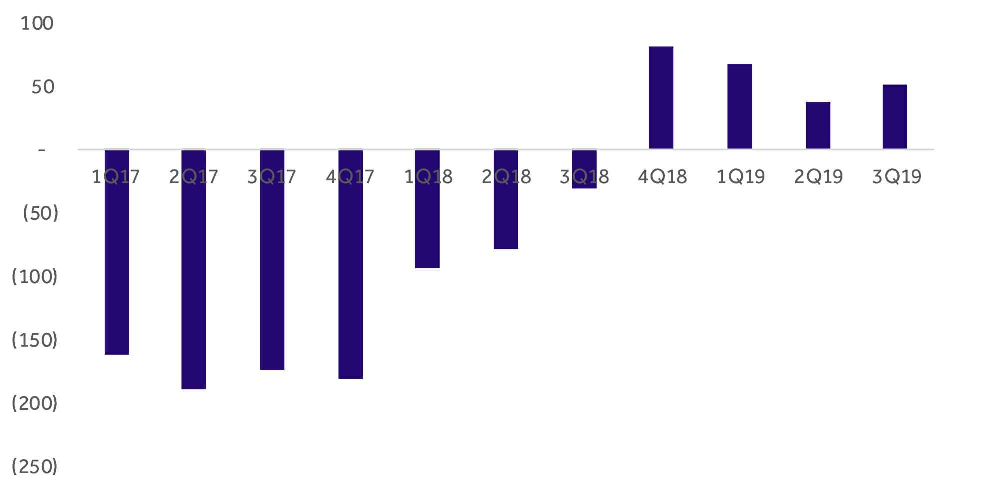


Source: Riyad Capital, Company Reports

Positive bottom line expected to continue

Mobily has delivered positive net profit for the fourth consecutive quarter, as 3Q2019 net profit reached SAR 51 million compared to a loss of SAR (31) million in 3Q2018. The company managed to return to profitability despite market conditions that were negative for it, Mobily achieved net income of SAR 156 million for 9M 2019 and we expect it to reach SAR 191 million for 9M 2020 period.

Exhibit 10: Achieving Profit (mln)



Source: Riyad Capital, Company Reports

Exhibit 11: Positive Net Income Expected To Continue

Source: Riyad Capital, Company Reports

Valuations

We have valued Mobily on the basis of Discounted Cash Flows (DCF) and EV/EBITDA multiple. We have integrated the two valuation methods, 50% of our target price is based on DCF and the other 50% on EV/EBITDA. We arrive at a fair value of SAR 22.20. Thus, we raise our target price from SAR 20.00 to SAR 22.00 but continue with a Neutral recommendation.

Valuation Summary

Valuation Method	Target price	Weight	Price
DCF	24.66	50%	12.33
EV/EBITDA	19.74	50%	9.87
Target price (SAR)			**22.20**

Source: Riyad Capital

1-Discounted Cash Flows (SAR 24.66)

Using the Discounted Cash Flow model, we have assumed a risk-free rate of 4.7% and we have used 0.90 as 2-year weekly beta obtained from Bloomberg. Cost of debt at 7% while long-term growth is assumed at 1%. We arrive at a weighted average cost of capital of 9%. Discounting the cash flows, we come to a fair value of SAR 24.66.
Our assumptions are detailed below:

Discounted Cash Flow (DCF) Valuation (SAR mln)

Assumptions	
Risk free rate	4.7%
Beta	0.9
Equity risk premium	7%
Cost of equity	11%
Cost of debt	7%
Terminal growth rate	1%
Average Equity Weight	58%
Average Debt Weight	42%
WACC	**9%**

Assumptions	
Enterprise value	
DCF calculation as of	
NPV of explicit period	3,616
NPV of terminal value	26,613
Enterprise value	30,229
Net Debt	11,242
Equity value	18,987
Target price	**SAR 24.66**

Assumptions	2019	2020	2021	2022
EBITDA	4,615	4,675	4,738	4,928
Capex	(2,758)	(2,669)	(2,705)	(2,813)
Change in NWC	(327)	720	(707)	634
FCF	1,530	2,726	1,327	2,749
PV		**2,500**	**1,116**	**2,120**
Terminal Value				34,508
PV Of TV				26,613

Source: Riyad Capital

2- EV/EBITDA multiple (SAR 19.74)

We used EV/EBITDA multiple as it incorporates growth rate, risk, operational performance and to an extent also incorporates the market view. We have selected 5 companies in the Gulf region but we limited the comparison companies to not be the first or incumbent operator in the country in which they operate.

The average EV/EBITDA of comparable companies comes to 3.3x. Mobily's EBITDA per share for 2019 is expected to be SAR 5.99. Thus, we arrive at a fair value of SAR 19.74 per share.

Comparable Company Analysis

Company Name	EV/EBITDA
ZAINKSA	4.4x
OOREDOO KK	2.9x
VIVA KK	4.0x
ZAINBH BI	2.2x
ORDS OM	3.0x
Average	3.3x

	EBITDA	Average EV/EBITDA	Fair Price
Mobily	5.99	3.3x	SAR 19.74

Source: Riyad Capital

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

Disclaimer

Riyad Capital is a Saudi Closed Joint Stock Company with Paid up capital of SR 200 million, licensed by the Saudi Arabian Capital Market Authority NO.07070-37. Commercial Registration No: 1010239234. Head Office: Granada Business Park 2414 Al-Shohda Dist. – Unit No 69, Riyadh 13241 - 7279 Saudi Arabia. Ph: 920012299.