Zain tower sale to IHS Holding Ltd… scraped on regulations

Zain KSA announced that the tower sales deal with IHS holding Ltd has been called off , as the buyer IHS global limited was not able to fulfil the regulatory requirement.

“We have received a letter from the Communications and Information Technology Commission (CITC) indicating that IHS Holding Limited did not fulfill the regulatory requirements pertaining to the sale and lease back of the passive towers infrastructure”, the statement added.

It is pertinent to add ,the agreement included sales of roughly 8,100 passive towers, and the building of additional 1500 tower over a period of 6 years. Zain intended to re-lease the tower, for a period of 15 years with an option to extend. The deal was expected to bring an immediate inflow of approximately SAR 2.5bn.

From the inflows, Zain intended to re-pay a part of its debt burden of SAR 10.4bn from commercial banks, which would have had a multi facet impact on the company

- Reduction in debt would have helped the company in decreasing their financial expense, which in FY18 stood at SAR 930mn.
- The Company would have been able to re-negotiate its lending rates, on back of improved financial performance and lower debt burden.
- Depreciation expenses would have declined, however lease payment would have increased.
- Cash flow in year one would have seen a jump of SAR 2.5bn.Whereas in subsequent years, cash flow would be lower, since non-cash expense (Depreciation) would be replaced by cash expense (Lease payment).

Scenario Analysis	FY 19		
	Before Deal	After Deal	
IN Mn SAR	Expectation	Lending Rate remains Same	Lending rate 50bps lower
Revenue	7,616	7,616	7,616
Cost of Sales	(1,868)	(1,868)	(1,868)
Gross profit	5,748	5,748	5,748
Gross Margins	75%	75%	75%
Operating Expenses			
Distribution and marketing	(2,175)	(2,175)	(2,175)
General and administrative expenses	(290)	(290)	(290)
Depreciation and amortization	(1,814)	(1,689)	(1,689)
Lease Expense	-	125	125
Total Operating Expenses	(4,279)	(4,279)	(4,279)
Operating Profits(Loss)	1,469	1,469	1,469
Operating Margins	19%	19%	19%
Other income/(expenses)			
Finance Charges	(929)	(791.20)	(719.95)
Finance Income	27	26.80	27
Commission income	1	1	1
Net loss for the year	569	706	777
DEBT-Commercial--a	10,405	7,905	7,905
Debt-Shareholders--b	6,345	6,345	6,345
Total Debt	16,751	14,251	14,251
Finance Cost (Total Debt) (a+b)	5.6%	5.6%	5%

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Based on above calculation for our FY19 estimates, towers sales would have resulted in lower Commercial debt of SAR 7.9bn, which would have resulted in lower finance cost of SR 791mn. In addition, if the company is also able to re-negotiate its loans due to the lower debt burden a 50bps decline in lending rates would have resulted in finance cost of SAR 719.9mn

The cancellation of deal also will have an impact on the intended rights issue of the company. We believe, inflow of SAR 2.5, would have given investors a level of comfort on the back of Improved financial performance, lower debt burden and lower finance cost. Along with that rights issues could have been smaller in size had the deal gone through.

AJC view and valuation

Zain KSA showed a much improved Q1-19 performance. Strong revenue growth was the hallmark of Q1-19 result, going forward if the company is able to sustain the topline, along with the revised royalty fee, is bound to improve financial performance. The sector in term of retail growth remains weak. Zain on the other hand has quite a few initiatives that might help in strengthening the financial position of the company. i)a new SAR 2.25bn Islamic Murabha facility agreement to refinance its existing USD 600mn (SAR 2.25) commercial loan with better terms reflecting the improvement in the Company's performances . ii) Subsequent capital decrease and capital increase by rights issues, will help the company in cleaning up its balance sheet by decreasing its accumulated losses and by also decreasing its debt balance. The failure of tower sales deal in our view will have a negative bearing on the company, as expected inflows would have eased the leverage burden and as discussed would have helped the company in improving its financial performance, however we believe tower sales is still a possibility, as company will continue to search for a new buyer, or IHS holding Ltd might fulfil the regulatory requirement for the deal to go through. We maintain our earnings for Zain of SAR 569.0mn (0.97). The company is currently trading at a PE of 12.8x, against our forward FY19 PE of 12.2x. We maintain our TP of **SAR 11.5 /share**, while maintaining our "**Neutral** "recommendation,

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RATING TERMINOLOGY

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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