الراجحي المالية
Al Rajhi Capital

US$4.073bn	61%	US$18.19mn
Market cap	Free float	Avg. daily volume

Target price	17.50	-11.8% over current
Current price	19.84	as at 29/7/2018

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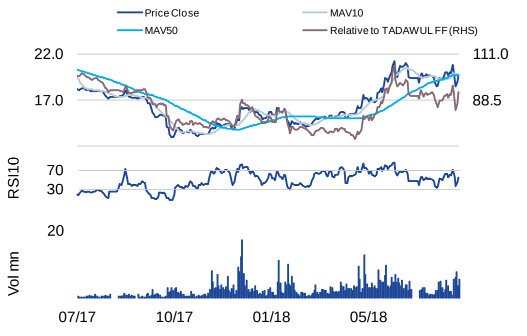
Existing rating

Underweight	**Neutral**	**Overweight**

Performance



Source: Bloomberg

Earnings

(SARmn)	2017	2018e	2019e
Revenue	11,351	11,578	11,810
Y-o-Y	-9.7%	2.0%	2.0%
Gross profit	6,530	6,947	7,086
Gross margin	57.5%	60.0%	60.0%
EBITDA	3,646	4,167	4,249
EBITDA margin	32.1%	36.0%	36.0%
Net profit	(709)	(385)	(49)
EPS (SAR)	-0.92	-0.50	-0.06
DPS (SAR)	0.00	0.00	0.00
EV/ EBITDA (Curr)		7.0	6.4
EV/EBITDA (Target)		6.7	6.1

Source: Company data, Al Rajhi Capital

Mobily (EEC AB)

On path to profits but cash flows remain our concern

Mobily reported a net loss of SAR79mn in Q2 2018, better than our expectation of net loss of SAR100mn and consensus expectation of SAR113mn loss. The key highlight was the ~7% q-o-q growth in gross profit. However, after adjusting for other income, the operating profit was flat and without this adjustment, bottom line would have been lower than what was reported in the last quarter. Despite the increase in gross profits, the underlying FCF still remains weak for us to change our view on the company. In the last 8 quarters, average EBITDA was ~SAR932mn while operating cash flows after adjusting for increase in accounts payable was only ~SAR700mn. On the other hand average capex paid was ~SAR640mn in the same period, implying cash flow concerns without further benefit from accounts payables. Even with a further 100bps gross profit margin improvement, cash flows would not materially improve though bottom-line may become profitable. Our revised TP on Mobily is SAR17.5/sh based on equal mix of DCF and EV/EBITDA.

Improvement in gross margins – a positive: The key surprise for most investors in Q2 was the step improvement in gross margin to 61.3% from 57.2% in Q2 2017 and 58.7% in Q1 2018. More interestingly, the absolute level of COGS declined while revenue increased. We believe that this could be the outcome of declining network mobile voice calls (both international and local), resulting in decline in network usage charges in the form of lower international and local termination fee. This is evident in the declining usage revenue, as reported by the company. However revenue was slightly up because of increasing activation and subscription fee which, in our view, could be related to normal and special promotional offers/packages announced by the company from time to time. Overall consumer revenue was flat, implying changing mix.

Bottom-line benefited from other income; Provisions increased q-o-q: Despite the gross profit improvement by SAR112mn q-o-q, EBIT (before other income) was flat because of provisions of SAR92mn (which the company accounts for in G&A expenses). Overall adjusted EBITDA margin touched an exceptional 38.6%. However, accounts receivables increased by SAR300mn in Q2.

Cash flow generation: Despite an improvement in bottom-line, our key focus remains on cash flow, rather than profitability. Though the company generated an EBITDA of ~SAR2.1bn in H1 2018, the reported operating cash flow was only ~SAR1.56bn. If we exclude benefit from accounts payable of SAR0.34bn, the cash flow from operations will be only SAR1.22bn. We believe accounts payables are mainly related to capex payables (as seen from 2017 annual report). Account payables have increased from SAR3.85bn to SAR5.14bn in the last 6 quarters.

Thus for a clean comparison, one could either increase capex or decrease accounts payables from operating cash flows to arrive at the real sustainable FCF. We calculate this to be at SAR0.38bn (SAR1.22bn CFO, i.e., after accounts payables adjustment minus SAR0.84bn capex) for H1 2018. After adjusting for accrued expenses and other factors, semi-annual FCF could be around SAR0.5bn on a sustainable basis. At this rate, the company may be able repay only SAR1bn of debt a year (total debt: ~SAR14bn).

The company also has a contingent liability of ~SAR0.72bn and other provisions of ~SAR1.2bn. If we were to look at last 8 quarters' average data, FCF would be even lower based on the below table.

8 quarters average data	SARmn
Average EBITDA	932
Average CFO	814
Average CFO minus accounts payables	694
Average Capex	641

Valuation: For our price target, we use an equal mix of DCF (SAR8.5/share) and EV/EBITDA (SAR9/share, based on 7x multiple) methods and arrive at a revised target price of SAR17.5/share with an Underweight rating. In a nutshell, we believe the company is improving but overall the company has a visibility of top line growth of <3% y-o-y for the next 2 years and EBITDA margin is more likely at the higher end for a telecom company. The debt is high and the operating cash flows (without any benefit from accounts payables) are only marginally higher than capex required and pays no dividends. If one were to value it purely on EV/FCF basis, i.e., applying 17x multiple, which is the average multiple for telecom firms, and deducting the debt & liabilities, the range of implied value of the company would be significantly lesser.

Upside risks to our valuation are improved gross margins, improving receivables and no bad debts, faster than expected top-line growth.

Figure 1 Mobily Q2 2018 results

(SARmn)	Q2 2017	Q1 2018	Q2 2018	y-o-y	q-o-q	Our est.
Revenue	**2,854**	**2,833**	**2,895**	**1.4%**	**2.2%**	**2,862**
Gross Profit	1,633	1,663	1,775	8.7%	6.7%	1,689
Gross margin (%)	57.2%	58.7%	61.3%			59.0%
Adjusted EBITDA	**893**	**966**	**1,117**	**25.0%**	**15.6%**	**1,030**
Adjusted EBITDA margin (%)	31.3%	34.1%	38.6%			36.0%
Interest exp	(163)	(188)	(192)	18.0%	2.4%	(188)
Net profit	**(190)**	**(93)**	**(79)**	**NM**	**NM**	**(100)**
Capex	(505)	(448)	(392)	-22.4%	-12.4%	(452)
Zakat	(24)	(12)	(20)	-18.2%	72.3%	(17)

Source: Company data, Al Rajhi Capital

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"Overweight": Our target price is more than 10% above the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

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