APRIL 2018

SAUDI TELECOM SECTOR

الأهلي كابيتال
NCB Capital

NEW REGULATIONS TO IMPACT THE SECTOR

We believe the outlook for the Saudi Telecom sector is muted due the impact of the economic reforms and CITC's new regulations. The sector's net income is expected to decline -1.4% in 2018E to SR9.3bn driven by lower revenues. However, we expect the potential inclusion to EM indices will continue to drive stock prices going forward. We maintain our Neutral ratings on the three teleocm companies under coverage.

This is an extract of our published report, the full version of which can be found on the alahlicapital.com website

- **Mobile users to continue to decline in 2018E:** With the implementation of the economic reforms, we expect the number of mobile users to continue to decline in 2018E. We expect a decline of -2.9% to 39mn mobile users, resulting in a penetration rate of 123%. This is compared to a -16.1% YoY decline in 2017 with a penetration rate of 127%. Therefore, we expect a decline in the top-line and net income by -1.5% and -1.4%, respectively in 2018E. We expect the sector EBITDA margin to expand to 37.0% from 36.4% driven by better cost control and the impact of lower MTR charges for Mobily and Zain

- **New regulations to impact the sector in 2018E:** CITC introduced several regulations in 2017 which are expected to continue to impact the sector. These include i) lower MTR, ii) VoIP ban removal and iii) fair usage policy cancelation. CITC reduced MTRs by 45%, starting from January 2018 with Zain being the main beneficiary from this reduction due to its low market share, and hence higher MTR costs. We expect the removal of the VoIP ban to reduce revenue from international calls, which account for c.7.0% of sector revenue. However, the fair usage policy cancelation will increase data usage and offset the negative impact as higher price data bundles are introduced.

- **EM indices inclusion to drive the sector**: STC, Mobily and Zain are expected to be included in FTSE and MSCI EM indices. This is expected to drive their stock prices for the next 14 months, until the inclusion happen and implementation is completed. The stock prices are expected to move away from fair value, driven by momentum due to increased inflows during this period.

- **Remain Neutral on the sector:** We remain Neutral on STC (PT:SR80.2). STC is trading at 2018E P/E of 16.1x, higher than the peer group average of 14.5x, with all positives priced in. We remain Neutral on Mobily (PT: SR16.5), whilst it's ability to breakeven is a key catalyst. We are also Neutral on Zain (PT: SR8.3), where the success of its on-going capital restructuring is vital.

Saudi Telecom companies – Valuation matrix

	Rating	PT (SR)	Upside/ Downside (%)	MCap $mn	P/E (x) '18	EV/ EBITDA '18	P/BV (x) '18	DY (%) '18	ROE (%) '18
STC	N	80.2	1.9%	42,008	16.2	8.2	2.5	5.1	15.4
Mobily	N	16.5	8.9%	3,121	NM	5.7	0.8	0.0	(3.2)
Zain	N	8.3	11.9%	1,153	52.5	4.4	1.2	0.0	2.3

Source: NCBC Research, All prices as of March 21, 2018
N: Neutral, UW: Underweight, OW: Overweight, NC: Not Covered, UR: Under Review

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NCBC Investment Ratings

OVERWEIGHT: Target price represents an increase in the share price in excess of 15% in the next 12 months

NEUTRAL: Target price represents a change in the share price between -10% and +15% in the next 12 months

UNDERWEIGHT: Target price represents a fall in share price exceeding 10% in the next 12 months

PRICE TARGET: Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon

Other Definitions

NR: Not Rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or in circumstances when NCB Capital is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations

CS: Coverage Suspended. NCBC has suspended coverage of this company

NC: Not covered. NCBC does not cover this company