January 9, 2018

Saudi Arabian Telecom

4Q2017 Preview

4Q2017 Expectations

4Q2017 will be impacted by VoIP, which allows users voice and video communications through different apps using the internet rather than going through the network. Overall, all operators are feeling the pinch as the market is shrinking. Companies have tried to maintain market share through adding benefits to its existing packages in 4Q with no changes to its prices as they try to avoid price wars and focus on keeping their subscribers base.
Subscriber base increased slightly during 3Q by +1% Q/Q but may decline in 4Q. Penetration rate also increased marginally by 130 bps Q/Q in 3Q to reach 138.7% after witnessing a drop of 900 bps in the first two quarters of 2017.
With the implementation of VoIP, the sector is facing pressure, particularly on voice calls. Companies are trying to control costs and improve their topline by focusing on high ARPU clients. However, 4Q trends show that companies have incurred higher operating costs, thus, lower bottom-line Q/Q for the sector is assumed, although Y/Y number would be higher.

Table 1: 4Q2017 Estimates (SAR mln, except per share data)

	Revenue			Gross Profit Margin			Net Income/Loss			Earning/Loss Per Share		
Company	4Q2016	4Q2017E	Y/Y Chg	4Q2016	4Q2017E	Y/Y Chg (bps)	4Q2016	4Q2017E	Y/Y Chg	4Q2016	4Q2017E	Y/Y Chg
STC	12,012	12,643	5%	62%	58%	(400)	2,150	2,404	12%	1.08	1.20	12%
Mobily	2,908	2,750	-5%	57%	58%	100	(71)	(161)	127%	(0.09)	(0.21)	127%
Zain	1,801	1,825	1%	63%	68%	500	(135)	2	-	(0.23)	0.00	-
Group Total	**16,721**	**17,217**	**3%**	**-**	**-**	**-**	**1,945**	**2,244**	**15%**	**-**	**-**	**-**

Source: Riyad Capital, Company Reports

STC remains the dominant player

Although it was a tough quarter for the sector, we believe STC with its higher market share and higher ARPU clients, consisting of post-paid subscribers and corporates, did not suffer much. We expect revenues to decline slightly by -2% Q/Q but increase +5% Y/Y to reach SAR 12.6 billion. Gross profits are likely to touch SAR 7.3 billion, lower than the preceding quarter by -5% and -2% lower Y/Y. Operating expenses are expected to increase +1% Q/Q but decrease -9% Y/Y to reach SAR 4.7 billion with operating profits at SAR 2.5 billion, a decrease of -14% Q/Q and an increase of +13% Y/Y. Net income for the period is forecasted to reach SAR 2.4 billion, a decline of -8% Q/Q but +12% higher Y/Y with net margins up 100 bps Y/Y. We stick to our Neutral recommendation on the stock with a target price of SAR 73.00 as the current price is reflective of the company's stability.

Earnings dip to continue for Mobily

We believe that the Company's earnings will continue its declining trend this quarter, particularly as VoIP affects gross margins Q/Q. Revenues are expected to reach SAR 2.8 bln with a decline of -5% Y/Y and -2% Q/Q. Gross margins are expected to rise 100bps over last year but drop 200 bps Q/Q. We expect lower operating expenses of SAR 28 million on the back of cost-reduction strategy of the Company with a decline of -1.1% Y/Y and -6.5% Q/Q. Net loss is likely to persist for the period at SAR (161) million, lower than the previous quarter but considerably higher than SAR (71) million last year. We reinstate our Neutral recommendation on the stock with a revised target price of SAR 18.00.

Market changes have been favorable for Zain

We believe that past regulations worked in favor of Zain's data oriented strategy. We forecast that the Company's earnings will remain in the black; although with a minor SAR 2.0 million, in line with a positive bottom line last quarter and reversing a loss of SAR (135) million last year led by a minor +1% Y/Y growth in revenues to SAR 1.83 billion. Gross margins are

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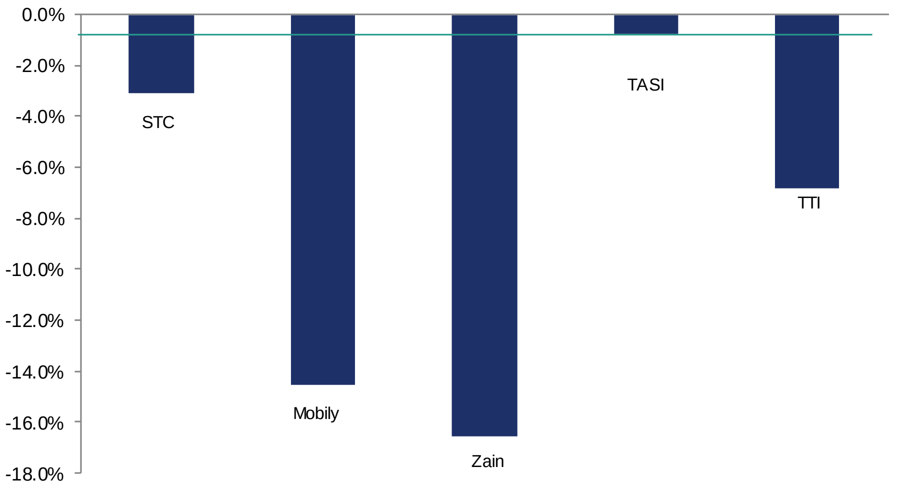
expected to remain flat Q/Q at 68% but 500bps higher Y/Y. We expect good operating profits of SAR 228 million as compared to SAR 87 million last year. Finance charges are still eating up most of operating profits with an expected SAR (228) million charge this quarter. We have reduced our target price to SAR 12.00 in our "Saudi Equities Outlook" report but maintain our Buy recommendation on the stock.

Sector underperformed TASI significantly

4Q2017 witnessed a downturn for the telecom stocks with fears of earnings impact brought about by VoIP and expected VAT implementation leading to changes in consumer behavior. We see that STC was impacted the least in the sector because of its inherent strength; while Zain was impacted the most as the capital restructuring was not received well by investors.

Exhibit 1: 4Q Telecom Sector vs. TASI Performance



Source: Tadawul

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*

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