Telcom

STC	BUY
12M Price Target (SAR)	44.00
CMP (SAR)	38.60
Potential Upside (%)	14.0%
Market Cap (SAR mn)	193,000
P/B (2024e)	2.3x
P/E (2024e)	15.5x
EV/EBITDA (2024e)	7.5x
Dividend Yield (2024e)	4.1%
ROE (2024e)	15.0%

Mobily	BUY
12M Price Target (SAR)	59.00
CMP (SAR)	52.60
Potential Upside (%)	12.2%
Market Cap (SAR mn)	40,502
P/B (2024e)	2.2x
P/E (2024e)	17.6x
EV/EBITDA (2024e)	6.9x
Dividend Yield (2024e)	2.8%
ROE (2024e)	12.3%

Zain KSA	HOLD
12M Price Target (SAR)	13.00
CMP (SAR)	12.82
Potential Upside (%)	1.4%
Market Cap (SAR mn)	11,522
P/B (2024e)	1.1x
P/E (2024e)	26.9x
EV/EBITDA (2024e)	6.1x
Dividend Yield (2024e)	3.0%
ROE (2024e)	4.0%

Saudi Telcom Sector – Stability and Value

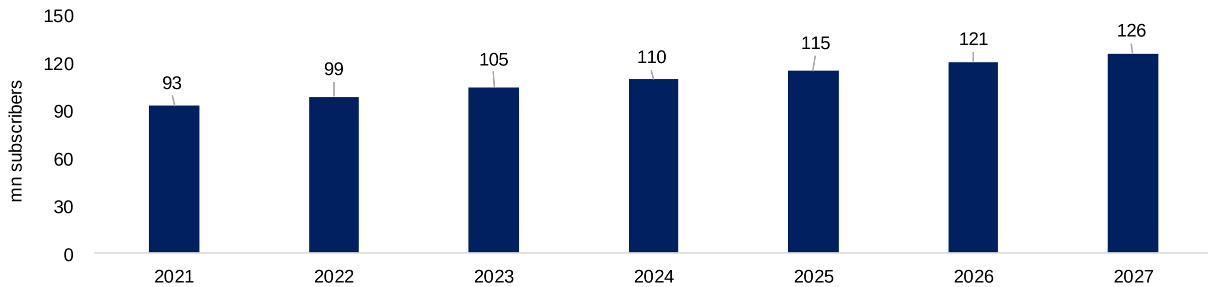
The Saudi telcom market is expected to remain steady and grow at c.3-5% in the medium term. Growth will continue to be driven by improvement in subscriber base and will be aided by the return of normalcy in Hajj & Umrah pilgrims and the influx of foreign workers, post the lull witnessed during Covid times. Growth is also likely to be driven by changing industry dynamics, including the adoption and increased penetration of 5G and FTTH. Competition is likely to remain high, as we expect players attempting to grow by capturing/retaining market share. This is likely to put pressure on the ARPUs of the players, despite it being higher than most of its regional peers. We also expect the capex requirement to remain high, averaging c.14-16% of the topline. Further, the leverage of companies in the industry is likely to remain material, due to the consistent investments in infrastructure and outlays on diversifying their revenue stream. However, the cash-generating capacity of the companies mostly remains strong, which will aid them to manage their leverage.

We have a positive outlook of Saudi Telcom Company (STC), given its leadership position in the industry and its extensive network servicing regions across the Kingdom. We also see a strong growth outlook for its subsidiaries, which have strong market positions in their respective business verticals. The company's strong operating cash flow has aided it to maintain a minimum dividend of SAR1.6/share over the period, while paying one-time dividends during times of excess cash flows. We see a potential for a one-time dividend of c.SAR1.3-1.8/share in 2024e, in addition to its normal dividend of SAR1.6/sh, on the completion of its stake sale in subsidiary Tawal. Overall, we have a positive outlook on STC and initiate coverage with a *BUY* rating and a target price of *SAR44/share*.

Etihad Etisalat (Mobily) is positively aided by its strong market position as the second-largest player in the industry. We see the revenue from its core consumer segment improve at a steady rate, in line with the industry performance. Growth on the other hand will be aided by its continued strong performance of the business segment and the growing opportunities in the government and private sectors. Investments to improve digitization in Saudi, and the opportunities provided by the various Mega & Giga projects will be the key drivers. Overall, we have a positive outlook on Mobily and initiate coverage with a *BUY* rating and a target price of *SAR59/share.*

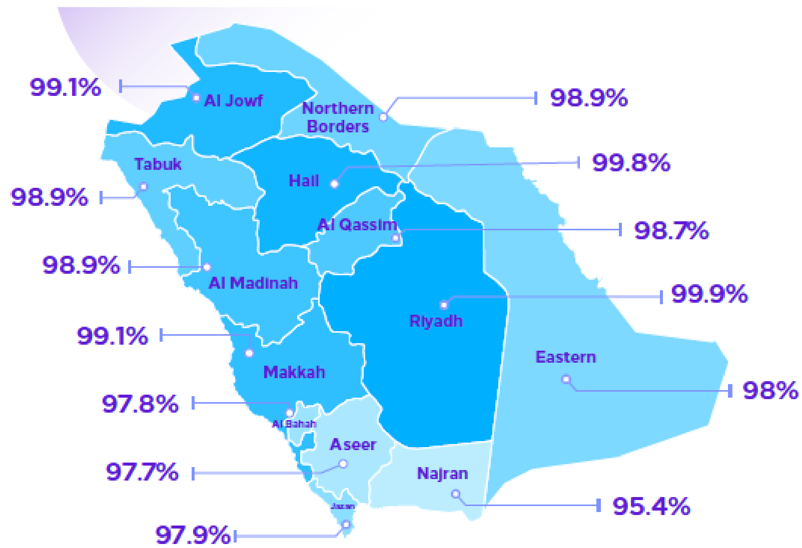
The financial performance of Mobile Telecommunication Company Saudi Arabia (Zain KSA), will continue to remain steady, driven by the performance of its Mobile Telecommunication segment. Growth on the other hand will come from its microfinance arm (Tamam), given the dearth of big institutions in this segment. The leverage of the company remains high and though we expect it to moderate in the coming years, the same is likely to happen at a relatively slow pace. Overall, we feel that at the current price, most of the positives of the company are accounted for. We initiate coverage on Zain KSA with a *HOLD* rating, and a target price of SAR13/share.

GCC mobile subscribers to grow consistently driven by 5G; KSA is projected to account for >60% of new subscribers



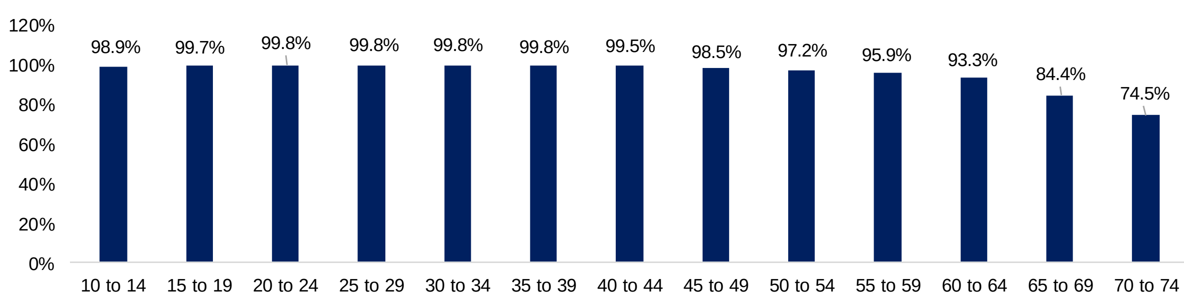
Source: Nokia MEA Broadband Index and US Research

Internet penetration in KSA strong across regions



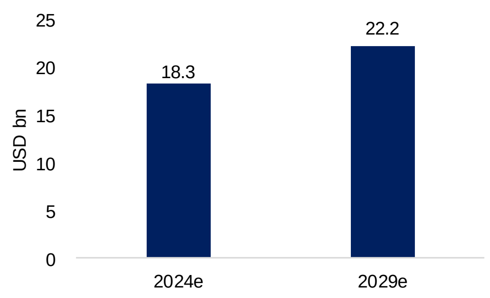
Source: CST Saudi Internet Report 2022

Internet penetration high across ages

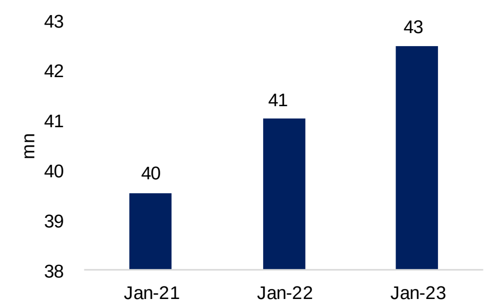


Source: Internet Saudi Report 2022 and US Research

Saudi Telcom market to grow at a CAGR of 4%

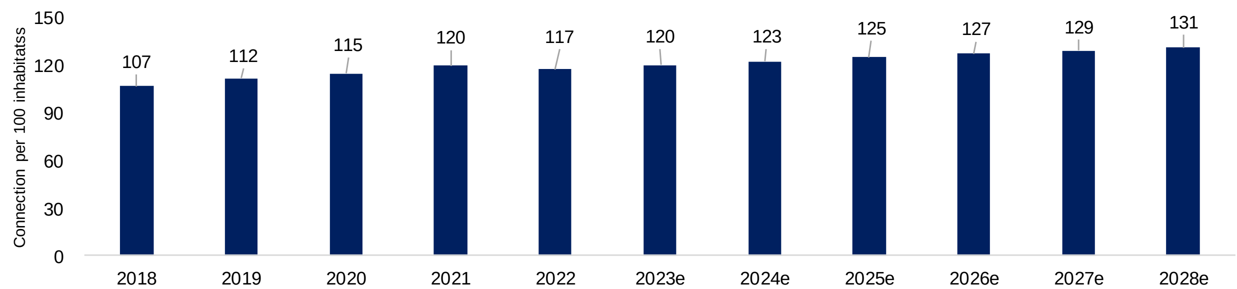


Saudi mobile connections grows at a CAGR of 3.7%



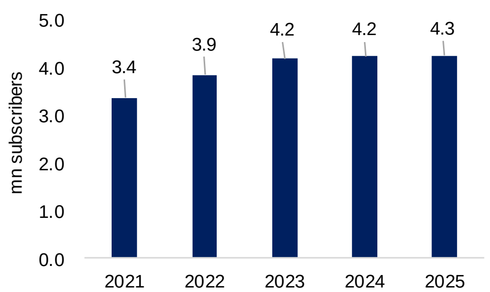
Source: Mordor Intelligence, GSMA and US Research

Mobile broadband connection (per inhabitants) to grow at a steady pace

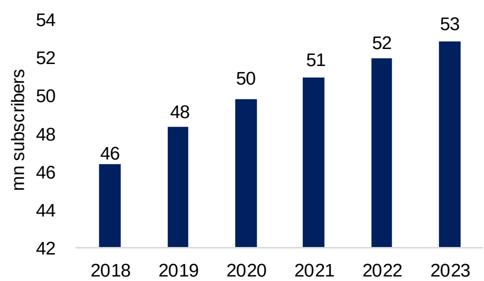


Source: Mordor Intelligence, ITU, OECD and US Research

Broadband subscribers to grow at a moderate rate

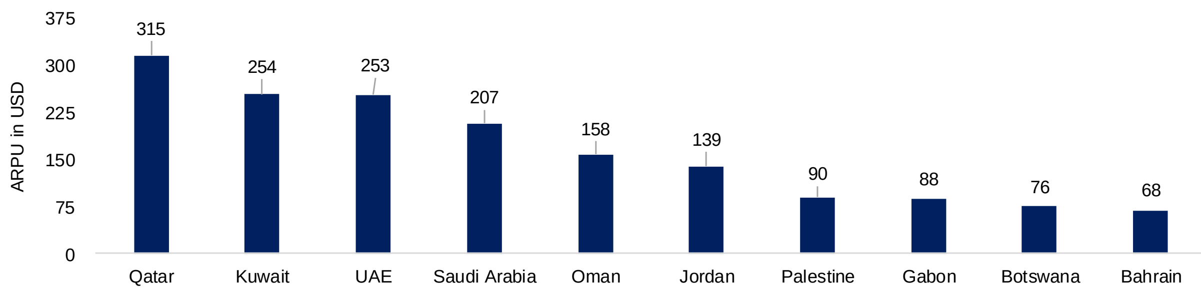


Wireless subscribers grow consistently



Source: Bloomberg and US Research

Saudi is projected to have one of the highest ARPU in the MENA region in 2027



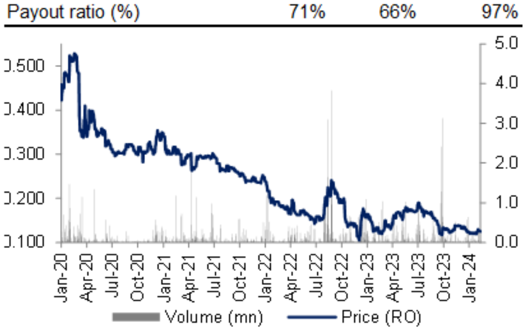
Source: Nokia MEA Broadband Index and US Research

COMPANIES SECTION

Telcom

BUY: 12M TP @ 44
Upside 14.0%

Valuation Summary (TTM)			
Price (SAR)			**38.6**
PER TTM (x)			14.5
P/Book (x)			2.4
P/Sales (x)			2.7
EV/Sales (x)			2.7
EV/EBITDA (x)			7.8
Dividend Yield (%)			4.1
Free Float (%)			33%
Shares O/S (mn)			5,000
YTD Return (%)			-4%
Beta			1.1
(mn)		**SAR**	**USD**
Market Cap		193,000	51,454
EV		182,432	48,637
Price performance (%)	**1M**	**3M**	**12M**
Saudi Telecom Co	-8%	-4%	-5%
Tadawul All Share Index	1%	6%	17%
Trading liquidity (,000)	**1M**	**3M**	**6M**
Avg daily turnover (SAR ,000)	115,555	138,216	142,526
Avg Daily Volume (,000)	3,216	3,355	3,627
52 week	**High**	**Low**	**CTL***
Price (SAR)	46.00	35.00	10.3
* CTL is % change in CMP to 52wk low			
Major shareholders			
PIF			64.0%
Vanguard Group Inc			1.5%
Black Rock Inc			1.1%
Others			33.4%
Other details			
Exchange			Saudi Arabia
Sector			Telecommunications
Index weight (%)			2.9%
Key ratios	**2021**	**2022**	**2023**
EPS (SAR)	2.26	2.44	2.67
BVPS (SAR)	13.85	14.70	15.85
DPS (SAR)	1.60	1.60	2.60
Payout ratio (%)	71%	66%	97%



Saudi Telecom Co – Value Proposition

Saudi Telcom Co. (STC) is the largest telcom player in the Kingdom. Its network across Saudi, robust infrastructure, and the dominating presence in the sector provide the company with a major competitive advantage over its peers. Over the years, STC has also diversified its revenue base through investments in various subsidiaries, making it one of the largest ICT conglomerates in the region. Currently c.45% of its revenue comes from its subsidiaries, with a presence in telcom tower management, IT, retail, digital banking, etc. Among its subsidiaries, Tawal, with a portfolio of 21,000 telcom towers under management, is the largest player in the region. Solutions, which is the IT arm of STC, is the largest player in the industry, with a market share of over 20%. We view this business model positively, as STC's core business has reached matured levels and is expected to grow at a stable 5-6% for the next five years. The revenue of the subsidiaries on the other hand are expected to grow at a much faster rate of 10-12%.

However, STC's standalone operations are more profitable, relative to its subsidiaries. Added to this, there has been an increasing trend of competition in STC's enterprise (corporate and government clients) business. Due to these, the EBITDA margins of STC have fallen from their historical levels of c.37% (2020-22) to the levels of 34% in 2023. We expect this trend to continue in the medium term, resulting in further moderation of margins. Overall, we forecast revenue of STC to grow at a CAGR of 7% between 2023-28e, while net income is likely to grow at a slightly slower pace of 6% for the same period.

In 2022, STC received an offer from PIF to purchase a 51% stake in Tawal (currently fully owned by STC) for an initial valuation of c.SAR21.9bn (excluding debt and cash). If the transaction goes through, Tawal will be reported as an associate company, currently fully consolidated, which we estimate will result in a reduction in the net income by c.5%. However, we expect STC to make a one-time dividend payment to its shareholders on the fruition of the transaction. We estimate this one-time dividend will be in the range of SAR1.3-1.8/share.

STC's capex requirement has been consistently high in the past, with its regular capex averaging 15% of its revenue in the past five years. Further, STC and its subsidiaries have been active in M&As to boost their growth prospect. As a result, it's leverage in 2023 increased to the levels of 24% (debt to total capital), from 15% maintained by it in the past few years. However, given its strong cash generating capacity, we expect the company to manage its capex and keep its leverage under control, while paying the minimum dividend of SAR1.6/sh. Overall, we have a positive outlook on the company and initiate coverage on STC with a target price of *SAR44/sh* with a *BUY* rating.

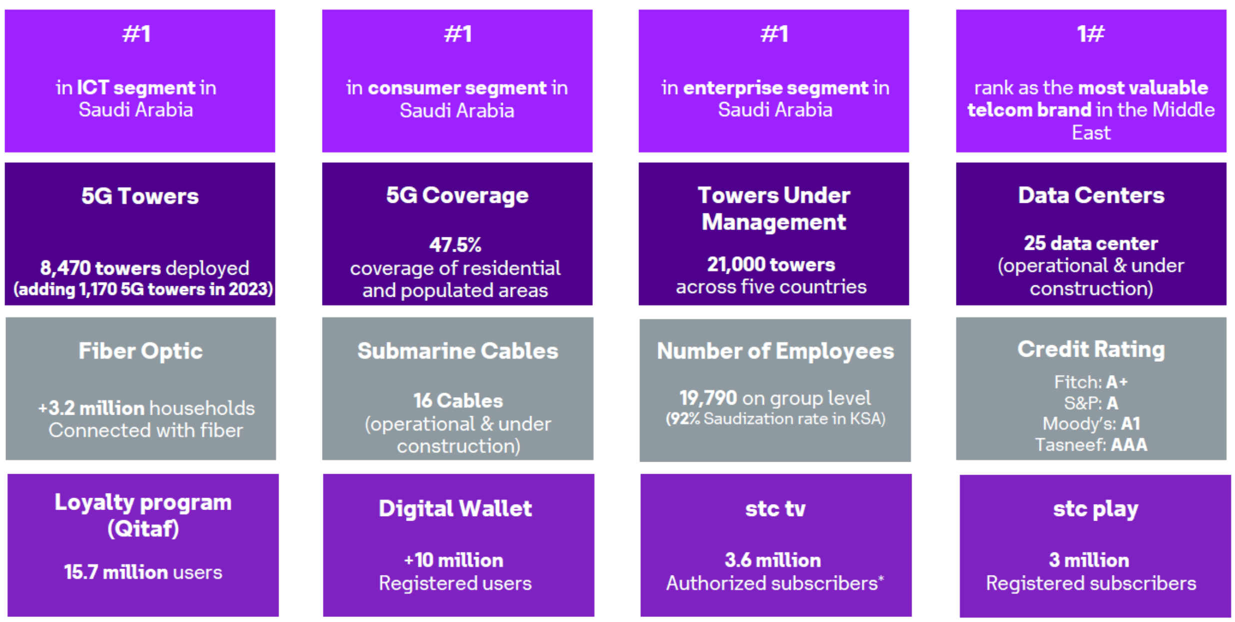
Valuations: We view positively STC's leading presence in the Saudi telcom industry, the growth opportunities provided by its subsidiaries, and its leading position across business verticals it has a presence in. We forecast margins will remain under pressure, while the capex requirement will continue to remain high. However, these are mitigated by STC's strong cash flows and the steps taken by it to unlock the value of its subsidiaries. STC's current policy of paying a minimum dividend of SAR1.6/share provides it with a minimum yield of c.4%. This along with our target price of ***SAR44/share*** is likely to provide a return of ***c.18%***, as we initiate coverage on the company with a ***BUY*** rating.

Market leader with presence across Saudi

Largest telcom player in Saudi

Saudi Telcom Company (STC), with more than 32mn fixed and mobile subscribers in the Kingdom, is the largest telecom player in the country. The company also has a competitive advantage over its peers through its wide footprint across the country servicing 26.5mn mobile and 5.6mn fixed line subscribers. It also has a leadership position in both the consumer and enterprise segment in Saudi, with it being ranked the most valuable telcom brand in the Middle East.

Leading presence with a strong operating infrastructure

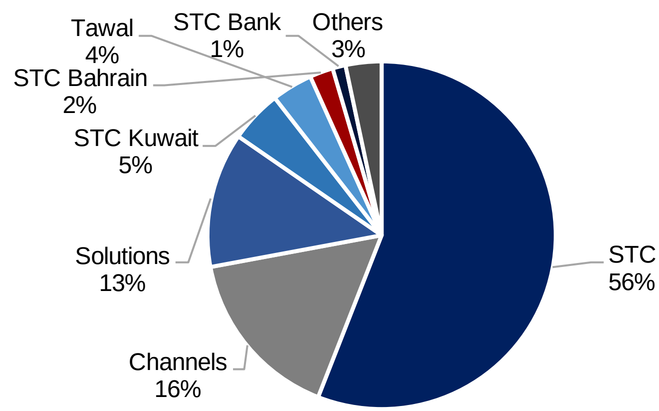


Source: Company filings

Strong physical infrastructure a key positive over its peers

It operates through a strong physical infrastructure of 21,000 towers, across 5 countries, including 8,470 5G towers, of which 1,170 towers were added in 2023. It has a 5G coverage of 47.5% of residential and populated areas. It has connected more than 3.2mn customers through fiber optic cables and has laid 16 submarine cables. The company has a leadership position in the ICT segment, through its vast experience in the industry and through its subsidiaries. STC owns 25 data centers, both operational and under construction, and also provides digital wallet (>10mn subscribers), STC TV (3.6mn authorized subscribers), and STC Play (3mn registered subscribers) services.

Revenue base moderately diversified



Source: Company filings and US Research

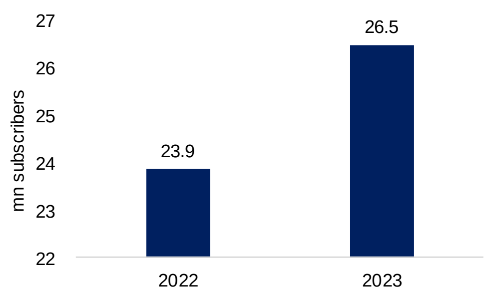
Investment in subsidiaries provide diversification and growth opportunities

STC through its more than 20 subsidiaries have access to a diversified set of businesses (apart from telcom) including ICT services, tower management, retail, digital banking, media production, etc. Its largest segment is its core telcom operations in KSA, which accounted for 56% of the company's revenue. This was followed by Channels (16% of 2023 revenue), the company's retail arm, and Solutions (13%), the IT arm. Its other major operations are STC Kuwait (5%), Tawal (tower operations 4%), and STC Bahrain (2%). The balance revenue was contributed by STC's operation under other segments, including digital banking, media & broadcasting, cyber security, and others.

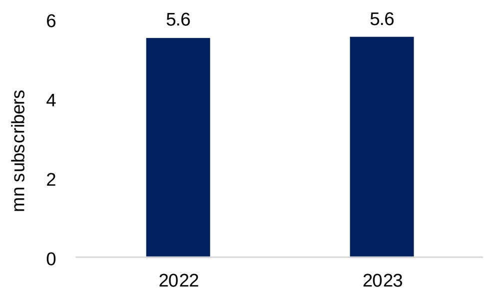
STC's standalone operations to report stable growth

STC's standalone vertical is the largest revenue-contributing segment and encompasses the core telcom operations in the Kingdom. This segment accounted for 56% of the company's total revenue. STC's total subscriber base in 2023 increased by 9% YoY to 32mn and was driven by an 11% YoY growth in mobile subscribers, while fixed-line subscribers were flat at 5.6mn. Mobile subscriber growth was at the back of a 12% YoY improvement in prepaid and a 9% YoY improvement in M2M subscribers, while postpaid subscribers increased by 8% YoY. Mobile subscribers were dominated by prepaid subscribers, which accounted for 74% of the total, and is also the fastest-growing segment. Postpaid on the other hand accounted for 22% of the subscribers and M2M 4%. In fixed subscribers, only fixed-wired broadband subscribers have grown, though the same accounted for a mere 8% of the total in this vertical.

Mobile subscribers grow by 11% YoY

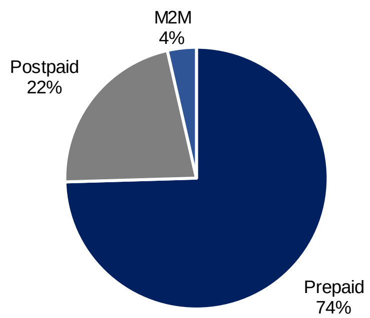


Fixed subscribers report flat performance

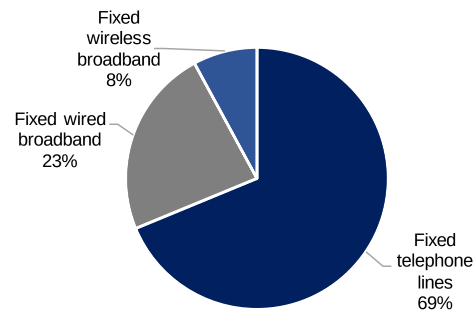


Source: Company filings and US Research

Prepaid dominates mobile subscriptions



Telephone lines account for most of fixed subscribers



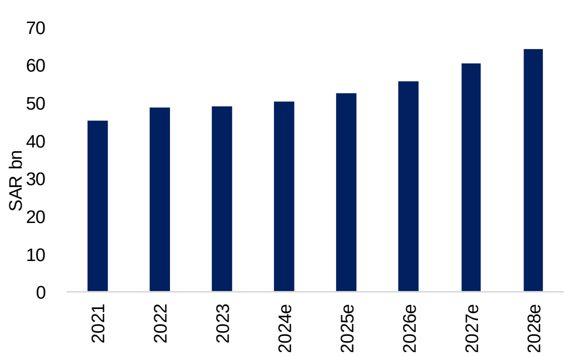
Source: Company filings and US Research

Return of foreign workers, restart of Hajj and Umrah, along with FTTH offers growth opportunities

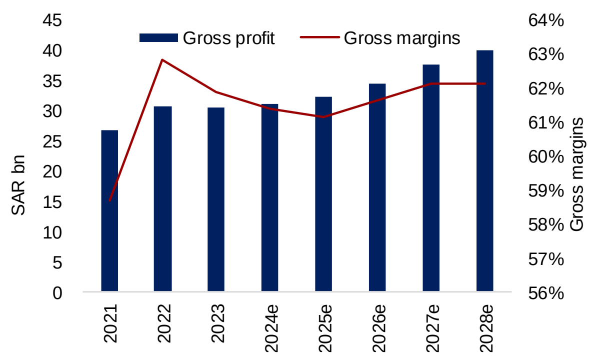
The influx of foreign workers and Hajj & Umrah pilgrims to Saudi have reached normal levels and is likely to keep the growth in the subscriber base steady. STC has a 5G coverage of 47.5% of the country's population and is undertaking consistent capex to improve its network across Saudi. Given this, we expect the company to capture a good proportion of the fresh inflow of workers and tourists into the country. Further growth upside is likely to be in the form of a pickup in Fibre to the Home (FTTH) which offers a substantial potential for growth in the Kingdom, given its relative under-penetration in the country. During 2023, STC added more than 3.2mn households with fiber connections, translating to more than 200k new connections. The strong presence of the company across the Kingdom and its favorable physical infrastructure places STC as a frontrunner to tap the potential growth in FTTH.

Revenue from this segment increased by a marginal 1% YoY in 2023 to SAR49bn, as the growth in subscriber base was more than made up by a fall in revenue per subscriber by 7% YoY to c.SAR1,500. Going forward, we expect the growth rates to recover and forecast revenue in the segment to improve at a CAGR of 6% between 2023-28e, with the revenue being driven by a consistent improvement in the subscriber base.

STC standalone revenue to grow steadily



Margins to come under pressure, before recovering



Source: Company filings and US Research

STC standalone operations one of the most profitable among its verticals

STC's core telcom operation is one of the more profitable verticals of the company, with its 2023 gross margins coming in at 62%. Though this is a decline from the levels of 63% in 2022, it continues to remain higher than most of its other operations. We see this fall in margins to be on account of the increase in mobile subscribers and a corresponding weakness in fixed line and broadband subscriptions. We expect this trend to broadly continue in the medium term, as we expect STC to concentrate on growing its revenue in this segment through favorable offers to mobile subscribers. However, we see a potential for improvement in the same once the company's penetration in FTTH improves, though we believe it is likely to take time to have a material impact on the financials.

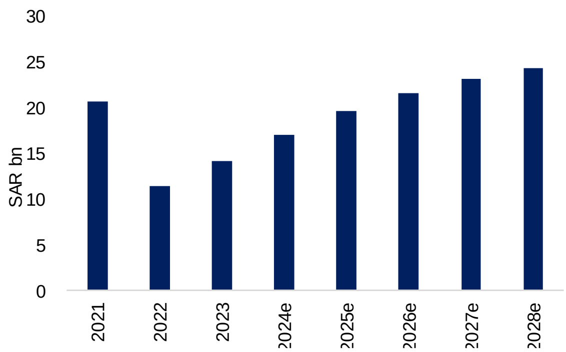
Channels provide potential for growth

Channels is the second largest segment of STC, with its revenue accounting for 16% of the total topline. It is the distribution arm of STC with a presence in both wholesale and retail trade of telcom equipment & devices, telcom fixed & mobile services, recharge card services, and computer services. This is operated through STC's 100% subsidiary, Saudi

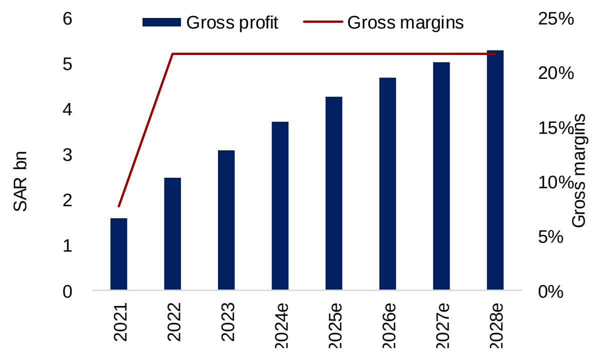
Channels is a leading distributor of telcom products, with presence in Saudi, Bahrain, Oman, and Kuwait

Telecom Channels Company. It has a leading presence in Saudi, Bahrain, Oman, and Kuwait and provides services to both companies and retail customers. It services more than 15mn customers through its vast network of +57k points of sales, +23 distribution centers, +226 stores, +19k merchants, and +400 self-service machines. It has partnerships with various leaders in the telcom industry. It is a preferred distributor of Virgin mobiles, an authorized reseller of Samsung & Huawei, an authorized reseller & after sales partner of Apple, and after sales partner of Samsung. In 2018, it also launched its e-commerce platform Mystore.

Revenue of Channels recovering steadily



Profitability to grow in line with revenue



Source: Company filings and US Research

Revenue growth likely to remain strong

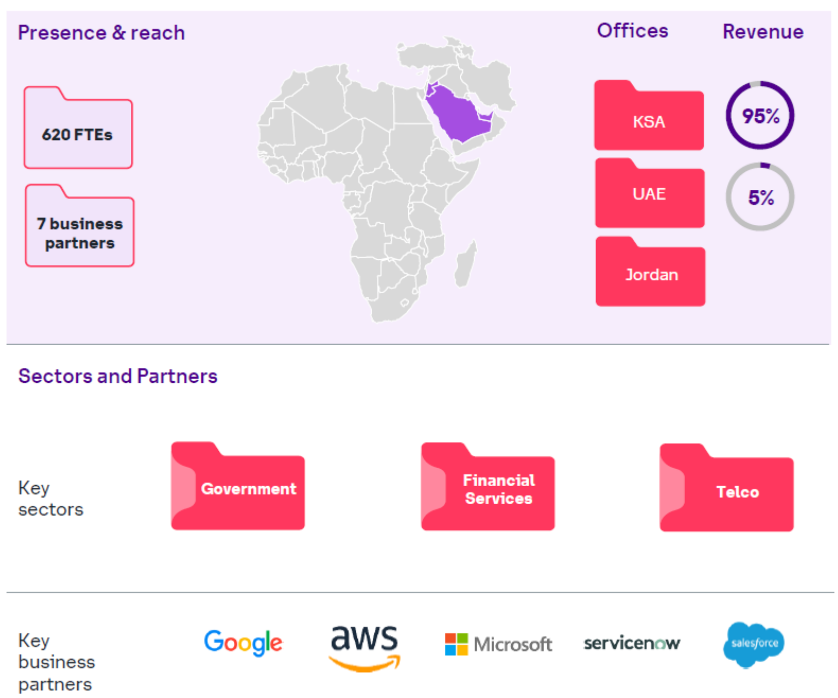
The revenue from this segment increased by 24% YoY to SAR14bn in 2023; this growth comes at the back of severe headwinds for the retail industry in the past few years, due to Covid and the disruptions caused in the supply chain in 2022. This resulted in 2022 revenue from Channels falling by 44% YoY to SAR11bn. Despite the impressive growth in 2023 revenue, the same continues to lag the levels reached by the company in 2021. Going forward, we expect the revenue from this vertical to grow at a CAGR of 11% between 2023-28e. This segment however had one of the lowest profitability compared to other verticals, with gross margins of c.22% in 2022 and 2023. We expect this trend to continue, as we expect the same to remain stable in the medium term.

Solutions is a market leader in the Saudi IT industry, holding a market share of 23%

Solution to provide consistent growth in revenue and profitability, with possible upside from acquisitions

Solutions is the third largest vertical of STC accounting for 13% of the revenue. It is a leading player in the Saudi IT industry with a market share of 23%. The company operates in the core ICT services, IT managed and operational services, and digital services segments. STC holds an 80% stake in Solutions and its finances are fully consolidated. Nearly 80% of Solutions revenue has come from the government & its agencies and STC in 2023. Given that government and telecom companies are the top spenders of IT in Saudi, Solutions strong relationship with leaders in these segments augurs well for its growth prospects. Through its ambitious Saudi Vision 2030, the country has plans to set up 285 smart cities with an outlay of USD500bn. The government is also targeting new data center capacities of 1,300MW by 2030, at an outlay of USD18bn. We expect the government to play a central role in the growth of the IT sector of the country and Solutions size, capabilities and strong presence in this segment will be a major positive to capture this upcoming opportunity.

Devoteam acquistion to add value

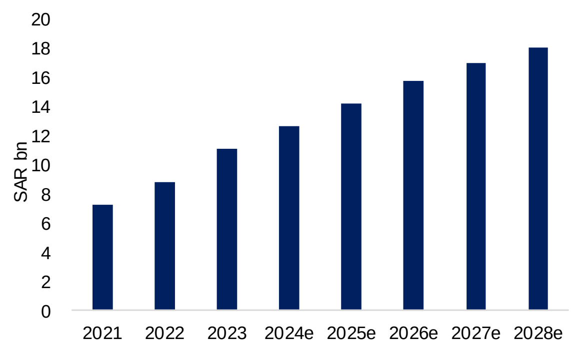


Source: Company filings

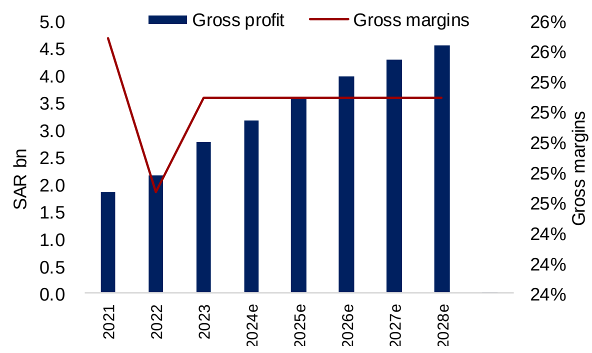
Revenue growth driven by both organic and inorganic drivers

The company's revenue has grown at a CAGR of over 20% between 2018-23 and the same has been supported by prudent acquisitions. We view positively this mode of growth in a fragmented IT sector in the region and expect the company to continue advancing through acquisitions in the medium term. Recently Solutions made two key acquisitions, Giza & CCC, which have aided Solutions to consolidate its position in the industry, by entering new markets, entering new verticals, and consolidating its position in its existing market/verticals. These acquisitions have been fully consolidated into the company and in 2023 they accounted for 20% of the revenue of Solutions. Another key investment made by it was a 40% acquisition of a stake in Devoteam, completed in Feb-2024, based on an EV of SAR742mn. This is expected to bring synergies in the ICT segment and complement its offerings in digital consulting & business transformation. Solutions has a strong balance sheet, with limited debt (D/E ratio of c.20%) and strong liquidity (cash and short-term investment to total assets of c.30%), which makes future growth by acquisition feasible. Overall, we expect revenue and gross profit of Solutions to grow at a CAGR of c.10% between 2023-28e.

Solutions revenue will continue to grow



Solutions margins to remain steady



Source: Company filings and US Research

Tawal stake sale to impact earnings, but will provide an opportunity for one-time dividends

Tawal is a wholly owned subsidiary of STC and in 2023 it accounted for 4% of the consolidated revenue. Tawal was carved out of STC in 2019 to manage its telcom towers. Currently, it operates more than 21,000 towers across five countries (Saudi Arabia, Slovenia, Croatia, Bulgaria, and Pakistan). It entered the market of Bulgaria, Croatia, and Slovenia in 2023 through its acquisition of United Group in 2023 at a valuation of EUR1.2bn (SAR5.3bn), which was financed completely through debt. Tawal entered Pakistan by acquiring a 100% stake in AWAL Telecom in 2022.

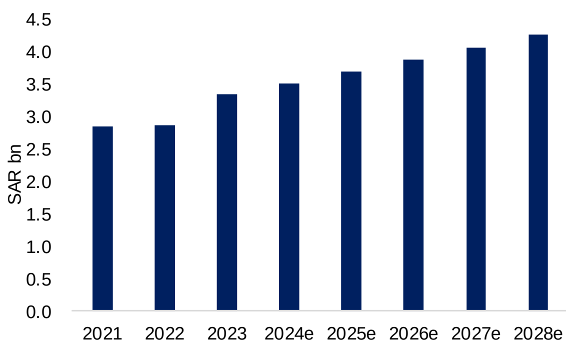
Special dividend	**SAR mn**				
Initial valuation	21,940				
Stake	51%				
Amount received by STC	**11,189**				
Payout Scenario	**60%**	**65%**	**70%**	**75%**	**80%**
One time dividend (SAR mn)	6,714	7,273	7,833	8,392	8,952
DPS (SAR)	1.3	1.5	1.6	1.7	1.8

Source: US Research

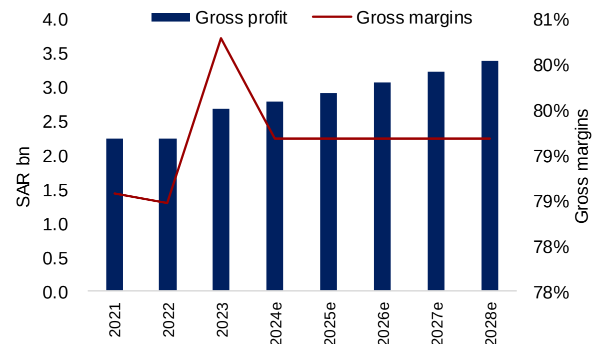
Acquisition of Tawal by PIF will result in a reduction in profitability by c.5%, though it will provide opportunity for one-time dividend

In 2023, PIF (which owns a 64% stake in STC) made a non-binding offer to acquire a 51% stake in Tawal from STC. The offer values Tawal at SAR21.9bn (100% enterprise value on cash free and debt-free basis). Post this acquisition, STC will continue to hold 49% of the stake in the tower company, though it will be accounted for as an associate. If the acquisition materializes, we estimate a reduction in STC's net income by c.5% due to the loss of controlling stake. On the other hand, if the transaction goes through, STC will receive c.SAR11bn as purchase consideration, and a portion of this is likely to be paid back to the shareholders as one-time dividend. We forecast the capex requirement of STC will be c.15% of its revenue in the medium term and the company is likely to retain a part of the purchase consideration towards this. Overall, we forecast special dividend will be in the range of SAR1.3/share to SAR1.8/share post the completion of the transaction, which we estimate will be by the end of 2024.

Tawal growth powered by overseas acquisitions



Tawal has the highest margins among STC's verticals



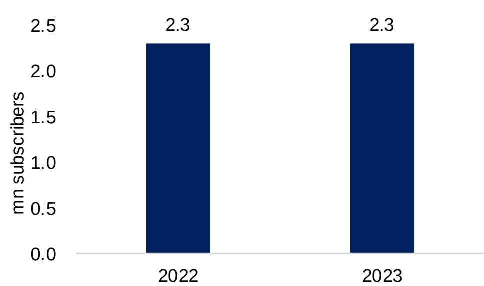
Source: Company filings and US Research

Telcom operations in Kuwait and Bahrain contributes to a moderate portion of STC's revenue

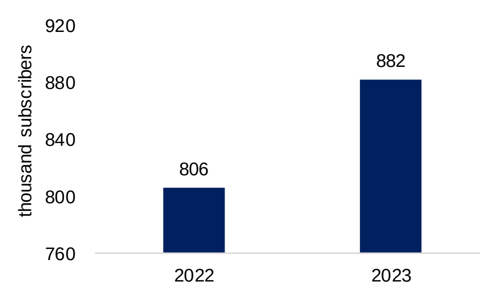
Kuwait and Bahrain telcom operations provide steady revenue and profitability growth

In 2023, STC Kuwait and Bahrain accounted for 5% and 2% respectively of the consolidated revenue. STC Kuwait operated with 2.3mn mobile subscribers (flat at 2022 levels) in 2023, while the revenue grew by 8% CAGR between 2021 and 2023. Going forward, we expect the company to report steady revenue growth and will be aided by improved utilization of existing subscribers. In Bahrain, it has a more marginal presence and operates with 882k subscribers (9% YoY growth), while its revenue has grown by a CAGR of 7% between 2021 and 2023. Going forward we expect subscriber growth to remain steady, aiding in a moderate revenue growth.

STC Kuwait reports flat subscriber numbers

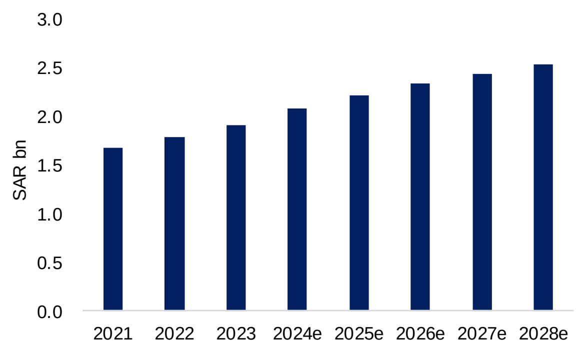


STC Bahrain reports strong subscriber numbers

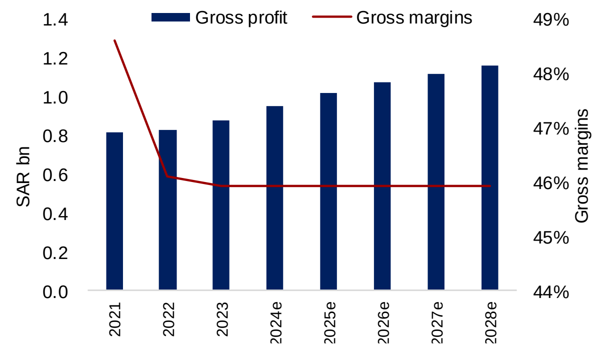


Source: Company filings and US Research

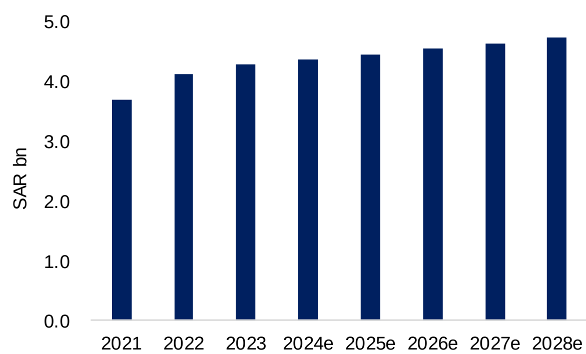
STC Bahrain revenue growth to remains steady



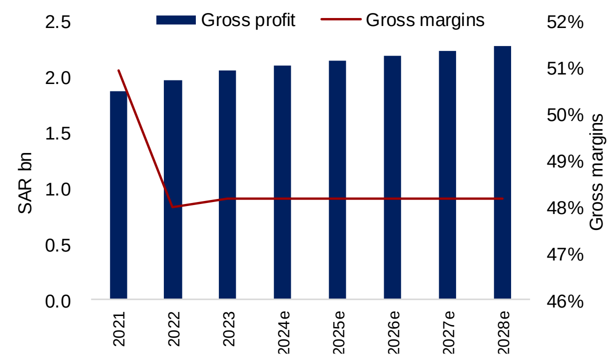
Margins off previous levels, though likely to stabilise



STC Kuwait revenue to remain stable



Margins likely to remain flat



Source: Company filings and US Research

STC Kuwait's gross margins at 48% and STC Bahrain's at 46% were lower than STC's standalone operations, given its business concentration to only mobile operations. We expect this trend to broadly continue, though the margins are likely to be stable at the current levels.

Other subsidiaries' current contribution limited

The other subsidiaries of STC together account for 5% of revenue and are currently at nascent stages of operation. Some of these include:

- STC Bank, with a revenue of SAR1.1bn (1% of revenue), was created in 2017 for providing digital payment services and currently operates with more than 10mn registered users. In 2020, the Saudi Central Bank provided a license for an electronic wallet and in 2021, the council of ministers approved the granting of digital banking services license. The company is looking to launch financial products in 2024 and is awaiting further regulatory approval.

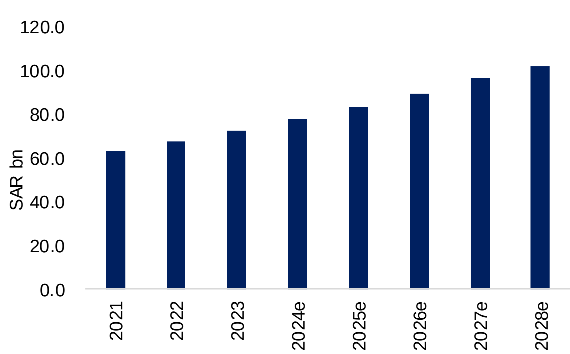
- STC Intigral, with a revenue of SAR643mn (1% of revenue), is the company's broadcasting and media production arm. It operates STC TV with 3.6mn authorized subscribers and STC Play with 3mn registered subscribers.
- Sirar with a revenue of SAR589mn (1% of revenue) is into cyber security. Though its proportion to total revenue is relatively low, the company has registered a robust growth of more than 85% CAGR between 2021 and 2023.

Revenue growth to be driven by subsidiaries, resulting in margin compression

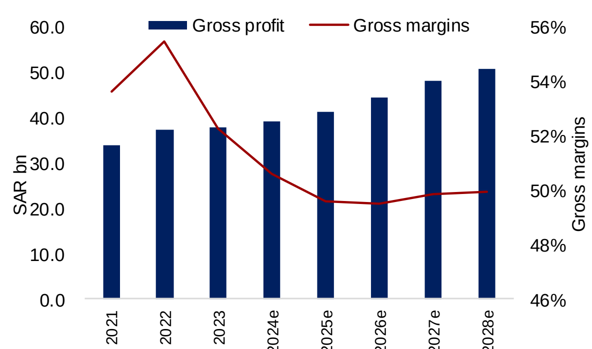
Subsidiaries shore up revenue growth

STC revenue grew by 7% YoY to SAR72.3bn and was driven by strong 23% YoY growth in revenue of its subsidiaries, including Solutions (25% YoY), Channels (24% YoY), and Tawal (17% YoY). Sales from STC, on the other hand, grew by a meager 1% YoY. Going forward, we expect the growth in STC revenues to improve, though a major part of the growth will continue to be driven by its subsidiaries. We forecast the subsidiary's revenue to grow at a CAGR of over 10% between 2023-28e, aiding in an overall revenue growth of 7% CAGR for the same period.

Revenue growth to be driven by subsdiaries



Margins to come under pressure



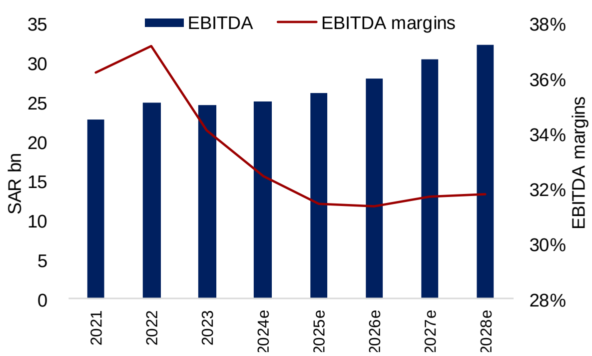
Source: Company filings and US Research

Margins to remain under pressure

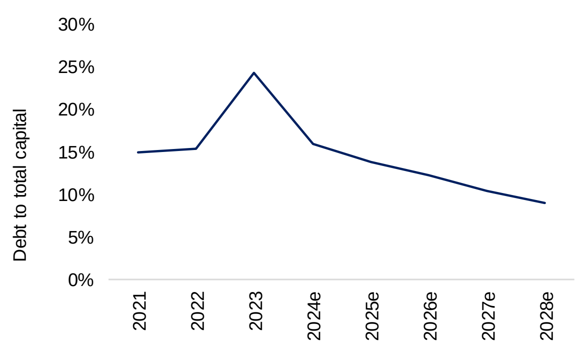
Gross margins of STC fell to 52% in 2023, compared to 55% for 2022; higher competition in the company's enterprise segment, higher revenue from mobile subscribers and the increasing proportion of revenue growth from subsidiaries are likely to be the main reason for the same. Most of the subsidiaries of STC operate at margins that are substantially lower than its parent's telcom operations. As the revenue from subsidiaries grows, we expect the average margins will come under pressure. Further, the enterprise segment, wherein the company services corporate and government entities, has been facing tough competition. Some of the government entities, which are clients of STC, have started tendering process to procure services. This in turn has resulted in pressure on margins for STC. Going forward, we expect this trend to continue, as a combination of increasing revenue from subsidiaries and pressure on enterprise business will keep the margins under check. Alleviation for this could come in the form of increased business from Giga projects, though the visibility of the same currently is limited.

Operating expenses have averaged at c.17-18% of revenue in the past three years and we expect this to remain at this level for the medium term. Overall, we expect EBITDA to increase at a CAGR of 6% between 2023-28e, at a rate slightly lower than revenue growth.

EBITDA growth to slightly lag revenue growth



Leverage to moderate



Source: Company filings and US Research

Leverage increases on acquisitions and investments

The leverage (debt to total capital) of STC, which has averaged c.15% in the past 4 years increased to 24% in 2023. STC had invested c.SAR8.5bn to acquire a 9.9% stake in Spain-based Telefonica. Telefonica is a major telcom player in Europe, with exposure to Spain, Germany, and UK. It also has a substantial presence in Latin America. During 2023, STC also completed certain acquisitions relating to some of its subsidiaries, Tawal (United Group and AWAL acquisitions), and Solutions (CCC acquisition), which further added to the company's investments, resulting in an accretion of debt.

In the past few years, STC has been consistently investing in capex to improve its infrastructure, in line with the changing industry dynamics. One of the core strengths of the company is its extensive presence in the Kingdom, and this has resulted in regular capex from its side to maintain its position. Going forward, we expect the company to continue its capex investments and we have forecasted for the same to average c.15% of revenue in the medium term.

Strong cash generating capacity to moderate leverage levels

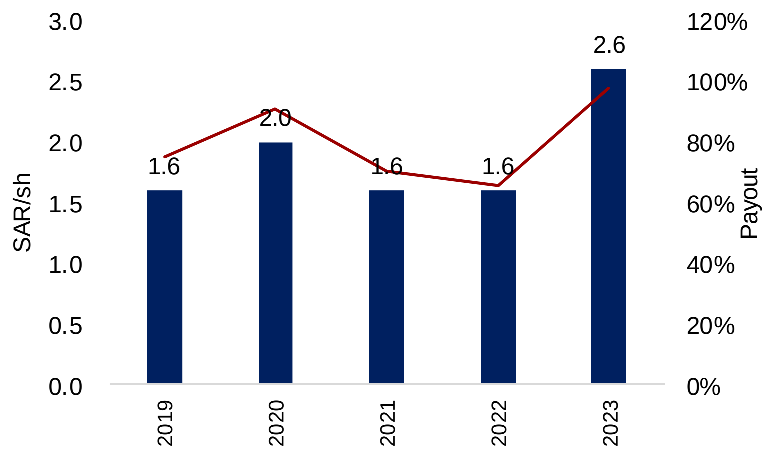
However, we also take into account the strong cash-generating capacity of the company, with its cash from operations averaging c.SAR24bn in the past two years (98% of EBITDA). Given this, we expect the leverage to moderate to its historical levels in the coming years. The cash flows will also be supported by Tawal's acquisition by PIF, which we expect will be completed in 2024.

In line with the increase in leverage, finance charges increased by 82% YoY in 2022. Going forward, we expect this to normalize, as leverage gets back to historical levels. Overall, we expect the net income of STC to grow at a CAGR of 6% between 2023-28e.

Consistent dividend payer

STC has a dividend policy of paying a minimum dividend of SAR0.4 per quarter, SAR1.6 p.a. This translates into a minimum yield of c.4% at the current levels. Apart from this, the company also pays one-time dividends based on its cash flow situation. In 2023, apart from its regular dividend of SAR1.6/share, it also paid a one-time dividend of SAR1/share. Going forward, we expect STC will continue to pay a steady dividend of SAR1.6/sh, given its stable core business profile. We also expect it to pay a one-dividend of between SAR1.3-1.8/share in 2024, depending on the completion of Tawal's stake sale.

Consistent dividend



Source: Company filings and US Research

Valuation:

Initiate coverage with a TP of *SAR44/share* and a *BUY* rating

Strong market position as an undisputed leader in the Saudi Telecom market, robust infrastructure and presence across the Kingdom, all imposes a high entry barrier on its competitor. The steady financial performance of its core telcom operations, consistent and strong cash flows, aids the company to pay regular, reliable & stable dividends. The strong growth prospects of its subsidiaries, is helping the company to emerge as a leading conglomerate globally in the growing ICT market. Though the subsidiaries provide revenue growth, most of them operate at a margin that is lower than the company's core operations. This is likely to result in moderate growth in profitability, vis-à-vis its revenue. Overall, we see STC as a strong value proposition, given that our ***target price of SAR44/sh*** provides a upside of 4% to the stock, while its regular dividend of SAR1.6 per share provides an annual yield of c.4%. Given this, we initiate coverage on STC with a ***BUY rating***.

We arrive at the target price using discounted cash flow to the firm methodology, which is based on a risk-free rate of 4.1%, a market risk premium of 4.7%, a beta of 1.1x, and a target debt to capital of 15%, giving us a WACC of 8.7%. Based on these inputs we arrive at a fair value price of ***SAR44/share***.

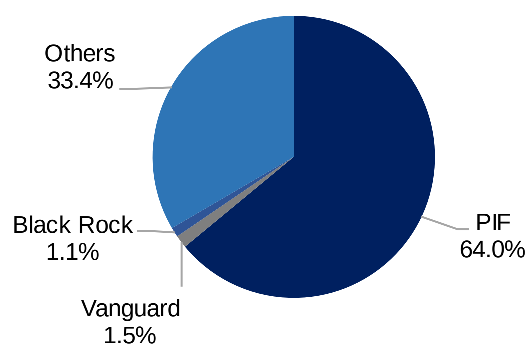
Discounted Cash Flow (SAR mn)	2024E	2025E	2026E	2027E	2028E
Net operating profit after tax	12,437	13,162	14,525	16,337	17,522
Add Depreciation	11,489	11,731	12,080	12,533	13,045
Working capital changes	785	515	(51)	(381)	(188)
Less: Capex	(11,166)	(12,006)	(12,889)	(13,854)	(14,641)
Free cash flow to firm	**13,545**	**13,401**	**13,665**	**14,634**	**15,738**
PV of free cash flow to firm	**12,742**	**11,611**	**10,905**	**10,756**	**10,654**
Sum of PV of free cash flow to firm					**56,668**
Add: Terminal value					165,334
EV					**222,002**
Less: Net debt					(1,291)
Less: Minority interest					(2,041)
Equity value					**218,670**
Fair value per share (SAR)					***44***

Cost of Capital	
Risk free rate	4.1%
Adjusted beta	1.1x
Equity risk premium	4.7%
Cost of equity	9.1%
Cost of debt	6.0%
Target D/E	15.0%
WACC	8.7%
Terminal growth rate	2.0%

About the company

STC is the largest telcom player in the Kingdom, with its revenue accounting for c.65% of the industry. It is also emerging as a conglomerate in the ICT segment with a presence in the telcom tower business, telcom equipment distribution, information technology, cyber security, digital banking, media & broadcasting, etc. It recently purchased a 9.9% stake in Telefonica, one of the leading players in the European telcom market, with an extensive presence in Latin America. It has a leadership position in KSA's ICT, consumer, & enterprise segments and is also the most valuable telcom brand in the Middle East.

Shareholding of STC



Board of Directors		
S.no	Name	Position
1	Mr. Mohammed K. A. Al Faisal	Chairman
2	Mr. Yazeed A. Al Humied	Vice-Chairman
3	Mr. H.E. Dr. Khaled H. Biyari	Director
4	Mr. H.E. Mohammed Talal Al-Nahhas	Director
5	Ms. Rania M. Nashar	Director
6	Mr. Arndt Rautenberg	Director
7	Mr. Sanjay Kapoor	Director
8	Ms. Sara J. Al Suhaimi	Director
9	Mr. Jameel A. Al Mulhem	Director
10	Mr. Waleed I. Shukri	Director
11	Mr. Ahmed Mohammed Al-Omran	Director

Source: Bloomberg, Company filings and US Research

Income Statement (SAR mn)	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Revenue	58,953	63,008	67,432	72,337	77,601	83,447	89,583	96,297	101,765
Cost of sales	(24,999)	(29,214)	(30,038)	(34,533)	(38,325)	(42,069)	(45,241)	(48,286)	(50,944)
Gross profit	**33,954**	**33,794**	**37,393**	**37,804**	**39,276**	**41,378**	**44,343**	**48,011**	**50,821**
Operating expenses	(21,223)	(20,666)	(22,305)	(23,603)	(25,565)	(26,867)	(28,329)	(29,999)	(31,503)
Operating profit	**12,731**	**13,128**	**15,088**	**14,200**	**13,712**	**14,511**	**16,014**	**18,011**	**19,318**
Other income	(165)	(252)	(1,524)	353	(124)	(127)	(129)	(132)	(135)
Finance expenses - Net	(210)	(241)	(94)	242	312	208	371	598	822
Earnings before tax	**12,356**	**12,635**	**13,470**	**14,795**	**13,899**	**14,592**	**16,255**	**18,478**	**20,005**
Tax	(1,170)	(1,040)	(1,083)	(1,375)	(1,292)	(1,357)	(1,511)	(1,718)	(1,860)
Earnings before MI	**11,185**	**11,595**	**12,387**	**13,419**	**12,607**	**13,235**	**14,744**	**16,760**	**18,145**
Minority interest	(190)	(283)	(216)	(124)	(117)	(122)	(136)	(155)	(168)
Net income	**10,995**	**11,311**	**12,171**	**13,295**	**12,490**	**13,113**	**14,607**	**16,605**	**17,978**

Balance Sheet (SAR mn)	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Property and equipment	47,848	47,205	46,645	48,101	48,911	50,132	51,739	53,733	55,958
Intangibles	10,466	10,735	11,775	17,282	17,262	17,458	17,846	18,416	19,091
Right to use assets	2,893	2,952	3,030	3,802	3,846	3,947	4,097	4,291	4,504
Other non-current assets	14,906	15,420	14,979	19,273	19,474	19,678	19,884	20,093	20,304
Total non-current assets	**76,113**	**76,311**	**76,430**	**88,459**	**89,492**	**91,215**	**93,566**	**96,533**	**99,858**
Contract assets	6,059	5,733	6,624	7,482	8,026	8,631	9,266	9,960	10,526
Receivables	15,725	24,857	23,179	21,401	22,959	24,688	26,504	28,490	30,108
Inventories	1,009	918	1,023	1,905	2,114	2,321	2,496	2,664	2,810
Cash & Cash Equivalents	9,004	8,281	17,794	13,414	8,604	11,587	15,690	20,443	27,032
Short term murabaha	10,434	7,944	7,989	14,767	14,767	14,767	14,767	14,767	14,767
Other current assets	3,628	3,735	4,181	12,254	12,377	12,500	12,624	12,750	12,877
Total current assets	**45,859**	**51,468**	**60,790**	**71,224**	**68,847**	**74,494**	**81,347**	**89,074**	**98,120**
Total assets	**121,972**	**127,779**	**137,220**	**159,683**	**158,340**	**165,709**	**174,913**	**185,607**	**197,978**
Share Capital	20,000	20,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Total reserves	43,946	49,271	23,500	28,985	33,475	38,588	45,196	53,801	63,778
Minority interest	1,321	2,115	2,526	2,530	2,647	2,769	2,906	3,061	3,228
Total equity	**65,267**	**71,386**	**76,026**	**81,515**	**86,122**	**91,358**	**98,101**	**106,861**	**117,007**
Short term borrowings	318	1,457	277	8,316	1,720	1,002	1,498	929	109
Short term lease liabilities	742	870	913	948	923	918	931	958	993
Trade payables	19,711	17,114	20,708	22,154	24,586	26,988	29,023	30,976	32,682
Contract liabilities	1,901	3,592	4,671	4,581	5,084	5,581	6,002	6,406	6,759
Other current liabilities	10,218	10,528	9,831	12,072	12,415	12,755	13,060	13,357	13,631
Total current liabilities	**32,891**	**33,561**	**36,400**	**48,071**	**44,728**	**47,245**	**50,514**	**52,627**	**54,173**
Long term debt	8,638	7,847	10,214	13,642	10,498	9,496	7,998	7,068	6,959
Long term lease liabilities	2,238	2,354	2,383	3,252	3,165	3,151	3,195	3,287	3,407
Other non-current liabilities	12,938	12,633	12,197	13,204	13,826	14,459	15,105	15,763	16,433
Total non-current liabilities	**23,814**	**22,833**	**24,794**	**30,097**	**27,489**	**27,107**	**26,297**	**26,119**	**26,798**
Total Liabilities	**56,705**	**56,393**	**61,194**	**78,168**	**72,218**	**74,352**	**76,812**	**78,746**	**80,972**
Equity and liabilities	**121,972**	**127,779**	**137,220**	**159,683**	**158,340**	**165,709**	**174,913**	**185,607**	**197,978**

Cash Flows (SAR mn)	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Cash from operations	28,325	11,220	26,354	22,418	25,370	25,980	27,282	29,430	31,531
Cash from investments	(17,429)	(1,715)	(8,579)	(28,383)	(11,166)	(12,006)	(12,889)	(13,854)	(14,641)
Cash from financing	(9,919)	(10,235)	(8,256)	1,591	(19,014)	(10,990)	(10,290)	(10,823)	(10,302)
Net changes in cash	976	(730)	9,520	(4,375)	(4,810)	2,983	4,103	4,753	6,589
Closing balance (C/b)	**9,004**	**8,281**	**17,794**	**13,414**	**8,604**	**11,587**	**15,690**	**20,443**	**27,032**

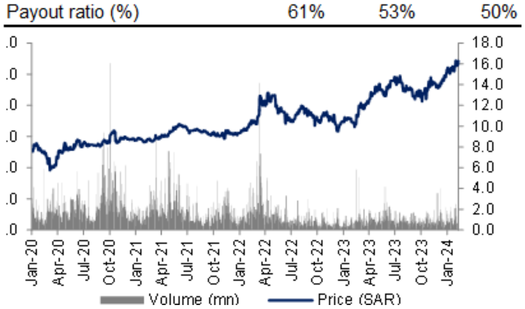
Ratios	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Per Share (SAR)									
EPS	2.2	2.3	2.4	2.7	2.5	2.6	2.9	3.3	3.6
BVPS	12.8	13.9	14.7	15.8	16.7	17.7	19.0	20.8	22.8
DPS	2.0	1.6	1.6	2.6	1.6	1.6	1.6	1.6	1.6
FCF/share	2.2	1.9	3.6	(1.2)	2.8	2.8	2.9	3.1	3.4
Revenue/share	11.8	12.6	13.5	14.5	15.5	16.7	17.9	19.3	20.4
Valuations									
M.Cap (SAR mn)	193,100	243,400	208,350	199,150	193,000	193,000	193,000	193,000	193,000
EV (SAR mn)	186,919	241,816	198,879	199,655	188,582	183,983	179,070	173,093	165,897
P/E	17.6	21.5	17.1	15.0	15.5	14.7	13.2	11.6	10.7
EV/EBITDA	8.5	10.6	7.9	8.1	7.5	7.0	6.4	5.7	5.1
EV/Sales	3.2	3.8	2.9	2.8	2.4	2.2	2.0	1.8	1.6
P/BV	3.0	3.5	2.8	2.5	2.3	2.2	2.0	1.9	1.7
P/S	3.3	3.9	3.1	2.8	2.5	2.3	2.2	2.0	1.9
Div. yield	5.2%	3.3%	3.8%	6.5%	4.1%	4.1%	4.1%	4.1%	4.1%
FCF yield	5.6%	3.9%	8.5%	-3.0%	7.4%	7.2%	7.5%	8.1%	8.8%
Liquidity									
Cash Ratio	0.3	0.2	0.5	0.3	0.2	0.2	0.3	0.4	0.5
Current ratio	1.4	1.5	1.7	1.5	1.5	1.6	1.6	1.7	1.8
Quick ratio	1.4	1.5	1.6	1.4	1.5	1.5	1.6	1.6	1.8
Return ratio									
ROA	9.2%	9.1%	9.0%	8.4%	8.0%	8.0%	8.4%	9.0%	9.2%
ROE	17.2%	16.3%	16.6%	16.8%	15.0%	14.8%	15.3%	16.0%	15.8%
ROCE	16.5%	15.6%	16.8%	13.2%	13.4%	13.7%	14.3%	15.1%	15.0%
Cash cycle									
Contract asset turnover	9.7	11.0	10.2	9.7	9.7	9.7	9.7	9.7	9.7
Payables turnover	1.3	1.7	1.5	1.6	1.6	1.6	1.6	1.6	1.6
Contract liabilities turnover	13.1	8.1	6.4	7.5	7.5	7.5	7.5	7.5	7.5
Receivables turnover	3.7	2.5	2.9	3.4	3.4	3.4	3.4	3.4	3.4
Inventory turnover	24.8	31.8	29.4	18.1	18.1	18.1	18.1	18.1	18.1
Contract asset days	38	33	36	38	38	38	38	38	38
Payable days	288	214	252	234	234	234	234	234	234
Contract liabilities days	28	45	57	48	48	48	48	48	48
Receivables days	97	144	125	108	108	108	108	108	108
Inventory days	15	11	12	20	20	20	20	20	20
Cash Cycle	(166)	(70)	(135)	(117)	(117)	(117)	(117)	(117)	(117)
Profitability ratio									
Gross margins	57.6%	53.6%	55.5%	52.3%	50.6%	49.6%	49.5%	49.9%	49.9%
EBITDA margins	37.5%	36.3%	37.2%	34.1%	32.5%	31.4%	31.4%	31.7%	31.8%
Operating margins	21.6%	20.8%	22.4%	19.6%	17.7%	17.4%	17.9%	18.7%	19.0%
PBT margins	21.0%	20.1%	20.0%	20.5%	17.9%	17.5%	18.1%	19.2%	19.7%
Net margins	18.7%	18.0%	18.0%	18.4%	16.1%	15.7%	16.3%	17.2%	17.7%
Effective tax rate	9.5%	8.2%	8.0%	9.3%	9.3%	9.3%	9.3%	9.3%	9.3%
Leverage									
Total debt (SAR mn)	11,936	12,526	13,787	26,157	16,307	14,568	13,622	12,243	11,468
Net debt (SAR mn)	2,932	4,245	(4,008)	12,743	7,703	2,981	(2,068)	(8,200)	(15,564)
Debt/Capital	15.5%	14.9%	15.4%	24.3%	15.9%	13.8%	12.2%	10.3%	8.9%
Debt/Total assets	9.8%	9.8%	10.0%	16.4%	10.3%	8.8%	7.8%	6.6%	5.8%
Debt/Equity	0.2	0.2	0.2	0.3	0.2	0.2	0.1	0.1	0.1
Debt/EBITDA	0.5	0.5	0.5	1.1	0.6	0.6	0.5	0.4	0.4
Net debt/EBITDA	0.1	0.2	(0.2)	0.5	0.3	0.1	(0.1)	(0.3)	(0.5)

Telcom

Etihad Etisalat Co – There is still steam left

BUY: 12M TP @ 59
Upside 12.2%

Valuation Summary (TTM)			
Price (SAR)			**52.6**
PER TTM (x)			18.1
P/Book (x)			2.3
P/Sales (x)			2.4
EV/Sales (x)			2.7
EV/EBITDA (x)			7.3
Dividend Yield (%)			2.8
Free Float (%)			68%
Shares O/S (mn)			770
YTD Return (%)			7%
Beta			1.1
(mn)		**SAR**	**USD**
Market Cap		40,502	10,798
EV		39,233	10,460
Price performance (%)	**1M**	**3M**	**12M**
Etihad Etisalat Co	-5%	4%	29%
Tadawul All Share Index	1%	6%	17%
Trading liquidity (,000)	**1M**	**3M**	**6M**
Avg daily turnover (SAR ,000)	43,441	56,717	51,458
Avg Daily Volume (,000)	909	1,066	1,033
52 week	**High**	**Low**	**CTL***
Price (SAR)	57.00	40.30	30.5
* CTL is % change in CMP to 52wk low			
Major shareholders			
Emirates Telecom			28.0%
Black Rock Inc			2.3%
Vanguard Group Inc			2.0%
Others			67.8%
Other details			
Exchange			Saudi Arabia
Sector			Telecommunications
Index weight (%)			1.5%
Key ratios	**2021**	**2022**	**2023**
EPS (SAR)	1.39	2.15	2.90
BVPS (SAR)	19.74	21.24	22.89
DPS (SAR)	0.85	1.15	1.45
Payout ratio (%)	61%	53%	50%



Etihad Etisalat (Mobily) is the second largest telcom player in Saudi and operates through four main segments, consumer, business, wholesale, and others. The consumer segment is the largest segment (c.65% of 2023 revenue) and offers mobile voice calls, mobile internet, and fixed internet services. Mobily services c.12mn mobile subscribers and c.0.3mn FTTH subscribers. We expect revenue from this segment to grow at a steady pace of c.1.5% CAGR between 2023-28e and will be driven by the return to normalcy of Hajj & Umrah pilgrims and the growth in incoming foreign labor to pre-Covid levels. The upside could also come from growth in FTTH subscribers, which is largely under-penetrated in the Kingdom.

Business is the second largest segment for Mobily (c.20% of revenue), though it is one of the fastest-growing segments. In this segment, the company provides fixed connectivity and customized solutions including cloud and data center services. Opening up of government contracts through tendering, steps taken by the Saudi government to improve digitization in the Kingdom as per Vision 2030, and the penetration of latest technologies, including cloud, AI, and data centers among corporates have all aided in the improvement of demand in this segment. The steps taken by Mobily to enter into partnerships with government agencies, Mega & Giga projects, hyper-scalers, and other technology enablers have helped Mobily to improve its presence in this segment. We forecast revenue in this segment to register a CAGR over 15% between 2023-28e.

In the wholesale segment (10% of revenue) Mobily monetizes its assets by providing interconnection, transition, and roaming services between operators. The infrastructure created in this segment is critical for the growth prospects of all the other verticals. Critical investments, including Africa-1 and SEA-ME-WE 6, which are designed to connect key Saudi cities with their international neighbours are expected to drive growth in this operation. Overall, we expect revenue to grow at a CAGR of c.8% between 2023-28e.

We expect the margin of Mobily to come under pressure in the near term. Increasing competition in both the consumer and business segments is likely to result in the EBITDA margins compressing to c.37.5% during our forecast period, from the current levels of 39.5%. We also expect Mobily's capex to average c.15% during our forecast period of 2023-28e. On the other hand, the cash flow generation of the company has improved in the past two years (cash from operations has grown at a CAGR of 11% between 2020-23), which has helped it to reduce its leverage (debt to total capital) from 48% in 2021 to 40% in 2023. We expect this trend to continue and expect leverage to consistently fall during our forecast period, aiding in lower finance costs. Overall, despite pressure on margins, we expect the net income of Mobily to register a CAGR of over 10% between 2023-28e.

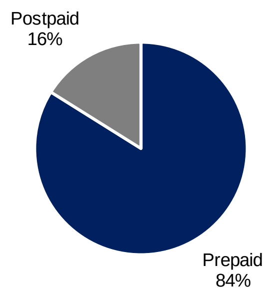
Valuations: We have a positive outlook on Mobily aided by its strong position in the telcom market**,** solid growth prospects in the business segment, steady performance of the consumer segment, strong & improving cash flows, and falling levels of leverage are all likely to more than makeup for the pressure on margins. Given this, we initiate coverage on Mobily with a ***BUY*** rating at a ***target price*** of ***SAR59/share.***

Leading presence in the Saudi telcom industry

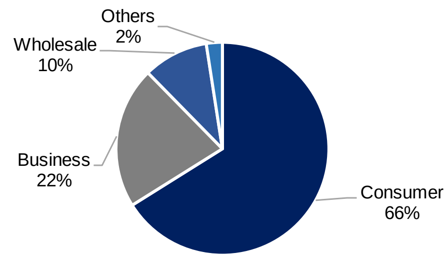
2nd largest telcom player in Saudi

Mobily is the second largest telcom player in Saudi Arabia and one of the three major players offering mobile connectivity in the Kingdom. In 2023, the company operated with 11.8mn mobile subscribers and 0.3mn FTTH subscribers. Prepaid subscribers dominated its base accounting for 84% of total subscribers, followed by postpaid, which accounted for 16%. In 2023, Mobily had 98% call service coverage and 93% internet coverage on the Main roads of KSA. Its 3G and 4G services cover +98% and +96% of the country's population respectively. The company's 5G services on the other hand cover more than 84% of the Kingdom's 7 main cities. It has also extended its FTTH network to cover nearly 60k km across Saudi with +430 exclusive channels, including +70 flagship stores & c.360 branded outlets, and c.2,500 3rd party retailers.

Prepaid dominates mobile subscriptions



Consumer and business dominates Mobily's revenue



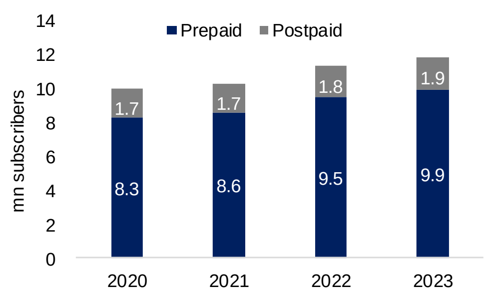
Source: Company filings and US Research

Mobily operates through four segments, consumer, business, wholesale, and outsourcing & others. Consumer is the largest segment and accounted for 66% of 2023 revenue, followed by business (22%), wholesale (10%), and others (2%).

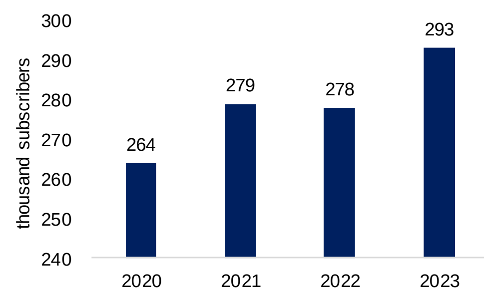
Consumer revenue to report steady growth

The consumer is the largest segment of Mobily and in this vertical, the company provides services including mobile voice calls, mobile internet, and fixed internet. Revenue from this segment has grown at a CAGR of 3% between 2018-23, with steady growth in both the mobile and FTTH subscriber base helping the company maintain its performance. Further, steps taken by it to launch new products, including Mobily Gamers, revamping Mobily TV, and upgrading its FTTH for higher speed, have all aided the company.

Mobile subscribers report consistent growth



FTTH growth on the slower side

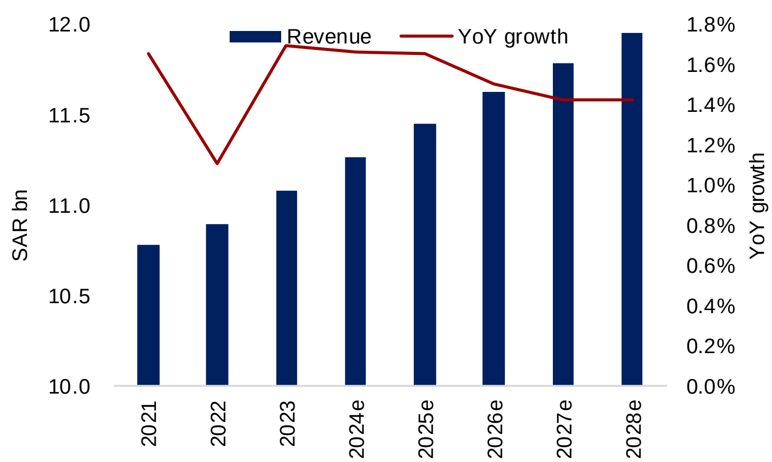


Source: Company filings and US Research

Consumer segment provides stable, though low revenue growth

The mobile subscriber base of the company has consistently grown in the past few years, registering a CAGR of 6% between 2020-23. The growth has been driven mainly by the prepaid segment, which grew by 6% CAGR for the same period, followed by postpaid, which grew at a CAGR of 4%. Recovery in the Hajj and Umrah pilgrims and the return of foreign workers post-Covid have aided the growth in the subscriber base of Mobily.

Consumer segment revenue to report steady growth



Source: Company filings and US Research

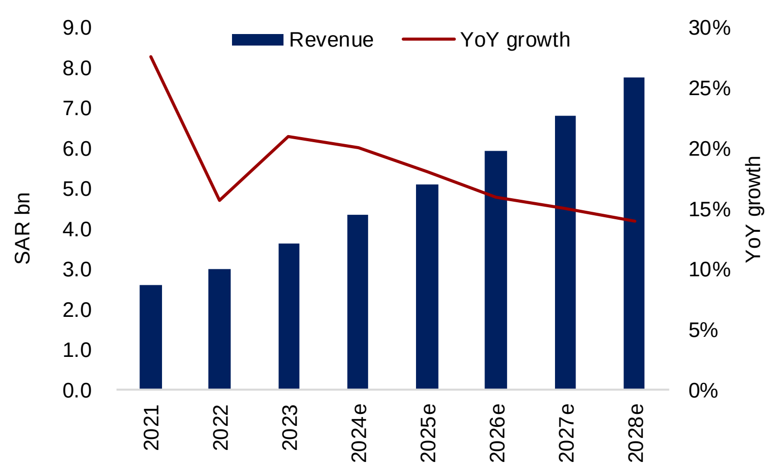
The company also provided FTTH services and currently has a subscriber base of 293k and has grown at a CAGR of 4% between 2020-23. Despite the weak growth, we see strong potential for this segment, given the Kingdom's relatively low penetration in FTTH vis-à-vis global averages. Going forward, we expect the revenue from this segment to remain steady, as we forecast revenue growth of CAGR 1.5% between 2023-28e.

Business segment revenue to drive growth

Business segment is the fastest growing vertical for Mobily

This is the second largest segment of Mobily, accounting for more than 20% of its revenue, and is the fastest-growing vertical for the company. Through this segment the company provides fixed connectivity and customized solutions including cloud and data center services. Between 2018-23 revenue from this segment grew at a CAGR of 22% and was assisted by a general opening up of activities in the corporate and government clientele. The government and its related entities are increasingly tendering their requirements, compared to directly selecting vendors earlier, which in turn has opened up this segment. Apart from this, increasing investments by corporates in technology and the general push by the government towards digitalization have all aided in making this segment attractive.

Business segment to report solid growth numbers



Source: Company filings and US Research

Mobily has taken various steps to entrench its position in the segment. In 2023, the company added two new data centers, taking the total centers operated to 10, and also entered into a partnership with Equinix, a global leader in data centers, to enhance its service quality. It has also entered into partnerships with hyper-scalers like Microsoft and Amazon, to enhance its offering in cloud-based solutions. It also became the first operator in the Kingdom to ensure fixed connectivity for NEOM. We expect the growth in this segment to remain strong and will be aided further by the ongoing execution of Mega & Giga projects across the Kingdom and the steps taken by the government to improve digitization in line with its Vision 2030. Mobily has entered into partnerships with the Ministry of Health, the Ministry of Municipal and Rural Affairs and Housing, and The Red Sea project. It has also signed a MOU with the Royal Commission for Al-Ula, to aid the latter in achieving goals in line with Vision 2030. These are all likely to keep the growth engine in this segment chugging. Overall, we expect the revenue from this segment to grow at a CAGR of over 15% between 2023-28e.

Investment in infrastructure and partnerships to keep the growth going

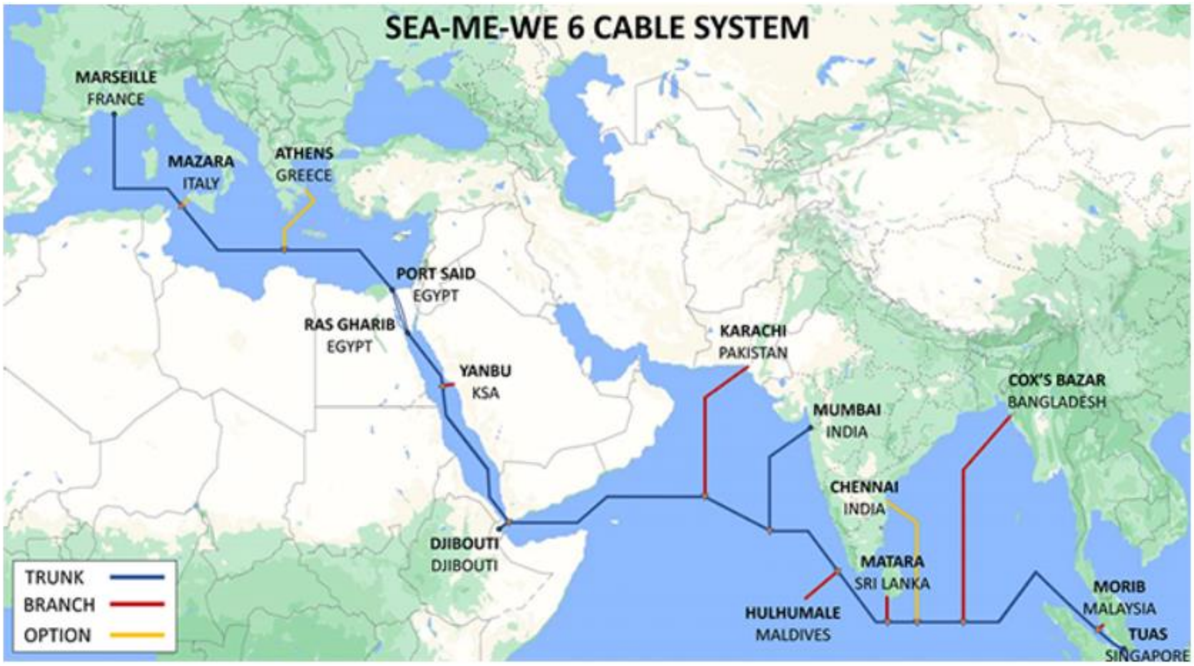
Wholesale unit investments are key to support growth across company segments

The wholesale segment accounted for 10% of Mobily's revenue and is the third largest business. The operations in this segment include interconnection, transition, and roaming services between operators. The performance of these processes, apart from providing growth to the company's revenue, is also key for the growth of the other businesses, as it provides critical infrastructure for the other verticals to operate. Revenue performance in this segment has been strong with it registering a CAGR of over 15% between 2018-23.

Wholesale segment key to other segment growth, while effectively monetizing its infrastructure

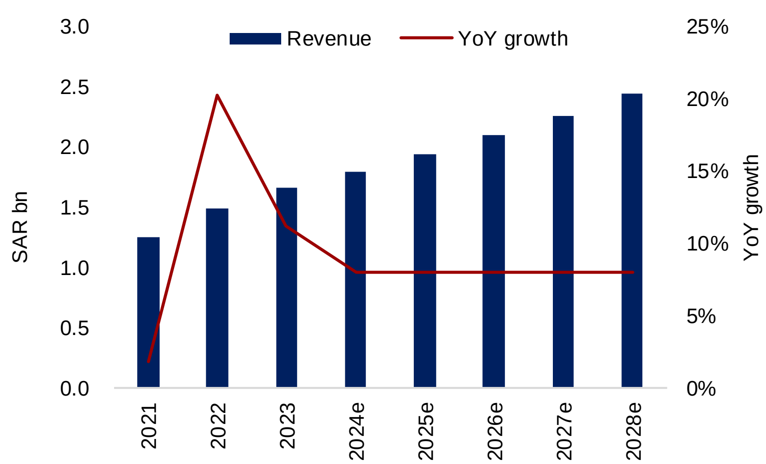
The company has carried out key investments in improving its national & international networks and data center capacities. It has also entered into various partnerships to ensure a carrier-neutral internet ecosystem. In 2022, Mobily entered into a cable system consortium, Africa-1, which will connect Saudi with the Middle East, Africa, and Europe. The 10,000 km subsea cable will initially have landing stations in Saudi Arabia, UAE, Egypt, Sudan, Algeria, France, Pakistan, Kenya and Djibouti. The next phase will see further stations in Yemen, Somalia, Tanzania and Mozambique. It had also entered into a MOU with telcom Egypt to build the first direct bilateral submarine cable system connecting Saudi Arabia to Egypt. This MOU is looking at various alternatives to expand both the company's infrastructure and to connect them to neighboring countries.

Strategically located subsea cable to connect Saudi with 10 other countries



Source: Argaam

Wholesale segment offers fresh oppurtunities



Source: Company filings and US Research

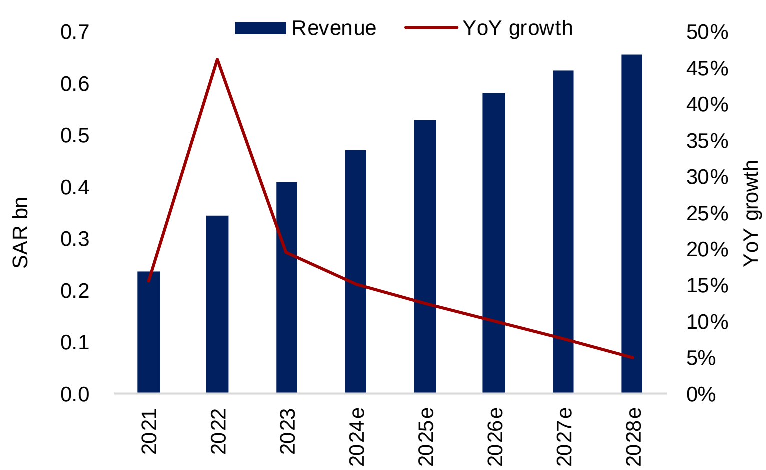
Key partnerships to enhance international connectivity

Mobily has also entered into a consortium with SEA-ME-WE 6 (Southeast Asia-Middle East-Western Europe 6) to build a 19,200-kilometer-long subsea cable system that will connect the Kingdom with ten other countries. The cable is expected to be anchored in the port of Yanbu strategically located adjacent to data centers and Vision 2030 projects. This is likely to make it one of the leading cable landing stations in the region.

Overall, we expect the growth in this segment to remain strong, and will also enable the company to utilize its current infrastructure towards additional revenue streams. We forecast revenue from this segment to register a CAGR of 8% between 2023-28e.

Digital wallet provides growth opportunities

E-wallet operations offer potential



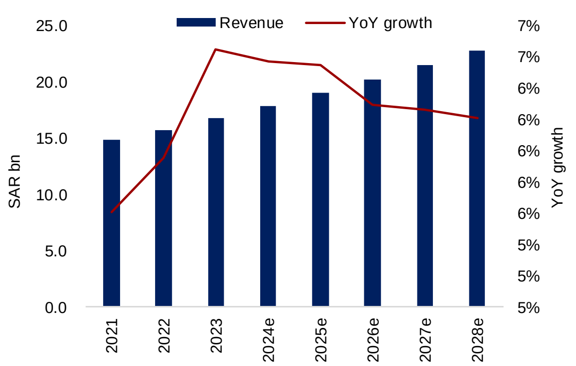
Source: Company filings and US Research

The other segment, which includes HR outsourcing and digital wallet operations is the smallest accounting for 2% of Mobily's revenue. It has however reported a strong performance, with its topline increasing at a CAGR of 27% between 2018-23. In 2022, the company had launched Mobily Pay, a digital e-wallet service. Through this initiative, Mobily is looking to get a foothold into the mobile financial services market in the region. Going forward, we expect the revenue from this segment to register a CAGR of 10% between 2013-28e.

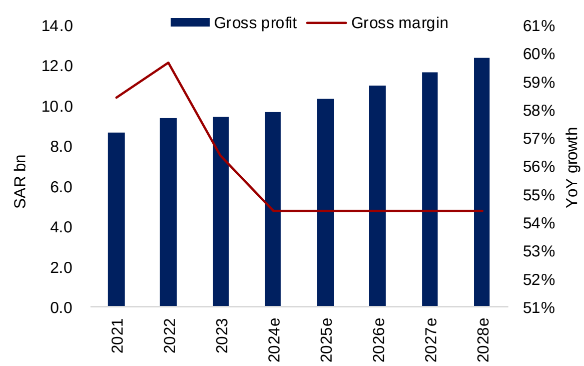
Financial performance to remain strong

The topline of Mobily increased by 6.7% YoY and was aided by improvement in revenue across segments, especially business, which grew by 21.0% YoY. Others and wholesale segments grew at a strong 19.4% YoY and 11.1% YoY respectively, while its consumer segment grew by a steady 1.7% YoY. Going forward we expect this trend to broadly continue, as we expect consumer segment performance to be steady, while growth will be driven by the other segments, especially business. We have forecasted for the revenue of Mobily to increase at a CAGR of 6% between 2023-28e.

Revenue to grow consistently



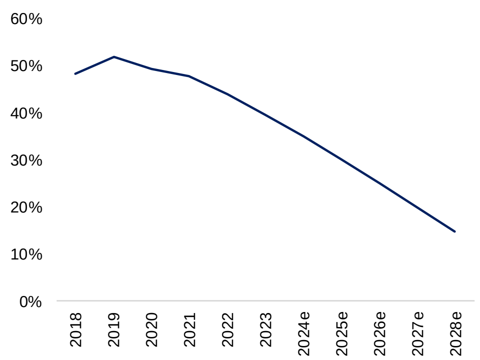
Gross margins to come under pressure



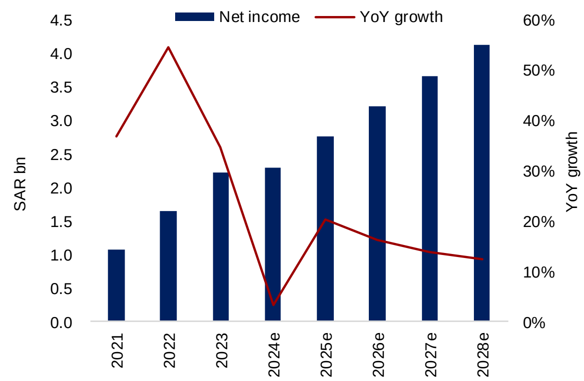
Source: Company filings and US Research

Gross margins witnessed a fall from 59.7% in 2022 to 56.4% in 2023; margin levels between 2019-22 had been stable at c.58-60%, though the same came under pressure in 2023. Increased competition in both the consumer and business segments is likely to have been the reason for this. Going forward we see further margin compression in the near term, before stabilizing at c.54.5% in the medium term. Operating expenses however fell by 8.2% YoY at the back of lower general and administrative expenses, as EBITDA increased by 7.2% YoY. EBITDA margins improved to 39.5% in 2023, compared to 39.3% a year ago, as lower gross margins were more than made up by lower operating expenses.

Leverage to moderate



Lower finance cost to support net income growth



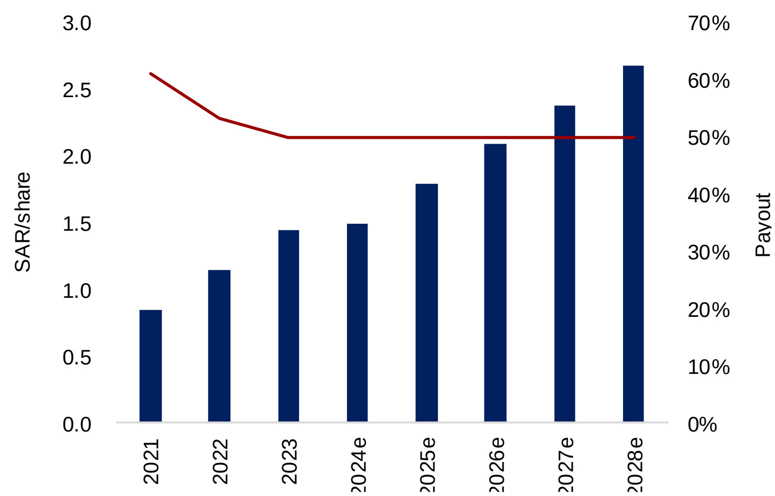
Source: Company filings and US Research

The leverage (debt to total capital) of Mobily, which had been at c.48% before 2022, has been witnessing a reduction in the past two years and was at 40% in 2023. The company has been making investments consistently in the past to shore up its infrastructure to cater to the dynamic industry needs and towards revenue growth. As a result, capex has averaged c.16-17% in the past five years. We forecast it to average c.15% between 2023-28e. However, this has been largely mitigated by improving cash generation by Mobily. Cash from operations of Mobily has improved at a CAGR of 11% between 2020 and 2023, averaging c.90% of EBITDA in the past two years. This in turn has aided the company to reduce its leverage. We forecast for a consistent drop in leverage in the medium term, leading to lower finance costs (a fall of 15% CAGR between 2023-28e). Overall, we forecast for the net income of Mobily to increase at a CAGR of 13% between 2023-28e.

Dividends to improve as profitability rises

Unlike its larger peer STC, Mobily does not have a minimum dividend policy. Given its relatively nascent stages of operation and investment requirement, the company's dividend policy is evolving. In 2023, it made a dividend payment of SAR1.5/share (50% payout), which gives a yield of c.3%. We expect the dividend payments to improve, as the profitability improves and we forecast it to maintain an average payout of c.50% between 2023-28e.

Dividends to consistently improve



Source: Company filings and US Research

Initiate coverage with a TP of *SAR59/share* and a *BUY* rating

Valuation:

Growing market position, consistent investment in infrastructure, strong growth opportunities from the business segment, and stable revenue from the consumer segment are likely to aid Mobily post mid-single digit growth rates in revenue. However, the gross margins have come under pressure in the recent past and we expect this to continue in the short term before they stabilize. Further, we expect the capex requirement of Mobily to continue to be material, requiring consistent fund infusions. This will be mitigated by strong cash flow generation, which is likely to result in the reduction in leverage, resulting in lower financial costs. This and stable SG&A expenses are likely to aid growth in net income, despite pressure on margins. Overall, we have a positive outlook on Mobily and initiate coverage with a target price of ***SAR59/share*** and a ***BUY rating***.

Discounted Cash Flow (SAR mn)	2024E	2025E	2026E	2027E	2028E
Net operating profit after tax	2,770	3,150	3,516	3,883	4,252
Add Depreciation	3,666	3,687	3,736	3,808	3,904
Working capital changes	511	225	230	243	256
Less: Capex	(2,754)	(2,934)	(3,119)	(3,314)	(3,520)
Free cash flow to firm	**4,192**	**4,128**	**4,363**	**4,620**	**4,892**
PV of free cash flow to firm	**3,936**	**3,561**	**3,458**	**3,364**	**3,273**
Sum of PV of free cash flow to firm					**17,592**
Add: Terminal value					35,820
EV					**53,412**
Less: Net debt					(7,741)
Equity value					**45,671**
Fair value per share (SAR)					***59***

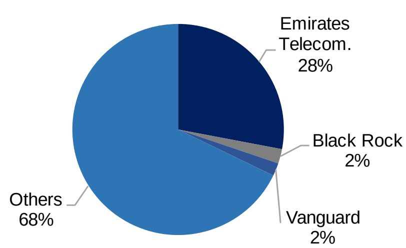
Cost of Capital	
Risk free rate	4.1%
Adjusted beta	1.1x
Equity risk premium	4.7%
Cost of equity	9.2%
Cost of debt	6.0%
Target D/E	10.0%
WACC	8.8%
Terminal growth rate	2.0%

We arrive at the target price using discounted cash flow to the firm methodology, which is based on a risk-free rate of 4.1%, a market risk premium of 4.7%, a beta of 1.1x, and a target debt to capital of 10%, giving us a WACC of 8.8%. Based on these inputs we arrive at a fair value price of ***SAR59/share***.

About the Company

Mobily is the second largest telcom player in Saudi. It was established in 2004 and was the winning bidder for the country's second GSM license. It commenced its operations in 2005 acquiring over 1mn subscribers in the first 90 days. In 2006 the company launched 3.5G services, with 4G and 5G being launched in 2011 and 2019 respectively. Mobily has grown over the period through strategic acquisitions, including Bayanat al-Oula, a licensed data service provider, and the purchase of a majority stake in Zajil, a leading internet service provider in Saudi in 2008. It also owns a 66% stake in Saudi National Fiber Network (SNFN), which is one of the largest fiber optic networks globally. The company has one of the largest wireless network coverages in the region and one of the widest FTTH networks. It also has one of the largest data center systems worldwide. Emirates Telecommunications Group, with a 28% stake is the largest shareholder of Mobily.

Mobily major shareholders



Mobily board members

Board of Directors		
S.no	Name	Position
1	Mr. Abdulkarim I. AlNafie	Chairman
2	Mr. Suliman A. AlGwaiz	Vice-Chairman
3	Eng. Homood A. AlTuwaijri	Director
4	Eng. Khalifa H. AlShamsi	Director
5	Dr. Khaled A. AlGhoneim	Director
6	Eng. Mutaz K. AlAzzawi	Director
7	Dr. Mohammed K. Bennis	Director
8	Eng. Hatem M. Dowidar	Director
9	Dr. Nabeel M. AlAmudi	Director
10	Eng. Ahmed A. Aboudoma	Director

Source: Bloomberg, Company filings and US Research

Income Statement (SAR mn)	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Revenue	14,046	14,834	15,717	16,763	17,864	19,033	20,232	21,498	22,833
Cost of sales	(5,894)	(6,163)	(6,336)	(7,311)	(8,146)	(8,679)	(9,226)	(9,803)	(10,412)
Gross profit	**8,152**	**8,672**	**9,381**	**9,452**	**9,718**	**10,354**	**11,006**	**11,695**	**12,421**
Operating expenses	(6,782)	(7,018)	(7,053)	(6,475)	(6,679)	(6,898)	(7,148)	(7,434)	(7,756)
Operating profit	**1,370**	**1,654**	**2,328**	**2,977**	**3,039**	**3,456**	**3,858**	**4,261**	**4,666**
Other income	(4)	(3)	12	(2)	(2)	(2)	(2)	(2)	(2)
Finance expenses - Net	(540)	(500)	(561)	(526)	(509)	(412)	(322)	(232)	(140)
Earnings before tax	**826**	**1,151**	**1,779**	**2,449**	**2,529**	**3,042**	**3,534**	**4,027**	**4,524**
Tax	(43)	(79)	(122)	(217)	(224)	(270)	(313)	(357)	(401)
Net income	**783**	**1,072**	**1,657**	**2,232**	**2,305**	**2,773**	**3,220**	**3,670**	**4,123**

Balance Sheet (SAR mn)	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Property and equipment	21,321	20,380	19,508	19,012	18,968	19,083	19,341	19,732	20,250
Intangibles	8,240	7,911	7,608	7,316	7,066	6,832	6,613	6,409	6,219
Right to use assets	2,321	2,730	2,703	2,730	2,775	2,846	2,942	3,058	3,194
Other non-current assets	50	259	235	259	292	325	359	393	427
Total non-current assets	**31,932**	**31,279**	**30,053**	**29,317**	**29,101**	**29,087**	**29,254**	**29,592**	**30,089**
Contract assets	485	876	1,209	1,424	1,542	1,643	1,746	1,856	1,971
Receivables	3,895	4,593	3,338	3,391	3,613	3,850	4,092	4,348	4,618
Inventories	73	108	109	151	168	179	190	202	215
Cash & Cash Equivalents	929	1,051	828	1,654	2,083	2,274	2,530	2,869	3,304
Investments	300	1,000	2,014	2,128	2,128	2,128	2,128	2,128	2,128
Other current assets	793	457	628	752	760	767	775	783	790
Total current assets	**6,476**	**8,085**	**8,125**	**9,500**	**10,294**	**10,841**	**11,461**	**12,186**	**13,026**
Total assets	**38,408**	**39,364**	**38,178**	**38,817**	**39,395**	**39,928**	**40,716**	**41,777**	**43,115**
Share Capital	7,700	7,700	7,700	7,700	7,700	7,700	7,700	7,700	7,700
Total reserves	6,745	7,496	8,659	9,923	11,075	12,461	14,071	15,906	17,968
Total equity	**14,445**	**15,196**	**16,359**	**17,623**	**18,775**	**20,161**	**21,771**	**23,606**	**25,668**
Short term borrowings	1,349	1,211	1,313	1,611	1,611	1,611	1,611	1,611	256
Short term lease liabilities	769	928	1,010	1,179	531	560	591	624	624
Trade payables	4,669	4,606	2,941	3,341	3,723	3,967	4,217	4,481	4,759
Contract liabilities	1,067	738	695	786	876	933	992	1,054	1,119
Other current liabilities	3,130	3,601	4,106	4,280	4,643	4,880	5,122	5,378	5,647
Total current liabilities	**10,985**	**11,083**	**10,065**	**11,197**	**11,384**	**11,951**	**12,532**	**13,147**	**12,405**
Long term debt	10,134	9,624	8,310	6,700	5,089	3,478	1,867	256	0
Long term lease liabilities	1,836	2,193	2,211	2,045	2,850	2,996	3,156	3,329	3,552
Other non-current liabilities	1,008	1,268	1,233	1,253	1,297	1,342	1,389	1,438	1,490
Total non-current liabilities	**12,978**	**13,085**	**11,755**	**9,998**	**9,235**	**7,816**	**6,412**	**5,024**	**5,042**
Total Liabilities	**23,963**	**24,168**	**21,820**	**21,195**	**20,620**	**19,767**	**18,944**	**18,171**	**17,447**
Equity and liabilities	**38,408**	**39,364**	**38,178**	**38,817**	**39,395**	**39,928**	**40,716**	**41,777**	**43,115**

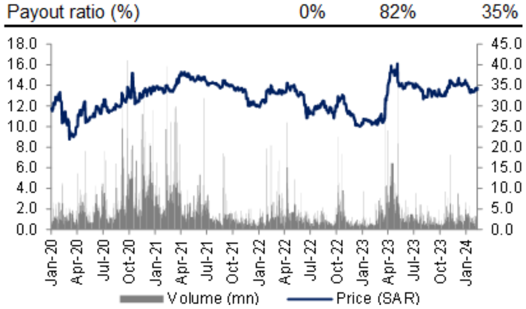
Cash Flows (SAR mn)	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Cash from operations	4,170	4,729	5,684	5,771	6,451	6,654	7,155	7,690	8,251
Cash from investments	(2,866)	(2,916)	(3,406)	(2,023)	(2,754)	(2,934)	(3,119)	(3,314)	(3,520)
Cash from financing	(1,626)	(1,692)	(2,501)	(2,922)	(3,268)	(3,529)	(3,781)	(4,036)	(4,296)
Net changes in cash	(322)	121	(223)	827	428	192	256	339	435
Closing balance (C/b)	**929**	**1,051**	**828**	**1,654**	**2,083**	**2,274**	**2,530**	**2,869**	**3,304**

Ratios	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Per Share (SAR)									
EPS	1.0	1.4	2.2	2.9	3.0	3.6	4.2	4.8	5.4
BVPS	18.8	19.7	21.2	22.9	24.4	26.2	28.3	30.7	33.3
DPS	0.5	0.9	1.2	1.5	1.5	1.8	2.1	2.4	2.7
FCF/share	1.7	2.4	3.0	4.9	4.8	4.8	5.2	5.7	6.1
Revenue/share	18.2	19.3	20.4	21.8	23.2	24.7	26.3	27.9	29.7
Valuations									
M.Cap (SAR mn)	20,688	23,736	28,218	33,363	40,502	40,502	40,502	40,502	40,502
EV (SAR mn)	33,547	35,640	38,222	41,115	46,372	44,744	43,069	41,326	39,503
P/E	26.4	22.2	17.0	14.9	17.6	14.6	12.6	11.0	9.8
EV/EBITDA	6.3	6.4	6.2	6.2	6.9	6.3	5.7	5.1	4.6
EV/Sales	2.4	2.4	2.4	2.5	2.6	2.4	2.1	1.9	1.7
P/BV	1.4	1.6	1.7	1.9	2.2	2.0	1.9	1.7	1.6
P/S	1.5	1.6	1.8	2.0	2.3	2.1	2.0	1.9	1.8
Div. yield	1.9%	2.8%	3.1%	3.3%	2.8%	3.4%	4.0%	4.5%	5.1%
FCF yield	6.3%	7.6%	8.1%	11.2%	9.1%	9.2%	10.0%	10.8%	11.7%
Liquidity									
Cash Ratio	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.3
Current ratio	0.6	0.7	0.8	0.8	0.9	0.9	0.9	0.9	1.1
Quick ratio	0.6	0.7	0.8	0.8	0.9	0.9	0.9	0.9	1.0
Return ratio									
ROA	2.0%	2.7%	4.3%	5.7%	5.9%	6.9%	7.9%	8.8%	9.6%
ROE	5.4%	7.1%	10.1%	12.7%	12.3%	13.8%	14.8%	15.5%	16.1%
ROCE	4.8%	5.7%	8.0%	10.2%	10.5%	12.0%	13.3%	14.5%	15.5%
Cash cycle									
Contract asset turnover	29.0	16.9	13.0	11.8	11.6	11.6	11.6	11.6	11.6
Payables turnover	1.3	1.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Contract liabilities turnover	5.5	8.4	9.1	9.3	9.3	9.3	9.3	9.3	9.3
Receivables turnover	3.6	3.2	4.7	4.9	4.9	4.9	4.9	4.9	4.9
Inventory turnover	80.4	57.2	58.1	48.5	48.5	48.5	48.5	48.5	48.5
Contract asset days	13	22	28	31	32	32	32	32	32
Payable days	289	273	169	167	167	167	167	167	167
Contract liabilities days	66	44	40	39	39	39	39	39	39
Receivables days	101	113	78	74	74	74	74	74	74
Inventory days	5	6	6	8	8	8	8	8	8
Cash Cycle	(237)	(176)	(98)	(94)	(93)	(93)	(93)	(93)	(93)
Profitability ratio									
Gross margins	58.0%	58.5%	59.7%	56.4%	54.4%	54.4%	54.4%	54.4%	54.4%
EBITDA margins	38.0%	37.6%	39.3%	39.5%	37.5%	37.5%	37.5%	37.5%	37.5%
Operating margins	9.8%	11.2%	14.8%	17.8%	17.0%	18.2%	19.1%	19.8%	20.4%
PBT margins	5.9%	7.8%	11.3%	14.6%	14.2%	16.0%	17.5%	18.7%	19.8%
Net margins	5.6%	7.2%	10.5%	13.3%	12.9%	14.6%	15.9%	17.1%	18.1%
Effective tax rate	5.2%	6.9%	6.8%	8.9%	8.9%	8.9%	8.9%	8.9%	8.9%
Leverage									
Total debt (SAR mn)	14,089	13,955	12,845	11,534	10,081	8,645	7,225	5,820	4,433
Net debt (SAR mn)	13,159	12,904	12,017	9,880	7,998	6,370	4,695	2,951	1,129
Debt/Capital	49.4%	47.9%	44.0%	39.6%	34.9%	30.0%	24.9%	19.8%	14.7%
Debt/Total assets	36.7%	35.5%	33.6%	29.7%	25.6%	21.7%	17.7%	13.9%	10.3%
Debt/Equity	1.0	0.9	0.8	0.7	0.5	0.4	0.3	0.2	0.2
Debt/EBITDA	2.6	2.5	2.1	1.7	1.5	1.2	1.0	0.7	0.5
Net debt/EBITDA	2.5	2.3	1.9	1.5	1.2	0.9	0.6	0.4	0.1

Telcom

HOLD: 12M TP @ 13
Upside 1.4%

Valuation Summary (TTM)			
Price (SAR)			**12.8**
PER TTM (x)			9.1
P/Book (x)			1.1
P/Sales (x)			1.2
EV/Sales (x)			2.1
EV/EBITDA (x)			7
Dividend Yield (%)			3.9
Free Float (%)			59%
Shares O/S (mn)			899
YTD Return (%)			-9%
Beta			1.2
(mn)		**SAR**	**USD**
Market Cap		11,522	3,072
EV		19,528	5,206
Price performance (%)	**1M**	**3M**	**12M**
Mobile Telecommunications	-8%	-9%	-3%
Tadawul All Share Index	1%	6%	17%
Trading liquidity (,000)	**1M**	**3M**	**6M**
Avg daily turnover (SAR ,000)	70,657	76,349	59,911
Avg Daily Volume (,000)	8,483	5,610	4,364
52 week	**High**	**Low**	**CTL***
Price (SAR)	16.34	12.54	2.2
* CTL is % change in CMP to 52wk low			
Major shareholders			
Zain Group			37.0%
Black Rock Inc			2.2%
Vanguard Group Inc			2.0%
Others			58.8%
Other details			
Exchange			Saudi Arabia
Sector			Telecommunications
Index weight (%)			0.3%
Key ratios	**2021**	**2022**	**2023**
EPS (SAR)	0.24	0.61	1.41
BVPS (SAR)	10.06	10.91	11.78
DPS (SAR)	0.00	0.50	0.50
Payout ratio (%)	0%	82%	35%



Mobile Telecommunication Co – Limited upside

Mobile Telecommunication Company Saudi Arabia (Zain KSA) is one of the three companies in the Kingdom offering mobile telephony. It is the 3rd largest player in the country and operates in three major business segments. Mobile Telecommunication Co (MTC), which is the largest segment accounting for 86% of the revenue. Zain Sales Co. (11%), which is the distribution arm of the company, and Zain Payments Co (Tamam) (3%), which is the fintech arm offering microfinance in the Kingdom. The company operates MTC with 8.9mn customers in 2023, with the number of customers registering a CAGR of 8% between 2020-23. We expect the subscriber base is likely to grow steadily and will be driven by the return to normal of Hajj and Umrah visitors and the revival in the influx of foreign workers. However, the competition in this segment has also increased, with the players looking to grow/retain market share. As a result of this, ARPU's have fallen at an average rate of 6% between 2020-23. We expect this trend to continue, as revenue is likely to be driven by growth in subscribers, while ARPU will remain under pressure. We also see potential for growth in FTTH, given its relatively nascent absorption within the country, providing potential upside to revenues. Overall, we expect MTC sales to increase at a CAGR of 2-3% between 2023-28e.

Tamam, despite being the 3rd largest vertical for Zain KSA, is the fastest growing business for the company. Revenue from this segment grew by a robust 123% YoY in 2023. Given the limited presence of micro-finance agencies in the Kingdom we see strong potential for growth. Further, this business is also one of the most profitable operations of Zain KSA, and its increasing importance will also provide a positive impetus to the company's overall profitability. Overall, we expect the revenue from this segment to register a CAGR of c.30% between 2023-28e. Zain Sales Co. has been a laggard in terms of performance, with both the revenue and profitability underperforming its other verticals. This is likely to continue, though we expect the performance to stabilise in the medium term. Overall, we expect the revenue of Zain KSA to register a CAGR of 3-4% between 2023-28e. However, we expect the operating performance growth to be much better, as we forecast operating profit to grow at a CAGR of c.12% over the same period, and will be aided by an improvement in gross margins, powered by improving sales mix, and better control over operating costs.

The leverage (debt to total capital) of Zain KSA at 46% appears to be on the higher side, due to its consistently high capex in the past (18% of revenue between 2019-23). We expect the company will continue with its capex outlay, with it averaging c.16-18% between 2024e-28e. Further, we also expect it to maintain a dividend of SAR0.5/sh in the medium term. Given this, we expect Zain KSA's leverage to remain high, though the same is likely to moderate from the current levels.

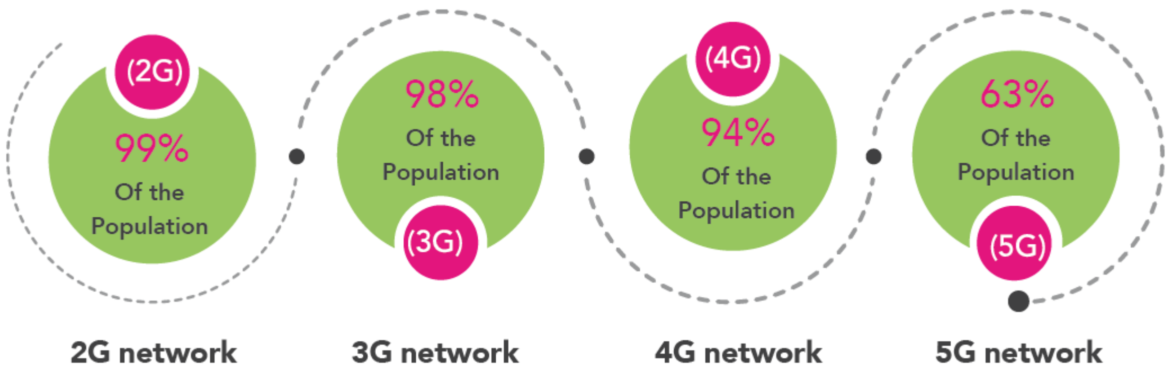
Valuations: We take into account the steady performance of Zain KSA's MTC segment and the strong growth from Tamam operations. We also expect the profit growth to be firm in the medium term aided by improvement in margins and better control over operating cost. However, our view is tempered by the high leverage and the current valuation, which at 27x its 2024e EPS offers limited upside from the current levels. Overall, we initiate coverage on Zain KSA with a ***Hold*** rating at a target price of ***SAR13/share.***

3rd largest telcom player in Saudi

Strong presence in the Saudi telcom industry

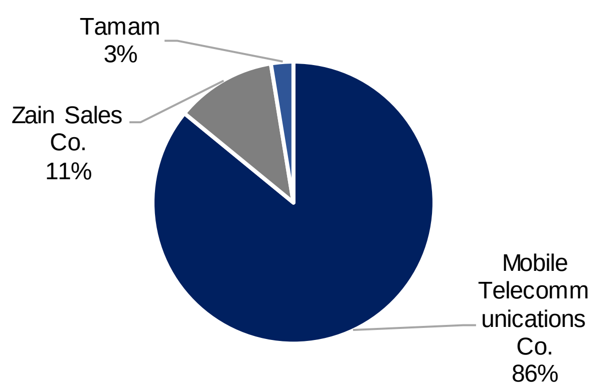
Mobile Telecommunication Company Saudi Arabia (Zain KSA) is the third largest telcom player in Saudi Arabia. The company services 8.9mn customers, covering 10,385 sites with 566 cities covered with 3G, 479 cities covered with 4G, and 65 cities covered with 5G. It has a coverage of 99% population in 2G, 98% in 3G, 94% in 4G, and 65% in 5G. Its distribution network includes 253 shops and 4,377 POS. Apart form its core operations of providing mobile services to its customers, the company has also branched out to selling of telcom equipments, fintech, digital entertainment, IoT, AI, clound, etc.

Strong network coverage



Source: Company filings

Mobile operations dominate revenue



Source: Company filings and US Research

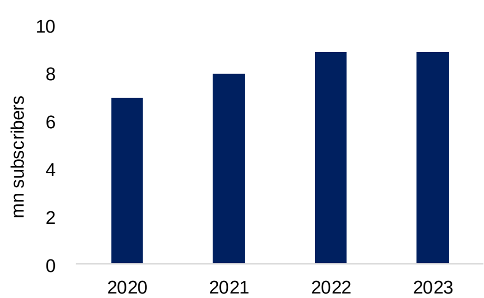
Zain KSA operates through four segments, Mobile Telecomunication Company (MTC), which accounts for 86% of the revenue, Zain Sales Company, which accounts for 11% of the revenue, Zain Payment Company (Tamam), which accounts for 3% of the revenue, and Zain Drones, which currently has a negligble contribution to the total revenue.

Mobile telcom operation offers stable growth

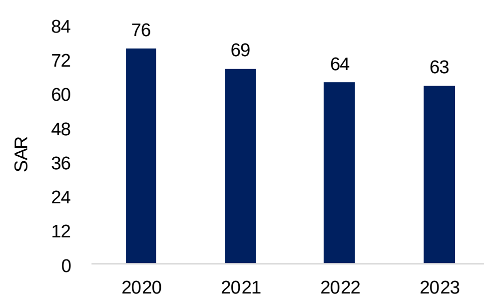
Revenue growth to remain steady and will be driven by customer growth

MTC includes the core operations of Zain KSA, of providing mobile telecommunication services to its customers and is the largest vertical of its operations. The company is one of the three mobile service providers in the country, with the revenue from MTC growing at a CAGR of 7% between 2020-23. Revenue has been largely driven by the growth in its customer base, which has increased at a CAGR of 8% from 7mn customers in 2020 to 9mn customers in 2023. This segment is highly concentrated and competitive, with all the three players looking at capturing market share aggressively. This has resulted in the blended ARPU of the company registering a fall of 6% CAGR from SAR76 in 2020 to SAR63 in 2023. Going forward, we expect this trend to broadly continue, as we expect the ARPUs to remain under pressure and growth is likely to come at the back of an improvement in the subscriber base. With religious tourism (Hajj and Umrah) and the overseas flow of workers reverting back to normal, we expect user demand to remain steady. Overall, we expect the revenue of MTC to grow at a CAGR of 2.5% between 2023-28e.

Steady growth in subscriber base



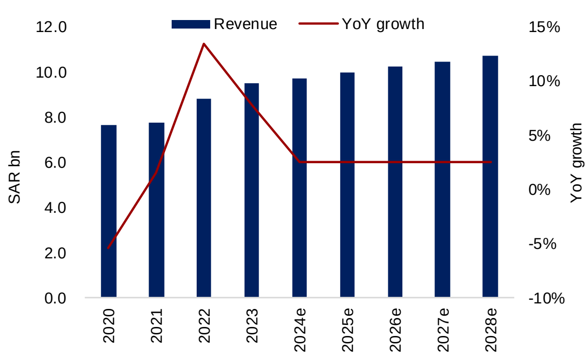
ARPU's come under pressure



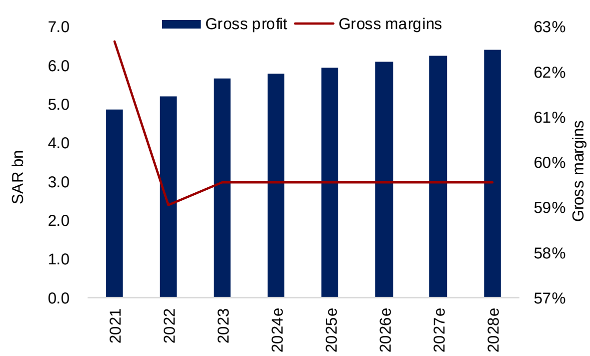
Source: Company filings and US Research

This segment's profitability has been historically robust, with its gross profit growing at a CAGR of 8% between 2021-23. Despite the fall in gross margins from 62.7% in 2021 to 59.6% in 2023, the profitability remains strong. High levels of competition to capture/retain market share was the main reason for the same. However, we expect the profitability to stabilize at the current levels in the years to come. Overall, we expect gross profits of MTC to increase at a CAGR of 2-3% between 2023-28e.

Core telcom revenue to report steady growth



Gross margins to stabilise



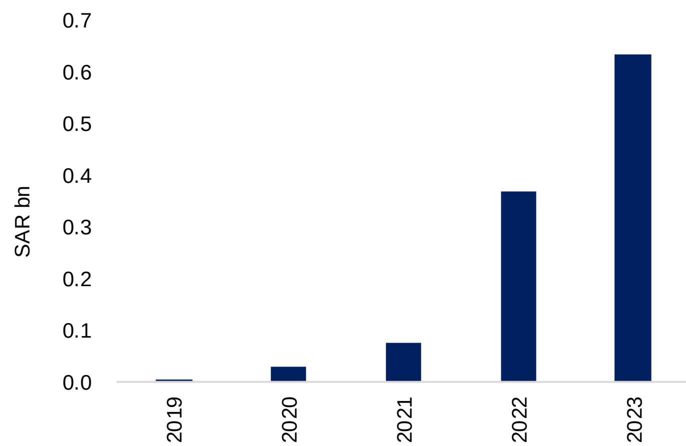
Source: Company filings and US Research

Tamam is the fastest growing segment of Zain KSA

Tamam offers growth opportunities

Tamam is the fintech arm of Zain KSA and offers Sharia compliant micro finance to its customers. Though this is the third largest segment, accounting for a mere 3% of revenue in 2023, it is one of the fastest growing segments for Zain KSA. Its total assets have grown from a mere SAR28mn in 2020 to SAR636mn in 2023, while revenue more than doubled from SAR127mn in 2022 to SAR284mn in 2023. Given the relatively low penetration of micro-finance in the country, and a relative absence of major companies tapping this segment, we expect the growth outlook to remain strong for Tamam. We forecast revenue from this vertical to grow at a CAGR of 30% between 2023-28e. However, we also remain cautious, given the structural risk present in this segment, due to the inherent high credit risk in the business model. As of Jun-23, the company's NPL levels were at c.15% of its net loans; though these levels are at par of the micro-finance industry, it does expose the company to potential default risk.

Tamam total assets have grown exponentially

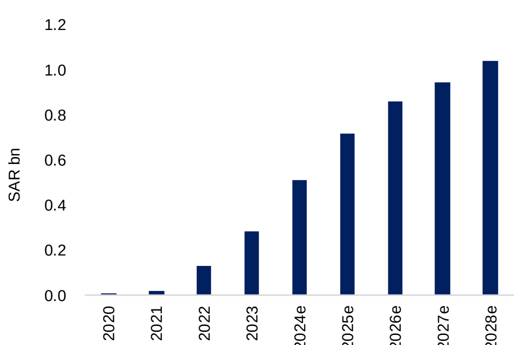


Source: Company filings and US Research

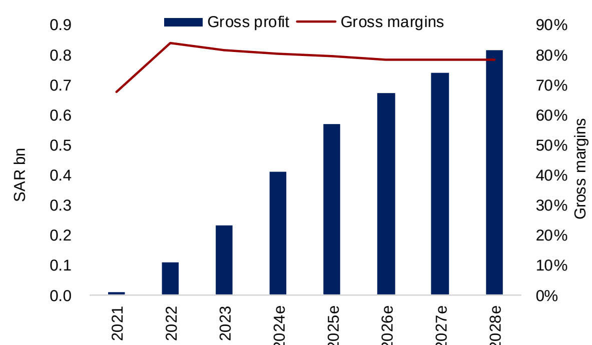
Tamam the most profitable segment of Zain KSA

The segment is also the most profitable vertical for Zain KSA, with its gross profit margins attractive at 81.5% for 2023 (84.1% in 2022). We expect this trend to broadly continue and forecast gross profit growth of 30-40% CAGR between 2022-28e.

Tamam revenue to grow consistently



Gross margins to remain elevated

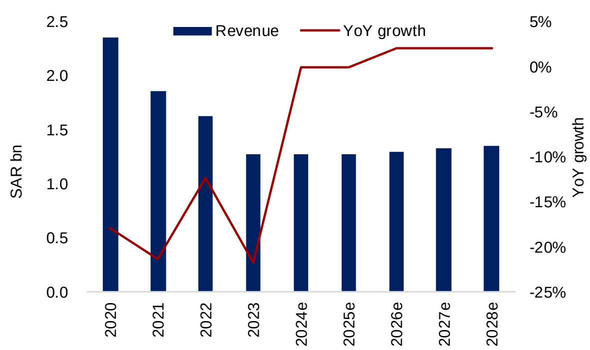


Source: Company filings and US Research

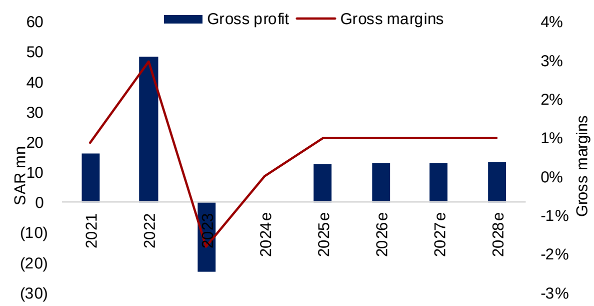
Zain Sales to remain a laggard

Zain Sales is the 2nd largest segment of Zain KSA, accounting for 11% of the revenue. This vertical is into the sale of telcom equipment & handset and providing consulting services. The wholly owned subsidiary was established as the sales arm of the company and is a bridge between Zain KSA and consumer sales & distribution channels. However, the importance of this segment to total revenue has been diminishing, as its proportion to total revenue has come down from 30% in 2020 to the current levels. The sales from this vertical have fallen at a CAGR of 19% between 2020-23. Going forward, we expect the revenue in this vertical to stabilize, though its overall importance is likely to continue to fall.

Revenue to stabilise, though will lag other verticals



Profitability to remain low, despite revovery from 2023



Source: Company filings and US Research

Financial performance will continue to lag the overall performance

Profitability of this segment too has been a drag on the overall profitability, as the company registered a gross loss of SAR23mn (-1.8% gross margins) in 2023. Even historically it has operated with thin margins and we expect this trend to broadly continue for our forecast period.

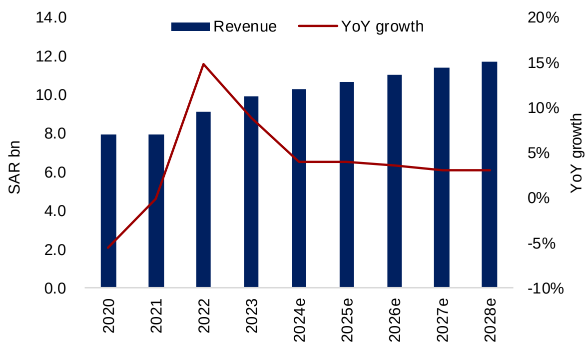
Financial performance to be stable, though leverage remains high

Revenue growth to be driven by Tamam

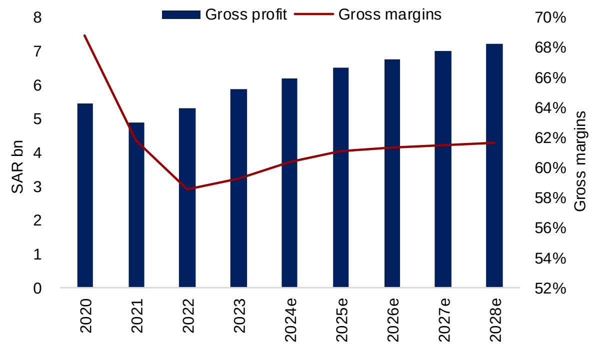
Zain KSA revenue for 2023 increased by 8.9% YoY to SAR9.9bn, driven by a 123.5% YoY increase in the sale from Tamam and a 7.8% YoY improvement in revenue from MTC. The revenue of Zain Sales on the other hand fell by 21.8% YoY. Going forward, we expect the revenue to grow at a CAGR of 3-4%, with it being driven by continued robust performance from Tamam and a steady performance from MTC.

Gross profits increased by 10.2% YoY to SAR5.9bn for 2023, aided by higher revenue and gross margins improving by c.70bps YoY to 59.3%. A more than 50bps YoY improvement in the margins of MTC's operation was the main reason for this. Going forward, we expect the gross margins to consistently improve during our forecast period, and will be aided by the increasing importance of Tamam and stable margins from MTC.

Revenue growth to remain stable



Gross margins to improve aided by Tamam



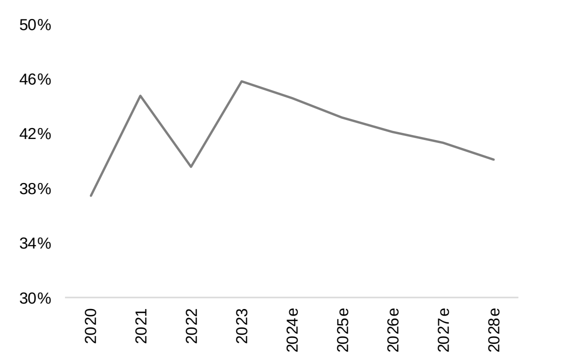
Source: Company filings and US Research

Operating expenses on the other hand increased by 17.3% YoY, at the back of higher SG&A expenses. Despite higher revenue and an improvement in the gross margins, EBITDA of Zain KSA fell by 5.6% YoY to SAR3.0bn at the back of higher opex. Going forward, we expect the opex to come under control during our forecast period, which will aid in an improvement in EBITDA at a CAGR of 5% between 2023-28e.

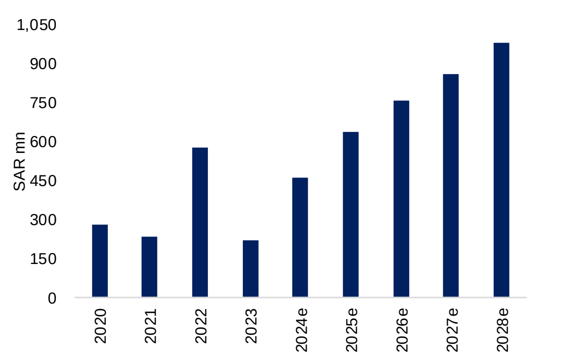
Leverage levels to moderate, though slowly

Zain KSA's leverage levels at 45.8% (debt to total capital) in 2023 was on the higher side and has been driven by the consistently high capex requirement for the business. Capex to revenue in the past five years have averaged c.18% of total revenue. Going forward, we expect it to remain high for Zain KSA and we forecast it to average between 16-18% in the next five years.

Leverage levels to moderate, slowly



Net income pre-one offs to improve consistently



Source: Company filings and US Research

In 2023, Zain KSA finalized the transfer of 8,069 of its telcom towers to Golden Lattice Investment Co. (GLIC) for a total consideration of SAR3.0bn. The consideration was settled through a cash payment of SAR2.4bn and a 20% stake in GLIC. Zain KSA, during the year, sold its 20% stake in GLIC to PIF for a consideration of SAR0.7bn. It used a part of these to reduce its debt. Despite this, the leverage levels are high, though we expect it to moderate though the same will be gradual.

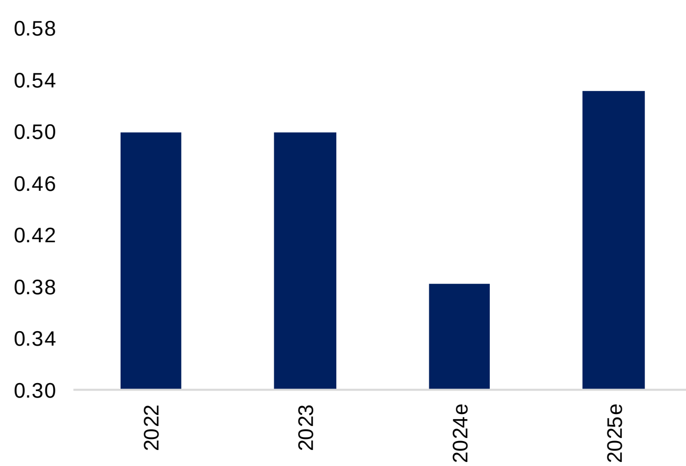
One-off gains aids net income growth in 2023

In 2023, the company booked a net gain from the sale of its towers and stake in GLIC of SAR1.1bn, which in turn aided in the net income growing by a robust 130.5% YoY to SAR1.3bn. But for these one-off gains the financial performance would have been weak. Going forward we expect the net income before tax and one-off gains to grow at a CAGR of 35%, between 2023-28e and will be aided by improvement in margins, and a moderation in finance cost.

Dividend to remain flat

Zain KSA started paying dividend from 2022 and have maintained it at 0.5/share (yield of c.4%) in 2023 too. We expect the company will continue to pay dividend at these levels and the same is likely to average between SAR0.4 to 0.5 per share, as we expect excess cash to be utilized towards reduction of its leverage.

Dividend to be in the range of SAR0.4 to SAR0.5/share



Source: Company filings and US Research

Initiate coverage with a TP of *SAR13*/share and a *Hold* rating

Valuation:

Steady growth in Zain KSA's core telcom business, and strong growth in its microfinance operations, through Tamam is likely to aid in a moderate growth of revenue. The growth in Tamam's operation is also likely to aid in the improvement of overall margins, aiding in net income growth. However, leverage of the company continues to remain elevated. Given its high capex requirement, the reduction in leverage is likely to be slow. The company is currently trading at 27x its 2024e earnings, and we do not see much upside from the current levels. Overall, we initiate coverage on Zain KSA with a ***target price of SAR13/share*** and a ***Hold rating***.

Discounted Cash Flow (SAR mn)	2024E	2025E	2026E	2027E	2028E
Net operating profit after tax	999	1,147	1,252	1,346	1,452
Add Depreciation	2,141	2,181	2,214	2,237	2,255
Working capital changes	181	205	226	12	12
Less: Capex	(1,848)	(1,920)	(1,987)	(2,046)	(2,107)
Free cash flow to firm	**1,474**	**1,613**	**1,705**	**1,550**	**1,612**
PV of free cash flow to firm	**1,379**	**1,381**	**1,334**	**1,109**	**1,055**
Sum of PV of free cash flow to firm					**6,257**
Add: Terminal value					13,487
EV					**19,744**
Less: Net debt					(8,007)
Equity value					**11,737**
Fair value per share (SAR)					***13***

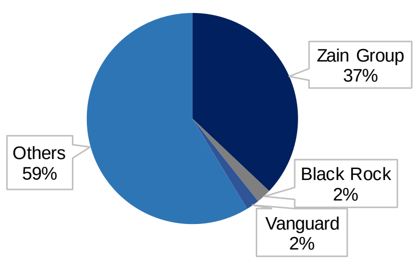
Cost of Capital	
Risk free rate	4.1%
Adjusted beta	1.2x
Equity risk premium	4.7%
Cost of equity	9.7%
Cost of debt	8.0%
Target D/E	15.0%
WACC	9.4%
Terminal growth rate	2.0%

We arrive at the target price using discounted cash flow to the firm methodology, which is based on a risk-free rate of 4.1%, a beta of 1.2x, a market risk premium of 4.7%, and a target debt to capital of 15%, giving us a WACC of 9.4%. Based on these inputs we arrive at a fair value price of ***SAR13/share***.

About the Company

Zain KSA is one of the leading telcom operators in the Kingdom and was established as a listed company in 2008. The company provides telecom services, digital payment services, cloud computing, IoT solutions, fiber services, drones, etc. It was the first operator in Saudi Arabia to launch 4G/LTE network in 2011. In 2019 it started it's 5G journey by establishing 2,600 towers covering 28 cities across the country. In its second phase it covers 53 cities through 5,000 towers and is ranked the fourth largest 5G deployment globally. Zain Group, which is one of the leading telcom players in the region, with presence in Kuwait, Saudi, Bahrain, Iraq, Jordan, Sudan, South Sudan and Morocco, owns 37% stake in the company.

Zain KSA major shareholders



Zain KSA board members

Board of Directors		
S.no	Name	Position
1	Mr. Abdulkarim I. AlNafie	Chairman
2	Mr. Suliman A. AlGwaiz	Vice-Chairman
3	Eng. Homood A. AlTuwaijri	Director
4	Eng. Khalifa H. AlShamsi	Director
5	Dr. Khaled A. AlGhoneim	Director
6	Eng. Mutaz K. AlAzzawi	Director
7	Dr. Mohammed K. Bennis	Director
8	Eng. Hatem M. Dowidar	Director
9	Dr. Nabeel M. AlAmudi	Director
10	Eng. Ahmed A. Aboudoma	Director

Source: Company filings and US Research

Income Statement (SAR mn)	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Revenue	7,917	7,901	9,075	9,883	10,266	10,665	11,038	11,365	11,707
Cost of sales	(2,472)	(3,016)	(3,760)	(4,025)	(4,065)	(4,149)	(4,268)	(4,376)	(4,487)
Gross profit	**5,445**	**4,885**	**5,315**	**5,857**	**6,201**	**6,516**	**6,770**	**6,989**	**7,219**
Operating expenses	(4,443)	(4,186)	(4,250)	(4,986)	(5,132)	(5,289)	(5,430)	(5,548)	(5,666)
Operating profit	**1,002**	**699**	**1,066**	**871**	**1,069**	**1,227**	**1,340**	**1,441**	**1,554**
Other income	176	22	74	1,203	75	67	61	62	62
Finance expenses - Net	(898)	(489)	(566)	(719)	(684)	(655)	(641)	(640)	(635)
Earnings before tax	**280**	**231**	**574**	**1,356**	**459**	**639**	**760**	**862**	**980**
Tax	(20)	(17)	(24)	(89)	(30)	(42)	(50)	(57)	(64)
Net income	**260**	**214**	**550**	**1,267**	**429**	**597**	**710**	**805**	**916**

Balance Sheet (SAR mn)	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Property and equipment	6,857	6,640	4,926	4,736	4,996	5,309	5,670	6,073	6,521
Intangibles	16,280	15,561	14,967	14,245	14,005	13,796	13,616	13,460	13,329
Right to use assets	1,285	1,331	440	843	1,080	1,264	1,407	1,517	1,603
Other non-current assets	353	564	648	801	801	801	801	801	801
Total non-current assets	**24,775**	**24,096**	**20,980**	**20,625**	**20,882**	**21,170**	**21,493**	**21,852**	**22,254**
Contract assets	96	67	151	118	122	127	131	135	139
Receivables	1,996	2,988	3,990	5,532	5,544	5,546	5,519	5,683	5,853
Inventories	187	214	147	158	159	163	167	172	176
Cash & Cash Equivalents	1,103	512	375	946	528	197	207	179	177
Other current assets	0	0	2,818	0	0	0	0	0	0
Total current assets	**3,383**	**3,781**	**7,481**	**6,753**	**6,354**	**6,033**	**6,024**	**6,169**	**6,345**
Total assets	**28,158**	**27,877**	**28,461**	**27,378**	**27,235**	**27,203**	**27,517**	**28,021**	**28,599**
Share Capital	8,987	8,987	8,987	8,987	8,987	8,987	8,987	8,987	8,987
Total reserves	(258)	52	815	1,604	1,690	1,809	2,093	2,415	2,873
Total equity	**8,729**	**9,040**	**9,802**	**10,591**	**10,677**	**10,797**	**11,081**	**11,403**	**11,861**
Short term borrowings	0	3,214	837	1,187	522	302	102	965	792
Short term lease liabilities	319	264	110	216	219	221	223	225	227
Trade payables	4,586	4,691	5,136	4,954	5,146	5,346	5,533	5,697	5,868
Other current liabilities	4,194	2,131	3,167	1,577	1,584	1,600	1,621	1,641	1,661
Total current liabilities	**9,099**	**10,300**	**9,250**	**7,934**	**7,471**	**7,468**	**7,479**	**8,529**	**8,549**
Long term debt	3,836	2,638	5,171	6,533	6,576	6,274	6,173	5,207	5,231
Long term lease liabilities	1,065	1,209	310	1,017	1,208	1,360	1,482	1,579	1,656
Other non-current liabilities	5,429	4,691	3,928	1,303	1,303	1,303	1,303	1,303	1,303
Total non-current liabilities	**10,330**	**8,538**	**9,408**	**8,853**	**9,087**	**8,938**	**8,958**	**8,089**	**8,189**
Total Liabilities	**19,429**	**18,837**	**18,659**	**16,787**	**16,558**	**16,406**	**16,437**	**16,618**	**16,738**
Equity and liabilities	**28,158**	**27,877**	**28,461**	**27,378**	**27,235**	**27,203**	**27,517**	**28,021**	**28,599**

Cash Flows (SAR mn)	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Cash from operations	4,029	1,574	1,912	1,716	2,752	2,984	3,150	3,054	3,183
Cash from investments	(1,825)	(1,085)	(1,344)	1,618	(1,848)	(1,920)	(1,987)	(2,046)	(2,107)
Cash from financing	(2,215)	(861)	(699)	(2,762)	(1,322)	(1,395)	(1,154)	(1,036)	(1,079)
Forex changes	(2)	(3)	(2)	(1)	0	0	0	0	0
Net changes in cash	(13)	(376)	(133)	571	(418)	(331)	9	(27)	(3)
Closing balance (C/b)	**1,103**	**512**	**375**	**946**	**528**	**197**	**207**	**179**	**177**

Ratios	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Per Share (SAR)									
EPS	0.3	0.2	0.6	1.4	0.5	0.7	0.8	0.9	1.0
BVPS	9.7	10.1	10.9	11.8	11.9	12.0	12.3	12.7	13.2
DPS	-	-	0.5	0.5	0.4	0.5	0.5	0.5	0.5
FCF/share	2.5	0.5	0.6	3.7	1.0	1.2	1.3	1.1	1.2
Revenue/share	8.8	8.8	10.1	11.0	11.4	11.9	12.3	12.6	13.0
Valuations									
M.Cap (SAR mn)	10,725	12,499	11,073	11,707	11,522	11,522	11,522	11,522	11,522
EV (SAR mn)	14,842	19,311	17,125	19,714	19,518	19,482	19,294	19,319	19,251
P/E	41.3	58.3	20.1	9.2	26.9	19.3	16.2	14.3	12.6
EV/EBITDA	4.3	6.2	5.4	6.6	6.1	5.7	5.4	5.3	5.1
EV/Sales	1.9	2.4	1.9	2.0	1.9	1.8	1.7	1.7	1.6
P/BV	1.2	1.4	1.1	1.1	1.1	1.1	1.0	1.0	1.0
P/S	1.4	1.6	1.2	1.2	1.1	1.1	1.0	1.0	1.0
Div. yield	0.0%	0.0%	4.1%	3.8%	3.0%	4.1%	3.7%	4.2%	4.0%
FCF yield	20.5%	3.9%	5.1%	28.5%	7.8%	9.2%	10.1%	8.8%	9.3%
Liquidity									
Cash Ratio	0.1	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Current ratio	0.4	0.4	0.8	0.9	0.9	0.8	0.8	0.7	0.7
Quick ratio	0.4	0.3	0.8	0.8	0.8	0.8	0.8	0.7	0.7
Return ratio									
ROA	0.9%	0.8%	1.9%	4.6%	1.6%	2.2%	2.6%	2.9%	3.2%
ROE	3.0%	2.4%	5.6%	12.0%	4.0%	5.5%	6.4%	7.1%	7.7%
ROCE	7.2%	4.3%	6.6%	4.5%	5.6%	6.5%	7.0%	7.4%	7.9%
Cash cycle									
Contract asset turnover	82.1	117.5	60.1	84.0	84.0	84.0	84.0	84.0	84.0
Payables turnover	0.5	0.6	0.7	0.8	0.8	0.8	0.8	0.8	0.8
Receivables turnover	4.0	2.6	2.3	1.8	1.9	1.9	2.0	2.0	2.0
Inventory turnover	13.2	14.1	25.6	25.5	25.5	25.5	25.5	25.5	25.5
Contract asset days	4	3	6	4	4	4	4	4	4
Payable days	677	568	499	449	462	470	473	475	477
Receivables days	92	138	160	204	197	190	183	183	183
Inventory days	28	26	14	14	14	14	14	14	14
Cash Cycle	(553)	(401)	(318)	(226)	(246)	(262)	(272)	(274)	(276)
Profitability ratio									
Gross margins	68.8%	61.8%	58.6%	59.3%	60.4%	61.1%	61.3%	61.5%	61.7%
EBITDA margins	43.5%	39.6%	34.8%	30.1%	31.3%	32.0%	32.2%	32.4%	32.5%
Operating margins	12.7%	8.8%	11.7%	8.8%	10.4%	11.5%	12.1%	12.7%	13.3%
PBT margins	3.5%	2.9%	6.3%	13.7%	4.5%	6.0%	6.9%	7.6%	8.4%
Net margins	3.3%	2.7%	6.1%	12.8%	4.2%	5.6%	6.4%	7.1%	7.8%
Effective tax rate	7.0%	7.3%	4.2%	6.6%	6.6%	6.6%	6.6%	6.6%	6.6%
Leverage									
Total debt (SAR mn)	5,220	7,324	6,427	8,953	8,524	8,157	7,979	7,976	7,906
Net debt (SAR mn)	4,117	6,812	6,052	8,007	7,996	7,960	7,773	7,797	7,729
Debt/Capital	37.4%	44.8%	39.6%	45.8%	44.4%	43.0%	41.9%	41.2%	40.0%
Debt/Total assets	18.5%	26.3%	22.6%	32.7%	31.3%	30.0%	29.0%	28.5%	27.6%
Debt/Equity	0.6	0.8	0.7	0.8	0.8	0.8	0.7	0.7	0.7
Debt/EBITDA	1.5	2.3	2.0	3.0	2.7	2.4	2.2	2.2	2.1
Net debt/EBITDA	1.2	2.2	1.9	2.7	2.5	2.3	2.2	2.1	2.0

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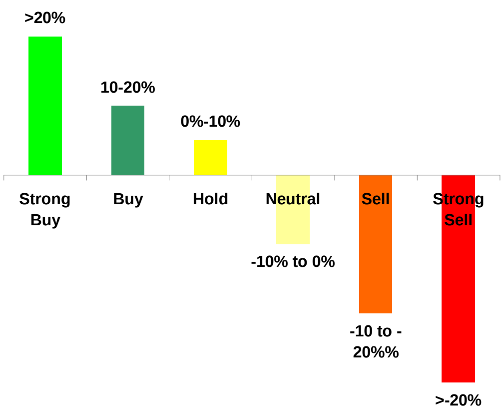
Rating Criteria and Definitions

Rating



Rating Definitions

Strong Buy	This recommendation is used for stocks whose current market price offers a deep discount to our 12-Month target price and has an upside potential in excess of 20%
Buy	This recommendation is used for stocks whose current market price offers a discount to our 12-Month target price and has an upside potential between 10% to 20%
Hold	This recommendation is used for stocks whose current market price offers a discount to our 12-Month target price and has an upside potential between 0% to 10%
Neutral	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential between 0% to -10%
Sell	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential between -10% to -20%
Strong Sell	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential in excess of 20%
Not rated	This recommendation used for stocks which does not form part of Coverage Universe

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