



Zain KSA to go for capital reduction, followed by rights issue to strengthen the capital structure

Zain KSA announced its plan to reduce capital from SAR 5.8bn to SAR 4.2bn, representing a decrease of ~28%, to wipe out accumulated losses of SAR 1.6bn. Subsequently, the company will issue rights worth a total of SAR 4.5bn, increasing the capital from SAR 4.2bn to SAR 8.7bn

In FY19, Zain KSA reduced its accumulated losses to SAR 1.6bn (~28% of total capital) from SAR 1.8bn (~31%) in FY18. With the proposed capital cut, the company would be able to erase accumulated losses from the balance sheet, while capital raised through the rights issue will be used to reduce debt. This will help the company in terms of interest savings. Zain KSA also mentioned the possibility of dividend distribution to shareholders post rights issue.

Table 1

(In SARmn)	Current (as of Dec 2019)	After capital reduction	Post rights issue
Share capital	5,837	4,229	8,729
Accumulated losses	-1,608	0	0
Equity	4,103	4,103	8,603
Debt	16,750	16,750	16,750
Cash	1,157	1,157	5,657
D/E	4.1	4.1	1.9

Source: Company filings, Aljazira Capital
*as of Sep 2019

According to our calculations, the process of capital reduction and subsequent issuance of rights should improve Zain KSA's leverage ratio from 4.1x to 1.9x, even if the additional capital is not used to repay debt.

In case of debt repayment from the new capital, we consider three scenarios:

Scenario 1: Debt repayment of SAR 1,500mn

Scenario 2: Debt repayment of SAR 3,000mn

Scenario 3: Debt repayment of SAR 4,500mn

Table 2

(In SARmn)	Scenario 1 Debt repayment of SAR 1,500mn	Scenario 2 Debt repayment of SAR 3,000mn	Scenario 3 Debt repayment of SAR 4,500mn
Share capital	8,729	8,729	8,729
Accumulated losses	0	0	0
Equity	8,603	8,603	8,603
Debt	15,250	13,750	12,250
Cash	4,157	2,657	1,157
D/E	1.8	1.6	1.4
Finance cost	951	857	764
Interest rate	6.1%	6.1%	6.1%
Savings in finance cost	91	183	274

Source: Company filings, Aljazira Capital

Thus, the rights issue and debt reduction are expected to benefit the company financials by improving leverage ratio from 4.1x to 1.4–1.8x and reducing annual finance cost by SAR 91 - 274mn.

Moreover, improved financial ratios and the capacity to generate higher profit would allow Zain KSA to borrow at lower interest rates. For FY19, Zain KSA's interest charges stood at ~6.1% of total debt, approximately 400bps above the six-month SAIBOR. We expect a decline of 150–250bps in interest rates after debt reduction. This will further ease finance cost for the company.

Neutral

Target Price (SAR) 11.5

Upside / (Downside)* 4.5%

Source: Tadawul *prices as of 19th of February 2020

Key Market Data

Market Cap(mn) 6,153

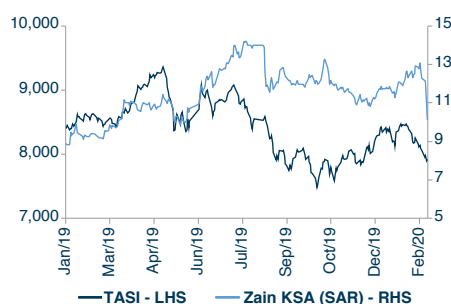
YTD% -13.6

52 week (High)/(Low) 14.46/9.03

Share Outstanding (mn) 583.7

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

Head of Research

Talha Nazar

+966 11 2256250

t.nazar@aljaziracapital.com.sa



Table 3

(In SARmn)	Scenario 1 Debt repayment of SAR 1,500mn	Scenario 2 Debt repayment of SAR 3,000mn	Scenario 3 Debt repayment of SAR 4,500mn
Share capital	8,729	8,729	8,729
Accumulated losses	0	0	0
Equity	8,603	8,603	8,603
Debt	15,250	13,750	12,250
D/E	1.8	1.6	1.4
Reduction in interest rate	150bps	200bps	250bps
Interest rate	4.7%	4.2%	3.7%
Finance cost	722	582	458
Savings in finance cost	322	462	587

Source: Company filings, Aljazira Capital

*as of Sep 2019

Assuming 150bps, 200bps and 250bps reduction in the above-mentioned Scenarios 1, 2 and 3, respectively, would result in savings of SAR 322–587mn in finance cost. This may effectively increase the company's net profit (FY19: SAR 485mn) by ~1.6-2.2x. With the number of shares increasing from 584mn to 873mn (~1.5x), the capital restructuring exercise may turn EPS accretive for shareholders.

Table4

(In SARmn)	Scenario 1 Debt repayment of SAR 1,500mn	Scenario 2 Debt repayment of SAR 3,000mn	Scenario 3 Debt repayment of SAR 4,500mn
Actual net profit	485	485	485
No. of shares	584	584	584
EPS (SAR)	0.83	0.83	0.83
Savings in finance cost	322	462	587
Net profit post savings	796	930	1,050
No. of shares	873	873	873
Effective EPS (SAR)	0.91	1.07	1.20
Incremental EPS	0.08	0.23	0.37

Source: Company filings, Aljazira Capital

*as of Sep 2019

AJC view: We believe that the proposed restructuring of capital from Zain KSA was an essential step for the company to improve financial health. The company's bottom-line is expected to benefit from the lower finance cost. Moreover, a strong balance sheet would support the high level of capex (FY19: SAR 1.9bn) anticipated in the next 2–3 years as the company continues to invest in network infrastructure and the 5G rollout. Zain KSA is currently trading at a PE of 12.2x. If valued at the same multiple (12.2x) to an effective EPS range of SAR 0.91-1.20, the share price would range from **SAR 11.1-14.7/ share**.



RESEARCH DIVISION

AGM-Head of Research
Talha Nazar
+966 11 2256250
t.nazar@aljaziracapital.com.sa

Senior Analyst
Jassim Al-Jubran
+966 11 2256248
j.aljabran@aljaziracapital.com.sa

Analyst
Abdulrahman Al-Mashal
+966 11 2256374
A.Almashal@Aljaziracapital.com.sa

BROKERAGE AND INVESTMENT CENTERS DIVISION

General Manager – Brokerage Services & sales
Alaa Al-Yousef
+966 11 2256060
a.yousef@aljaziracapital.com.sa

AGM-Head of international and institutional brokerage
Luay Jawad Al-Motawa
+966 11 2256277
l.almutawa@aljaziracapital.com.sa

AGM-Head of Qassim & Eastern Province
Abdullah Al-Rahit
+966 16 3617547
aalrahit@aljaziracapital.com.sa

AGM-Head of Central & Western Region Investment Centers
Sultan Ibrahim AL-Mutawa
+966 11 2256364
s.almutawa@aljaziracapital.com.sa

RESEARCH DIVISION

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- Underweight:** This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
- Neutral:** The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
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Head Office: King Fahad Road, P.O. Box: 20438, Riyadh 11455, Saudi Arabia, Tel: 011 2256000 - Fax: 011 2256068