

# Saudi Telecom Sector

Telecom Industrial

Saudi Arabia

09 December 2012

الراجحي المالية  
Al Rajhi Capital



**US\$ 38.5bn** Market cap  
**34.0%** Free float  
**US\$44.1mn** Avg. daily volume

Target mkt cap **167.4** 15.9% over current  
Consensus mkt cap. **174.3** 20.7% over current  
Current mkt cap. **144.4** as at 09/12/2012

Research Department

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Underweight

Neutral

**Overweight**

## Key themes

We remain positive on the Saudi telecom sector on the back of rising smart-phone penetration and consequent growth in data consumption. Mobily continues to strengthen its position in the Saudi market, while STC concentrates on its international businesses.

## Implications

Mobily remains our top pick in the sector. We also remain Overweight on STC on the back of improvement in profitability of its international businesses. We have slashed our estimates for Zain KSA, as the company is struggling with its financial problems and losing revenue market share to the other two players. We remain Neutral on Zain KSA, considering a sharp correction in the stock.

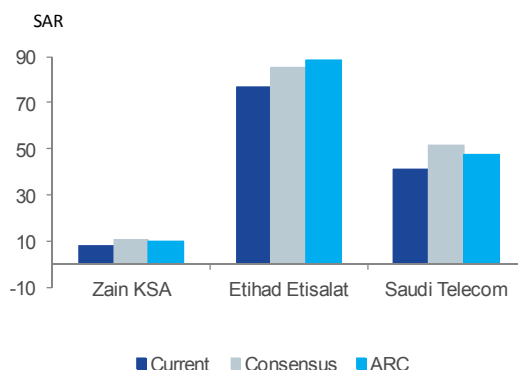
## What do we think?

Stock	Rating	Price Target
Mobily	Overweight	SAR88.7
STC	Overweight	SAR47.2
Zain	Neutral	SAR10.0

## Why do we think it?

Stock	3 year EBITDA CAGR	2013 EV/EBITDA
STC	4.4%	4.2x
Mobily	10.1%	6.1x
Zain	14.9%	19.2x

## Where are we versus consensus?



Source Bloomberg, Al Rajhi Capital



## Saudi Telecoms Sector: Data segment to drive growth

We remain bullish on the Saudi telecom sector despite the saturating mobile penetration levels, as we believe information and communications technology services will only grow in importance over time. Broadband remains the key growth driver for telecom operators in Saudi Arabia, as increasing smart-phone penetration levels and changing usage patterns of consumers are expected to result in a sharp rise in data consumption. Mobily remains our top pick in the sector, as it continues to outpace its peers, while STC will benefit from improving profitability from its international businesses. On the other hand, Zain is struggling to improve performance both on financial and operational fronts. We have slashed our target price on Zain KSA but continue with Neutral rating, considering a more than 50% correction in the stock price post restructuring.

**Mobily – maintains its growth trajectory.** We believe Mobily will continue to post robust growth next year, driven by rising subscriber base and data consumption. The company has increased its dividend payout in line with its financial performance, a move which was well received by the market. We expect the dividend payout to increase to SAR5 per share in 2013, implying a dividend yield of 6.6%.

**STC – international business key trigger.** STC's international business provides new avenues for growth in a saturating domestic mobile market. Recent financials have signaled that the profitability of its international businesses has been improving. The stock looks attractive at the current level.

**Zain – need to reduce its debt.** Despite the capital restructuring the company has not been able to refinance its debt obligations yet. The weak operating performance during 9M 2012 has added to the company's woes.

**Valuation and conclusion.** We maintain our Overweight rating on Mobily and STC with a revised target price of SAR88.7 and SAR47.2 respectively. We reiterate Neutral rating on Zain KSA, after slashing our target price to SAR10 per share.



# Saudi Telecom sector

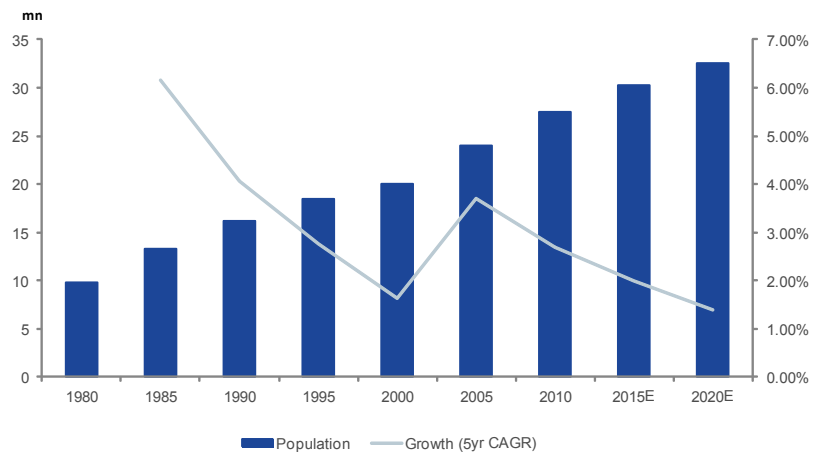
## Positive fundamentals to boost growth

About half the Saudi population is below the age of 26; and being tech savvy augurs well for the telecom sector

### Favorable demographics to support data revenues

Saudi Arabia is one of the youngest countries in the world, with 30% population is below 15, while about 50% below the age of 26 years (source: CIA World Fact book). In addition, the Kingdom's population is growing at a rate of about 2.3% (source: World Bank), which is greater than the MENA region as a whole and also higher compared to emerging countries such as Brazil, China and India. Both these factors of high population growth and the high percentage of youth augur well for the telecom sector. A study conducted by Neilson in 2011 showed that the Saudi youth led their peers in the BRIC countries and even the US in downloads of screen savers and ring tones, and were second only to US in checking e-mails. This data indicates that the current Saudi generation is increasingly IT-literate. Thus, the young population of Saudi Arabia is likely to drive data usage, as the youth are more technology savvy.

Figure 1 Rising Saudi population



Source: World Bank, Al Rajhi Capital

### Rising smartphone penetration

The availability of relatively cheap entry-level and mid-level smartphones are giving a boost to smartphone sales in the Kingdom. According to estimates by Informa telecoms & media, smartphone penetration in Saudi Arabia stood at 25% at the end of 2011, and is expected to jump to 48.5% by 2016. Our talks with various operators in the country has also indicated that smartphone penetration on their network is around 30% currently and about 50% of new phones being sold are smartphones which reflects huge potential of data usage in years to come.

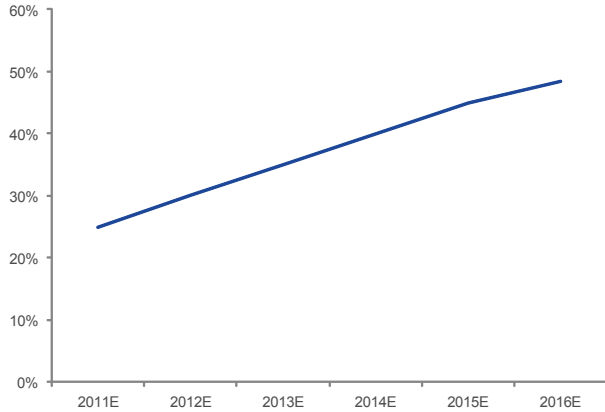
According to estimates by CISCO, a smartphone generated 35 times more mobile data traffic than a basic feature phone in 2011, as users were able to download digital content (applications/games/ringtones/wallpapers) easily and stay connected (e-mails/instant messaging applications). Thus, rising smartphone penetration will lead to huge growth in data consumption. In addition, smartphones are also being increasingly used in our daily lives as people use mobile banking, mobile payments, make online purchases etc. According to estimates by CISCO, data consumption by an average smartphone has trebled from 2010 to 2011, indicating that people are increasingly using data services on their smartphones.

CISCO estimates that the mobile data traffic in the MENA region will grow at a CAGR of more than 100% from 2011 to 2016. Since Saudi Arabia is one of the biggest mobile markets, we believe the Kingdom will lead the rise in data consumption in the region.

According to various market research, Smartphone penetration is expected to increase from 25% in 2011 to 48.5% in 2016

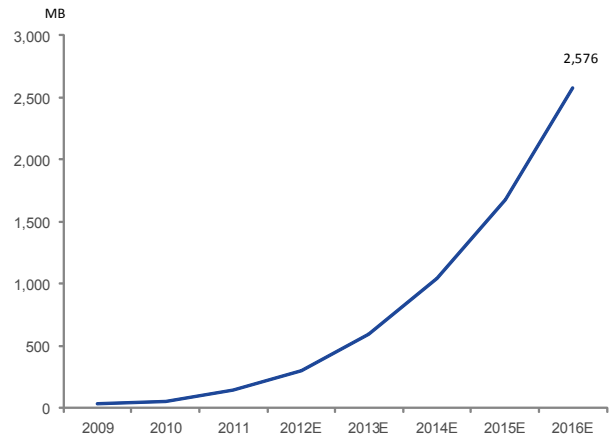


**Figure 2 Smartphone penetration rising in Saudi Arabia**



Source: Informa Telecom & Media, Al Rajhi Capital

**Figure 3 Average monthly data usage by a smartphone**



Source: CISCO, Al Rajhi Capital

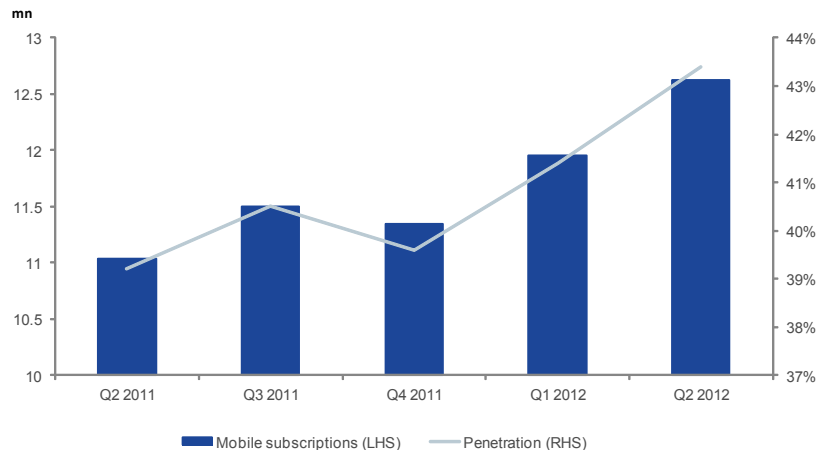
**Launch of 4G network will boost data usage in the Kingdom**

**Launch of LTE (4G) services to augment data usage**

LTE (also called 4G) services were launched in Saudi Arabia in late 2011 with all three telecom operators claiming to be the first to launch such service in the Kingdom. This technology can support speeds of up to 100Mbps, compared to 3G speed of up to 7Mbps and 3.5G HSPA+ speed of up to 42.2 Mbps. 3G services were launched in Saudi Arabia in 2006, and data usage has grown exponentially since then. Now with the launch of 4G services, data consumption will get another impetus, as 4G will enable users to watch high quality video content and live mobile TV with ease. 4G will also accelerate access to streaming video and audio data, and accelerate video conferencing. We believe the adoption of 4G services will increase with the launch of a number of 4G supporting mobiles phones (like Iphone 5). Even as 3G users transfer to 4G services, 2G users will continue to migrate towards 3G as most low-end and mid-level phones now support 3G technology.

Broadband usage in Saudi Arabia has shot up over the past few years. Fixed broadband subscriptions have increased 10 fold from 0.22mn subscribers in 2006 to 2.21mn at the end of H1 2012. However, mobile broadband has only caught consumer fancy over the past three years, as subscribers rose from 1.31mn at the end of 2009 to 12.62mn at the end of H1 2012. The Kingdom’s mobile broadband penetration has reached 43.4% at the end of H1 2012, which is high compared to countries like Germany, Italy and Canada. However, mobile broadband penetration level in the Kingdom is still low compared to the US (76.1%), and the UK (53.0%) (Source: OECD).

**Figure 4 Mobile broadband subscriptions**



Source: CITC, Al Rajhi Capital



## Strong growth in data segment to drive growth

With Mobile penetration reaching 187.5% in Saudi Arabia, we maintain our view that broadband data is the growth driver for the maturing telecom sector in Saudi Arabia. We believe that all three mobile operators share our view, which can be inferred by heavy investments going into the 4G technology. We expect revenues from data will continue to form a bigger portion of the total revenues for the telecom companies over the coming years. Currently Mobily obtains about 20-25% of its revenues from data services, and we expect it to increase to 30% by 2013. STC generated about 18% of its consolidated revenues from data services in the first three quarters in 2012, up from about 13% in 2011. This figure is likely to continue to increase steadily over the next few quarters. Zain has also seen an increasing percentage of revenues from the data segment.

Figure 5 Data revolution: Expected data usage growth per device, per month

Device Type	2010	2011	2016
Nonsmartphone	1.9MB	4.3MB	108MB
E-reader	0.5MB	0.73MB	2.8MB
Smartphone	55MB	150MB	2,576MB
Portable gaming console	244MB	317MB	1,056MB
Tablet	405MB	517MB	4,223MB
Laptop and netbook	1,460MB	2,131MB	6,942MB
M2M module	35MB	71MB	266MB

Source: CISCO, Al Rajhi Capital

As a result of the rapid growth in data consumption, all three telecom players are competing to garner maximum share in the segment. To entice customers to adopt the 4G technology data subscription, Zain is offering the first 100,000 customers' double data limit for life, at no extra cost. That is, the first 100,000 customers can enjoy for eg. 10 GB data limit at the price of 5 GB for life. Mobily is also wooing customers by offering an extra 10 GB of data limit on 5GB plans for two consecutive month renewals. STC, which has the biggest market share in the Kingdom, also have very competitive packages.

Figure 6 Various services provided by telecom operators

STC	Mobily	Zain
Mobile voice & data	Mobile voice & data	Mobile voice & data
Dedicated mobile data	Dedicated mobile data	Dedicated mobile data
Wireless broadband	Wireless broadband	Wireless broadband
Fixed line broadband internet		
Fixed Line voice		
IPTV		

Source: Company data, Al Rajhi Capital

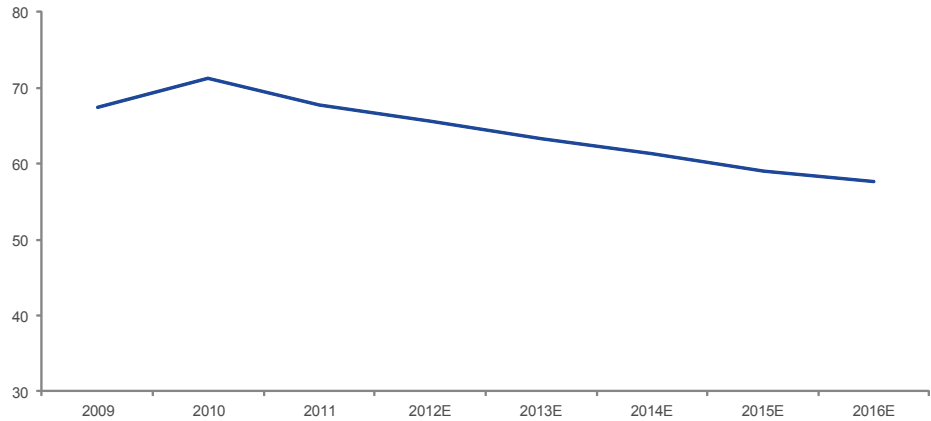
## ARPU's to remain under pressure as competition intensifies

ARPU's used to be artificially lower earlier as telecom operators used to include inactive connections to their subscriber base. Inactive sim cards had become a considerable portion of the total mobile base since millions of tourists used to take temporary sim cards in Saudi Arabia on an annual basis during their visit for the Hajj pilgrimage. With CITC's decision to exclude inactive connections from the subscriber base calculation, ARPU figures are at a more sensible level now. Nevertheless, with mobile penetration reaching close to 190% levels, the voice market is saturating. In addition, intense competition among the telecom operators to capture market share has led to a price war among the telecom operators and resulted in declining ARPU's in the Saudi market. As per Business Monitor International (BMI), Saudi Arabia's total blended ARPU is expected to fall from about SAR71.3 in 2010 to SAR65.6 in 2012. Moreover, with three new operators (MVNO's) expected to commence operations over the next few quarters, ARPU's are likely to slide further (BMI expects Saudi Arabia's blended ARPU to reach SAR59 level by 2015). Thus, telecom operators will continue to face margin pressure's over the foreseeable future.

According to CISCO, data usage is expected to grow 8 to 10 times in the next five years; which will benefits telecom companies globally



Figure 7 Saudi Arabia blended ARPU's expected to decline



Source: BMI, Al Rajhi Capital

Blended ARPU continue to decline to a brisk rate

### CITC mandate to verify all sims a big task for operators

The CITC's regulation making it compulsory for telecom operators to verify sim cards of all subscribers has become a big task for operators in the kingdom. All three operators are doing their best to complete the verification formalities in order to ensure that customers are able to recharge their accounts smoothly. Failure to verify the sims on time also results in a risk of customers moving to other operators. In our view, this regulation has been implemented to stop the illegal sales of sims and to prevent any security threat to the country from the same. We believe both Mobily and Zain will face the risk of losing subscribers as both constitute a high percentage of prepaid sims in their subscriber base. As per our estimates, Mobily has about 87% of prepaid customers, whereas Zain's subscriber base consists of more than 90% of prepaid customers. On the other hand, STC's prepaid accounts constitutes of around 80%. While STC too has a fairly high percent of prepaid sims, the company has arranged verification of sims through its wide coverage of outlets, kiosks and special tents as well as emails and sms's in order to try and validate each and every customer. We believe STC could gain from this regulation as it has the strongest network and can afford to reach its customers for validation. Thus, it will be able to do the task in a more efficient way compared to the other two operators. However, the general administrative expenses of all operators should show a spike for another couple of quarters due to increase in staff hours dedicated to these validations. For the moment, we have not included much of its impact in our financials as we await Q4 results to verify the same.

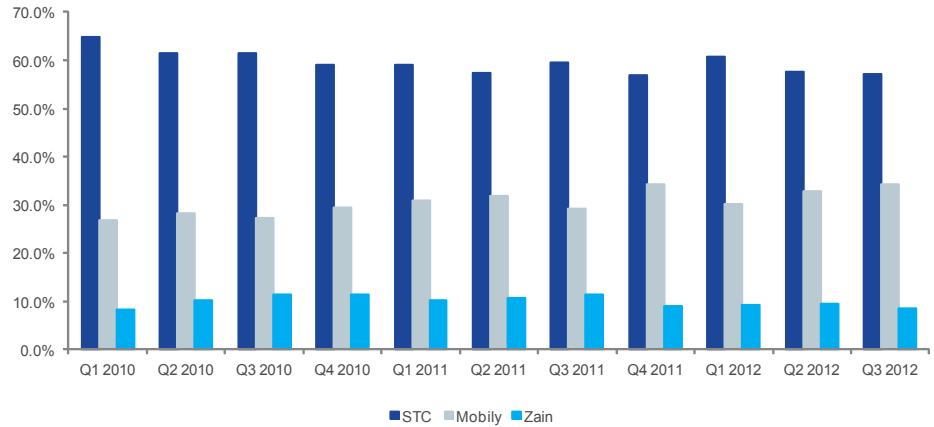
CITC's mandate to verify sims has become a tough task for operators

### Revenue market share matters more

Kingdom's second largest telecom operator Mobily has been steadily gaining market share in terms of subscribers as well as revenue. The company's revenue market share has increased from an estimated 27% in Q1 2010 to about 30% in Q1 2012, and to 34.2% to Q3 2012. Zain, on the other hand, after gaining revenue market share last year, has started to lose the same in 2012. Zain's revenue market share increased from 8.2% in Q1 2010 to 10.2% in Q1 2011 and then fell to 9.2% in Q1 2012, and has fallen further to 8.5% in Q3 2012. STC has lost revenue market share as well as subscriber market share over the past many quarters, which is understandable, as competition has increased in the sector. The company's revenue market share has come down from about 65% during the first quarter of 2010 to 60.7% during the corresponding quarter this year. During Q3 2012, STC's revenue market share stood at 57.2%.



Figure 8 Quarterly revenue market share



Source: Company data, Al Rajhi Capital

Mobily has been successful in increasing market share consistently

## MVNO – Opportunity or Threat?

The Saudi telecom regulator, CITC, plans to issue three MVNO (Mobile Virtual Network Operator) licenses in the near future. MVNO's generally do not own radio spectrum or wireless network infrastructure, instead they enter into a business agreement with a mobile network operator to lease their network infrastructure in order to provide telecom services to its customers. CITC wants each of the three mobile telecom operators in Saudi to partner with an MVNO.

MVNO is being viewed as a positive step by the operators

The introduction of MVNO's can be both an opportunity and a threat for the existing telecom operators. The entrance of new players in the market will definitely lead to price competition and hence lower ARPU's. However, existing players will benefit as they will be able to lease their excess capacity to the MVNOs, thus generating revenue from their new competitors. More importantly, existing telecom operators can also benefit by tying up with MVNO's that provide them with a strategic advantage of focusing on the type of customers or service that the network operator currently does not target.

After our talks with the management of telecom companies we understand that most companies are quite positive about CITC's plan and view the move as an opportunity. STC in particular plans to tie up with an MVNO to provide value added services and target the youth. We expect some development on the MVNO licenses in 2013.

We believe the introduction of MVNO's is a positive step for the saturated Saudi telecom sector. The launch of MVNO's will provide more options for the consumers, while providing a strategic opportunity for telecom operators to target different types of customers.

## iPhone 5 launch – next important driver

The iPhone 5 is expected to be released in Saudi Arabia in the month of December. The phone is expected to lead to a sharp rise in sales of handsets, given the huge fan following that Apple products enjoy. The phone which set record after 5mn handsets were sold in just the first weekend of being released is likely to be very well received in the Kingdom despite negative reviews about its mapping software. We believe the 4G capable phone will drive data usage due to the ease of using internet on such high-end smart-phones. Both STC and Mobily is believed to be launching iPhone5 sales on December 14<sup>th</sup> while Zain is releasing it just a day before on 13<sup>th</sup> December.



## Changes in estimates

### We have raised our forecasts for Mobily, while cutting the estimates for Zain

We have increased our estimates for Mobily, following the better-than-expected result reported by the company during the 9M 2012 and an uptick in data usage in the Kingdom. We have raised our revenue estimate for the company by about 8.6% for 2013 and 6.4% in 2014, taking into account the company's strong performance in 2012 and impressive management guidance for the next year. For STC, we have only marginally tweaked our revenue estimates by less than 1% for both 2013 and 2014 as the company's numbers have been mostly in line with our expectations. However, we have raised net profit estimate for STC by more than 17% for both 2013 and 2014, indicating our expectation of reduced effect of currency fluctuations on the company's bottom line and the improving profitability of its international businesses. On the other hand, we have slashed the revenue estimate for Zain by about 11.2% and 9.1% for 2013 and 2014 respectively, after the company posted a year-on-year decline in its topline during the second and third quarters of 2012.

We have cut our forecasts on zain following a series of poor quarterly performance

Figure 9 Key changes to estimates (SAR in mn)

	2013E	2014E	2015E
<b>STC</b>			
Revenues Old	62,429	65,784	–
Revenues New	62,950	65,280	66,821
Change	0.8%	-0.8%	N/A
EBITDA Old	22,067	23,551	–
EBITDA New	22,418	22,861	23,361
Change	1.6%	-2.9%	N/A
Net Income Old	8,548	9,115	–
Net Income New	10,036	10,681	10,772
Change	17.4%	17.2%	N/A
<b>Mobily</b>			
Revenues Old	23,741	25,905	28,013
Revenues New	25,771	27,568	28,699
Change	8.6%	6.4%	2.5%
EBITDA Old	9,022	9,714	10,645
EBITDA New	9,342	9,957	10,705
Change	3.5%	2.5%	0.6%
Net Income Old	5,975	6,295	6,941
Net Income New	6,320	6,800	7,152
Change	5.8%	8.0%	3.0%
<b>Zain</b>			
Revenues Old	8,018	8,881	9,718
Revenues New	7,119	8,070	8,924
Change	-11.2%	-9.1%	-8.2%
EBITDA Old	1,559	1,963	2,284
EBITDA New	1,096	1,364	1,673
Change	-29.7%	-30.5%	-26.7%
Net Income Old	(678)	(213)	118
Net Income New	(1,261)	(946)	(610)
Change	86.0%	344.1%	-616.8%

Source: Company data, Al Rajhi Capital

## Valuation

### Increased TP for both Mobily and STC while cutting target for Zain

We have reduced the WACC assumption of Mobily taking into account its strong performance in 2012

We have raised our target price of STC from SAR43.5 to SAR47.2

Zain continues to get strangle in financial issues prompting us to reduce our target by around 50%

#### Mobily

As mentioned earlier, Mobily remains our top pick in Saudi Arabia's telecom sector. We have reduced the cost of capital for Mobily from 11.1% to 10.2%, as we have reduced our assumption for risk free rate to 2% from 4.4% earlier. Moreover, we have tweaked our forecasts, to take into account Mobily's strong performance over the last couple of quarters and management guidance. Mobily is currently trading at a PE of 8.4 and a dividend yield of about 6.6% based on our 2013 estimates. Based on our assumptions, we arrive at a fair value of SAR88.7 for the stock, which provides a potential upside of 15.2% from the current market price of SAR77. At our target price, the dividend yield comes out to 5.6%.

#### Saudi Telecom Company

We have valued STC based on the DEP valuation methodology and arrived at a fair value of SAR47.2 for the STC stock, implying a potential upside of 15.2% from the current market price. Hence, we maintain our Overweight rating on the stock. We believe the STC stock deserves a premium over its peers given its international exposure and inherent advantage in the Saudi telecom market (fixed line broadband and voice service). Currently the stock is trading at a PE of 8.1 on 2013 earnings, which we believe is attractive. At our target price of SAR47.2, the stock is valued at a PE of 9.4.

#### Zain KSA

Zain KSA continues to reel under its high debt levels. The company recently went through a capital restructuring process, wherein Zain wrote off its accumulated debt with its share capital and then raised SAR6bn through a rights issue. In addition, the cash strained firm also extended the repayment of a SAR9bn loan for the fifth time. These extensions indicate that the company is finding it extremely difficult to refinance the large amount of outstanding debt. Nevertheless, the company has indicated that it is in advanced talks with a syndicate of banks to refinance the debt and is likely to sign the deal in the fourth quarter.

We have valued Zain based on DEP (discounted economic profit) valuation methodology, with a WACC of 12%. Based on our estimates, we arrive at a fair value target price of SAR10, as against our previous target of SAR15.9. However, we maintain our Neutral rating on the Zain KSA stock giving the extremely high volatility and the significant risks attached to the stock.



**US\$21.86bn** Market cap  
**16%** Free float  
**US\$8.65mn** Avg. daily volume

Target price **47.20** 15.2% over current  
Consensus price **43.53** 6.2% over current  
Current price **41.00** as at 8/12/2012

Research Department

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Underweight

Neutral

**Overweight**

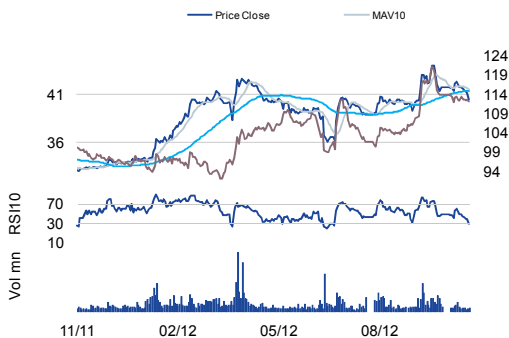
### Key themes

STC is a one stop telecom solutions provider in the KSA. The company also provides diversification benefits with its exposure to international markets. STC plans to increase investments in international businesses. Further, there is a chance for the company to increase its dividend payout. However, fluctuation foreign currency poses a risk for STC.

### Implications

We are positive on STC's long term business and its strong balance sheet. With a low PE and a modest dividend yield, STC is a safe investment option

### Performance

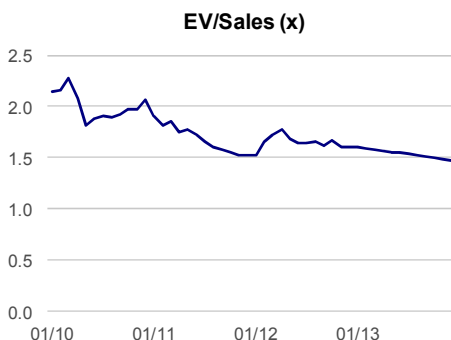


### Earnings

Period End (SAR)	12/12E	12/13E	12/14E	12/15E
Revenue (mn)	59,611	62,950	65,280	66,821
Revenue Growth	6.0%	5.6%	3.7%	2.4%
EBITDA (mn)	21,367	22,418	22,861	23,361
EBITDA Growth	6.2%	4.9%	2.0%	2.2%
EPS	4.69	5.02	5.34	5.39
EPS Growth	22.2%	7.0%	6.4%	0.8%

Source: Company data, Al Rajhi Capital

### Valuation



Source: Company data, Al Rajhi Capital

## Saudi Telecom Company Strong long term bet

*With recovering domestic growth and improving performance of its international subsidiaries, STC remains a strong long term story. The company's international businesses provide new growth avenues, as the domestic market reaches a saturation point. STC has a huge cash balance, which it plans to utilize towards increasing its international presence. We believe that there is also a possibility of the company increasing its dividend payout, which could be a major trigger for the stock. We have raised our net profit estimates for STC for couple of year and thus revised our target price upwards to SAR47.2. We remain overweight.*

**Exposure to international markets:** STC is the only telecom operator in the Kingdom with presence globally and earns about 33% of its revenues from its international businesses, and has a target to increase it to 50% by 2014. With growth likely to slow down in the domestic market as Saudi Arabia's telecom sector reaches a saturation level, the company's international subsidiaries provide new avenues for the company. STC's Kuwait and Bahrain-based businesses have recorded revenue growth of about 46.8% and 37% y-o-y during 9M 2012, while its domestic business grew at 11.3%. The company's investment in Turk Telekom (through Oger Telecom) is also doing well with net profit jumping 38.3% during 9M 2012. Moreover, the asset turnovers of all the subsidiaries have been consistently increasing, suggesting improved performance at the bottom line level as well.

**Gaining market share through bundling packages:** STC is doing well in bundling packages including data, voice and digital television which has helped the company to reach 58% market share till 9M 2012. Having such diversified product also makes it a preferred choice for the corporate sector. This bundling of services also reduces customer churn for STC, as it is difficult for customers to switch away from a single service provider to different service providers for different services.

**Overhang from currency risk:** Since the company has substantial overseas operations, it is exposed to high foreign exchange fluctuation risk. In 2011, the company suffered a foreign exchange loss of more than SAR1.1bn. The large loss in foreign exchange was primarily due to a sharp fall in the value of the Turkish Lira. Nevertheless, the management has indicated that it has taken steps to mitigate this risk by hedging its foreign exchange exposure. We believe that the foreign exchange exposure will continue to be an overhang on the company.

**Valuation:** STC remains a good investment story, due to its competitive advantage in the Saudi market, and the diversification benefits the company offers. STC is currently trading at a PE ratio of 8.7 and 8.1, based on its 2012 and 2013 earnings respectively. We have valued the company based on the DEP valuation methodology and raised our fair value to SAR47.2. This provides a potential upside of about 15.2% from its current market price.



### Corporate summary

STC is the largest telecom operator in the GCC region, with a market value of US\$21.86bn. STC completely dominates the Saudi fixed-line telecom market and retains the highest share of the mobile market by revenues. STC is committed to expansion by investment abroad and acquisition, and has made major investments in Turkey, Malaysia, South Africa and elsewhere. These investments account for around one-third of its value.

### Share information

Market cap (SAR/US\$)	82.00bn / 21.86bn		
52-week range	33.30 - 43.90		
Daily avg volume (US\$)	8.65mn		
Shares outstanding	2,000mn		
Free float (est)	16%		
Performance:	1M	3M	12M
Absolute	-3.1%	1.5%	23.1%
Relative to index	-0.7%	6.1%	14.7%
Major Shareholder:			
Public Investment Fund	70.0%		
Gen. Organisation for Social Insc.	7.0%		

Source: Bloomberg, Al Rajhi Capital

### Valuation

Period End	12/12E	12/13E	12/14E	12/15E
Revenue (SARmn)	59,611	62,950	65,280	66,821
EBITDA (SARmn)	21,367	22,418	22,861	23,361
Net Profit (SARmn)	9,376	10,036	10,681	10,772
EPS (SAR)	4.69	5.02	5.34	5.39
DPS (SAR)	2.00	2.00	2.50	2.80
EPS Growth	22.2%	7.0%	6.4%	0.8%
EV/EBITDA (x)	4.5	4.2	3.9	3.7
P/E (x)	8.7	8.1	7.6	7.6
P/B (x)	1.5	1.4	1.3	1.2
Dividend Yield	4.9%	4.9%	6.1%	6.9%

Source: Company data, Al Rajhi Capital

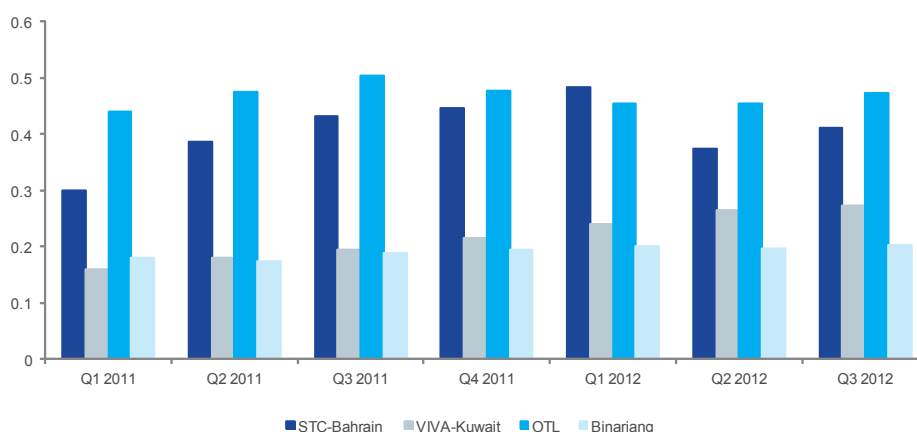
## STC: International businesses key driver

### Improving performance

STC's GCC-based subsidiaries (Bahrain and Kuwait), which are comparatively on a nascent stage currently, are witnessing strong top line growth. The company's other, more developed subsidiaries, Oger Telecom (Turkey and South Africa) and Binariang (Malaysia and India), are also growing, but at a steady pace. However, due to the lack of information made available by STC, we do not know the profitability of these businesses. Therefore, we calculate the asset turnovers of these subsidiaries, using the only information available to us (revenue and total assets), to look at their performance. We notice that OTL's asset turnover is stable in the 45-50% range over the last 11 quarters. Binariang has seen a steady improvement in its asset turnover from 18.3% in Q1 2010 to 20.3% in Q3 2012. STC's smaller subsidiaries VIVA Kuwait, STC-Bahrain and GDMH have witnessed a sharp improvement in their asset turnover, as the top line of these smaller businesses have grown at a high pace.

Improving asset turnover denotes that the business is growing at a steady pace

Figure 10 Improving asset turnover of subsidiaries



Source: Company data, Al Rajhi Capital

### Net profit margin to rise on improved performance of subsidiaries

STC's net profit margin has improved from 13.2% during 9M 2011 to 15.5% in 9M 2012, supported by improving performance of the company's various subsidiaries. As discussed above, though the profitability of all the subsidiaries is not disclosed, the increasing asset turnover of these businesses indicates towards improving performance at the bottom line level as well. VIVA Kuwait turned EBITDA positive in 2011 with a profit of KDO.5mn at the EBITDA level. With a more than 46% y-o-y jump in revenues in the first nine months of 2012, we believe the VIVA Kuwait's bottom line performance would have only improved



STC's huge cash balance will encourage the company to go for further expansion overseas

further. Similarly, revenues from the company's Bahrain and Indonesian businesses have jumped 37% and 75% respectively during 9M 2012. Going forward, we expect STC to report a net profit margin of about 15.7% in 2012, compared to 13.6% in 2011, which is further expected to improve to 16.8% by 2014.

### Huge cash balance

STC has a huge cash balance of about SAR13.8bn at the end of Q3 2012. The management is likely to use this cash to increase its presence in the Middle East. However, with recovery in growth in the domestic market, improving cash balance, and few opportunities for expansion, STC may allocate some cash towards increasing its dividend payout. In addition, the net debt to EBITDA ratio is very low at 0.8, which can again motivate the STC management to increase its dividend payout. If STC increases its dividend payout to SAR2.5 per share, the stock at the current price of SAR40 will offer an attractive dividend yield of 6.2%. We believe the increase in dividend payout could be the much needed trigger for the stock.

STC's margins could improve in Q4 benefiting from international operations

## Expectations for Q4 2012

### Revenues to be flat, margins to improve

Saudi Telecom Company is likely to report revenues of around SAR15.2bn, flat compared to the same period last year. As a result, revenue for 2012 will stand at SAR59.6bn, up 6% y-o-y. We expect the company's EBITDA to stand at SAR5.4bn, about 6.9% higher on a y-o-y basis. EBITDA margin is likely to come in at 35.2% compared to 32.9% during the same period last year, on the back of an improved performance of its international businesses. For the full year, EBITDA margin is expected to be flat at 35.8%, which would turn into an EBITDA of SAR21.4bn, up 6.2% y-o-y. We expect the net profit for the quarter to stand at about SAR2.5bn, up 9.2% from the corresponding quarter last year. For 2012, the company's bottom line is expected to jump about 22.2% y-o-y to SAR 9.4bn. The sharp growth in STC's net profit for 2012 is primarily due to the marginal expected foreign exchange loss of SAR54.5mn in 2012, compared to a loss of SAR1.1bn in 2011.

Figure 10 Saudi Telecom: Q4 & FY2012 estimates

SARmn	Q4 2011A	Q4 2012E	YoY chg. %	FY 2011A	FY2012E	YoY chg. %
Revenues	15,249	15,232	-0.1%	56,220	59,611	6.0%
EBITDA	5,021	5,369	6.9%	20,119	21,367	6.2%
Operating Profit	2,814	3,154	12.1%	11,266	12,506	11.0%
Net Profit	2,278	2,494	9.5%	7,670	9,376	22.2%

Source: Company data, Al Rajhi Capital



Income Statement (SARmn)	12/11A	12/12E	12/13E	12/14E	12/15E
<b>Revenue</b>	<b>56,220</b>	<b>59,611</b>	<b>62,950</b>	<b>65,280</b>	<b>66,821</b>
Access Charges	(9,773)	(10,206)	(11,443)	(11,881)	(12,188)
Employee Costs	(6,683)	(7,302)	(7,694)	(8,095)	(8,219)
Government Charges	(6,271)	(5,660)	(5,742)	(6,071)	(6,181)
S.G. & A. Costs	(7,343)	(7,868)	(8,348)	(8,800)	(9,188)
Repairs & Maintenance Costs	(6,031)	(7,208)	(7,306)	(7,572)	(7,684)
<b>Operating EBIT</b>	<b>11,266</b>	<b>12,506</b>	<b>13,215</b>	<b>13,971</b>	<b>14,148</b>
Cash Operating Costs	(36,101)	(38,244)	(40,532)	(42,419)	(43,460)
<b>EBITDA</b>	<b>20,119</b>	<b>21,367</b>	<b>22,418</b>	<b>22,861</b>	<b>23,361</b>
Depreciation and Amortisation	(8,853)	(8,861)	(9,202)	(8,890)	(9,213)
<b>Operating Profit</b>	<b>11,266</b>	<b>12,506</b>	<b>13,215</b>	<b>13,971</b>	<b>14,148</b>
Net financing income/(costs)	(1,768)	(2,080)	(1,930)	(1,700)	(1,730)
Forex and Related Gains	(1,105)	(55)	(178)	(178)	(178)
Provisions	(414)	(417)	(452)	(452)	(452)
Other Income	516	861	776	776	776
Other Expenses					
<b>Net Profit Before Taxes</b>	<b>8,495</b>	<b>10,815</b>	<b>11,430</b>	<b>12,416</b>	<b>12,563</b>
Taxes	(685)	(864)	(1,041)	(1,121)	(1,170)
Minority Interests	(141)	(575)	(352)	(614)	(621)
<b>Net profit available to shareholders</b>	<b>7,670</b>	<b>9,376</b>	<b>10,036</b>	<b>10,681</b>	<b>10,772</b>
Dividends	(4,000)	(4,000)	(4,000)	(5,000)	(5,600)
Transfer to Capital Reserve	-	-	-	-	-
	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
Adjusted Shares Out (mn)	2,000	2,000	2,000	2,000	2,000
CFPS (SAR)	8.33	9.41	9.80	10.09	10.30
EPS (SAR)	3.84	4.69	5.02	5.34	5.39
DPS (SAR)	2.000	2.000	2.000	2.500	2.800
<b>Growth</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
Revenue Growth	8.6%	6.0%	5.6%	3.7%	2.4%
EBITDA Growth	2.5%	6.2%	4.9%	2.0%	2.2%
Operating Profit Growth	2.6%	11.0%	5.7%	5.7%	1.3%
Net Profit Growth	-18.7%	22.2%	7.0%	6.4%	0.8%
EPS Growth	-18.7%	22.2%	7.0%	6.4%	0.8%
<b>Margins</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
EBITDA margin	35.8%	35.8%	35.6%	35.0%	35.0%
Operating Margin	20.0%	21.0%	21.0%	21.4%	21.2%
Pretax profit margin	15.1%	18.1%	18.2%	19.0%	18.8%
Net profit margin	13.6%	15.7%	15.9%	16.4%	16.1%
<b>Other Ratios</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
ROCE	13.6%	13.7%	13.6%	13.5%	13.1%
ROIC	13.8%	16.0%	16.0%	16.2%	15.7%
ROE	16.7%	18.8%	17.8%	17.2%	15.9%
Effective Tax Rate	8.1%	8.0%	9.1%	9.0%	9.3%
Capex/Sales	13.1%	15.3%	20.6%	19.7%	18.9%
Dividend Payout Ratio	52.2%	42.7%	39.9%	46.8%	52.0%
<b>Valuation Measures</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
P/E (x)	10.7	8.7	8.2	7.7	7.6
P/CF (x)	4.9	4.4	4.2	4.1	4.0
P/B (x)	1.8	1.5	1.4	1.3	1.2
EV/Sales (x)	1.8	1.6	1.5	1.4	1.3
EV/EBITDA (x)	5.0	4.5	4.2	3.9	3.7
EV/EBIT (x)	8.9	7.7	7.1	6.5	6.2
EV/IC (x)	1.4	1.3	1.2	1.1	1.0
Dividend Yield	4.9%	4.9%	4.9%	6.1%	6.8%

Source: Company data, Al Rajhi Capital

We expect dividend to rise gradually as STC will look to spend more funds on Capex

The EBITDA margin shrank by 2.1 percentage points in 2011; we expect it to hover around 35% over the next three years

ROIC remains well above cost of capital; STC is generating economic profits

STC is one of the attractive valued stocks based on multiples valuation



STC's balance sheet is expanding as a result of investment overseas

Balance Sheet (SARmn)	12/11A	12/12E	12/13E	12/14E	12/15E
Cash and Cash Equivalents	6,589	14,263	16,645	19,264	21,241
Current Receivables	12,048	10,967	12,360	15,406	16,638
Inventories	-	-	-	914	869
Other current assets	6,573	5,975	5,975	5,975	5,975
<b>Total Current Assets</b>	<b>22,764</b>	<b>31,205</b>	<b>34,981</b>	<b>41,559</b>	<b>44,723</b>
Fixed Assets	55,175	56,625	61,672	66,944	71,611
Investments	2,682	2,747	2,747	2,747	2,747
Goodwill	-	-	-	-	-
Other Intangible Assets	29,210	29,141	27,866	26,591	25,316
<b>Total Other Assets</b>	<b>2,350</b>	<b>2,027</b>	<b>2,027</b>	<b>2,027</b>	<b>2,027</b>
<b>Total Non-current Assets</b>	<b>89,417</b>	<b>90,541</b>	<b>94,313</b>	<b>98,309</b>	<b>101,701</b>
<b>Total Assets</b>	<b>112,181</b>	<b>121,746</b>	<b>129,294</b>	<b>139,868</b>	<b>146,424</b>
Short Term Debt	5,930	5,243	5,243	5,243	5,243
Trade Payables	20,130	21,746	23,491	28,186	29,474
Dividends Payable	-	-	-	-	-
Other Current Liabilities	(0)	(0)	(0)	(0)	(0)
<b>Total Current Liabilities</b>	<b>26,059</b>	<b>26,989</b>	<b>28,734</b>	<b>33,429</b>	<b>34,717</b>
Long-Term Debt	24,001	26,170	25,583	24,917	24,243
Other LT Payables	5,492	4,559	4,559	4,559	4,559
Provisions	3,062	3,314	3,314	3,314	3,314
<b>Total Non-current Liabilities</b>	<b>32,555</b>	<b>34,043</b>	<b>33,456</b>	<b>32,790</b>	<b>32,116</b>
Minority interests	6,864	7,497	7,849	8,463	9,084
Paid-up share capital	20,000	20,000	20,000	20,000	20,000
Total Reserves	26,702	33,218	39,254	45,185	50,507
<b>Total Shareholders' Equity</b>	<b>46,702</b>	<b>53,218</b>	<b>59,254</b>	<b>65,185</b>	<b>70,507</b>
<b>Total Equity</b>	<b>53,566</b>	<b>60,715</b>	<b>67,103</b>	<b>73,648</b>	<b>79,591</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>112,181</b>	<b>121,746</b>	<b>129,294</b>	<b>139,868</b>	<b>146,424</b>

STC's financial ratios are mostly healthy

Ratios	12/11A	12/12E	12/13E	12/14E	12/15E
Net Debt (SARmn)	20,897	17,150	14,181	10,896	8,245
Net Debt/EBITDA (x)	1.04	0.80	0.63	0.48	0.35
Net Debt to Equity	39.0%	28.2%	21.1%	14.8%	10.4%
EBITDA Interest Cover (x)	11.4	10.3	11.6	13.4	13.5
BVPS (SAR)	23.35	26.61	29.63	32.59	35.25

Cashflow Statement (SARmn)	12/11A	12/12E	12/13E	12/14E	12/15E
Net Income before Tax & Minority Interest	8,495	10,815	11,430	12,416	12,563
Depreciation & Amortisation	8,853	8,861	9,202	8,890	9,213
Decrease in Working Capital	(4,811)	74	352	736	101
Other Operating Cashflow	4,373	325	(1,041)	(1,121)	(1,170)
<b>Cashflow from Operations</b>	<b>16,911</b>	<b>20,075</b>	<b>19,943</b>	<b>20,921</b>	<b>20,706</b>
Capital Expenditure	(7,346)	(9,104)	(12,974)	(12,886)	(12,605)
New Investments	(29)	(52)	-	-	-
Others	(855)	(972)	-	-	-
<b>Cashflow from investing activities</b>	<b>(8,230)</b>	<b>(10,128)</b>	<b>(12,974)</b>	<b>(12,886)</b>	<b>(12,605)</b>
<b>Net Operating Cashflow</b>	<b>8,681</b>	<b>9,947</b>	<b>6,970</b>	<b>8,034</b>	<b>8,101</b>
Dividends paid to ordinary shareholders	(4,432)	(3,996)	(4,000)	(4,750)	(5,450)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(3,307)	242	-	-	-
<b>Cashflow from financing activities</b>	<b>(7,997)</b>	<b>(2,273)</b>	<b>(4,587)</b>	<b>(5,416)</b>	<b>(6,124)</b>
Total cash generated	684	7,674	2,382	2,618	1,977
Cash at beginning of period	5,904	6,589	14,263	16,645	19,264
<b>Implied cash at end of year</b>	<b>6,589</b>	<b>14,263</b>	<b>16,645</b>	<b>19,264</b>	<b>21,241</b>

Ratios	12/11A	12/12E	12/13E	12/14E	12/15E
Capex/Sales	13.1%	15.3%	20.6%	19.7%	18.9%

Source: Company data, Al Rajhi Capital

While Capex declined in 2011, we expect it to increase in the next couple of years as STC will look for more inorganic expansion as well as network up gradation



**US\$14.37bn** Market cap      **55%** Free float      **US\$13.29mn** Avg. daily volume

Target price **88.70** 15.2% over current  
 Consensus price **71.21** 6.2% over current  
 Current price **77.00** as at 8/12/2012

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**Underweight**      **Neutral**      **Overweight**

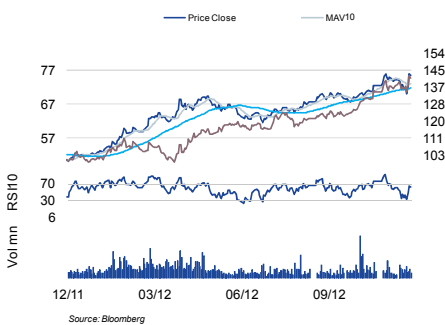
**Key themes**

We expect the data segment to remain in focus for the next few years due to advent of latest technology smart phones in the market. Mobily has taken a clear lead in 3.5G mobile data, and is focussing on increasing market share in the corporate segment by providing bundled services. A strong dividend payout forecast makes the stock attractive to investors.

**Implications**

Mobily is our top pick in the Telecom sector. Mobily trades at a nominal PE of 8.4 and with a dividend yield of 6.6% (based on our 2013 estimates), making it one of the attractive stock in the Saudi market.

**Performance**

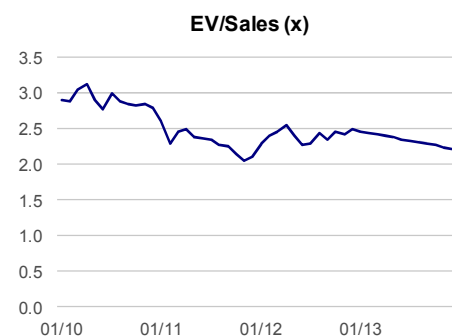


**Earnings**

Period End (SAR)	12/12E	12/13E	12/14E	12/15E
Revenue (mn)	23,384	25,771	27,568	28,699
Revenue Growth	16.6%	10.2%	7.0%	4.1%
EBITDA (mn)	8,447	9,342	9,957	10,705
EBITDA Growth	13.3%	10.6%	6.6%	7.5%
EPS	8.43	9.03	9.71	10.22
EPS Growth	16.1%	7.1%	7.6%	5.2%

Source: Company data, Al Rajhi Capital

**Valuation**



Source: Company data, Al Rajhi Capital

# Mobily Continues to lead the pack

*Mobily has been the pick of the telecoms sector, outperforming its peers in terms of revenue and profit growth as well as stock performance. The company has achieved double digit growth in bottom-line for the last four consecutive quarters, taking advantage of the opportunity provided by the surge in data consumption. Off late, Mobily has shifted its focus on the enterprise segment to drive growth in a maturing telecom market. We think this strategy will ensure a positive performance in the coming years. We have increased Mobily's target price to SAR88.7, implying an upside potential of about 15.2% and maintain our Overweight rating.*

**Diversifying towards the stable corporate segment:** Mobily has been focusing on the corporate segment, with an intention to diversify its revenue stream. The company has made two important tie-ups in order to become a one stop telecom solution provider for corporate. It has signed a five-year contract with IBM for SAR1bn to provide comprehensive IT solutions, which will enable it to offer services such as data security and cloud computing. It has also tied up with Etihad Atheeb to provide fixed line services. As a result of these tie-ups, Mobily will be able to provide a bundled service package to corporate and eventually aim at decent earnings growth in the coming years.

**Broadband on the go:** Mobily has always devoted its attention to the lucrative mobile broadband segment. It has always been aggressive with bringing new technology such as HSPA and 4G in the market. With smart-phone penetration increasing in Saudi market, innovative offers on broadband is the key for operators to gain revenue share. We believe Mobily is still ahead in identifying the growth potential in broadband and catering to customers which will help maintain its bottom-line growth.

**Dividend is a big trigger:** Mobily has been consistently increasing its dividend payout over the past few years. The company dividend increased from SAR1.25 per share in 2009 to SAR2.0 in 2010 and SAR3.25 in 2011. Moreover, despite its high capex plan over the next couple of years, the management has guided for further increasing its dividend in 2012 and 2013 to SAR4.0 per share and SAR5.0 per share respectively. This implies dividend yield of 5.3% and 6.6% for 2012 and 2013 respectively. It also recently announced bonus shares (1:10) stressing the fact that dividend distribution is one of the focus area of the management.

**High capex planned to improve infrastructure:** The management plans to spend more than SAR4bn in 2012 and about a similar amount in 2013 in order to improve its 4G reach in the Kingdom. The commitment to high capex will keep Mobily's infrastructure updated with the latest technology, allowing it to provide high quality of services to clients and maintain its competitive advantage.

**Valuation and conclusion:** Based on our DEP valuation, we arrive at a fair value of SAR88.7 for Mobily, which is also our target price and thus implying an upside of 15.2%.



### Corporate summary

Etiyah Etisalat (Mobily) is the second placed telecoms operator in Saudi Arabia, with a market value of US\$14.4bn. Mobily has a market share of mobile accounts of more than 40%, although its revenue share is lower at about 34%. Mobily has at least 42% of mobile broadband subscriptions; this is the fastest-growing segment of the Saudi telecoms market. Mobily's presence in fixed-line service is very limited, but should expand due to selective acquisitions. Mobily is an affiliate of Emirates Telecoms Corp., which owns 27.4% of its shares.

### Share information

Market cap (SAR/US\$) 53.90bn / 14.37bn  
52-week range 51.25 - 77.00  
Daily avg volume (US\$) 13.29mn  
Shares outstanding 700.0mn  
Free float (est) 55%

Performance:

	1M	3M	12M
Absolute	3.7%	9.6%	51%
Relative to index	6.1%	14.2%	42.6%

Major Shareholder:

Emirates Telecoms Corp.	27.54%
Gen. Organisation for Social Insc.	11.24%

Source: Bloomberg, Al Rajhi Capital

### Valuation

Period End	12/12E	12/13E	12/14E	12/15E
Revenue (SARmn)	23,384	25,771	27,568	28,699
EBITDA (SARmn)	8,447	9,342	9,957	10,705
Net Profit (SARmn)	5,901	6,320	6,800	7,152
EPS (SAR)	8.43	9.03	9.71	10.22
DPS (SAR)	4.00	5.00	5.50	6.00
EPS Growth	16.1%	7.1%	7.6%	5.2%
EV/EBITDA (x)	6.9	6.1	5.4	4.7
P/E (x)	9.0	8.4	7.8	7.4
P/B (x)	2.5	2.2	2.0	1.7
Dividend Yield	5.3%	6.6%	7.3%	7.9%

Source: Company data, Al Rajhi Capital

## Mobily: Improving profitability

### ROE stands at an impressive 30%

Mobily's return on invested capital (ROIC) has improved from 9.2% in 2006 to 19.3% in 9M 2012. The company's return on equity (ROE) has increased steadily to reach almost 30% in 2011, indicating improving profitability. A DuPont analysis indicates that the company is achieving an improvement in ROE despite declining leverage. As mentioned earlier, Mobily has been steadily reducing its debt level, thus the falling leverage is not surprising. The DuPont analysis shows that both asset turnover and net profit margin have improved substantially over the last five years, overshadowing the decline in financial leverage, resulting in an improvement in ROE. Though going forward we expect the company's ROE to taper off steadily, Mobily will continue to outperform its peers in the Kingdom.

### Q4 should be driven by Hajj season

We expect Mobily to continue to post double digit y-o-y growth figures in the last quarter of 2012. The sharp rise in minutes of usage and a rise in subscriber base due to the Hajj season would help the company post revenues of more than SAR23bn for 2012. For the fourth quarter, we expect the company to achieve a top line of about SAR6.5bn, implying a growth of 12.3% y-o-y. We believe the company has taken advantage of the opportunity provided by the Hajj season, and garnered a major share of Hajj pilgrims. We expect the company's EBITDA margin to be close to 37% in the last quarter, resulting in a net profit of SAR1.76bn and earnings per share of about SAR2.5.

Figure 11 Mobily : Q4 & FY2012 estimates

SARmn	Q4 2011A	Q4 2012E	YoY chg. %	FY 2011A	FY2012E	YoY chg. %
Revenues	5,802	6,513	12.3%	20,052	23,384	16.6%
EBITDA	2,305	2,397	4.0%	7,454	8,447	13.3%
Operating Pr	1,754	1,840	4.9%	5,305	6,131	15.6%
<b>Net Profit</b>	<b>1,697</b>	<b>1,761</b>	<b>3.8%</b>	<b>5,083</b>	<b>5,901</b>	<b>16.1%</b>

Source: Company data, Al Rajhi Capital

### Ban lifted on prepaid sims positive for Mobily

CITC temporarily suspended Mobily to sell new prepaid sims on 24<sup>th</sup> November unless the company fully meets the regulatory requirements. However, this ban was uplifted on 8<sup>th</sup> December after CITC made some research on various locations to ensure that the company has fulfilled all regulatory requirements. This lifting of the ban should reflect in the positive performance of the stock going ahead.

Mobily's ROE is increasing steadily, indicating improving profitability

We estimate a revenue growth of 12% and net profit growth of around 4% in Q4 2012



We estimate a revenue growth of about 10% for 2013; powered by handset sales and broadband growth

We expect Mobily to pay a dividend of about SAR5 next year. This does not include the bonus shares announced

We expect gross margin to stabilize around 50%, due to sales of low margin cell phones

Mobily's ROIC is well above its WACC

Mobily still trades on a cheap 2013 PE of 8.5x and EV/EBITDA of 6.2x

Income Statement (SARmn)	12/11A	12/12E	12/13E	12/14E	12/15E
<b>Revenue</b>	<b>20,052</b>	<b>23,384</b>	<b>25,771</b>	<b>27,568</b>	<b>28,699</b>
Cost of Goods Sold	(9,728)	(11,409)	(12,794)	(13,745)	(14,091)
<b>Gross Profit</b>	<b>10,324</b>	<b>11,974</b>	<b>12,977</b>	<b>13,822</b>	<b>14,608</b>
Government Charges					
S.G. & A. Costs	(2,870)	(3,528)	(3,635)	(3,865)	(3,903)
<b>Operating EBIT</b>	<b>5,305</b>	<b>6,131</b>	<b>6,611</b>	<b>6,940</b>	<b>7,391</b>
Cash Operating Costs	(12,598)	(14,937)	(16,429)	(17,610)	(17,995)
<b>EBITDA</b>	<b>7,454</b>	<b>8,447</b>	<b>9,342</b>	<b>9,957</b>	<b>10,705</b>
Depreciation and Amortisation	(2,149)	(2,316)	(2,731)	(3,018)	(3,314)
<b>Operating Profit</b>	<b>5,305</b>	<b>6,131</b>	<b>6,611</b>	<b>6,940</b>	<b>7,391</b>
Net financing income/(costs)	(213)	(189)	(222)	(148)	(155)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	46	68	77	77	77
Other Expenses	-	-	-	-	-
<b>Net Profit Before Taxes</b>	<b>5,138</b>	<b>6,010</b>	<b>6,466</b>	<b>6,869</b>	<b>7,313</b>
Taxes	(54)	(109)	(145)	(69)	(161)
Minority Interests	-	-	-	-	-
<b>Net profit available to shareholders</b>	<b>5,083</b>	<b>5,901</b>	<b>6,320</b>	<b>6,800</b>	<b>7,152</b>
Dividends	(2,275)	(2,800)	(3,500)	(3,850)	(4,200)
Transfer to Capital Reserve	-	-	-	-	-
	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
Adjusted Shares Out (mn)	700.0	700.0	700.0	700.0	700.0
CFPS (SAR)	10.33	11.74	12.93	14.03	14.95
EPS (SAR)	7.26	8.43	9.03	9.71	10.22
DPS (SAR)	3.25	4.00	5.00	5.50	6.00
	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
<b>Growth</b>					
Revenue Growth	25.2%	16.6%	10.2%	7.0%	4.1%
Gross Profit Growth	17.5%	16.0%	8.4%	6.5%	5.7%
EBITDA Growth	20.9%	13.3%	10.6%	6.6%	7.5%
Operating Profit Growth	21.8%	15.6%	7.8%	5.0%	6.5%
Net Profit Growth	20.7%	16.1%	7.1%	7.6%	5.2%
EPS Growth	20.7%	16.1%	7.1%	7.6%	5.2%
	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
<b>Margins</b>					
Gross profit margin	51.5%	51.2%	50.4%	50.1%	50.9%
EBITDA margin	37.2%	36.1%	36.2%	36.1%	37.3%
Operating Margin	26.5%	26.2%	25.7%	25.2%	25.8%
Pretax profit margin	25.6%	25.7%	25.1%	24.9%	25.5%
Net profit margin	25.4%	25.2%	24.5%	24.7%	24.9%
	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
<b>Other Ratios</b>					
ROCE	27.4%	22.7%	23.3%	22.8%	22.7%
ROIC	24.5%	25.3%	24.9%	24.5%	25.8%
ROE	29.9%	30.1%	28.4%	26.7%	24.9%
Effective Tax Rate	1.1%	1.8%	2.3%	1.0%	2.2%
Capex/Sales	18.4%	17.7%	17.9%	18.0%	18.0%
Dividend Payout Ratio	44.8%	47.4%	55.4%	56.6%	58.7%
	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
<b>Valuation Measures</b>					
P/E (x)	10.6	9.1	8.5	7.9	7.5
P/CF (x)	7.5	6.6	6.0	5.5	5.2
P/B (x)	2.9	2.6	2.3	2.0	1.8
EV/Sales (x)	3.0	2.5	2.3	2.0	1.8
EV/EBITDA (x)	8.0	7.0	6.2	5.5	4.8
EV/EBIT (x)	11.2	9.6	8.8	7.9	6.9
EV/IC (x)	2.5	2.3	2.1	2.0	1.8
Dividend Yield	4.2%	5.2%	6.5%	7.1%	7.8%

Source: Company data, Al Rajhi Capital



We expect cash balance to reach about SAR4.3bn by 2014

Balance Sheet (SARmn)	12/11A	12/12E	12/13E	12/14E	12/15E
Cash and Cash Equivalents	1,690	2,991	2,501	4,294	6,470
Current Receivables	6,323	6,253	8,003	7,168	7,175
Inventories	470	599	580	662	660
Other current assets	1,411	2,012	2,012	2,012	2,012
<b>Total Current Assets</b>	<b>9,893</b>	<b>11,854</b>	<b>13,095</b>	<b>14,135</b>	<b>16,317</b>
Fixed Assets	16,412	17,343	19,802	22,314	24,734
Investments	-	-	-	-	-
Goodwill	1,530	1,530	1,530	1,530	1,530
Other Intangible Assets	9,665	9,366	8,798	8,230	7,661
Total Other Assets	-	-	-	-	-
<b>Total Non-current Assets</b>	<b>27,607</b>	<b>28,239</b>	<b>30,130</b>	<b>32,074</b>	<b>33,926</b>
<b>Total Assets</b>	<b>37,501</b>	<b>40,093</b>	<b>43,224</b>	<b>46,209</b>	<b>50,243</b>
Short Term Debt	6,096	2,032	2,097	1,822	1,672
Trade Payables	11,757	10,942	12,556	13,784	15,785
Dividends Payable	-	-	-	-	-
Other Current Liabilities	194	27	27	27	27
<b>Total Current Liabilities</b>	<b>18,047</b>	<b>13,001</b>	<b>14,680</b>	<b>15,633</b>	<b>17,484</b>
Long-Term Debt	977	6,173	4,630	3,361	2,243
Other LT Payables	-	-	-	-	-
Provisions	89	129	129	129	129
<b>Total Non-current Liabilities</b>	<b>1,066</b>	<b>6,302</b>	<b>4,759</b>	<b>3,490</b>	<b>2,372</b>
Minority interests	-	-	-	-	-
Paid-up share capital	7,000	7,000	7,000	7,000	7,000
Total Reserves	11,388	13,790	16,785	20,085	23,387
<b>Total Shareholders' Equity</b>	<b>18,388</b>	<b>20,790</b>	<b>23,785</b>	<b>27,085</b>	<b>30,387</b>
<b>Total Equity</b>	<b>18,388</b>	<b>20,790</b>	<b>23,785</b>	<b>27,085</b>	<b>30,387</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>37,501</b>	<b>40,093</b>	<b>43,224</b>	<b>46,209</b>	<b>50,243</b>

Net debt/EBITDA is below 1.0x; which is a very comfortable number

Ratios	12/11A	12/12E	12/13E	12/14E	12/15E
Net Debt (SARmn)	5,383	5,215	4,226	890	(2,555)
Net Debt/EBITDA (x)	0.72	0.62	0.45	0.09	(0.24)
Net Debt to Equity	29.3%	25.1%	17.8%	3.3%	-8.4%
EBITDA Interest Cover (x)	34.9	44.8	42.0	67.3	68.8
BVPS (SAR)	26.27	29.70	33.98	38.69	43.41

We expect a Capex of SAR4.6bn for 2013

Cashflow Statement (SARmn)	12/11A	12/12E	12/13E	12/14E	12/15E
Net Income before Tax & Minority Interest	5,138	6,010	6,466	6,869	7,313
Depreciation & Amortisation	2,149	2,316	2,731	3,018	3,314
Decrease in Working Capital	(792)	(444)	(116)	1,981	1,995
Other Operating Cashflow	179	198	(145)	(69)	(161)
<b>Cashflow from Operations</b>	<b>6,673</b>	<b>8,080</b>	<b>8,935</b>	<b>11,799</b>	<b>12,461</b>
Capital Expenditure	(3,690)	(4,130)	(4,622)	(4,962)	(5,166)
New Investments	450	-	-	-	-
Others	(168)	(262)	-	-	-
<b>Cashflow from investing activities</b>	<b>(3,408)</b>	<b>(4,391)</b>	<b>(4,622)</b>	<b>(4,962)</b>	<b>(5,166)</b>
<b>Net Operating Cashflow</b>	<b>3,265</b>	<b>3,689</b>	<b>4,313</b>	<b>6,837</b>	<b>7,295</b>
Dividends paid to ordinary shareholders	(2,275)	(3,500)	(3,325)	(3,500)	(3,850)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	-	-	-	-	-
<b>Cashflow from financing activities</b>	<b>(3,237)</b>	<b>(2,388)</b>	<b>(4,804)</b>	<b>(5,044)</b>	<b>(5,119)</b>
Total cash generated	28	1,301	(490)	1,793	2,177
Cash at beginning of period	1,661	1,690	2,991	2,501	4,294
<b>Implied cash at end of year</b>	<b>1,690</b>	<b>2,991</b>	<b>2,501</b>	<b>4,294</b>	<b>6,470</b>

Ratios	12/11A	12/12E	12/13E	12/14E	12/15E
Capex/Sales	18.4%	17.7%	17.9%	18.0%	18.0%

Source: Company data, Al Rajhi Capital



<b>US\$2.275bn</b> Market cap	<b>48%</b> Free float	<b>US\$22.20mn</b> Avg. daily volume
Target price	<b>10.00</b>	26.40% over current
Consensus price	<b>7.90</b>	6.2% over current
Current price	<b>7.90</b>	as at 8/12/2012

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<b>Underweight</b>	<b>Neutral</b>	<b>Overweight</b>
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## Zain KSA

### Reeling under huge debt

#### Key themes

The extension on repayment of the SAR9bn loan, suggests that the company is unable to raise funds even after the recent restructuring. Moreover, the company is losing revenue and subscriber market share. Frequent changes in the management have also dented investor confidence in the stock.

#### Implications

We have cut our estimates for Zain, and slashed our target price to SAR10 per share.

#### Performance

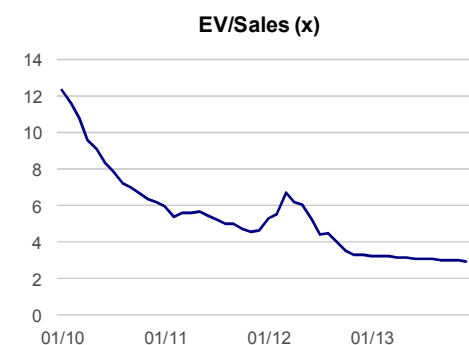


#### Earnings

Period End (SAR)	12/12E	12/13E	12/14E	12/15E
Revenue (mn)	6,516	7,119	8,070	8,924
Revenue Growth	-2.7%	9.3%	13.4%	10.6%
EBITDA (mn)	960	1,096	1,364	1,673
EBITDA Growth	6.8%	14.2%	24.4%	22.7%
EPS	(1.17)	(1.02)	(0.88)	(0.56)
EPS Growth	-15.0%	-12.7%	-14.3%	-35.5%

Source: Company data, Al Rajhi Capital

#### Valuation



Source: Company data, Al Rajhi Capital

*Despite the recent capital restructuring, Zain continues reel under the pressure of its huge outstanding debt. The company has been unable to refinance its SAR9bn loan for over the past year and a half, and has recently extended its repayment for the fifth time. Moreover, negative free cash flow after five years of being in operation and inability to improve its top-line is denting its recovery story. The frequent changes in management have also not helped the company's cause, as it has led to lack of clarity and focus. The stock price has declined to multi year low and we do not expect a turnaround in the next 3-4 years. As a result, we have reduced our target price on Zain to SAR10 per share and maintain Neutral rating.*

#### Uncertain debt repayment continues to be a major hindrance:

Zain continues to struggle with a huge debt outstanding (SAR13.5bn) at the end of Q3 2012) and reducing its debt is becoming difficult due to negative free cash flow. Recently, Zain repaid about SAR750mn of debt, using funds raised through the rights issue. However, the company is still unable to refinance a loan of SAR9bn (which was due in August 2011) and has extended the payment for the fifth time to December 19, 2012. In addition, another loan of about SAR2.25bn will be due on April 2013. Thus, with a total of SAR11.25bn of debt being due by Q1 2013, the company seems unable to arrange a refinancing facility. At present, the financial condition of Zain KSA looks grim.

**Slow growth in revenue:** Over the last couple of quarters, Zain witnessed a decline in its revenue and market share. This subdued performance comes at a time when its peers are witnessing a decent growth in their top line despite being in a more matured cycle than Zain. The company's market share has fallen from about 15.6% at the end of 2010 to below 12% currently. Tight financial conditions and negative cash flows have limited the company's ability to introduce innovative plans and increase its advertising spend. As a result, we have slashed our revenue estimate for the company by 8.7% and 9.1% for 2013 and 2014 respectively.

**Frequent changes in leadership:** The continuing weak financial performance of the company has led Zain Kuwait (founder) to change the senior leadership of its Saudi subsidiary several times with the hope of a turnaround. The company saw its third CEO over a period of just six months and in the past three years the company has seen five different CEOs. These frequent changes in the leadership not only deny enough time to the top management to turn the company around but also increase investor pessimism.

**Valuation:** Based on our estimates, we have arrived at a fair value of SAR10 per share, which is a more than 50% cut to our previous target price (SAR15.9). Part of the reason for the fall in Zain's valuation is an increase in our estimate of the cost of capital for the company (from 10.9% to YY%), which is in line with the increase in risks. In addition, we have also reduced our forecasts for the company. The only positive development for Zain could be possible refinance of its debt for a longer term which could help the company to recover from its financial mess.



### Corporate summary

Zain KSA is the third largest telecom operator in Saudi Arabia, with a market cap of US\$2.275bn. The company launched its services in Q3 2008. By our estimate, Zain enjoys a 11-12% market share in mobile accounts, although its revenue share is lower at 8-9%. Zain has no presence in the fixed-line market. Zain KSA is an affiliate of the Zain Group of Kuwait. Zain Kuwait is an emerging telecom player operating in various markets in the Middle East and Africa.

### Share information

Market cap (SAR/US\$) 8.53bn / 2.275bn  
52-week range 7.60 - 23.09  
Daily avg volume (US\$) 22.20mn  
Shares outstanding 1,080mn  
Free float (est) 48%

Performance:	1M	3M	12M
Absolute	-10.7%	-36%	-25.1%
Relative to index	-8.3%	-31.4%	-33.5%

Major Shareholder:  
Mobile Telecommunications Co. (Kuwait) 37.0%  
Faden Trading and Contracting 5.9%

Source: Bloomberg, Al Rajhi Capital

### Valuation

Period End	12/12E	12/13E	12/14E	12/15E
Revenue (SARmn)	6,516	7,119	8,070	8,924
EBITDA (SARmn)	960	1,096	1,364	1,673
Net Profit (SARmn)	(1,637)	(1,267)	(946)	(610)
EPS (SAR)	(1.17)	(1.02)	(0.88)	(0.56)
DPS (SAR)	-	-	-	-
EPS Growth	-15.0%	-12.7%	-14.3%	-35.5%
EV/EBITDA (x)	22.2	19.2	13.4	10.5
P/E (x)	na	na	na	na
P/B (x)	1.3	1.2	1.3	1.5
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

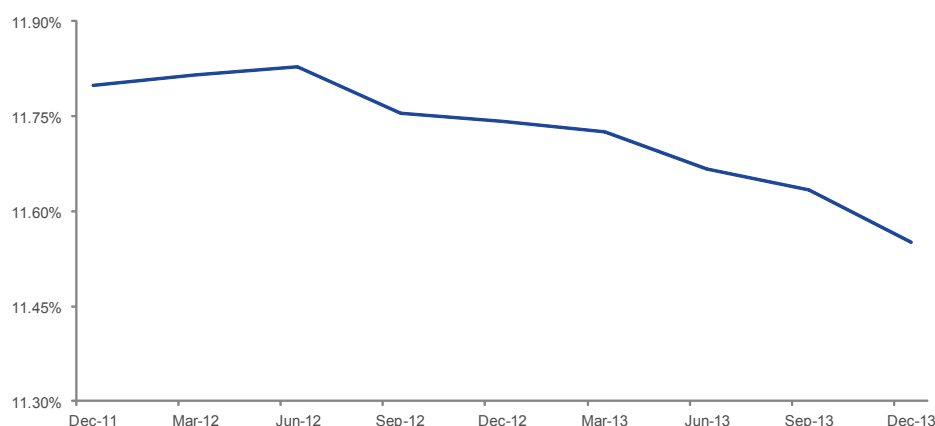
## Zain KSA : Losing the race

### Decline in the market share expected to continue

Zain's market share has fallen to less than 12% currently

At the end of 2010, Zain's market share stood at about 15.6%. However, increased competition from the other two telecom players have eaten into the company's market share, which has fallen to less than 12% currently. Going forward, competition will remain intense between the three mobile players, as each operator tries to increase its subscriber base in the fast saturating market. We believe Zain will find it difficult to match its peers in wooing customers with innovative offers and bundled services, as it mainly competes on pricing. We expect Zain's market share to slide from about 11.85% currently, to about 11.5% by the end of 2013. Moreover, the CITC's latest regulations concerning recharge of prepaid sim cards and compulsory identification on new connection might also hamper subscriber base growth for the company.

Figure 12 Zain's market share expected to decline



Source: CITC, Company data, Al Rajhi Capital

### Cutting our estimates for 2013 and 2014

We have cut our estimates for Zain following the company's dismal top line performance in the nine months of 2012. During the first quarter revenues for the company increased by a paltry 3% y-o-y, which was followed by a 4% and 15% y-o-y fall in revenues in Q2 and Q3 2012, respectively. This, while the revenue of the total market (combined revenues of the three mobile telecom players from the KSA region) grew by 11.4%, 5.6% and 11.8% on a y-o-y basis during Q1, Q2 and Q3 2012, respectively.



We reduce our estimates following poor Q2 and Q3 performance

As a result, we have reduced our revenue estimate for Zain KSA from SAR8bn in 2013 to SAR7.3bn. Our net loss estimate for 2013 has increased to SAR840mn from SAR678mn earlier. In 2014, we expect the company to report a turnover of about SAR8bn (from SAR8.8bn earlier), and post a loss of about SAR351mn at an operating level. On a net level, we expect the company will continue to post losses (SAR946mn in 2014).

We expect the company to turn profitable only after the next 3-4 years, once its cash from operations improves and interest expense reduces. The company financial situation is likely to start improving post 2016, when it starts to report a meaningful profit at the operating level. Nevertheless, as the company already has accumulated losses of almost SAR2bn, we do not expect the company to distribute dividends in the foreseeable future.

### Low capex hurting growth

Zain continued to report negative free cash flows even after five years of being in operation. The modest cash from operations that the company generates, combined with its huge debt obligation, has restricted the company's ability to spend on expanding and developing its infrastructure. Zain's capital expenditure fell from 16% of revenues in 2010 to a modest 10% during 2011, and is likely to remain around the same level in 2012. On the other hand, Mobily's capex stands at around 18% of on a higher revenue base. We believe the low capex is hurting Zain's growth. According to CITC, Zain's service coverage stood at 89% at the end of 2011, while Mobily and STC boast of 99% coverage in Saudi Arabia.

Huge debt in books has restricted Capex plan

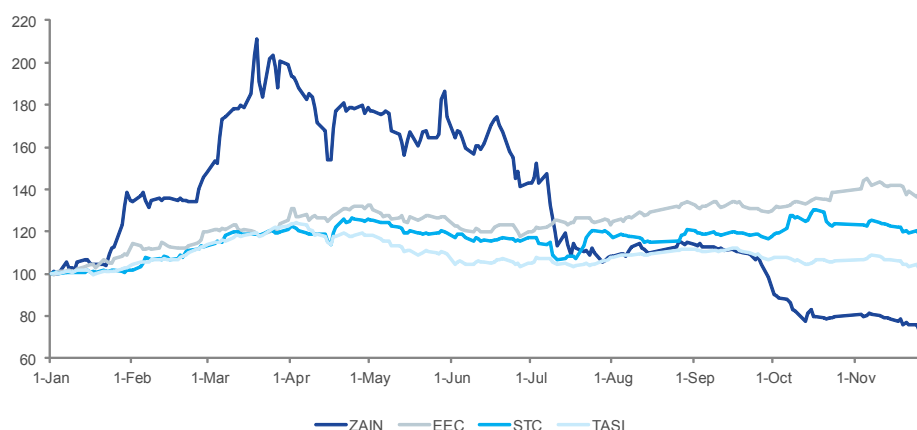
Thus, Zain is stuck in a vicious cycle, where its ability to generate revenues is being hampered by low capex, which the company is unable to increase due to its high debt obligations. The company is unable to reduce this debt burden due to its inability to increase its cash flow from operations, which we believe would improve with top-line growth.

### Declining investor confidence

We believe the continuous extension on the repayment of the SAR9bn of debt and the frequent changing of the top management has badly hit investor confidence in the company. This can be seen in the stock's underperformance on the Saudi bourse. The TASI has gained about 5.6% on YTD basis, while the Zain KSA stock has fallen drastically by XX% and trading near its all time lows. As one can see from the rebased price performance chart, there was an initial euphoria among investors in the early part of the year, on the company's capital restructuring plan, leading to a sharp rise in Zain's stock price. However, the disappointing progress on the debt reduction, and lower-than-expected earnings resulted in a sharper fall in Zain's stock.

Zain has corrected 50% post restructuring

**Figure 13 Performance of Zain against the TASI and other telecom stocks**



Source: Bloomberg data, Al Rajhi Capital



We reduce our estimates following poor Q2 and Q3 performance

## Q4 2012: Muted expectations

### Likely to witness low single digit revenue growth

For the fourth quarter of 2012, we expect Zain to witness a low single digit growth in revenue on a y-o-y basis, though on a sequential basis revenue is likely to rise by about 13%, due to the higher minutes of usage and subscriber base witnessed in the Hajj season. We expect Zain to post a turnover of about SAR1,725mn, and an EBITDA of SAR267.4mn during the last quarter of 2012. Revenue growth is expected to be the lowest amongst the peers and we expect the company to lose market share. We expect the company to post a loss of SAR347mn in Q4 2012, lower as compared to a loss of SAR461mn, supported mainly by a lower interest expense.

Figure 14 Zain : Q4 & 2012 estimates

SARmn	Q4 2011A	Q4 2012E	YoY chg. %	2011A	2012E	YoY chg. %
Revenues	1,715	1,725	0.6%	6,699	6,406	-4.4%
EBITDA	260	267	2.9%	899	943	4.9%
Operating Prof	(213)	(170)	-20.1%	(811)	(840)	3.5%
<b>Net Profit</b>	<b>(461)</b>	<b>(348)</b>	<b>-24.7%</b>	<b>(1,925)</b>	<b>(1,654)</b>	<b>-14.1%</b>

Source: Company data, Al Rajhi Capital

### Note on Zain's recommendation:

While our target price on Zain denotes an upside potential of more than 25% over current market price, we have not upgraded our rating and we continue to advise a Neutral recommendation on the company. This is because of the volatility and significant risks attached to the stock.



Income Statement (SARmn)	12/11A	12/12E	12/13E	12/14E	12/15E
<b>Revenue</b>	<b>6,699</b>	<b>6,516</b>	<b>7,119</b>	<b>8,070</b>	<b>8,924</b>
Cost of Goods Sold	(3,499)	(3,541)	(3,712)	(4,124)	(4,462)
<b>Gross Profit</b>	<b>3,200</b>	<b>2,974</b>	<b>3,407</b>	<b>3,946</b>	<b>4,462</b>
Government Charges					
S.G. & A. Costs	(2,301)	(2,015)	(2,310)	(2,583)	(2,789)
<b>Operating EBIT</b>	<b>(811)</b>	<b>(823)</b>	<b>(643)</b>	<b>(352)</b>	<b>(62)</b>
Cash Operating Costs	(5,800)	(5,556)	(6,023)	(6,707)	(7,251)
<b>EBITDA</b>	<b>899</b>	<b>960</b>	<b>1,096</b>	<b>1,364</b>	<b>1,673</b>
Depreciation and Amortisation	(1,710)	(1,783)	(1,740)	(1,715)	(1,736)
<b>Operating Profit</b>	<b>(811)</b>	<b>(823)</b>	<b>(643)</b>	<b>(352)</b>	<b>(62)</b>
Net financing income/(costs)	(1,114)	(814)	(623)	(594)	(547)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	-	-	-	-	-
Other Expenses	-	-	-	-	-
<b>Net Profit Before Taxes</b>	<b>(1,925)</b>	<b>(1,637)</b>	<b>(1,267)</b>	<b>(946)</b>	<b>(610)</b>
Taxes	-	-	-	-	-
Minority Interests	-	-	-	-	-
<b>Net profit available to shareholders</b>	<b>(1,925)</b>	<b>(1,637)</b>	<b>(1,267)</b>	<b>(946)</b>	<b>(610)</b>
Dividends	-	-	-	-	-
Transfer to Capital Reserve	-	-	-	-	-
	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
Adjusted Shares Out (mn)	1,400	1,400	1,080	1,080	1,080
CFPS (SAR)	(0.153)	0.104	0.382	0.712	1.042
EPS (SAR)	(1.375)	(1.169)	(1.021)	(0.876)	(0.565)
DPS (SAR)	0	0	0	0	0
<b>Growth</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
Revenue Growth	12.9%	-2.7%	9.3%	13.4%	10.6%
Gross Profit Growth	26.5%	-7.1%	14.5%	15.8%	13.1%
EBITDA Growth	171.9%	6.8%	14.2%	24.4%	22.7%
Operating Profit Growth	-30.3%	1.4%	-21.8%	-45.4%	-82.3%
Net Profit Growth	-18.4%	-15.0%	-22.6%	-25.3%	-35.5%
EPS Growth	-18.4%	-15.0%	-12.7%	-14.3%	-35.5%
<b>Margins</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
Gross profit margin	47.8%	45.6%	47.9%	48.9%	50.0%
EBITDA margin	13.4%	14.7%	15.4%	16.9%	18.8%
Operating Margin	-12.1%	-12.6%	-9.0%	-4.4%	-0.7%
Pretax profit margin	-28.7%	-25.1%	-17.8%	-11.7%	-6.8%
Net profit margin	-28.7%	-25.1%	-17.8%	-11.7%	-6.8%
<b>Other Ratios</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
ROCE	-7.2%	-7.2%	-3.4%	-2.0%	-0.4%
ROIC	-3.9%	-4.2%	-3.4%	-2.1%	-0.4%
ROE	-36.9%	-25.5%	-16.0%	-13.9%	-10.1%
Effective Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%
Capex/Sales	10.6%	9.6%	9.0%	8.0%	7.5%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%
<b>Valuation Measures</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
P/E (x)	na	na	na	na	na
P/CF (x)	na	75.9	20.7	11.1	7.6
P/B (x)	2.6	1.3	1.2	1.3	1.5
EV/Sales (x)	3.9	3.3	3.0	2.3	2.0
EV/EBITDA (x)	29.2	22.2	19.2	13.4	10.5
EV/EBIT (x)	na	na	na	na	na
EV/IC (x)	1.3	1.1	1.1	1.1	1.2
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

We do not expect net profit or a dividend till 2016; unless the company refinances its debt

We expect a respectable EBITDA growth over 2012-15

The EBITDA margin should continue to improve in the next two years, though the growth will be capped by marketing expenses

Zain is not cheap on EV/sales, which is the one of the simplest valuation measures for a loss-making company



Balance Sheet (SARmn)	12/11A	12/12E	12/13E	12/14E	12/15E
Cash and Cash Equivalents	780	3,312	2,715	1,823	1,562
Current Receivables	1,007	1,101	1,061	968	892
Inventories	44	73	79	101	152
Other current assets	602	702	702	702	702
<b>Total Current Assets</b>	<b>2,432</b>	<b>5,189</b>	<b>4,556</b>	<b>3,594</b>	<b>3,309</b>
Fixed Assets	4,059	4,198	4,107	4,046	3,987
Investments	-	-	-	-	-
Goodwill	-	-	-	-	-
Other Intangible Assets	20,253	19,268	18,260	17,252	16,244
Total Other Assets	-	-	-	-	-
<b>Total Non-current Assets</b>	<b>24,312</b>	<b>23,466</b>	<b>22,367</b>	<b>21,297</b>	<b>20,231</b>
<b>Total Assets</b>	<b>26,744</b>	<b>28,655</b>	<b>26,923</b>	<b>24,892</b>	<b>23,540</b>
Short Term Debt	9,748	11,394	1,394	1,394	1,394
Trade Payables	5,691	5,783	6,317	6,235	6,492
Dividends Payable	-	-	-	-	-
Other Current Liabilities	72	47	47	47	47
<b>Total Current Liabilities</b>	<b>15,511</b>	<b>17,224</b>	<b>7,759</b>	<b>7,676</b>	<b>7,934</b>
Long-Term Debt	6,242	2,153	11,154	10,151	9,151
Other LT Payables	675	682	682	682	682
Provisions	23	26	26	26	26
<b>Total Non-current Liabilities</b>	<b>6,940</b>	<b>2,861</b>	<b>11,862</b>	<b>10,859</b>	<b>9,859</b>
Minority interests	-	-	-	-	-
Paid-up share capital	14,000	10,801	10,801	10,801	10,801
Total Reserves	(9,707)	(2,232)	(3,498)	(4,444)	(5,054)
<b>Total Shareholders' Equity</b>	<b>4,293</b>	<b>8,569</b>	<b>7,303</b>	<b>6,357</b>	<b>5,747</b>
<b>Total Equity</b>	<b>4,293</b>	<b>8,569</b>	<b>7,303</b>	<b>6,357</b>	<b>5,747</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>26,744</b>	<b>28,655</b>	<b>26,923</b>	<b>24,892</b>	<b>23,540</b>

Net debt for 2013e stands at 1.38x sales; it has come down sharply post restructuring

Ratios	12/11A	12/12E	12/13E	12/14E	12/15E
Net Debt (SARmn)	15,209	10,235	9,833	9,722	8,983
Net Debt/EBITDA (x)	16.92	10.66	8.97	7.13	5.37
Net Debt to Equity	354.3%	119.4%	134.6%	152.9%	156.3%
EBITDA Interest Cover (x)	0.8	1.2	1.8	2.3	3.1
BVPS (SAR)	3.07	6.12	6.76	5.89	5.32

Cashflow Statement (SARmn)	12/11A	12/12E	12/13E	12/14E	12/15E
Net Income before Tax & Minority Interest	(1,925)	(1,637)	(1,267)	(946)	(610)
Depreciation & Amortisation	1,710	1,783	1,740	1,715	1,736
Decrease in Working Capital	43	(498)	570	(13)	283
Other Operating Cashflow	85	287	-	(0)	-
<b>Cashflow from Operations</b>	<b>(88)</b>	<b>(66)</b>	<b>1,043</b>	<b>757</b>	<b>1,409</b>
Capital Expenditure	(711)	(627)	(641)	(646)	(669)
New Investments	-	-	-	-	-
Others	(9)	-	-	-	-
<b>Cashflow from investing activities</b>	<b>(720)</b>	<b>(627)</b>	<b>(641)</b>	<b>(646)</b>	<b>(669)</b>
<b>Net Operating Cashflow</b>	<b>(807)</b>	<b>(693)</b>	<b>402</b>	<b>111</b>	<b>740</b>
Dividends paid to ordinary shareholders	-	-	-	-	-
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	3,321	-	-	-
Other Financing Cashflow	-	-	-	-	-
<b>Cashflow from financing activities</b>	<b>885</b>	<b>3,224</b>	<b>(1,000)</b>	<b>(1,003)</b>	<b>(1,000)</b>
Total cash generated	78	2,532	(598)	(892)	(260)
Cash at beginning of period	702	780	3,312	2,715	1,823
<b>Implied cash at end of year</b>	<b>780</b>	<b>3,312</b>	<b>2,715</b>	<b>1,823</b>	<b>1,562</b>

Capex/sales ratio is falling rapidly due to shrinking cash balances and high accumulated losses

Ratios	12/11A	12/12E	12/13E	12/14E	12/15E
Capex/Sales	10.6%	9.6%	9.0%	8.0%	7.5%

Source: Company data, Al Rajhi Capital



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### Additional disclosures

#### 1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

**"Overweight"**: Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

**"Neutral"**: We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

**"Underweight"**: Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

#### 2. Definitions

**"Time horizon"**: Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

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

**"Target price"**: This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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