

Mobile Telecommunications Company Saudi Arabia (Zain KSA)

Target Price: SAR 14.7

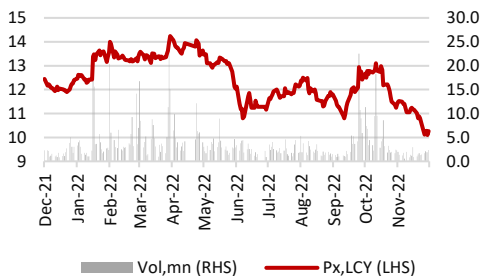
Upside: 43.0%

Recommendation	Buy
Bloomberg Ticker	ZAINKSA:AB
Current Market Price (SAR)	10.3
52wk High / Low (SAR)	14.2 / 10.1
12m Average Vol. (mn)	3.7
Mkt.Cap. (SAR bn)	9.2
Shares Outstanding (mn)	899
Free Float (%)	63.0%
3m Avg Daily Turnover (SAR mn)	45.3
6m Average Daily Turnover (SAR mn)	37.0
PE 2023e (x)	31.1x
EV/EBITDA 2023e (x)	5.5x
Dividend Yield '23e (%)	1.3%

Price Performance:	
1 month (%)	-9.8%
3 months (%)	-11.1%
12 months (%)	-17.5%

Source: Refinitiv, as of 15th Dec. 2022

Price -Volume Performance



Source: Refinitiv

Valuation method	SAR	Percentage from CMP	Weights
DCF	16.5	61%	80%
EV/EBITDA	9.3	-9%	10%
PE	5.6	-45%	10%
Target price	14.7	43.0%	

Source: U Capital Research

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Valuation:

- One of the leading telecommunication services providers in Saudi Arabia
- Diversified service offering catering to B2B and B2C sub-segment
- Refinancing and availing loans at better commercial terms to support bottom-line
- Cash generation from tower sale increases the likelihood of future dividend distribution
- We retain our previous Buy rating on the stock

Zain KSA's revenue increased by 15.3% YoY (+3.7% QoQ) to SAR 2,287.0 mn in 3Q22, in line with our estimate of SAR 2,249.4 mn. The increase was driven by the growth in B2B and 5G services and the return of international visitors (for Umrah and business) after relaxing the COVID pandemic restrictions. The total number of active customers stood at 8.6 mn in 3Q22. Zain KSA also enjoyed sustained growth in enterprise and digital platforms, including the company's digital offering Yaqoot and its financing platform Tamam. The 5G network reached 53 cities by the end of 3Q22, with population coverage of 62.5%.

Zain KSA's 3Q22 net income increased by 40.8% YoY to SAR 85.0 mn (-36.5% QoQ). Apart from higher revenue, the company's profitability was supported by a reduction in depreciation and amortization expenses which decreased by SAR 115 in 3Q22 mn compared to SAR 618 mn in 3Q21, further to the announced disposal plan of the telecom towers. The upside in profitability was partially offset by an increase in finance cost, which increased by SAR 39 mn sequentially in 3Q22 due to a rise in Sibor/Libor. The gross margin in 3Q22 was 60% compared to 63% in 3Q21. EBITDA margin declined to 33% in 3Q22 compared to 41% in 3Q21, driven by higher distribution and marketing expenses from the early launch of iPhone14.

With the sale of the passive tower business, the company will generate cash amounting to SAR 2.4 bn on financial completion and a gain of SAR 1.1 bn over the 18 months. The company considers the financial completion once it transfers at least 3000 towers.

Valuation and risk: Post 3Q22 earnings, we revised our bottom-line estimate upward on Zain KSA for FY22 by 46.1% due to improved performance supported by growth in the company's 5G customer base, resumption of the Hajj pilgrimage, growth in digital platform Yaqoot and growth in micro-lending services Tamam. After adjusting the bottom line and accounting for changes in valuation, we arrive at our revised target price of SAR 14.7 per share as compared to SAR 13.8 per share. We retain our previous **Buy** rating on the stock. We feel the company is well poised to experience the next phase of growth with improvements across the company's major segments and incremental cash generated from the sale of towers. We will be awaiting further disclosures from the company regarding where the cash generated from the tower deal will get deployed. Currently, the stock trades at 31.1x P/E and 5.5x EV/EBITDA, based on our FY23 estimates. The downside risks to the valuation include reduced market share, decreased subscriber base, and delay in selling tower assets. Key upside risks include expansion of B2B portfolio, expansion of 5G network coverage, increased contribution from Tamam Finance company, advancement in digital offerings, and increase in subscriber base.

Discounted Cash Flow Method

	FY22	FY23	FY24	FY25	FY26	Terminal Value
Pegged on Time period index	0.04	1.04	2.05	3.05	4.05	4.05
Free cash flow						
PAT	332	296	213	243	1,235	
Interest (1-tax rate)	533	518	500	468	951	
Depreciation	2,036	2,024	2,265	2,492	6,218	
Changes in Working Capital	164	50	(119)	(139)	(468)	
Less: Capex	(1,508)	(1,521)	(1,533)	(1,540)	(4,005)	
Free cash flow to firm (FCFF)	1,556	1,368	1,327	1,524	1,670	20,914
Discounted FCFF	1,550	1,249	1,111	1,170	1,176	14,720
Enterprise Value						20,976
Less: Net debt (Includes lease liabilities)						(9,615)
Equity Value						14,808
Shares O/S						899
Equity Value per share						16.5
Current share price (SAR)						10.3
% upside/downside						60.6%

We use DCF methodology with a WACC of 9.1% and a long-term growth rate of 1%, giving us a TP of SAR 16.5. Our DCF valuation is based on the following assumptions i) Risk-free rate of 4.3%, ii) Equity risk premium of 6.0% iii) After-tax cost of debt of 8.1%. We have given a weightage of 80% to DCF valuation.

Telecom comps

Company	Region	MCap (USD bn)	PE FY23E	EV/EBITDA FY23E
Zain KSA	KSA	2.5	31.1	5.5
Etiad Etisalat Company	KSA	6.5	21.4	6.5
Saudi Telecommunication Company	KSA	48.3	5.9	8.0
Emirates Telecommunications	UAE	55.2	22.4	10.2
Emirates Integrated Telecommunications	UAE	7.0	19.5	5.2
Ooredoo	Qatar	7.9	14.6	4.5
Bahrain Telecommunications Company	Bahrain	2.0	NaN	5.2
Singapore Telecommunications	Singapore	31.5	19.4	13.0
Telecom Egypt Co	Egypt	1.6	4.5	3.6
Turkcell Iletisim Hizmetleri	Turkey	4.3	7.2	3.4
Oman Telecommunications Company	Oman	1.8	NaN	5.2
Median			17.0	5.2

We have given a weightage of 35% each to the EV/EBITDA and P/E multiples. At median peer P/E multiple of 17.0x and EV/EBITDA multiple of 5.2x, we arrive at target price of SAR 5.6 and SAR 9.3 per share, respectively.

Sensitivity table

ZAINKSA AB

		Cost of Equity					ARPU						
		8%	9%	10%	11%	12%							
Terminal Growth rate	Subscriber base mn	0.50%	16.6	15.1	13.8	12.7	11.8	75	80	85	90	95	
		0.75%	17.1	15.6	14.2	13.1	12.1	7.64	11.8	12.8	13.9	14.9	15.9
		1.00%	17.7	16.1	14.7	13.5	12.4	8.14	12.1	13.2	14.3	15.3	16.4
		1.25%	18.4	16.6	15.1	13.8	12.7	8.64	12.5	13.6	14.7	15.8	16.9
		1.50%	19.1	17.2	15.6	14.3	13.1	9.14	12.9	14.0	15.1	16.2	17.3
									9.64	13.2	14.4	15.5	16.6

Key Financials

(SAR mn)	FY19	FY20	FY21	Prev. FY22e	FY22e	Prev. FY23e	FY23e	Prev. FY24e	FY24e
Income Statement									
Sales	8,386	7,917	7,901	8,312	8,873	8,346	8,870	8,322	8,979
COGS	(2,418)	(2,472)	(3,016)	(3,515)	(3,762)	(3,503)	(3,987)	(3,456)	(3,845)
Gross profit	5,969	5,445	4,885	4,797	5,112	4,843	4,883	4,866	5,134
Operating and administrative expenses	(1,899)	(1,763)	(1,749)	(1,753)	(2,009)	(1,760)	(2,073)	(1,768)	(2,192)
Operating profit	1,511	1,002	699	672	906	821	786	739	677
Share of results of investments in associates	0	0	0	0	0	59	59	59	59
Other income – net	11	28	20	20	6	20	6	20	6
Finance charges	(1,045)	(898)	(489)	(447)	(576)	(465)	(560)	(445)	(540)
Income before tax	504	280	231	245	350	436	320	375	230
Income tax	(19)	(20)	(17)	(18)	(18)	(32)	(23)	(28)	(17)
Net income for the period	485	260	214	227	332	404	296	348	213
Balance Sheet									
Cash and equivalents	1,157	1,103	512	1,786	1,453	2,242	1,401	2,830	1,328
Trade and other receivables	1,730	1,996	2,988	3,302	3,647	3,430	3,645	3,354	3,680
Inventories	242	187	214	249	267	257	293	264	294
Property and Equipment	6,080	6,857	6,640	5,051	5,379	4,513	5,117	4,298	5,144
Right-of-use assets	1,448	1,285	1,331	460	671	1,714	2,128	1,838	2,352
Intangible assets	16,216	16,280	15,561	15,026	15,116	14,497	14,676	13,954	14,226
Investment in associates	0	0	0	0	0	87	86.5	86.5	86.5
Total assets	27,738	28,158	27,877	26,529	27,193	27,417	28,031	27,324	27,821
Trade and other payables	3,100	3,488	3,692	4,042	4,550	4,037	4,648	3,968	4,586
Borrowings and notes payable	7,139	4,396	6,326	5,727	5,727	5,818	5,818	5,871	5,871
Lease liabilities	1,476	1,384	1,473	655	665	1,558	1,645	1,640	1,813
Share capital	5,837	8,987	8,987	8,987	8,987	8,987	8,987	8,987	8,987
Statutory reserve	0	0	21	44	55	85	84	119	106
Retained earnings	(1,608)	(54)	139	343	437	707	586	1,020	692
Total stockholders' equity	4,103	8,729	9,040	9,267	9,371	9,671	9,549	10,019	9,677
Total liabilities & stockholders' equity	27,738	28,158	27,877	26,529	27,193	27,417	28,031	27,324	27,821
Cash Flow Statement									
Cash from operating activities	3,326	4,029	1,574	1,650	1,611	2,611	2,496	2,782	2,484
Cash from investing activities	(2,035)	(1,825)	(1,085)	1,165	872	(1,264)	(1,521)	(1,296)	(1,533)
Cash from financing activities	(1,551)	(2,215)	(861)	(1,542)	(1,542)	(891)	(1,027)	(898)	(1,024)
Net changes in cash	(260)	(11)	(372)	1,274	941	456	(52)	588	(72)
Cash at the end of the period	1,157	1,103	512	1,786	1,453	2,242	1,401	2,830	1,328
Key Ratios									
Current ratio	0.8	0.4	0.4	0.5	0.5	0.6	0.5	0.7	0.5
Inventory turnover ratio	10.4	11.5	17.1	15.2	18.0	13.8	14.3	13.3	13.1
Debtors' turnover ratio	5.1	4.2	3.4	2.6	2.5	2.5	2.4	2.5	2.5
Creditors turnover ratio	0.7	0.8	0.7	0.9	0.8	0.9	0.9	0.9	0.8
Gross profit margin	71.2%	68.8%	61.8%	57.7%	57.6%	58.0%	55.0%	58.5%	57.2%
Operating margin	18.0%	12.7%	8.8%	8.1%	10.2%	9.8%	8.9%	8.9%	7.5%
Net profit margin	5.8%	3.3%	2.7%	2.7%	3.7%	4.8%	3.3%	4.2%	2.4%
EBITDA margin	45.6%	43.5%	39.6%	36.6%	33.2%	36.9%	31.7%	37.2%	32.8%
Average return on equity	12.0%	4.1%	2.4%	2.5%	3.6%	4.3%	3.1%	3.5%	2.2%
Average return on assets	1.8%	0.9%	0.8%	0.8%	1.2%	1.5%	1.1%	1.3%	0.8%
Debt/Equity (x)	2.1x	0.7x	0.9x	0.7x	0.7x	0.8x	0.8x	0.7x	0.8x
Interest coverage ratio (x)	1.4x	1.1x	1.4x	1.5x	1.6x	1.8x	1.4x	1.7x	1.3x
P/E	16.3x	38.5x	53.5x	44.6x	27.8x	25.1x	31.1x	29.1x	43.2x
EV/EBITDA	3.7x	4.9x	5.8x	5.3x	5.2x	5.2x	5.5x	5.2x	5.2x
EV/Sales	1.7x	2.1x	2.3x	1.9x	1.7x	1.9x	1.7x	1.9x	1.7x
EPS (SAR)	0.7	0.4	0.2	0.3	0.4	0.4	0.3	0.4	0.2
Dividend payout ratio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Dividend yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.3%	0.0%	0.9%
Net debt	7,458	4,677	7,286	4,595	4,938	5,134	6,062	4,681	6,355
Net debt/ EBITDA	2.0	1.4	2.3	1.5	1.7	1.7	2.2	1.5	2.2
ROCE	6.5%	5.3%	4.0%	4.0%	5.4%	4.7%	4.5%	4.2%	3.9%

Source: Company Reports, U Capital Research

Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%



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