Zain KSA

Telecom – Industrial
ZAINKSA AB: Saudi Arabia
13 October 2010

Al Rajhi Capital

US$3.000bn	48.1%	US$10.60mn
Market cap	Free float	Avg. daily volume

Target price	8.00	0% over current
Consensus price	8.70	8.7% over current
Current price	8.00	as at 12/10/2010

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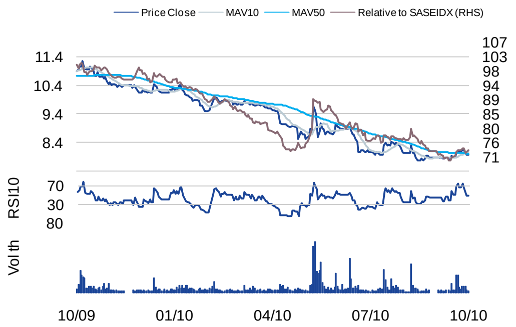
Existing rating

Underweight	**Neutral**	Overweight

Flash view

Flash View is an analyst's preliminary interpretation of a results announcement or the impact of a major event. Our investment rating and earnings estimates are not being changed in this report. Any formal changes to our investment rating or earnings estimates will be made in a subsequent report, which may differ from the preliminary views expressed here.

Performance

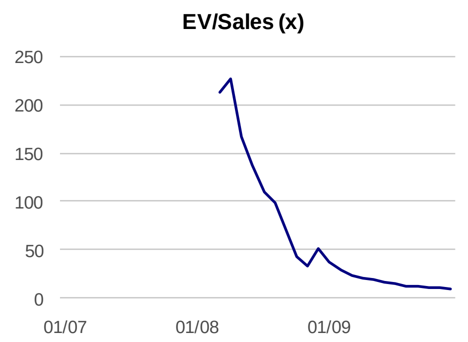


Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	3,004	5,650	7,705	9,516
Revenue Growth	494.6%	88.1%	36.4%	23.5%
EBITDA (SARmn)	(1,073)	328	1,484	2,474
EBITDA Growth	-15.2%		351.8%	66.7%
EPS	- 2.21	- 1.65	- 0.84	- 0.12
EPS Growth	36.0%	-25.4%	-49.3%	-85.4%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Zain KSA

Results not key driver for the stock

Zain KSA's results for Q3 2010 again featured strong sales growth but what look like high depreciation and interest costs. Thus, while sales and gross profit exceeded our estimates, the net loss was above our forecast. Zain has issued targets for 2011 which are in line with our assumptions. We expect Zain's share price to be driven not by its results, but by Etisalat's bid for Zain Kuwait – whose implications in our view are negative for its affiliate – and the timing of financial restructuring. We remain Neutral with a target price of SAR8.0.

Earnings vs our forecast	Above	**In Line**	Below
Likely impact:			
Earnings estimates	Up	**No Change**	Down
Dividend estimates	Up	**No Change**	Down
Recommendation	Upgrade	**No Change**	Downgrade
Long term view	Stronger	**Confirmed**	Weaker

- **Sales:** Zain KSA reported sales of SAR1,662mn, up by 95% year-on-year and by 15% versus Q2; sales were 7% above our estimate of SAR1,554mn. This strong performance appears to reflect continuing robust subscriptions growth and high call volumes. Zain does not seem to have published a figure for mobile accounts at the quarter-end; our estimate was 7.43mn.

- **Gross profit and EBITDA:** Gross profit of SAR712mn was up by 193% year-on-year and was 9% above our estimate of SAR653mn. We suspect that one of the key reasons for this strong performance was further roll-out of Zain KSA's network; this should have reduced roaming payments to Mobily. We have not yet seen an EBITDA number. However, the strong gross profit suggests that our estimate of Q3 EBITDA of SAR140mn was too cautious.

- **Net profit:** Unlike sales and gross profit, the operating loss of SAR235mn was only 5% below our estimate of SAR246mn. This suggests depreciation and amortisation charges remain at the level of the past four quarters, i.e. SAR360-375mn or higher. Similarly, the fact that the net loss of SAR544mn was 2% above our estimate of SAR532mn suggests net financial costs are running at a level of over SAR300mn per quarter. We have not yet seen Q3 balance sheet data, but we estimate that net debt stood at SAR14.4bn.

- **Targets for 2011:** Zain KSA has stated that it hopes to achieve 10.0mn mobile accounts, sales of over SAR8bn and EBITDA of SAR1.5bn in 2011. These targets may be compared with our existing estimates for next year: 10.42mn mobile accounts, sales of SAR7.61bn and EBITDA of SAR1.46bn.

- **Conclusion:** We do not see Zain KSA's reassuring operating performance as particularly relevant right now. We expect Zain's share price to be driven by factors largely beyond its control, i.e. Etisalat's bid for Zain Kuwait and the timing of financial restructuring. We see the bid for Zain Kuwait as negative for Zain because if it succeeds we expect Etisalat to try to sell Zain Kuwait's stake in Zain KSA and to focus on its existing affiliate Mobily.

Corporate summary

Zain KSA is the third-placed telecoms operator in Saudi Arabia, with a market alue of just over US$3bn; it launched service in Q3 2008. By our estimate Zain has a market share of mobile accounts of 13-14%, although its revenue share is lower at 9-10%. 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 telecoms player operating in several markets in the Middle East, but it now faces an acquisition offer from Etisalat of the UAE.

Share information

Market cap (SAR/US$)	11.20bn / 3.000bn
52-week range	7.80 - 11.25
Daily avg volume (US$)	10.60mn
Shares outstanding	1,400mn
Free float (est)	48.1%

Performance:	1M	3M	12M
Absolute	1.3%	-1.2%	-27.3%
Relative to index	0.7%	-3.2%	-26.4%

Major Shareholder:	
Mobile Telecommunications Co. (Kuwait)	25%
Faden Trading and Contracting	6.9%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	3,004	5,650	7,705	9,516
EBITDA (SARmn)	(1,073)	328	1,484	2,474
Net Profit (SARmn)	(3,099)	(2,314)	(1,172)	(171)
EPS (SAR)	- 2.21	- 1.65	- 0.84	- 0.12
DPS (SAR)	-	-	-	-
EPS Growth	36.0%	-25.4%	-49.3%	-85.4%
EV/EBITDA (x)	NA	80.4	18.2	11.1
P/E (x)	NA	NA	NA	NA
P/B (x)	1.3	1.8	2.2	2.3
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

Disclaimer and additional disclosures for Equity Research

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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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