



US\$2.594bn Market cap	48.1% Free float	US\$34.81 mn Avg. daily volume
Target price	7.50	7.9% over current
Consensus price	8.40	20.9% over current
Current price	6.95	as at 2/5/2011

Research Department
Mazhar Khan, Equity Research Analyst
 Tel 966 12119248, khanm@alrajhi-capital.com

Underweight	Neutral	Overweight
--------------------	----------------	-------------------

Zain KSA

Too many distractions

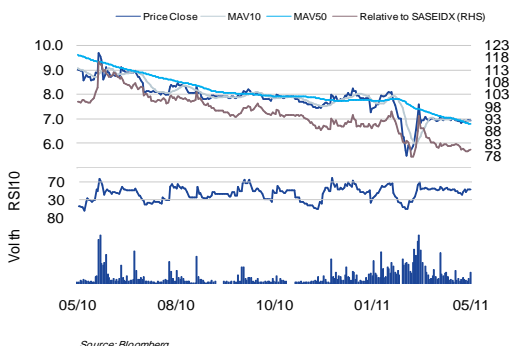
Key themes

We expect mobile to continue to outperform fixed-line telecoms in Saudi Arabia over the next few years, driven by mobile data. We think that STC has slightly lost its way in the domestic mobile market, to the benefit of its competitors.

Implications

Zain is performing decent as a number 3 operator, trying to tap the growth in voice and data services. The problem for Zain is its high debt burden, which reduces the share of enterprise value attributable to equity shareholders.

Performance

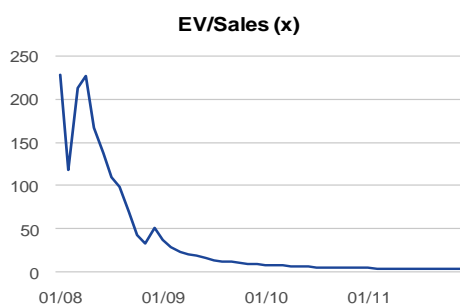


Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	5,934	7,421	10,000	12,901
Revenue Growth	97.5%	25.0%	34.8%	29.0%
EBITDA (mn)	331	1,212	2,200	3,548
EBITDA Growth		266.7%	81.4%	61.3%
EPS	(1.68)	(1.22)	(0.58)	0.24
EPS Growth	-23.9%	-27.7%	-52.6%	

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Zain results were disappointing and below our expectations. We had believed that Zain's operating prospects would start to strengthen but this is not visible at least for now. There are few issues with zain: the net debt is 13.1x of our estimate of 2011 EBITDA and a whopping SAR21bn of mobile license costs which needs to be amortized. Zain's financial restructuring plans need to be carried out, but firstly the company should complete the proposed 25% sale of stake to Kingdom & Batelco. Amid all these distractions, we think the share price of Zain is too risky for investing. We have cut our income statement forecasts for the remaining 2011 and for 2012 to factor in the Q1 results. Consequently, our target price has come down to SAR7.5 implying just 8% upside. We remain Neutral.

Decent sales growth and a positive EBITDA; however marketing expenses

surged: Revenues in Q1 2010 rose by 35% year-on-year, albeit from a low base. Though this growth is high, Zain, being a young operator, is in a rapid stage of growth. Revenues were below our forecasts, indicating greater pricing pressure than we had assumed. The EBITDA of SAR153.8mn was way below our estimated EBITDA of SAR287.6mn. We had hoped that EBITDA would rise significantly in 2011 after the company achieved EBITDA break even at the end of 2009 and a decent growth in 2010. This discrepancy between our estimates and actual results can be explained by lower margin on sales due to pricing pressure and higher SG&A costs than we had expected.

Net debt still high, resulting in high financial costs: Gross debt in Q1 stood at SAR15.7bn, surging 26% from last year, while Net Debt recorded at SAR15.2bn. As a result, financial costs surged by 31% to SAR298mn, which is as high as 20% of its sales recorded in Q1. This high financial cost pushed the net loss to SAR531.7mn, around 90mn below our optimistic estimate.

Zain still struggling to improve operationally: We have cut our revenue and income forecasts for 2011 and 2012, thus believing that being a number 3 operator, Zain will face fierce competition from Mobily (which has a bigger prepaid customer base) and to some extent from STC. We expect high financial costs and lower call rates to put further pressure on its revenues and hence high net losses. In view of high interest costs and uncertainty with the company, we have increased our WACC to 12.5%. Consequently, our estimated fair value of Zain now is SAR7.5.

No positive catalyst to invest: In our view, Zain will struggle to report a net profit at least till 2013 because of high financial costs due to huge debt in the books. The proposal of stake sale to Kingdom and Batelco might be positive news and its outcome will take Zain to its restructuring plans.. The deal is still in the negotiating and due diligence stage, and will take some time after which we expect the due restructuring to happen. Amid all these uncertainty, we think it is too risky to invest in a company with a 2011E EV/EBITDA of 21.1x and a negative PE. Zain is also not cheap on EV/Sales, which is one of the simplest measures for a loss making company. We remain Neutral with a lower target price of SAR7.5 versus our earlier price of SAR8.0.



Corporate summary

Zain KSA is the third-placed telecoms operator in Saudi Arabia, with a market value of US\$2.9bn; 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 was an emerging telecoms player operating in 24 markets in the Middle East and Africa, but it has sold the majority of its African assets to Bharti.

Share information

Market cap (SAR/US\$) 9.73bn / 2.594bn
52-week range 5.50 - 9.70
Daily avg volume (US\$) 34.81mn
Shares outstanding 1,400mn
Free float (est) 48.1%

Performance: 1M 3M 12M
Absolute 0.7% -7.3% -22.4%
Relative to index -1.1% -12.2% -19%

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

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	5,934	7,421	10,000	12,901
EBITDA (SARmn)	331	1,212	2,200	3,548
Net Profit (SARmn)	(2,358)	(1,705)	(808)	340
EPS (SAR)	(1.68)	(1.22)	(0.58)	0.24
DPS (SAR)	-	-	-	-
EPS Growth	-23.9%	-27.7%	-52.6%	na
EV/EBITDA (x)	73.8	21.1	12.0	7.3
P/E (x)	na	na	na	28.6
P/B (x)	1.6	2.2	2.7	2.4
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

Figure 1. Zain: Q1 & Q2 results (actual and our estimates)

(SAR) mn	2010Q1A	2011Q1E	2011Q1A	YOY % chg.	2010Q2A	2011Q2E	YOY % chg.
Revenues	1,094.2	1,917.4	1,484.2	35.6%	1,450.4	1,650.6	13.8%
EBITDA	(70.3)	287.6	153.9		57.1	264.1	362.2%
EBITDA margin (%)	-6.4%	15.0%	10.4%		3.9%	16.0%	
Operating profit	(435.3)	(104.1)	(233.1)	-46.4%	(314.5)	(137.6)	-56.2%
Operating profit margin (%)	-39.8%	-5.4%	-15.7%		-21.7%	-8.3%	
Net Income	(662.5)	(441.6)	(531.7)	-19.7%	(631.6)	(488.6)	-22.6%
Capex	38.8	306.8	121.2	212.6%	341.3	264.1	-22.6%
% of sales	4%	16%	8%		24%	16%	
Net Debt (bn)	12.0	14.6	15.3	27.6%	14.0	15.5	10.6%
Net Debt/EBITDA	(42.6)	12.7	24.8		61.4	14.7	

Source: Company data, Al Rajhi Capital



We have cut our sales forecasts by an average 2%. We have also cut EBITDA forecast for 2011 by 18% and for 2012 by 9%.

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	3,004	5,934	7,421	10,000	12,901
Cost of Goods Sold	(2,127)	(3,404)	(3,545)	(4,500)	(5,289)
Gross Profit	877	2,530	3,875	5,500	7,612
Government Charges	-	-	-	-	-
S.G. & A. Costs	(1,950)	(2,200)	(2,663)	(3,300)	(4,064)
Operating EBIT	(2,467)	(1,164)	(393)	464	1,691
Cash Operating Costs	(4,077)	(5,604)	(6,208)	(7,800)	(9,353)
EBITDA	(1,073)	331	1,212	2,200	3,548
Depreciation and Amortisation	(1,394)	(1,494)	(1,606)	(1,736)	(1,857)
Operating Profit	(2,467)	(1,164)	(393)	464	1,691
Net financing income/(costs)	(634)	(1,195)	(1,320)	(1,292)	(1,342)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	1	-	-	-	-
Other Expenses	-	-	-	-	-
Net Profit Before Taxes	(3,099)	(2,358)	(1,713)	(828)	349
Taxes	-	-	8	21	(9)
Minority Interests	-	-	-	-	-
Net profit available to shareholders	(3,099)	(2,358)	(1,705)	(808)	340
Dividends	-	-	-	-	-
Transfer to Capital Reserve	-	-	-	-	-

We do not expect net profit or a dividend till 2013

	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	1,400	1,400	1,400	1,400	1,400
CFPS (SAR)	(1.218)	(0.617)	(0.071)	0.663	1.570
EPS (SAR)	(2.214)	(1.685)	(1.218)	(0.577)	0.243
DPS (SAR)	0	0	0	0	0

We expect a robust sales and EBITDA growth over 2010-13

Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth	494.6%	97.5%	25.0%	34.8%	29.0%
Gross Profit Growth	5228.5%	188.5%	53.2%	41.9%	38.4%
EBITDA Growth	-15.2%	-	266.7%	81.4%	61.3%
Operating Profit Growth	45.1%	-52.8%	-66.2%	-	264.6%
Net Profit Growth	36.0%	-23.9%	-27.7%	-52.6%	-
EPS Growth	36.0%	-23.9%	-27.7%	-52.6%	-

The EBITDA margin should swing upwards sharply from now on, though the growth will be capped by marketing expenses

Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin	29.2%	42.6%	52.2%	55.0%	59.0%
EBITDA margin	-35.7%	5.6%	16.3%	22.0%	27.5%
Operating Margin	-82.1%	-19.6%	-5.3%	4.6%	13.1%
Pretax profit margin	-103.2%	-39.7%	-23.1%	-8.3%	2.7%
Net profit margin	-103.2%	-39.7%	-23.0%	-8.1%	2.6%

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

Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	-11.7%	-5.8%	-2.1%	2.4%	8.7%
ROIC	-11.0%	-5.7%	-1.9%	2.2%	8.1%
ROE	-30.5%	-32.0%	-32.2%	-19.9%	8.9%
Effective Tax Rate	0.0%	0.0%	0.5%	2.5%	2.5%
Capex/Sales	63.0%	16.3%	17.2%	18.2%	18.0%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%

Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	na	na	na	na	28.6
P/CF (x)	na	na	na	10.5	4.4
P/B (x)	1.1	1.6	2.2	2.7	2.4
EV/Sales (x)	7.2	4.1	3.4	2.6	2.0
EV/EBITDA (x)	na	73.8	21.1	12.0	7.3
EV/EBIT (x)	na	na	na	56.9	15.4
EV/IC (x)	1.1	1.2	1.3	1.3	1.3
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital



Shareholders' equity has been shrinking due to high net losses

Net debt currently stands at 2.6x annualised Q1 2011 sales

A large positive movement on working capital supported cash flow in 2009. This has proven unsustainable.

We expect the capex/sales ratio to rise in the coming year due to rising data traffic.

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	506	702	250	250	631
Current Receivables	1,007	1,463	1,568	3,302	3,354
Inventories	39	29	138	165	194
Other current assets	312	409	501	501	501
Total Current Assets	1,850	2,603	2,457	4,218	4,679
Fixed Assets	3,847	4,298	4,972	6,064	7,537
Investments	-	-	-	-	-
Goodwill	-	-	-	-	-
Other Intangible Assets	22,133	21,155	20,153	19,145	18,137
Total Other Assets	-	-	-	-	-
Total Non-current Assets	25,980	25,453	25,125	25,209	25,675
Total Assets	27,830	28,055	27,582	29,427	30,354
Short Term Debt	-	2,194	2,194	2,194	2,194
Trade Payables	6,247	5,403	5,708	7,514	8,100
Dividends Payable	-	-	-	-	-
Other Current Liabilities	543	457	515	515	515
Total Current Liabilities	6,789	8,054	8,417	10,223	10,809
Long-Term Debt	12,408	13,196	13,888	14,735	14,735
Other LT Payables	-	659	798	798	798
Provisions	10	17	18	18	18
Total Non-current Liabilities	12,418	13,872	14,704	15,551	15,551
Minority interests	-	-	-	-	-
Paid-up share capital	14,000	14,000	14,000	14,000	14,000
Total Reserves	(5,378)	(7,871)	(9,539)	(10,347)	(10,006)
Total Shareholders' Equity	8,622	6,129	4,461	3,653	3,994
Total Equity	8,622	6,129	4,461	3,653	3,994
Total Liabilities & Shareholders' Equity	27,830	28,055	27,582	29,427	30,354

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	11,902	14,687	15,832	16,678	16,298
Net Debt/EBITDA (x)	(11.10)	44.42	13.06	7.58	4.59
Net Debt to Equity	138.0%	239.6%	354.9%	456.5%	408.1%
EBITDA Interest Cover (x)	(1.7)	0.3	0.9	1.7	2.6
BVPS (SAR)	6.16	4.38	3.19	2.61	2.85

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	(3,099)	(2,358)	(1,713)	(828)	349
Depreciation & Amortisation	1,394	1,494	1,606	1,736	1,857
Decrease in Working Capital	2,060	246	109	45	505
Other Operating Cashflow	638	1,246	358	21	(9)
Cashflow from Operations	994	627	360	973	2,703
Capital Expenditure	(1,892)	(968)	(1,278)	(1,820)	(2,322)
New Investments	-	-	-	-	-
Others	3	2	0	-	-
Cashflow from investing activities	(1,889)	(966)	(1,278)	(1,820)	(2,322)
Net Operating Cashflow	(895)	(339)	(918)	(847)	381
Dividends paid to ordinary shareholders	-	-	-	-	-
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(575)	(2,150)	(14)	-	-
Cashflow from financing activities	818	535	466	847	-
Total cash generated	(78)	196	(452)	-	381
Cash at beginning of period	583	506	702	250	250
Implied cash at end of year	506	702	250	250	631

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	63.0%	16.3%	17.2%	18.2%	18.0%

Source: Company data, Al Rajhi Capital



Disclaimer and additional disclosures for Equity Research

Disclaimer

This research document has been prepared by Al Rajhi Capital Company ("Al Rajhi Capital") of Riyadh, Saudi Arabia. It has been prepared for the general use of Al Rajhi Capital's clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Al Rajhi Capital. Receipt and review of this research document constitute your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusion, or information contained in this document prior to public disclosure of such information by Al Rajhi Capital. The information contained was obtained from various public sources believed to be reliable but we do not guarantee its accuracy. Al Rajhi Capital makes no representations or warranties (express or implied) regarding the data and information provided and Al Rajhi Capital does not represent that the information content of this document is complete, or free from any error, not misleading, or fit for any particular purpose. This research document provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other investment products related to such securities or investments. It is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this document.

Investors should seek financial, legal or tax advice regarding the appropriateness of investing in any securities, other investment or investment strategies discussed or recommended in this document and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities or other investments, if any, may fluctuate and that the price or value of such securities and investments may rise or fall. Fluctuations in exchange rates could have adverse effects on the value of or price of, or income derived from, certain investments. Accordingly, investors may receive back less than originally invested. Al Rajhi Capital or its officers or one or more of its affiliates (including research analysts) may have a financial interest in securities of the issuer(s) or related investments, including long or short positions in securities, warrants, futures, options, derivatives, or other financial instruments. Al Rajhi Capital or its affiliates may from time to time perform investment banking or other services for, solicit investment banking or other business from, any company mentioned in this research document. Al Rajhi Capital, together with its affiliates and employees, shall not be liable for any direct, indirect or consequential loss or damages that may arise, directly or indirectly, from any use of the information contained in this research document.

This research document and any recommendations contained are subject to change without prior notice. Al Rajhi Capital assumes no responsibility to update the information in this research document. Neither the whole nor any part of this research document may be altered, duplicated, transmitted or distributed in any form or by any means. This research document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or which would subject Al Rajhi Capital or any of its affiliates to any registration or licensing requirement within such jurisdiction.

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.

Contact us

Dr. Saleh Alsuhaibani
Head of Research
Tel: +966 1 2119434
alsuhaibanis@alrajhi-capital.com

Al Rajhi Capital
Research Department
Head Office, King Fahad Road
P.O. Box 5561
Riyadh 11432
Kingdom of Saudi Arabia
Email: research@alrajhi-capital.com

Al Rajhi Capital, a subsidiary of Al Rajhi Bank, is licensed by the Saudi Arabian Capital Market Authority, License No. 07068/37.