

Saudi Telecom Sector

Telecom –Industrial

Saudi Arabia

04 December 2011

الراجحي المالية
Al Rajhi Capital



US\$ 29.06 bn Market cap	33.9% Free float	US\$21.3mn Avg. daily volume
Target mkt cap	137.4	25.7% over current
Consensus mkt cap.	144.7	32.4% over current
Current mkt cap.	109.3	as at 03/12/2011

Underweight	Neutral	Overweight
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Key themes

We expect the Saudi mobile market to continue to outperform fixed line, driven primarily by mobile data and smartphone sales. Consequently we expect robust growth for the next few years, despite the risk of declining tariffs. Though we like STC's overseas expansion, the company has still not achieved the synergies it has aimed for. Mobily, on the other hand, has focussed well on domestic market to strengthen its position.

Implications

Our preferred stock in the sector is Mobily, which we rate as Overweight. Mobily is performing well operationally and offers strong growth in the near term at a reasonable valuation. STC (Overweight) is also attractively valued and offers a modest yield of 6%. Zain KSA (Neutral) is performing well for a third operator, but is hobbled by a high debt burden and there is question market over its restructuring.

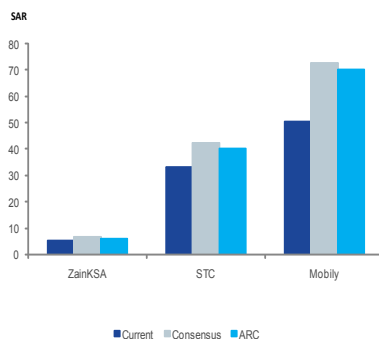
What do we think?

Stock	Rating	Price Target
STC	Overweight	SAR40.0
Mobily	Overweight	SAR70.0
Zain	Neutral	SAR6.0

Why do we think it?

Stock	3 year EBITDA CAGR	2012 EV/EBITDA
STC	6%	4.0x
Mobily	8%	5.1x
Zain	43%	10.4x

Where are we versus consensus?



Source Bloomberg, Al Rajhi Capital



Saudi Telecoms Sector: Mobily still ahead

Saudi Telecom sector is inching towards maturity and companies are gearing at taking the competition to the next level. With the launch of smartphones and tablets, the companies are able to bring exciting new offers and bundling packages in a bid to boost sales. Mobily is still ahead in identifying growth opportunities at the earliest and investing wisely in the domestic market. While investment in NGN at home and expanding overseas operations will boost long term prospects for STC, the latter carries the risk of high non-operating losses due to currency fluctuations, which was evident in Q3. However, STC is now modestly valued with a decent dividend yield of 6.0%. On the other hand, we believe it is still risky to invest in Zain prior to restructuring despite the recent dive in the stock. In our view, the restructuring outcome will decide the company's future rather than its operating performance.

STC – valuation attractive. STC's international business is rising, however it's vulnerable to currency fluctuations, which was evident in Q3, making it difficult to predict results. That said, we think the long term growth is still intact and the weak Q3 results have been already reflected on the share price (-8% post results), making the stock attractive at current levels.

Mobily – growth still intact. Mobily is the leader in mobile broadband with 42% market share and likely to continue generating double digit growth for at least two years. Though margins have slipped, robust revenue growth will continue to drive profitability. We estimate a full year dividend of SAR3.0 which implies 6.0% yield for 2011.

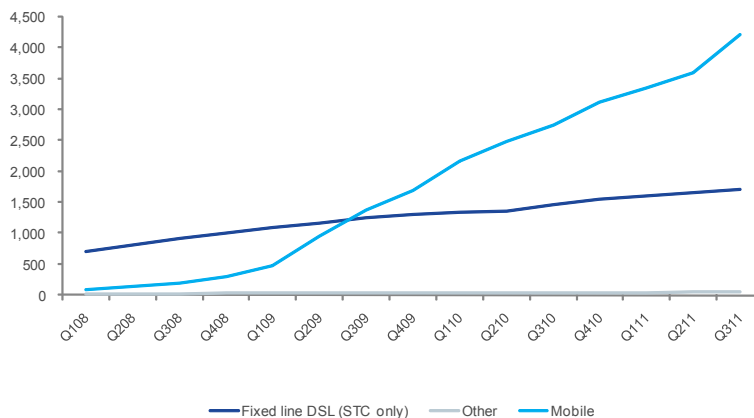
Zain KSA – restructuring to decide future. Although below expectations, Zain's operating performance was satisfactory. However, high financial costs continued to result in net losses; we expect accumulated losses to reach 69% of the paid up capital by end of 2011. Zain's fortune depends on the outcome of the restructuring, which is likely to go through in Q1 2012. Post restructuring, we expect accumulated losses to come down by 80% and net debt to decline 40%, thus making financials look much better.

Conclusion. We continue to rate Mobily as Overweight with a revised target price of SAR70; offering 39% upside; we also retain our Overweight rating on STC with a cut in our target price to SAR40.0. We remain Neutral on Zain and cut our target price to SAR6.0 as we think it is still risky prior to financial restructuring.



Mobile broadband accounts are surging, and are way ahead of fixed-line DSL.

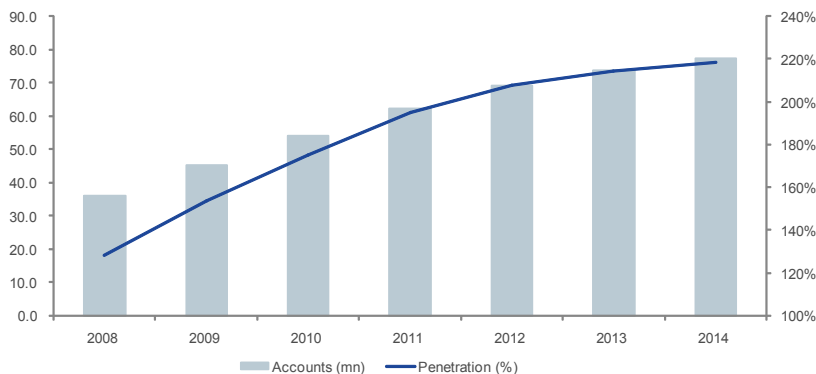
Figure 1. Fixed-line and mobile subscriptions in KSA (ARC estimates, 000s)



Source: Company data, Al Rajhi Capital

Figure 2. Saudi mobile market: forecasts for penetration and accounts

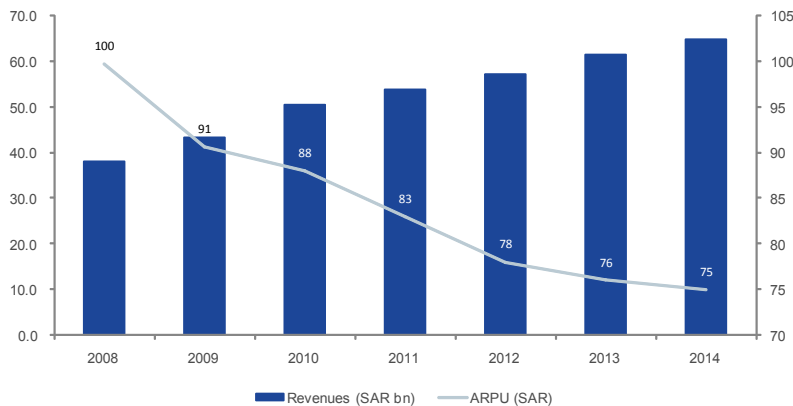
At 195%, Saudi mobile penetration rate moving faster towards maturity.



Source: Al Rajhi Capital estimates

Figure 3. Combined revenues and ARPU estimates

We believe ARPU will continue to fall and will stable around SAR75 by 2014.



Source: Al Rajhi Capital estimates

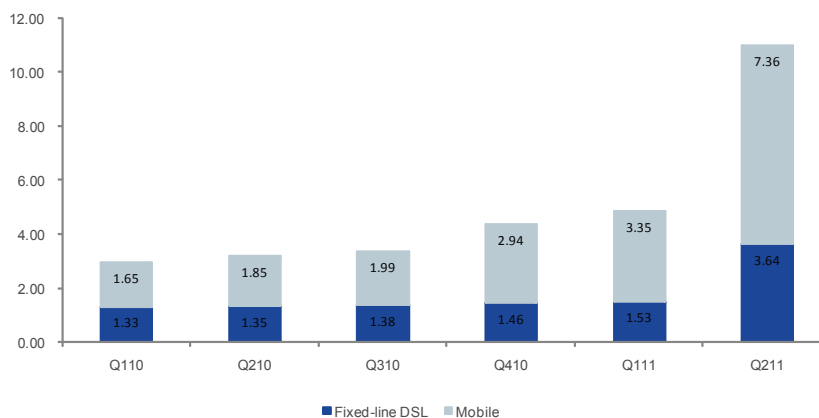


Broadband growth still intact competition intense

There is a substantial increase in CITC figures for broadband subscriptions for H1 2011. It shows 13 mn fixed and mobile broadband accounts.

Accurate data for the size of the Saudi Broadband market is very difficult to obtain. The Communication and Information Technology Commission (CITC), the Saudi telecom regulator, publishes figures on the size of the telecom and internet markets in a rather confusing manner. According to the recent H12011 report, the total broadband (fixed and mobile) subscriptions at the end of H12011 stood roughly at 13mn (11mn for mobile and 2.02mn for fixed line). It is worth noting that CITC changed its calculation methodology and adopted a new method of calculating the broadband subscriptions. The total subscriptions now include dedicated data sims, voice sims (which have data services), modems and dongles. As a result, the increase in subscriptions has been substantially higher than those reported in the earlier quarters. The number of subscriptions at the end of 2010 were 4.4mn (including around 1.46mn fixed (DSL) broadband). These figures certainly suggest that the mobile broadband market growth is still intact.

Figure 3. Saudi broadband accounts (CITC figures,mn)



Source: CITC, Al Rajhi Capital

Mobily is still ahead in terms of mobile broadband...

...but STC is catching up.

It is virtually impossible to reconcile this number with the claims made by operators. The operators have not published data on broadband subscriptions in Q3. Moreover, there is no breakdown of the data provided by CITC in Q3. Hence, we have maintained the old methodology and used our judgement to compute the broadband accounts of the telecom operators. We believe Mobily is ahead of STC in terms of mobile broadband accounts while STC is catching up slowly with the help of launching attractive packages and bundling them with fixed line, smart-phones sales etc. The third operator Zain seems to be far behind its rivals, largely due to the financial uncertainties surrounding the company and slowness in introducing competitive offers to the market. We estimate that Mobily has around 2.3mn mobile broadband customers, while STC has 1.9mn, and Zain around 2, 00,000 broadband accounts. These figures totalled at 4.4mn at the end of Q3 2011, a 42% growth from 3.1mn accounts in 2010. Thus, it is clear that mobile broadband is growing substantially faster than fixed line broadband (10% y-o-y growth)

With CITC reporting a mobile penetration rate of 195%, we think the competition among operators will continue to intensify. Going ahead, service providers will need to increase their marketing expenses and lower tariffs in a bid to maintain revenue growth. Recently, these companies have shifted their focus on smart phones and tablet sales which rely on various online applications and require constant internet connectivity.



30% of the population is below 15; we expect this segment to drive the underpenetrated smartphones market.

Change in demographics support our positive stance

Saudi Arabia is the largest country in the gulf region with an estimated population of 27mn. Growing at the rate of 2% annually, the country benefits from its young and fast growing population – 30% of the population is below 15, and 46% in the range of 15-39 indicating that retail consumption of the country will be high. This combined with a 20% of the total population being foreign guest workers helps ensure that money is being spent on telecoms services, are some of the factors positive for the Saudi Telecom sector.

We believe that the lifestyle of Saudis has been constantly changing with the young population actively joining the workforce and desire to follow a modern lifestyle. Looking specifically at the telecom sector, the markets have been flooded with exciting innovations like tablets and smartphones, which have opened a completely new segment for the industry. From introducing various offers with a motive of selling sims, the companies have now concentrated more on selling smartphones and tablets to gain market share. We can see young school and college goers actively purchasing these tablets and smartphones, which has become a part of their lifestyle. We see this segment as fast growing and under-penetrated and hence it offers a significant growth opportunity for all telecom companies as customers will continue to buy these items, trying to flow with the trend.

Zain is likely to gain more market share

Going ahead, we think that the market pie will continue to grow on the back of favourable demographics, though at a slower pace. We believe that all companies will increase their market share but the breakdown is likely to change. Assuming the restructuring goes through, Zain, being the third operator, will probably gain more market share than other operators, mainly at the expense of STC as Mobily is more focused on domestic market. Zain has been clearly targeting users below 15 years old; this is reflected in its TV ads and campaigns. We like this marketing strategy and expect it to payoff considering that 30% of population are below 15 years old.

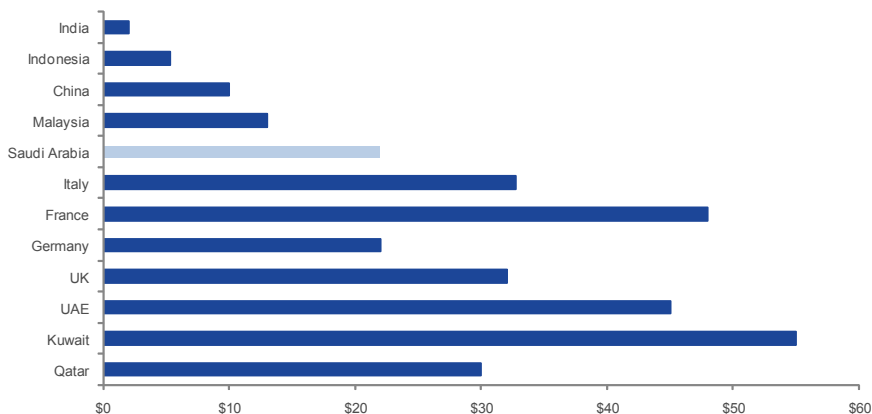
Price war in voice and broadband to pressurize ARPU

As we noted earlier, voice market is clearly moving towards maturity at a fast pace with penetration rate reaching 200%; operators have started lowering voice call charges in order to increase the minutes of usage(MOU). This will further push down ARPU levels from SAR83 in 2011 to SAR75 in 2014. By our estimates, STC has the highest ARPU of around SAR96-100 due to dominance in the postpaid segment while Mobily is far behind at SAR65 below Zain's which carries an ARPU of SAR77. However, it is worth mentioning here that Saudi mobile pricing is relatively high by the standards of developing markets. For example, ARPU in China is only around US\$10 and in Malaysia US\$13 while in India it is close to US\$2-4. On the other hand, ARPU in various gulf countries like UAE, Kuwait and Qatar stands at US\$30-55, which is substantially higher than that in Saudi Arabia. High ARPU in GCC countries reflects high GDP per capita and purchasing power parity in the region.

Call rates are being slashed in a bid to increase volumes.

Saudi Arabia aggregate ARPU stands at SAR83, which is much higher than emerging markets.

Figure 4. ARPU of various countries (2010)



Source: national regulator's data, CTIA reports, Al Rajhi Capital



RPM falling; but still higher compared to emerging markets

Though ARPU is one of the widely used trigger to judge profitability of telecom companies, in order to understand the margins we have used RPM (“revenue per minute”) as a guide. Again, it is very difficult to calculate RPM for Saudi operators, since they disclose very little information about MOU. From industry sources and our estimates, we believe that aggregate MOU for subscribers range between 140 minutes to 160 minutes. The usage has definitely increased from 2009 since people have started using multiple sims (of different operators) to take advantage of the relevant offers in the market. In our opinion, STC should be at the top of this range, since it has the largest number of post-paid customers and Mobily is at the bottom on account of a large share of prepaid customers. That said, the gap between three operators does not appear to be significantly large.

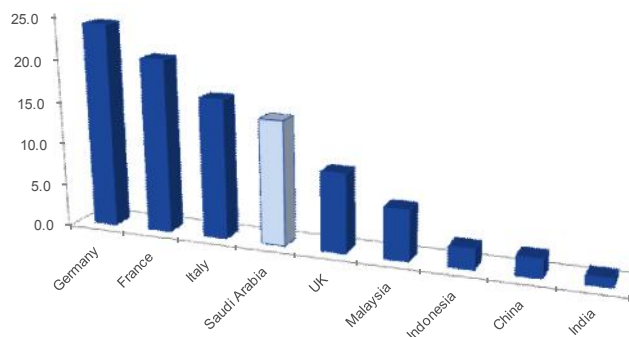
Based on our estimate for MOU, we calculate that aggregate RPM in the Saudi mobile market at around SAR0.50 at the end of Q3 2011, a fall of 17% since 2009. We estimate STC’s RPM at around SAR0.55 while Mobily and Zain at around SAR0.45. We think there is still room for prices to fall as increasing competition will lead to more tariff cuts in future. For instance, Zain has announced a new promotion plan of just 20 halalas per min. plan for international calls in a bid to take advantage of higher revenues from the hajj period and increasing volumes from foreign workers in the kingdom. We believe such aggressive promotional strategies force even other operators to cut tariffs (price war), squeezing RPM further.

While RPM in Saudi Arabia has fallen in the last three years, it is higher compared to most emerging markets. China and India are the two countries with one of the lowest RPM’s in the world ranging between 1-2 US cents compared to 14 US cents in Saudi Arabia. We assess RPM in Saudi Arabia is just below the average in European countries and close to UK. We think as MOU will increase due to introduction of various packages in the market, RPM will gradually fall from current levels due to intensifying competition, affecting margins of the telecom companies. However, growth in revenues should eventually support profits.

Aggressive tariff cuts expected to lower RPM gradually in the next few years.

RPM in Saudi Arabia is higher compared to emerging economies

Figure 5. RPM of various developed and developing countries



Source: CTIA, Al Rajhi Capital

Margins to decline gradually on account of falling RPM

As competition grows, we believe margin level of the all operators is set to fall due to a gradual decline in RPM. As we mentioned earlier, the overall RPM has declined by 17% from 2009 and the effect has been seen on the margins of all three operators. Our EBITDA margin estimate for STC has declined by 60bps to 37.3% for 2011 and 40 bps to 36.9% for 2012 on the back of higher advertising costs and falling call charges. For Mobily, we think the margins will fall gradually in 2012 as the company will concentrate on maintaining its double digit growth, but the fall should not be as steep as evident in 2011. We expect Mobily to end 2011 with a gross margin of 51.9%, a 300bps decline over last year.

Zain, on the other hand, has been constantly improving its margins due to better control on interconnection charges and operating costs. As Zain has a small market share in mobile broadband (less than 5%), we think the company has a potential to increase its presence in this segment, which will support margins as this segment carries higher margins than voice. However, considering intensifying competition and the company’s desire to maintain top line

Operating margins have been falling for both STC and Mobily amid intense competition to capture market share.



double-digit growth, we see further decline in voice margins, offsetting the hike in data margins. As a result, we expect Zain's gross margin to remain close to current level of 50%. We expect Zain's EBITDA margins to strengthen from current levels (13% in 2011) on account of increased sales leading to economies of scale and falling SG&A costs as a proportion of sales which currently stands high at 37% of sales.

Figure 6. Margins table

	2009	2010	2011E	2012E	2013E
STC					
Gross margin					
EBITDA margin	40.6%	37.9%	37.3%	36.9%	37.6%
Operating margin	25.2%	21.2%	21.3%	20.7%	21.4%
Mobily					
Gross margin	57.8%	54.9%	51.9%	51.0%	51.0%
EBITDA margin	37.0%	38.5%	37.4%	36.4%	35.5%
Operating margin	24.6%	27.2%	26.3%	25.5%	24.7%
Zain					
Gross margin	29.2%	42.6%	50.3%	51.2%	51.2%
EBITDA margin	-35.7%	5.6%	13.2%	18.7%	22.2%
Operating margin	-82.1%	-19.6%	-10.9%	-1.1%	5.5%

Source: Company data, Al Rajhi Capital (* STC does not provide gross margin break up)

We have cut our forecasts for all three companies to factor in slowing voice market and increasing penetration.

Going ahead: we have cut our forecasts

We have mostly cut our forecasts for all three companies to incorporate falling margins and slowing growth of the overall telecom sector. We have been aggressive with STC as it stands vulnerable towards foreign exchange fluctuations which will definitely weigh on the net profit. That said, long term growth of STC remains intact as we see value coming from its acquisitions abroad especially from Malaysia, Kuwait and Bahrain. We have modestly revised our forecasts for Mobily as we believe that it is capable of attaining double digit growth for at least two years. Margins will remain under pressure, but growth will offset the fall in margins. With regard to Zain, we were hoping Zain to arrive at a solution during 2011 to its high debt and consequent interest costs preventing the company to record operating and net profit. Nevertheless, we expect restructuring to happen pretty soon as the company cannot afford to record further losses and erosion in its market cap. With mobile broadband clearly leading fixed line, both Mobily and STC have done well in introducing new tablets and smartphones in the domestic market in a quick span. Attractive promotions and packages for these tablets and smartphones will drive the sales for the companies in future.

Positive on the macro picture

Despite falling margins and cut in our forecasts, we are positive on the overall sector and see robust value in it. Our major triggers for telecoms market for next couple of years:

- Significant growth in mobile broadband, probably at the expense of fixed line.
- Strong smartphones and tablets demand in the underpenetrated market;
- Young population with 30% below 15 driving demand for iphones, blackberry and tablets;
- Introduction of 4G network will result in high speed internet;
- Inorganic expansion to help achieve double digit growth, especially STC;

Below is a brief table on our adjusted forecasts of the three companies for the next couple of years.



Figure 7. Key changes to estimates (SAR in mn)

	2011E	2012E	2013E
STC			
Revenues old	56,003	58,642	60,320
Revenues new	55,276	58,596	61,708
Change	-1%	0%	2%
EBITDA old	21,446	23,327	24,429
EBITDA new	20,591	21,623	23,202
Change	-4%	-7%	-5%
Net Income old	9,366	11,093	11,255
Net Income new	7,764	7,866	8,618
Change	-17%	-29%	-23%
Mobily			
Revenues old	19,633	21,095	24,416
Revenues new	19,474	22,226	24,827
Change	-1%	5%	2%
EBITDA old	7,511	7,951	9,156
EBITDA new	7,276	8,084	8,814
Change	-3%	2%	-4%
Net Income old	5,108	5,336	6,161
Net Income new	4,910	5,417	5,915
Change	-4%	2%	-4%
Zain			
Revenues old	7,594	10,417	12,233
Revenues new	6,923	8,401	9,677
Change	-9%	-19%	-21%
EBITDA old	1,175	2,292	3,119
EBITDA new	911	1,572	2,148
Change	-22%	-31%	-31%
Net Income old	(1,655)	(672)	53
Net Income new	(1,878)	(1,108)	(612)
Change	14%	65%	

Source: Company data, Al Rajhi Capital

Valuation:

Attractive overall

We have maintained our Overweight rating on Mobily and STC as well as our Neutral rating on Zain KSA. We have cut our target price for all three companies under our coverage to factor in the increasing competition and maturing voice market leading to falling call rates. Zain, despite doing well as a number three operator, still presents a dull case due to its failure in addressing its huge debt and interest costs. With losses now close to 70% of the capital, capital restructuring becomes a top priority for Zain. Hence we maintain our Neutral rating on the stock. STC now trades at a 2012 PE of 8.4x and offers a dividend yield of 6.0%. Mobily, on the other hand, trades at 6.5x and offers similar dividend yield of 6.0%, which makes it one of the cheapest investment option available in the market.



STC

For STC, we have used our traditional weighted average of DEP valuation and sum of parts (SOTP) valuation to compute our target price. Under SOTP valuation, we have used our estimates for domestic and international operations of STC and valued each business based on multiples. We assign 70% weighting to the DEP valuation and 30% weighting to SOTP.

Thus, on a SOTP basis, we estimate fair value per share for STC at SAR44.7. Though adverse foreign exchange movements brought the valuation down, higher than expected international performance coupled with the stake increase in Binariang Indonesia has pushed the fair value up from SAR39.6 in 2009 to SAR44.7. Our fair value of STC as per SOTP is below:

Figure 8. STC: SOTP valuation

(In Millions)	Method	EBITDA		2011E	2012E	Currency	Exch. Rate	Interest in EV	2011E	2012E
		2011E	2012E						2011E	2012E
STC Domestic	Comparables	10,038	10,421	7.4x	7.3x	SAR	1.00	100%	74,452	76,139
Turk Telekom	Comparables	5,174	5,437	4.5x	4.4x	TL	2.10	35%	17,153	17,744
Cell C	Comparables	2,382	2,816	4.8x	5.2x	ZAR	0.47	35%	1,876	2,406
Maxis Malaysia	Comparables	4,553	4,594	5.6x	6.3x	MYR	1.19	25%	7,538	8,627
Binariang & Others	Comparables	1,010	1,303	9.6x	8.2x	MYR	1.19	80%	9,244	10,193
Kuwait Telecom Company (Viva)	Comparables	257	430	4.8x	5.2x	SAR	1.00	26%	319	580
Bahrain Third Mobile Licence	Comparables	243	328	4.8x	5.2x	SAR	1.00	100%	1,163	1,703
									111,746	117,391
<i>In SAR mn except per share data</i>										
Enterprise Value at YE 2011	111,746									
Net Debt	22,394									
Total Equity Value	89,351									
Shares Outstanding (mn)	2,000									
Price per share	44.68									

Source: Company data, Al Rajhi Capital

As per DEP valuation, our fair value per share of SAR37.3 is calculated below:

Figure 9. STC valuation: discounted economic profit

Total value created / (destroyed)	30,263
Opening Invested capital	75,211
Total Enterprise Value	105,474
Less:	
Value of Debt (2011E)	-22,371
Minority Interests (2011E)	-8,469
Equity Value	74,634
No. of Shares (mn)	2000
Fair Value per share	SAR 37.3

Source: Company data, Al Rajhi Capital

Our target price of STC based on 70% weighting to DEP and 30% to SOTP now stands at SAR40, implying 20% upside. Thus we retain our Overweight rating.

Mobily

As mentioned earlier, we have increased our WACC for all our companies under coverage. We use long-run DEP valuation with a new WACC of 9.5% for Mobily. We have cut our overall revenue forecasts for Mobily to incorporate the moderate growth stage of Mobily coupled with contracted margins. As a result, our fair value for Mobily has fallen from SAR72.9 to SAR70.0. We think Mobily is undervalued at a 2012 PE of 6.5x and EV/EBITDA of 5.0x and an attractive dividend yield of 6.0%. Thus we maintain our Overweight rating.

Mobily does not look expensive at a 2012 PE of 6.5x.



Figure 10. Mobily valuation: discounted economic profit

Total value created / (destroyed)	34,480
Opening Invested capital	21,890
Total Enterprise Value	56,369
Less:	
Value of Debt (2011E)	-7,352
Minority Interests (2011E)	0
Equity Value	49,018
No. of Shares (mn)	700
Fair Value per share	SAR 70.0

Source: Company data, Al Rajhi Capital

Zain KSA

Like Mobily, Zain KSA has no international operations, so we have used DEP valuation with a WACC of 12% reflecting the uncertainty surrounding the company. Using an investment horizon of 30 years, we estimate a new fair value of SAR6.0, 9.0% upside from current level. Thus, we retain our Neutral rating on the stock. We present our calculation below:

Figure 11. Zain valuation: discounted economic profit

Total value created / (destroyed)	3,124
Opening Invested capital	20,817
Total Enterprise Value	23,941
Less:	
Value of Debt (2011E)	-15,523
Minority Interests (2011E)	0
Equity Value	8,418
No. of Shares (mn)	1400
Fair Value per share	SAR 6.0

Source: Company data, Al Rajhi Capital

Zain's fair value is affected by huge debt in the books.

- Zain's fair value has been affected by huge debt in the books which suppress the total enterprise value. Therefore, we think Zain needs restructuring on an urgent basis so that the debt level comes down, which will drastically reduce interest costs and increase profitability. We discuss the restructuring plan and impact of it on Zain's financials in the companies section.



US\$17.71bn Market cap	16.4% Free float	US\$5.61mn Avg. daily volume
Target price	40.00	20.1% over current
Consensus price	42.37	27.2% over current
Current price	33.30	as at 03/12/2011

Underweight **Neutral** **Overweight**

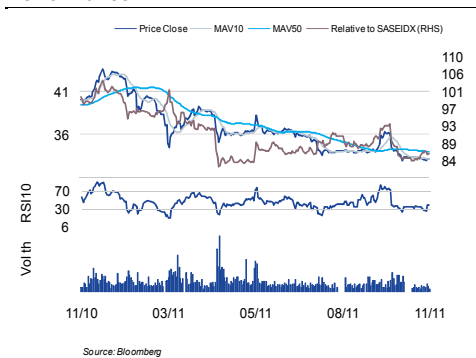
Key themes

We expect mobile to outperform fixed-line telecoms in Saudi Arabia over the next few years. Growth in 3.5G mobile broadband threatens the DSL market dominated by STC. Though, STC is concentrating on the lucrative domestic market, the international operations have not yielded the returns STC is aiming at.

Implications

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

Performance

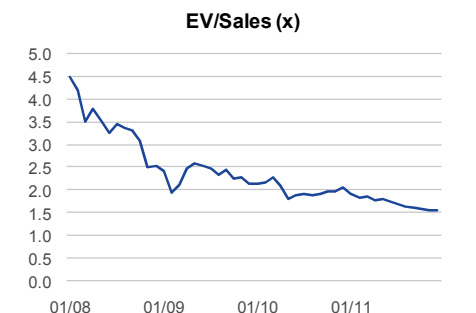


Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	51,787	55,276	58,596	61,708
Revenue Growth	2.0%	6.7%	6.0%	5.3%
EBITDA (mn)	19,625	20,591	21,623	23,202
EBITDA Growth	-4.8%	4.9%	5.0%	7.3%
EPS	4.72	3.88	3.93	4.31
EPS Growth	-13.1%	-17.8%	1.3%	9.6%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

STC Valuation attractive

STC reported weak Q3 results with a 53% y-o-y decline in net profit due to unexpected high foreign exchange losses (SAR780mn), reflecting that the overseas business is susceptible to currency fluctuation. Further, domestic performance in Q3 was below our estimates. That said, we still believe in STC's long term story and its growing focus on the domestic market. On the back of Q3 results, we have cut our earnings forecasts for STC to incorporate the vulnerability of its business. As a result, our target price has fallen from SAR43.6 to SAR40.0, representing 20% upside to current price levels; hence we remain Overweight. STC trades at a modest PE of 8.6x and carries a dividend yield of 6%, making it one of the attractive investments in the Saudi market.

Sales growth decent; bottom-line under pressure: While STC's results were mainly affected by exchange losses, operating performance was also below expectations. Although, sales grew by 5.9% y-o-y, EBITDA and operating profit declined by 4.0% and 7.8% respectively. Despite employee costs remained under control, the access charges and higher marketing expenses dented the operating performance in Q3. We believe that the access charges (interconnection rates) rose due to an increase in international traffic volumes from India, Indonesia and affiliates in other foreign markets. We expect these costs to be high in Q4 as well due to the Hajj season. Moreover, South Asian currencies have fallen (INR -15% YTD, MYR -4% YTD, IDR -1%) against USD indicating that forex losses might be significant in Q4 as well.

Financials strong but dividend cut dampener: At the end of Q3, STC's net debt/EBITDA ratio stood at 1.1x, below the level of 1.2x in Q2 2011. Balance sheet looks healthy; however, debt might increase as STC has committed to provide a loan of US\$1.2bn to its Indonesian subsidiary NTS. STC has cut its dividend from Q1 this year and thus dividend yield fell to a modest 6%. We feel investors sentiments have clearly been hit by the dividend cut, which is being reflected in the share price (-23% YTD).

Overseas expansion – a mixed bag: We believe STC is engaged in exciting initiatives in the domestic market such as Next Generation Network (NGN) which is likely to bring cost savings and high speed network in the country. Under fixed line, STC has been investing in FTTH (fibre-to-the-home) which involves replacing copper line network with optical fibre. On the other hand, we remain concerned over STC's overseas expansions, especially in countries like Indonesia and India which are too competitive with one of the lowest ARPU levels in the world. However, we like STC's investments in Bahrain, Turkey and Malaysia, where growth is quite robust.

Valuation: After reviewing our assumptions, we have cut our overall forecasts for 2012 and beyond. We have also increased our WACC from 11.3% to 11.5%. This impacted our long-run valuation and so we have lowered our target price for STC by 8% to SAR40.0. We are positive on STC's long term business model and its strong balance sheet. We believe the share price has already reached its bottom after falling by 8% since Q3 results and 23% YTD. STC trades at a low PE of 8.6x and carry a modest dividend yield of 6%, making it one of the attractive investments in the market. Thus, we retain our Overweight rating.

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Corporate summary	Share information	Valuation																																																							
STC is the largest telecoms operator in the GCC region, with a market value of US\$17.7bn. 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.	Market cap (SAR/US\$) 66.40bn / 17.71bn 52-week range 33.00 - 43.60 Daily avg volume (US\$) 5.61mn Shares outstanding 2,000mn Free float (est) 16.4%	<table border="1"> <thead> <tr> <th>Period End</th> <th>12/10A</th> <th>12/11E</th> <th>12/12E</th> <th>12/13E</th> </tr> </thead> <tbody> <tr> <td>Revenue (SARmn)</td> <td>51,787</td> <td>55,276</td> <td>58,596</td> <td>61,708</td> </tr> <tr> <td>EBITDA (SARmn)</td> <td>19,625</td> <td>20,591</td> <td>21,623</td> <td>23,202</td> </tr> <tr> <td>Net Profit (SARmn)</td> <td>9,440</td> <td>7,764</td> <td>7,866</td> <td>8,618</td> </tr> <tr> <td>EPS (SAR)</td> <td>4.72</td> <td>3.88</td> <td>3.93</td> <td>4.31</td> </tr> <tr> <td>DPS (SAR)</td> <td>3.00</td> <td>2.00</td> <td>2.00</td> <td>2.40</td> </tr> <tr> <td>EPS Growth</td> <td>-13.1%</td> <td>-17.8%</td> <td>1.3%</td> <td>9.6%</td> </tr> <tr> <td>EV/EBITDA (x)</td> <td>4.5</td> <td>4.2</td> <td>4.0</td> <td>3.8</td> </tr> <tr> <td>P/E (x)</td> <td>7.0</td> <td>8.6</td> <td>8.4</td> <td>7.7</td> </tr> <tr> <td>P/B (x)</td> <td>1.5</td> <td>1.4</td> <td>1.3</td> <td>1.2</td> </tr> <tr> <td>Dividend Yield</td> <td>9.0%</td> <td>6.0%</td> <td>6.0%</td> <td>7.2%</td> </tr> </tbody> </table>	Period End	12/10A	12/11E	12/12E	12/13E	Revenue (SARmn)	51,787	55,276	58,596	61,708	EBITDA (SARmn)	19,625	20,591	21,623	23,202	Net Profit (SARmn)	9,440	7,764	7,866	8,618	EPS (SAR)	4.72	3.88	3.93	4.31	DPS (SAR)	3.00	2.00	2.00	2.40	EPS Growth	-13.1%	-17.8%	1.3%	9.6%	EV/EBITDA (x)	4.5	4.2	4.0	3.8	P/E (x)	7.0	8.6	8.4	7.7	P/B (x)	1.5	1.4	1.3	1.2	Dividend Yield	9.0%	6.0%	6.0%	7.2%
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STC: complicated business

It is difficult to estimate STC's overseas business

Inconsistency in foreign exchange coupled with poor disclosures makes it difficult to estimate the performance of STC

STC continues to invest heavily overseas making its business model complex. Further, lack of proper disclosures and vulnerability to foreign exchange fluctuations make results forecasting very difficult. STC recently increased its stake in Axis (Indonesia) from 51% to 80%. As investment in international companies' increases, uncertainty and other costs such as depreciation rise. In the first nine months of 2011, STC has reported foreign exchange losses of SAR1,083mn i.e., 20% of its accumulated profits in 2011. The company argued that it has very efficient hedging policies to reduce the impact of exchange rates. Although we cannot judge to what extent these policies have offset the negative impact from exchange rate movements over revenues and net profit, numbers clearly show the opposite.

Figure 12. STC: foreign exchange gains and losses

(SAR mn)	2008	2009	2010	Q111	Q211	Q311
EBITDA	21,743	20,612	19,625	4814	5086	5198
Oper. profit	15,335	12,814	10,981	2669	2783	3000
Forex gains or losses	-1,415	642	372	-355	53	-780
Net profit	11,038	10,863	9,440	1573	2256	1562

Source: Company data, Al Rajhi Capital

Overseas investments: mix bag

In a bid to expand its business, STC has completed a number of acquisitions in different countries. So far, the company has invested in excess of US\$7.2bn but we haven't seen a remarkable impact on its performance yet. We think there are two major reasons behind this lower than expected performance. Firstly, STC has invested in Greenfield companies (Kuwait and Bahrain), which take time to gain a subscriber base. Secondly, STC has mostly invested in companies with position no.3 and below; these operators normally face stiff competition from market leaders, resulting in subdued performance.

Figure 13. STC: major overseas investments

	Ownership %	Major markets	Amount invested (US\$ mn)	Revenues (2011e; US\$mn)
Binariang	80.0%	Malaysia, India, Indonesia	3,471	1,209
Kuwaiti Telecom Company	26.0%	Kuwait	900	343
Oger Telecom	35.0%	Turkey, South Africa	2,560	3,051
Bahrain mobile licence	100.0%	Bahrain	230	324
Total invested			7,161	4,926

Source: STC, Al Rajhi Capital

Source: Company data, Al Rajhi Capital

So far STC has invested
US\$7.2bn overseas

STC's most valuable markets are Malaysia (Maxis) and Turkey (Turk Telecom). Maxis ranks no.1 in mobile market while Turk Telecom ranks no.1 in fixed line and no.3 in mobile market. We expect international business to reach 38% of the total revenues (currently 34%) by 2015 assuming STC is not making new major investments. That said, we think STC is looking at major acquisition targets in MENA to strengthen its position in the region. This was evident from the fact that STC was bidding for telecom license in Syria before it got cancelled due to ongoing political tensions in the country.

Q4: decent performance

We expect moderate growth for STC in Q4 2011 due to the fact that call rates have come down from last year. Further, as per our sources, we believe Mobily and Zain have utilized Hajj season more efficiently than STC. Mobily did an extensive coverage of Hajj period by distributing free goodies and establishing kiosks in areas close to locations important for Hajj rituals.

On the other hand, the depreciation of South East Asian currencies such as INR (15% YTD), MYR (4% YTD) and IDR (1% YTD) can lead to forex losses in Q4. Nevertheless, we believe the currency exchange losses should be moderate as compared to last quarter.

Figure 14. STC : Q4 & FY2011 estimates

SAR mn	Q4 2010A	Q4 2011E	YoY chg. %	FY 2010A	FY2011E	YoY chg. %
Revenue	13,444	14,305	6.4%	51,787	55,276	6.7%
EBITDA	5,244	5,493	4.7%	19,625	20,591	4.9%
Operating Profit	3,028	3,294	8.8%	10,981	11,746	7.0%
Net Profit	2,290	2,371	3.6%	9,440	7,763	-17.8%

Source: Company data, Al Rajhi Capital



We expect sales growth to be around 6% in 2012 and 5% in 2013

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	50,780	51,787	55,276	58,596	61,708
Access Charges	(7,494)	(8,086)	(8,703)	(9,183)	(9,873)
Employee Costs	(6,772)	(6,590)	(6,595)	(6,997)	(7,220)
Government Charges	(5,664)	(5,710)	(6,221)	(6,444)	(6,603)
S.G. & A. Costs	(7,614)	(7,110)	(7,378)	(8,068)	(8,639)
Repairs & Maintenance Costs	(2,623)	(4,665)	(5,787)	(6,281)	(6,171)
Operating EBIT	12,814	10,981	11,746	12,140	13,177
Cash Operating Costs	(30,168)	(32,162)	(34,685)	(36,974)	(38,506)
EBITDA	20,612	19,625	20,591	21,623	23,202
Depreciation and Amortisation	(7,799)	(8,645)	(8,845)	(9,483)	(10,026)
Operating Profit	12,814	10,981	11,746	12,140	13,177
Net financing income/(costs)	(1,023)	(1,497)	(1,552)	(1,709)	(1,809)
Forex and Related Gains	642	372	(1,349)	(1,440)	(1,440)
Provisions	(811)	(606)	(444)	(400)	(400)
Other Income	(178)	1,005	339	397	397
Other Expenses					
Net Profit Before Taxes	12,130	10,983	8,741	8,988	9,924
Taxes	(977)	(939)	(803)	(796)	(924)
Minority Interests	(290)	(604)	(175)	(326)	(382)
Net profit available to shareholders	10,863	9,440	7,763	7,865	8,618
Dividends	(6,000)	(6,000)	(4,000)	(4,000)	(4,800)
Transfer to Capital Reserve	-	-	-	-	-

We expect dividend to rise gradually

Operating profit fell for 2009 & 2010, but we expect it to remain positive for next three years

The EBITDA margin shrank by 2.8 percentage points in 2010; we expect it to hover around 37% over the next three years

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

	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	2,000	2,000	2,000	2,000	2,000
CFPS (SAR)	9.48	9.34	8.39	8.84	9.51
EPS (SAR)	5.43	4.72	3.88	3.93	4.31
DPS (SAR)	3.000	3.000	2.000	2.000	2.400
Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth	7.0%	2.0%	6.7%	6.0%	5.3%
EBITDA Growth	-5.2%	-4.8%	4.9%	5.0%	7.3%
Operating Profit Growth	-16.4%	-14.3%	7.0%	3.4%	8.5%
Net Profit Growth	-1.6%	-13.1%	-17.8%	1.3%	9.6%
EPS Growth	-1.6%	-13.1%	-17.8%	1.3%	9.6%
Margins	12/09A	12/10A	12/11E	12/12E	12/13E
EBITDA margin	40.6%	37.9%	37.3%	36.9%	37.6%
Operating Margin	25.2%	21.2%	21.3%	20.7%	21.4%
Pretax profit margin	23.9%	21.2%	15.8%	15.3%	16.1%
Net profit margin	21.4%	18.2%	14.0%	13.4%	14.0%
Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	16.6%	13.5%	14.0%	13.8%	14.3%
ROIC	18.4%	14.0%	14.2%	14.9%	15.2%
ROE	27.3%	21.7%	16.9%	16.0%	16.3%
Effective Tax Rate	8.1%	8.5%	9.2%	8.9%	9.3%
Capex/Sales	30.8%	28.3%	15.3%	27.2%	25.3%
Dividend Payout Ratio	55.2%	63.6%	51.5%	50.8%	55.7%
Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	6.1	7.0	8.6	8.4	7.7
P/CF (x)	3.5	3.6	4.0	3.8	3.5
P/B (x)	1.6	1.5	1.4	1.3	1.2
EV/Sales (x)	1.7	1.7	1.6	1.5	1.4
EV/EBITDA (x)	4.2	4.5	4.2	4.0	3.8
EV/EBIT (x)	6.8	8.0	7.3	7.1	6.7
EV/IC (x)	1.2	1.2	1.2	1.1	1.0
Dividend Yield	9.0%	9.0%	6.0%	6.0%	7.2%

Source: Company data, Al Rajhi Capital



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

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	7,710	5,904	8,769	8,263	7,102
Current Receivables	11,461	8,847	9,727	13,500	13,576
Inventories	710	732	858	920	926
Other current assets	2,782	3,183	3,930	3,930	3,930
Total Current Assets	22,663	18,666	23,285	26,614	25,534
Fixed Assets	52,737	55,135	56,070	63,592	70,245
Investments	2,533	2,540	2,644	2,644	2,644
Goodwill	-	-	-	-	-
Other Intangible Assets	29,222	31,806	29,218	28,181	27,143
Total Other Assets	2,433	2,561	2,349	2,349	2,349
Total Non-current Assets	86,924	92,043	90,282	96,766	102,381
Total Assets	109,587	110,709	113,566	123,380	127,915
Short Term Debt	8,579	8,452	6,666	6,666	6,666
Trade Payables	20,762	18,190	20,171	25,793	25,927
Dividends Payable	-	-	-	-	-
Other Current Liabilities	(0)	0	0	0	(0)
Total Current Liabilities	29,341	26,642	26,837	32,459	32,593
Long-Term Debt	22,711	21,736	24,497	24,497	24,497
Other LT Payables	3,859	5,868	4,933	4,933	4,933
Provisions	2,844	2,995	3,030	3,030	3,030
Total Non-current Liabilities	29,414	30,599	32,460	32,460	32,460
Minority interests	8,798	8,469	7,168	7,494	7,876
Paid-up share capital	20,000	20,000	20,000	20,000	20,000
Total Reserves	22,035	24,998	27,102	30,968	34,986
Total Shareholders' Equity	42,035	44,998	47,102	50,968	54,986
Total Equity	50,833	53,468	54,270	58,462	62,862
Total Liabilities & Shareholders' Equity	109,587	110,709	113,566	123,380	127,915

STC's financial ratios are mostly healthy

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	23,580	24,284	22,394	22,900	24,061
Net Debt/EBITDA (x)	1.14	1.24	1.09	1.06	1.04
Net Debt to Equity	46.4%	45.4%	41.3%	39.2%	38.3%
EBITDA Interest Cover (x)	20.1	13.1	13.3	12.7	12.8
BVPS (SAR)	21.02	22.50	23.55	25.48	27.49

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	12,130	10,983	8,741	8,988	9,924
Depreciation & Amortisation	7,799	8,645	8,845	9,483	10,026
Decrease in Working Capital	(3,671)	175	(828)	1,787	53
Other Operating Cashflow	(302)	(1,024)	(251)	(796)	(924)
Cashflow from Operations	15,956	18,780	16,507	19,461	19,079
Capital Expenditure	(15,637)	(14,677)	(8,436)	(15,967)	(15,641)
New Investments	-	(75)	(30)	-	-
Others	2,094	1,706	393	-	-
Cashflow from investing activities	(13,542)	(13,046)	(8,073)	(15,967)	(15,641)
Net Operating Cashflow	2,413	5,734	8,434	3,495	3,439
Dividends paid to ordinary shareholders	(5,943)	(6,109)	(4,441)	(4,000)	(4,600)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	3,874	(329)	(1,244)	-	-
Cashflow from financing activities	(2,764)	(7,540)	(4,710)	(4,000)	(4,600)
Total cash generated	(351)	(1,806)	3,724	(505)	(1,161)
Cash at beginning of period	8,061	7,710	5,904	8,769	8,263
Implied cash at end of year	7,710	5,904	9,629	8,263	7,102

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	30.8%	28.3%	15.3%	27.2%	25.3%

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



US\$9.33bn Market cap	55.3% Free float	US\$8.72mn Avg. daily volume
Target price	70.00	39.3% over current
Consensus price	72.51	44.3% over current
Current price	50.25	as at 03/12/2011

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Underweight	Neutral	Overweight
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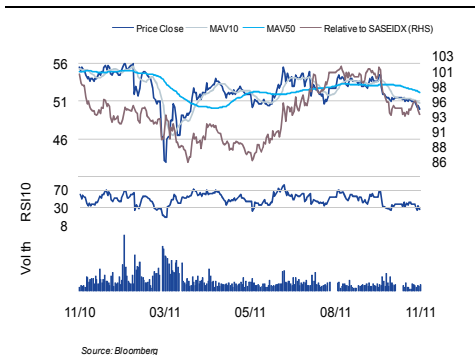
Key themes

We expect mobile to continue to outperform fixed-line telecom in Saudi Arabia over the next few years. Mobily has taken a clear lead in 3.5G mobile data, which is the fastest-growing segment of the market. While Mobily's strong focus on mobile is a clear positive, it is also making selective investments in fixed-line service.

Implications

Our preferred stock in the Saudi telecom sector is Mobily, which we rate as Overweight. Mobily is performing well operationally and offers strong growth in the near term at a reasonable valuation.

Performance

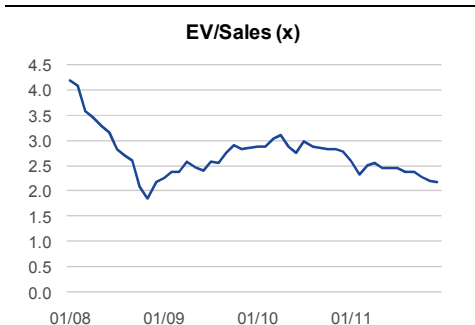


Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	16,013	19,474	22,226	24,827
Revenue Growth	22.6%	21.6%	14.1%	11.7%
EBITDA (mn)	6,165	7,276	8,084	8,814
EBITDA Growth	27.5%	18.0%	11.1%	9.0%
EPS	6.02	7.01	7.74	8.45
EPS Growth	39.7%	16.6%	10.3%	9.2%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Mobily

Growth still intact

Mobily's Q3 results were respectable but below our estimates. Revenue growth of 16% y-o-y was decent, while net profit grew by a meagre 8%. Intense promotions coupled with handset sales continue to squeeze gross margin which contracted in Q3 by 460bps from same quarter last year. We believe revenue and net profit growth will moderate from now on as the market is reaching a maturity stage. That said, we expect Mobily to increase promotional activities going forward along with bundling packages to stimulate handset sales. Thus, we still believe that Mobily has at least another two years of double digit growth. On the back of Q3 results, we have modestly cut our overall forecasts and set a new target price of SAR70, implying 39% upside. We retain our Overweight rating.

Revenue growth on remain double digit: Revenue grew by 16% year-on-year in Q3 after climbing by 29% and 25% in Q1 and Q2 respectively. We think the main reason for the slowdown was weak handset sales in Q3. We believe revenue growth should remain strong (17% y-o-y) in Q4 on the back of 1) the launch of iphone 4s which is likely to boost handset sales, and 2) Hajj season which witnessed more visitors compared to last year. That said, Q4 last year was extremely strong and thus making it difficult for Mobily to achieve a robust growth similar to that seen in Q1 and Q2.

Gross margin still healthy but under pressure: Mobily's gross margin has been falling as the company has concentrated more on growth. Though still healthy at 53.3%, gross margin contracted in Q3 by 460bps, continuing the pattern that started in Q2 2011 due to fierce competition and handset sales. We expect similar contraction in Q4, which will translate into weak bottom line growth. Nevertheless, we believe that the adverse impact of growing handset sales on margins has been already felt in 2011. Therefore, we think gross margin will fall gradually over the next two years as the company will concentrate on maintaining its double digit growth, but the fall should not be as steep as evident in 2011.

Balance sheet remains strong: Net debt was SAR6.4bn at the end of Q3, down from SAR6.9bn at the end of Q2. Higher EBITDA and lower debt pushed the net debt/EBITDA ratio further down to 0.9x at the end of Q3, versus 1.1x one year ago. This makes Mobily's balance sheet stronger than its peer STC (net debt/EBITDA is 1.1x). With very healthy finances, Mobily can continue to invest for growth. With ROE and ROCE strongly placed at 29.1% and 21.2% for 2011, we believe the company might declare stock dividends in the near future.

Higher dividend payout will favour the stock: Mobily paid a dividend of SR1.25 for the first half of 2011. It is worth noting that Mobily board has approved a dividend payout ratio of not less than 40% of its net profits in 2011. Hence, we estimate H2 dividend to be higher (SAR1.75 per share), indicating full year dividend of SAR3.0 implying an attractive dividend yield of 6%.

Conclusion: We believe Mobily has at least two years of double digit growth considering the launch of NGN network coupled with its focus on domestic market. Though margins have slipped, robust revenue growth will continue to drive profitability. Accordingly, we have cut our earnings forecasts to incorporate falling margins in our model. Our new target price is now SAR70.0 (old target: SAR72.9). Mobily trades at a 2012 PE of 6.5x and EV/EBITDA of 5.0x.



Corporate summary

Etiihad Etisalat (Mobily) is the second-placed telecoms operator in Saudi Arabia, with a market value of US\$9.3bn. Mobily has a market share of mobile accounts of about 40%, although its revenue share is lower at 30%. 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 27.5% of its shares.

Share information

Market cap (SAR/US\$) 35.00bn / 9.33bn
52-week range 43.00 - 56.00
Daily avg volume (US\$) 8.72mn
Shares outstanding 700.0mn
Free float (est) 55.3%

Performance: 1M 3M 12M
Absolute -2.4% -5.2% -9.9%
Relative to index -0.4% -7.4% -6.4%

Major Shareholder:
Emirates Telecoms Corp. 27.5%
Gen. Organisation for Social Insc. 11.2%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	16,013	19,474	22,226	24,827
EBITDA (SARmn)	6,165	7,276	8,084	8,814
Net Profit (SARmn)	4,211	4,910	5,417	5,915
EPS (SAR)	6.02	7.01	7.74	8.45
DPS (SAR)	2.00	3.00	3.00	3.38
EPS Growth	39.7%	16.6%	10.3%	9.2%
EV/EBITDA (x)	6.6	5.8	5.0	4.2
P/E (x)	8.3	7.1	6.5	5.9
P/B (x)	2.2	1.9	1.6	1.4
Dividend Yield	4.0%	6.0%	6.0%	6.8%

Source: Company data, Al Rajhi Capital

Q4: modest results

Below we present our forecasts for Q4 full year 2011:

Figure 15. Mobily : Q4 & FY2011 estimates

SAR mn	Q4 2010A	Q4 2011E	YoY chg. %	FY 2010A	FY2011E	YoY chg. %
Revenue	4,471	5,224	16.8%	16,013	19,474	21.6%
EBITDA	1,948	2,126	9.1%	6,165	7,276	18.0%
Operating Profit	1,465	1,572	7.3%	4,355	5,123	17.6%
Net Profit	1,459	1,516	3.9%	4,211	4,910	16.6%

Source: Company data, Al Rajhi Capital



We expect a revenue growth of 22% for 2011; powered by handset sales and broadband growth

We expect Mobily to pay a dividend of SAR3.0 this year and next year

We expect gross margin to fall in 2011 and beyond on account of increasing share of mobile sales carrying low margins

Mobily's ROIC is well above its WACC

Mobily trades on a PE of 7.3x and EV/EBITDA of 5.9x

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	13,058	16,013	19,474	22,226	24,827
Cost of Goods Sold	(5,512)	(7,230)	(9,362)	(10,890)	(12,165)
Gross Profit	7,547	8,783	10,112	11,336	12,662
Government Charges					
S.G. & A. Costs	(2,710)	(2,619)	(2,836)	(3,253)	(3,848)
Operating EBIT	3,208	4,355	5,123	5,670	6,129
Cash Operating Costs	(8,222)	(9,849)	(12,199)	(14,143)	(16,014)
EBITDA	4,837	6,165	7,276	8,084	8,814
Depreciation and Amortisation	(1,629)	(1,810)	(2,153)	(2,414)	(2,685)
Operating Profit	3,208	4,355	5,123	5,670	6,129
Net financing income/(costs)	(204)	(146)	(151)	(187)	(129)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	41	70	36	67	67
Other Expenses	-	-	-	-	-
Net Profit Before Taxes	3,045	4,279	5,008	5,550	6,067
Taxes	(31)	(67)	(98)	(133)	(152)
Minority Interests	-	-	-	-	-
Net profit available to shareholders	3,014	4,211	4,910	5,417	5,915
Dividends	(875)	(1,400)	(2,100)	(2,100)	(2,366)
Transfer to Capital Reserve	-	-	-	-	-
	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	700.0	700.0	700.0	700.0	700.0
CFPS (SAR)	6.63	8.60	10.09	11.19	12.29
EPS (SAR)	4.31	6.02	7.01	7.74	8.45
DPS (SAR)	1.250	2.000	3.000	3.000	3.380
Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth	21.0%	22.6%	21.6%	14.1%	11.7%
Gross Profit Growth	25.2%	16.4%	15.1%	12.1%	11.7%
EBITDA Growth	27.5%	27.5%	18.0%	11.1%	9.0%
Operating Profit Growth	28.5%	35.8%	17.6%	10.7%	8.1%
Net Profit Growth	44.1%	39.7%	16.6%	10.3%	9.2%
EPS Growth	16.8%	39.7%	16.6%	10.3%	9.2%
Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin	57.8%	54.9%	51.9%	51.0%	51.0%
EBITDA margin	37.0%	38.5%	37.4%	36.4%	35.5%
Operating Margin	24.6%	27.2%	26.3%	25.5%	24.7%
Pretax profit margin	23.3%	26.7%	25.7%	25.0%	24.4%
Net profit margin	23.1%	26.3%	25.2%	24.4%	23.8%
Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	17.2%	20.6%	21.2%	20.7%	19.7%
ROIC	18.4%	22.2%	23.4%	21.7%	22.6%
ROE	27.4%	30.3%	29.1%	27.4%	25.4%
Effective Tax Rate	1.0%	1.6%	1.9%	2.4%	2.5%
Capex/Sales	25.6%	21.1%	21.2%	18.5%	18.0%
Dividend Payout Ratio	29.0%	33.2%	42.8%	38.8%	40.0%
Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	11.6	8.3	7.1	6.5	5.9
P/CF (x)	7.5	5.8	5.0	4.5	4.1
P/B (x)	2.9	2.2	1.9	1.6	1.4
EV/Sales (x)	3.2	2.6	2.2	1.8	1.5
EV/EBITDA (x)	8.7	6.6	5.8	5.0	4.2
EV/EBIT (x)	13.1	9.4	8.3	7.1	6.1
EV/IC (x)	2.2	1.9	1.7	1.5	1.4
Dividend Yield	2.5%	4.0%	6.0%	6.0%	6.8%

Source: Company data, Al Rajhi Capital



We expect Mobily to have net cash by 2014

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	933	1,661	1,500	3,703	6,715
Current Receivables	6,081	6,186	5,474	5,773	9,188
Inventories	132	297	481	529	372
Other current assets	1,877	1,721	1,673	1,673	1,673
Total Current Assets	8,577	9,415	8,878	11,428	17,698
Fixed Assets	10,370	12,457	15,136	17,351	19,661
Investments	-	-	-	-	-
Goodwill	1,530	1,530	1,530	1,530	1,530
Other Intangible Assets	10,450	10,028	9,595	9,069	8,543
Total Other Assets	-	-	-	-	-
Total Non-current Assets	22,349	24,015	26,261	27,950	29,734
Total Assets	30,926	33,430	35,138	39,379	47,432
Short Term Debt	2,147	2,442	3,102	3,102	3,102
Trade Payables	9,831	9,533	8,567	9,665	13,903
Dividends Payable	-	-	(875)	(875)	(875)
Other Current Liabilities	211	281	55	55	55
Total Current Liabilities	12,189	12,256	10,848	11,946	16,185
Long-Term Debt	6,448	5,529	6,000	6,000	6,000
Other LT Payables	-	-	-	-	-
Provisions	47	66	83	83	83
Total Non-current Liabilities	6,495	5,595	6,083	6,083	6,083
Minority interests	-	-	-	-	-
Paid-up share capital	7,000	7,000	7,000	7,000	7,000
Total Reserves	5,243	8,580	11,207	14,349	18,164
Total Shareholders' Equity	12,243	15,580	18,207	21,349	25,164
Total Equity	12,243	15,580	18,207	21,349	25,164
Total Liabilities & Shareholders' Equity	30,926	33,430	35,138	39,379	47,432

Net debt/EBITDA is low; Mobily can invest for growth

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	7,062	5,860	7,352	5,148	2,137
Net Debt/EBITDA (x)	1.46	0.95	1.01	0.64	0.24
Net Debt to Equity	57.7%	37.6%	40.4%	24.1%	8.5%
EBITDA Interest Cover (x)	23.7	42.1	48.3	43.3	68.5
BVPS (SAR)	17.49	22.26	26.01	30.50	35.95

We are expecting capex of SAR4.1bn for 2011

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	3,045	4,279	5,008	5,550	6,067
Depreciation & Amortisation	1,629	1,810	2,153	2,414	2,685
Decrease in Working Capital	(388)	(727)	(1,290)	750	980
Other Operating Cashflow	(40)	109	49	(133)	(152)
Cashflow from Operations	4,246	5,470	5,919	8,581	9,580
Capital Expenditure	(3,339)	(3,376)	(4,137)	(4,103)	(4,469)
New Investments	450	150	200	-	-
Others	-	-	(95)	-	-
Cashflow from investing activities	(2,889)	(3,227)	(4,032)	(4,103)	(4,469)
Net Operating Cashflow	1,357	2,243	1,887	4,478	5,111
Dividends paid to ordinary shareholders	(525)	(875)	(3,150)	(2,275)	(2,100)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	-	-	-	-	-
Cashflow from financing activities	(1,687)	(1,516)	(2,040)	(2,275)	(2,100)
Total cash generated	(331)	728	(154)	2,203	3,011
Cash at beginning of period	1,264	933	1,661	1,500	3,703
Implied cash at end of year	933	1,661	1,508	3,703	6,715

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	25.6%	21.1%	21.2%	18.5%	18.0%

Source: Company data, Al Rajhi Capital



US\$2.016bn Market cap
48.3% Free float
US\$7.01mn Avg. daily volume

Target price **6.00** 9.2% over current
Consensus price **6.59** 22.0% over current
Current price **5.40** as at 03/12/2011

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

Underweight **Neutral** Overweight

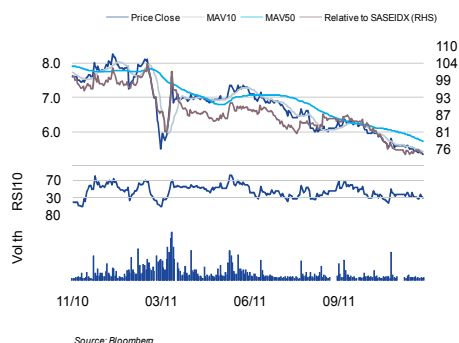
Key themes

We expect mobile to continue to outperform fixed-line telecom in Saudi Arabia for the next couple of years. Zain has been relying heavily on low income groups to generate revenues.

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

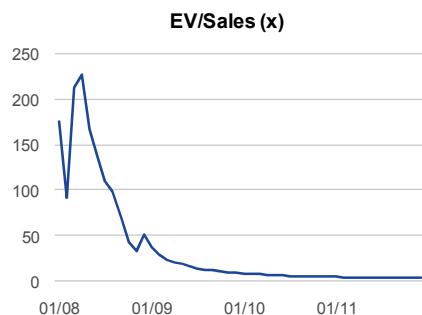


Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	5,934	6,923	8,401	9,677
Revenue Growth	97.5%	16.7%	21.3%	15.2%
EBITDA (mn)	331	911	1,572	2,148
EBITDA Growth		175.4%	72.6%	36.7%
EPS	(1.68)	(1.34)	(0.79)	(0.44)
EPS Growth	-23.9%	-20.4%	-41.0%	-44.8%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Zain KSA restructuring to decide future

Zain's results were poor for Q3 with only 8% y-o-y revenue growth and a net loss of SAR484mn. Though gross margins rose, Zain again recorded operating and net losses in the quarter due to high interest and depreciation costs. While we expect Q4 to be better keeping in mind the Hajj season, we opine that Zain desperately needs financial restructuring in order to come out of its financial mess. Post restructuring, we estimate a 39% decline in net debt and subsequent reduction in interest costs. On the back of Q3 results, we have cut our forecasts for Zain keeping in mind the slowdown in the voice call business (penetration rate reaching 200%). Hence, we have reduced our target price by 15% to SAR6.0. We retain our Neutral rating.

Poor revenue growth: Revenue grew only 8% y-o-y in Q3 to SAR1,795mn, 12% below our estimate of SAR2,038mn. We believe that this subdued performance was due to lower than expected growth in subscriptions in Q3 and lower call volumes. With Hajj season falling in Q4, we expect a better performance from Zain. It's worth noting that Zain slashed its selective international call rates to 20 halalas/min in a bid to boost call volumes in Q4.

Decent gross profit growth but below estimates: Gross profit of SAR870mn was up by 22% y-o-y but 20% below our expectation of SAR1,078mn. We believe that one of the key reasons for this below than expected performance was single digit growth in revenues. The company earned a gross margin of 48%; 500 bps above the 43% earned last year. While gross profit growth was decent, SG&A and depreciation costs surged by 14% and 52% y-o-y respectively. These high costs again depressed operating results; operating loss of SAR222mn was higher than our estimate of SAR111mn.

Surging financial charges still weighs on net profit: Net debt in Q3 declined marginally to SAR15.3 from SAR15.4bn in Q2. High debt led to high interest charges amounting to SAR262mn in Q3 at an effective interest cost of 6.6% (interest rate declined by 180bps year on year). The net debt/ EBITDA multiple stands at 18.2x with SAR20bn license fees still left to be amortized.

Restructuring is critical: As per our estimates, Zain's accumulated losses will reach 69% of the paid up capital by end of 2011, making capital restructuring a top priority. This involves cancelling 66% of paid up capital to eliminate accumulated losses. The company will then raise capital and pay off approximately 39% of the net debt. We expect the restructuring to go through in Q1 2012 as further losses might result in the stock being delisted. The proposed capital reduction and subsequent capital increase look sensible, and will probably make the company financially stronger.

Valuation and conclusion: Zain's CEO recently resigned bringing more depressing news for the company. In our view, however, it is only restructuring which will decide Zain's future. The major benefit of restructuring would be lower interest costs which will provide a major boost to net profits. In line with our assumption of slowing mobile voice market and growing penetration rate, we have cut our forecast for Zain. We have also increased our WACC of Zain to 12% factoring in the uncertainty surrounding its business. As a result, we have revised our target price downwards to SAR6.0. We retain our Neutral rating.



Corporate summary	Share information	Valuation																																																							
Zain KSA is the third-placed telecom operator in Saudi Arabia, with a market value of US\$2bn; 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 telecom player operating in 24 markets in the Middle East and Africa, but it has sold the majority of its African assets to Bharti.	Market cap (SAR/US\$) 7.56bn / 2.016bn 52-week range 5.40 - 8.25 Daily avg volume (US\$) 7.01mn Shares outstanding 1,400mn Free float (est) 48.3% Performance: 1M 3M 12M Absolute -3.6% -11.5% -29.9% Relative to index -2.1% -12.8% -26.2% Major Shareholder: Mobile Telecommunications Co. (Kuwait) 25% Faden Trading and Contracting 6.8% Source: Bloomberg, Al Rajhi Capital	<table border="1"> <thead> <tr> <th>Period End</th> <th>12/10A</th> <th>12/11E</th> <th>12/12E</th> <th>12/13E</th> </tr> </thead> <tbody> <tr> <td>Revenue (SARmn)</td> <td>5,934</td> <td>6,923</td> <td>8,401</td> <td>9,677</td> </tr> <tr> <td>EBITDA (SARmn)</td> <td>331</td> <td>911</td> <td>1,572</td> <td>2,148</td> </tr> <tr> <td>Net Profit (SARmn)</td> <td>(2,358)</td> <td>(1,878)</td> <td>(1,108)</td> <td>(612)</td> </tr> <tr> <td>EPS (SAR)</td> <td>1.68-</td> <td>1.34-</td> <td>0.79-</td> <td>0.44-</td> </tr> <tr> <td>DPS (SAR)</td> <td>-</td> <td>-</td> <td>-</td> <td>-</td> </tr> <tr> <td>EPS Growth</td> <td>-23.9%</td> <td>-20.4%</td> <td>-41.0%</td> <td>-44.8%</td> </tr> <tr> <td>EV/EBITDA (x)</td> <td>67.1</td> <td>25.3</td> <td>14.6</td> <td>10.4</td> </tr> <tr> <td>P/E (x)</td> <td>na</td> <td>na</td> <td>na</td> <td>na</td> </tr> <tr> <td>P/B (x)</td> <td>1.2</td> <td>1.7</td> <td>2.3</td> <td>2.9</td> </tr> <tr> <td>Dividend Yield</td> <td>0.0%</td> <td>0.0%</td> <td>0.0%</td> <td>0.0%</td> </tr> </tbody> </table> Source: Company data, Al Rajhi Capital	Period End	12/10A	12/11E	12/12E	12/13E	Revenue (SARmn)	5,934	6,923	8,401	9,677	EBITDA (SARmn)	331	911	1,572	2,148	Net Profit (SARmn)	(2,358)	(1,878)	(1,108)	(612)	EPS (SAR)	1.68-	1.34-	0.79-	0.44-	DPS (SAR)	-	-	-	-	EPS Growth	-23.9%	-20.4%	-41.0%	-44.8%	EV/EBITDA (x)	67.1	25.3	14.6	10.4	P/E (x)	na	na	na	na	P/B (x)	1.2	1.7	2.3	2.9	Dividend Yield	0.0%	0.0%	0.0%	0.0%
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Zain KSA: restructuring is sensible

Zain KSA will stage a capital reduction, followed by a capital increase

Zain KSA revived its financial restructuring plan on October 26th, 2011. The plan has two parts. Firstly, the company plans to stage a capital reduction, which will involve cancelling 66% of its issued shares and reducing its share capital from around SAR14.0bn to SAR4.8bn. The capital reduction will allow Zain to eliminate its accumulated losses, which stood at SAR9.2bn at the end of Q3 2011. Post capital reduction, the implied market price of Zain would be SAR16.5, well above its par value of SAR10.0. This will allow Zain to proceed to a capital increase, since in Saudi Arabia new share issues cannot be made at a discount to the par value. The capital increase is intended to raise Zain's capital from approximately SAR4.8bn to SAR10.8bn, i.e. by around SAR6.0bn or 125%. We believe restructuring should take place in Q1 2012 as an accumulated loss of Zain is expected to reach 69% of its paid up capital by the end of this year. Zain stands at a risk of being delisted as according to the rules of CMA, a stock could be delisted if accumulates losses of a particular company reaches 75% of its paid up capital.

Figure 16.1 Zain: no. of shares (m)

Current shares	1,400.0
Share reduction	-919.9
Interim new share base	480.1
Rights issue and debt-for-equity swap (new shares)	600.0
Final new share base	1,080.1

Source: Company data, Al Rajhi Capital

Figure 16.2 Zain: share capital (SAR mn)

		% chg.
Current share capital	14,000	
Capital reduction	-9,199	-65.7%
Interim new share capital	4,801	
Rights issue and debt-for-equity swap (new capital)	6,000	125.0%
Final new share capital	10,801	

Source: Company data, Al Rajhi Capital

We have assumed that 50% of the capital increase will come from founding shareholders and 50% from rights issue. We haven't discussed this yet with the company and hence cannot confirm. However, we are positive on our understanding as this was the strategy of the company when it was originally announced a year back. So, proceeding with this understanding, we believe that 50% contribution of founding shareholders will be arranged by swapping their debt with equity shares. As per Q2, founding shareholders have provided around SAR2.5bn in loans.

Similarly, other strategic investors like Almarai and Saudi Plastic Company etc. also have loans amounting to SAR1.5bn will also be given shares in exchange of debt. This move should be sensible as these shareholders might be unwilling to contribute new funds into the company. With regard to rights issue, we think minority shareholders should subscribe for new shares which will come at a discount of 39% to the market price; i.e., at SAR10 compared to SAR16.5 (based on share price SAR5.65) after the initial capital reduction. Raising SAR3bn should not be a problem for Zain as the issue should be fully underwritten.



We think that Zain KSA's restructuring plan will probably succeed and make the company financially stronger than it is today. As a result, the company should be able to raise further capital which is needed for expanding its existing network.

Figure 17. Zain: expected changes in market price

Current share base (m)	1,400.0
Current market price (SAR)	5.65
Current market cap. (SAR mn)	7,910
Interim new share base after capital reduction	480.1
Implied market price (SAR)	16.5
Expected market cap. after rights issue and debt-for-equity swap	13,910
Final new share base	1,080.1
Implied market price (SAR)	12.9

Assumption: new shares in the rights issue are offered at SAR10 each

Source: Company data, Al Rajhi Capital

We expect an implied share price of SAR12.9 post restructuring; based on Zain's share price at SAR5.65

Post restructuring, Zain's accumulated losses will come down by 85% and Net debt should fall by 40%; thus making financials look better

Zain's position post-restructuring Financials to look better

We tried to tweak our model with the present forecasts to see what are the noticeable changes happening to Zain's financial and fair value. We estimate that Zain's accumulated losses will come down by 85% in 2012 if restructuring will go through smoothly. Similarly, Net debt should fall by 40% while cash position should grow by 9 times supported by the cash proceeds earned through rights issue. Interest costs should reduce by 16% dropping the net losses.

Q4: we expect better performance

With regard to Q4, we believe Zain would be able to perform better as it has aggressively cut its international call charges to 20 halalas/min, the cheapest rate till date by any operator. We think this promotion has been announced to attract more customers and boost call volumes during Hajj period. Lower call rates can impact margins while boosting revenues; however, gross margin in Q4 last year was relatively weak. We therefore expect 12% growth in revenues and 17% in gross profit in Q4. The company will once again report a net loss due to high interest costs. The details of our estimates are below:

Figure 18. Zain : Q4 & FY2011 estimates

SAR mn	Q4 2010A	Q4 2011E	YoY chg. %	FY 2010A	FY2011E	YoY chg. %
Revenue	1,728	1,932	11.8%	5,934	6,923	16.7%
Gross Profit	826	966	17.0%	2,530	3,479	37.5%
EBITDA	209	271	29.4%	331	911	175.5%
Operating Profit	(179)	(158)	11.4%	(1,164)	(756)	35.0%
Net Profit	(521)	(415)	20.3%	(2,358)	(1,878)	20.4%

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%.

We do not expect net profit or a dividend till 2015

We expect a robust EBITDA growth over 2010-13

The EBITDA margin should swing upwards sharply 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

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	3,004	5,934	6,923	8,401	9,677
Cost of Goods Sold	(2,127)	(3,404)	(3,444)	(4,097)	(4,722)
Gross Profit	877	2,530	3,479	4,304	4,955
Government Charges	-	-	-	-	-
S.G. & A. Costs	(1,950)	(2,200)	(2,569)	(2,732)	(2,806)
Operating EBIT	(2,467)	(1,164)	(756)	(93)	528
Cash Operating Costs	(4,077)	(5,604)	(6,013)	(6,829)	(7,529)
EBITDA	(1,073)	331	911	1,572	2,148
Depreciation and Amortisation	(1,394)	(1,494)	(1,666)	(1,665)	(1,621)
Operating Profit	(2,467)	(1,164)	(756)	(93)	528
Net financing income/(costs)	(634)	(1,195)	(1,122)	(1,015)	(1,139)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	1	-	-	-	-
Other Expenses	-	-	-	-	-
Net Profit Before Taxes	(3,099)	(2,358)	(1,878)	(1,108)	(612)
Taxes	-	-	-	-	-
Minority Interests	-	-	-	-	-
Net profit available to shareholders	(3,099)	(2,358)	(1,878)	(1,108)	(612)
Dividends	-	-	-	-	-
Transfer to Capital Reserve	-	-	-	-	-
	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)	(0.151)	0.398	0.721
EPS (SAR)	(2.214)	(1.685)	(1.341)	(0.791)	(0.437)
DPS (SAR)	0	0	0	0	0
	12/09A	12/10A	12/11E	12/12E	12/13E
Growth					
Revenue Growth	494.6%	97.5%	16.7%	21.3%	15.2%
Gross Profit Growth	5228.5%	188.5%	37.5%	23.7%	15.1%
EBITDA Growth	-15.2%	-	175.4%	72.6%	36.7%
Operating Profit Growth	45.1%	-52.8%	-35.0%	-87.6%	-
Net Profit Growth	36.0%	-23.9%	-20.4%	-41.0%	-44.8%
EPS Growth	36.0%	-23.9%	-20.4%	-41.0%	-44.8%
	12/09A	12/10A	12/11E	12/12E	12/13E
Margins					
Gross profit margin	29.2%	42.6%	50.3%	51.2%	51.2%
EBITDA margin	-35.7%	5.6%	13.2%	18.7%	22.2%
Operating Margin	-82.1%	-19.6%	-10.9%	-1.1%	5.5%
Pretax profit margin	-103.2%	-39.7%	-27.1%	-13.2%	-6.3%
Net profit margin	-103.2%	-39.7%	-27.1%	-13.2%	-6.3%
	12/09A	12/10A	12/11E	12/12E	12/13E
Other Ratios					
ROCE	-11.7%	-5.8%	-6.4%	-0.8%	5.2%
ROIC	-11.0%	-5.7%	-3.6%	-0.5%	2.8%
ROE	-30.5%	-32.0%	-35.9%	-29.3%	-20.9%
Effective Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%
Capex/Sales	63.0%	16.3%	5.3%	5.5%	9.0%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%
	12/09A	12/10A	12/11E	12/12E	12/13E
Valuation Measures					
P/E (x)	na	na	na	na	na
P/CF (x)	na	na	na	13.4	7.4
P/B (x)	0.9	1.2	1.7	2.3	2.9
EV/Sales (x)	6.5	3.7	3.3	2.7	2.3
EV/EBITDA (x)	na	67.1	25.3	14.6	10.4
EV/EBIT (x)	na	na	na	na	42.2
EV/IC (x)	0.9	1.1	1.2	1.2	1.3
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital



Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	506	702	387	602	715
Current Receivables	1,007	1,463	698	855	1,161
Inventories	39	29	54	94	145
Other current assets	312	409	570	570	570
Total Current Assets	1,850	2,603	1,710	2,122	2,592
Fixed Assets	3,847	4,298	4,021	3,830	4,088
Investments	-	-	-	-	-
Goodwill	-	-	-	-	-
Other Intangible Assets	22,133	21,155	20,246	19,238	18,230
Total Other Assets	-	-	-	-	-
Total Non-current Assets	25,980	25,453	24,267	23,068	22,318
Total Assets	27,830	28,055	25,977	25,190	24,910
Short Term Debt	-	2,194	9,741	9,341	9,341
Trade Payables	6,247	5,403	4,342	4,565	5,398
Dividends Payable	-	-	-	-	-
Other Current Liabilities	543	457	84	84	84
Total Current Liabilities	6,789	8,054	14,166	13,990	14,822
Long-Term Debt	12,408	13,196	6,157	6,653	6,153
Other LT Payables	-	659	1,292	1,292	1,292
Provisions	10	17	23	23	23
Total Non-current Liabilities	12,418	13,872	7,471	7,968	7,468
Minority interests	-	-	-	-	-
Paid-up share capital	14,000	14,000	14,000	14,000	14,000
Total Reserves	(5,378)	(7,871)	(9,660)	(10,768)	(11,379)
Total Shareholders' Equity	8,622	6,129	4,340	3,232	2,621
Total Equity	8,622	6,129	4,340	3,232	2,621
Total Liabilities & Shareholders' Equity	27,830	28,055	25,977	25,190	24,910
Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	11,902	14,687	15,510	15,391	14,779
Net Debt/EBITDA (x)	11.10-	44.42	17.03	9.79	6.88
Net Debt to Equity	138.0%	239.6%	357.3%	476.2%	564.0%
EBITDA Interest Cover (x)	(1.7)	0.3	0.8	1.5	1.9
BVPS (SAR)	6.16	4.38	3.10	2.31	1.87
Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	(3,099)	(2,358)	(1,878)	(1,108)	(612)
Depreciation & Amortisation	1,394	1,494	1,666	1,665	1,621
Decrease in Working Capital	2,060	246	(201)	28	475
Other Operating Cashflow	638	1,246	160	-	-
Cashflow from Operations	994	627	(252)	585	1,483
Capital Expenditure	(1,892)	(968)	(367)	(466)	(871)
New Investments	-	-	0	-	-
Others	3	2	(8)	-	-
Cashflow from investing activities	(1,889)	(966)	(374)	(466)	(871)
Net Operating Cashflow	(895)	(339)	(626)	119	612
Dividends paid to ordinary shareholders	-	-	-	-	-
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(575)	(2,150)	-	-	-
Cashflow from financing activities	818	535	311	97	(500)
Total cash generated	(78)	196	(315)	215	112
Cash at beginning of period	583	506	702	387	602
Implied cash at end of year	506	702	387	602	715
Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	63.0%	16.3%	5.3%	5.5%	9.0%

Source: Company data, Al Rajhi Capital

Net debt for 2011e stands at
2.2x sales

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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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