الراجحي المالية
Al Rajhi Capital

Rating	**NEUTRAL**
Target price	**SAR10.00 (1.01% upside)**
Current	**SAR9.90**

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Zain KSA

Fee deferment will help Zain's cause

Zain KSA has received a lifeline from the Saudi Ministry of Finance (MoF) in the form of a seven-year deferment of its annual license fees. The deferred fee estimated at SAR800mn per annum will be treated as a commercial loan payable from 2021 onward. This unusual step shows the government's commitment to ensure the third operator's financial viability, which was also one of the largest non-oil sector foreign direct investments in the Kingdom.

Government's lifeline for Zain: The MoF has allowed Zain to defer its annual license fee, which could range between SAR 5.5 to 6bn in total over the next seven years, and treat it as a commercial loan payable from 2021 onward. This gesture shows the government's commitment to save Zain from potential bankruptcy, as this is expected to ease Zain's refinancing efforts. The survival of a third operator is critical for ensuring competition in the local market, which is currently dominated by STC and Mobily with over 90% share.

Few positives on Zain's fortunes: Our initial view on this announcement is positive since 1) Deferring fees will immediately improve the company's operating cash flows, thus providing more comfort for debt holders; 2) Provide more flexibility for Zain to refinance its existing debt with a longer term restructuring plan; and 3) Allow the company to concentrate on its competition and revenue growth, once short-to-medium term financial woes are addressed.

No clarity on interest and repayment period: According to the MoF announcement, the waived amount will be treated as a 'commercial loan', however, it does not mention the rate of interest nor the repayment period. We expect this loan to be treated similar to the facilities provided by other government agencies, resulting in significantly lower costs and a flexible repayment period.

May need more funding: With SAR12bn debt obligations, negative free cash flows and declining capex, Zain probably might require another round of funding from its shareholders. This will largely depend on how quickly Zain can resolve its short-term refinancing issues, allowing the company to focus on revenue generating efforts. Raising equity from the market will not be easy considering the lukewarm response for its last year's capital raising effort and the absence of any major operational improvements. We will revisit our key assumptions as we get more clarity on Zain's refinancing efforts and strategic initiatives in view of the government's lifeline.

Period End (SAR)	12/11A	12/12A	12/13E	12/14E	12/15E
Revenue (mn)	6,699	6,404	7,044	7,636	8,186
Revenue Growth	12.9%	-4.4%	10.0%	8.4%	7.2%
Gross profit margin	47.8%	44.7%	47.6%	50.8%	50.0%
EBITDA margin	13.4%	13.7%	15.5%	20.0%	18.8%
Net profit margin	-28.7%	-27.3%	-17.2%	-9.3%	-8.6%
EPS	(1.38)	(1.25)	(0.98)	(0.66)	(0.65)
EPS Growth	-18.4%	-9.1%	-21.6%	-32.9%	-0.7%
ROE	-36.9%	-27.5%	-15.5%	-10.5%	-12.0%
ROCE	-7.2%	-7.5%	-2.6%	-0.4%	-0.5%
Capex/Sales	10.6%	8.8%	9.0%	7.7%	7.5%

Source: Company data, Al Rajhi Capital

Key themes & implications

While Zain is performing decently as the number three operator in the Saudi telecoms market, its problem is its high debt burden, which reduces the share of enterprise value attributable to equity shareholders.

Share information

Market cap (SAR/US$)	10.69bn / 2.851bn
52-week range	7.60 - 19.08
Daily avg volume (US$)	34mn
Shares outstanding	1,080mn
Free float (est)	48%

Performance	1M	3M	12M
Absolute	18.6%	20.7%	-43.3%
Relative to index	12.5%	11.5%	-58.1%

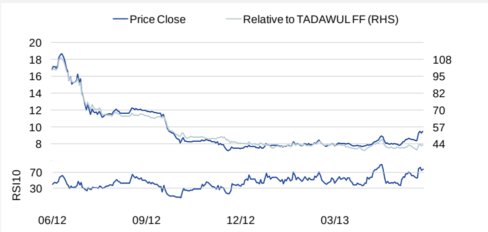
Major Shareholder:	
Mobile Telecommunications Co. (Kuwait)	25.0%
Faden Trading and Contracting	6.8%

Valuation

	12/12A	12/13E	12/14E	12/15E
P/E (x)	na	na	na	na
P/B (x)	1.6	1.5	1.7	1.9
EV/EBITDA (x)	15.8	11.2	7.0	7.0
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

Performance



Source: Bloomberg, Company data, Al Rajhi Capital

Company summary

Zain KSA is the third-largest telecom operator in Saudi Arabia, with a market value of US$2.8bn; it launched its service in Q3 2008. We estimate Zain to have a market share of 13-14% in mobile accounts, although its revenue share is lower at 9-10%. Zain has no presence in the fixed-line market. Zain KSA is an affiliate of the Zain Group of Kuwait. Zain Kuwait is an emerging telecom player operating in various markets in the Middle East and Africa.

Zain KSA
Ascertaining the benefits on fee deferment

The deferment of close to SAR800mn per year license fees (SAR5.6bn overall) will give more comfort to Zain's lenders when dealing with the company's proposed debt restructuring. Zain is now in a better position to negotiate and conclude its proposed and much delayed long-term facility restructuring. The company's financial commitments are as below:

This deferment will provide a cushion to lenders and will help Zain to conclude the debt restructuring deal

Figure 1 Zain's Financial commitments

Loan Details	2013
Syndicate loan from Saudi Fransi	9,000
Due to local banks	2,248
Facilities from international banks	753
Notes payable	132
Total debt as on Q1 2013	12,134

Source: Company data, Al Rajhi Capital

After the debt deferment announcement, the company also rescheduled its SAR2.25bn facility with a maturity extension of three years. This facility is now backed by the guarantee from the Zain Kuwait group. It is worth mentioning here that this debt is subordinate to the SAR9bn debt and the owners providing guarantee to it is expected to make it easier for the company while refinancing the SAR9bn debt.

Positive impact on operating cash flows

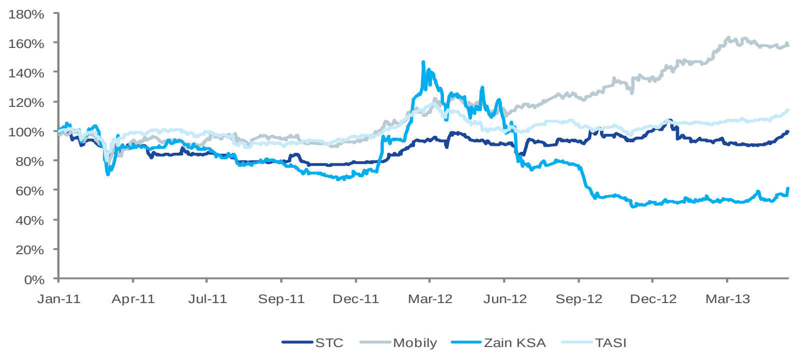
As per our initial calculations, the deferment will have a positive impact on Zain's operating cash flow, while impact on net profit will depend on the company's debt refinancing success, debt level, and interest rates. Since this is government assistance, we think that the interest costs will be on the lower side and have assumed an annual interest cost of around 2%. Freeing this cash flow could also help Zain to stimulate its capex and network building plans. We have not yet changed our estimates and would like to ascertain the full impact of the deferment and debt refinancing before updating the company's financials.

A big boost to declining investor confidence

The continuous extension on the repayment of its SAR9bn debt, recapitalization plan, and the frequent change in top management had badly affected investor confidence in the company. As a result, Zain KSA stock fell drastically (around 30%) in 2012 and traded near its all-time lows. As we can see from the rebased price performance chart, there was an initial euphoria among investors on the company's capital restructuring plan, leading to a sharp rise in Zain's stock price in the early part of 2012. However, the disappointing progress on debt reduction and a lukewarm response on its rights issue resulted in a sharp fall in Zain's stock. Following the MoF announcement, there has been a renewed interest in the company's prospects and we hope the company utilizes this opportunity to come back on track. The stock price has already rallied 12% after the fee deferment announcement.

Zain's share has performed poorly since the rights issue last year

Figure 2 Zain's stock performance vis-a-vis operators



Source: Bloomberg, Al Rajhi Capital

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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

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

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

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

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

2. Definitions

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

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

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

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

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