



US\$2.76bn Market cap	48.3% Free float	US\$27.07mn Avg. daily volume
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Target price	6.00	-18.9% over current
Consensus price	5.81	-21.5% over current
Current price	7.40	as at 14/2/2012

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▼
Underweight | Neutral | Overweight

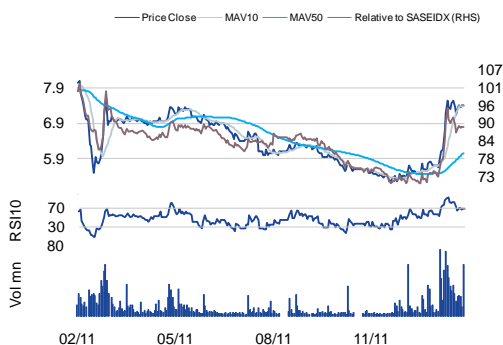
Key themes

We expect mobile to continue to outperform fixed-line telecoms in Saudi Arabia over the next few years, driven by mobile data. 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

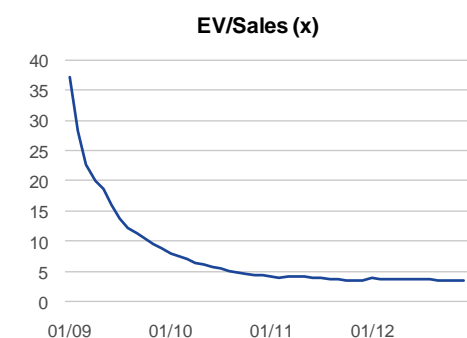


Earnings

Period End (SAR)	12/11A	12/12E	12/13E	12/14E
Revenue (mn)	6,699	7,401	8,244	9,066
Revenue Growth	12.9%	10.5%	11.4%	10.0%
EBITDA (mn)	899	1,248	1,601	2,004
EBITDA Growth	171.9%	38.8%	28.3%	25.2%
EPS	1.38-	1.05-	0.67-	0.39-
EPS Growth	-18.4%	-23.9%	-35.7%	-41.4%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Zain KSA

still risky to invest

Despite a favourable Hajj season, Zain's Q4 results were disappointing in terms of top line (4% decline q-o-q) but reasonable in terms of operating prospects. Zain has managed its SG&A costs and maintained a positive EBITDA, but it again reported net loss due to high financial costs on its massive debt. In our view, the key issue now for Zain is to plan out its restructuring smoothly as it's hurting the company's financials as well as morale. Accumulated losses have reached 69% of the paid up capital and thus restructuring is a necessity to avoid delisting. With financial restructuring plans being worked out, we think investing in Zain is still risky. We retain our target price of SAR6.0 but due to recent rally in the share price, we downgrade our rating to Underweight.

Disappointing sales growth: Revenues in Q4 2011 declined by 1% year-on-year, despite the lucrative Hajj season. We had expected a 12% increase in revenues. This clearly suggests that Zain couldn't gain any advantage during Hajj period. The company stated that an increase in the international tariffs in the fourth quarter led to a decline in call traffic. With the absence of this attraction (low price point), many customers would choose the other two operators considering their strong network and efficient distribution channels. This coupled with lack of attractive packages, unavailability of smart-phone sales and limited post-paid customers (a high ARPU segment) are the main reasons behind this weak figure.

Operating results just satisfactory: The EBITDA of SAR260mn was close but below our estimate of SAR271mn. Zain controlled its SG&A costs (25% of sales versus an average of 37% in previous quarters), but a 22% rise in depreciation and amortization charges resulted in an operating loss of SAR213mn, compared to our estimate of SAR158mn.

Net debt rising, financial costs still high: Zain recorded gross debt of around SAR16bn at the end of Q4, while net debt stood at SAR15.2bn, 14.6x of EBITDA. Although financial costs declined 27% year-on-year to SAR249mn, they remain relatively high, weighing on the bottom-line with net loss reaching SAR461mn in Q4.

Risky to invest ahead of restructuring: Zain is still working out a plan for its financial restructuring; which we now hope to be carried out in Q2 this year. Zain needs to cut its accumulated losses and reduce net debt by about SAR6bn. We believe that the restructuring will not only support Zain's financials, but also improve the company's damaged morale which has been reflected on its results. Once the restructuring gets completed, investors will hopefully be able to look at Zain afresh as a fast-growing operator.

We downgrade to Underweight: We think the recent rally in the share price of Zain was over speculations on restructuring and subsequent effect on its fortunes. However, financially Zain is still looking weaker with high debt and interest costs eroding the capital of the company. The brand name has without doubt taken a hit which is quite evident from weak sales growth in the last couple of quarters. Successful restructuring is the only resort for Zain to become an efficient operator in the market. We keep our target price unchanged and due to the recent rally we downgrade Zain to Underweight.



Corporate summary

Zain KSA is the third-placed telecom operator in Saudi Arabia, with a market value of US\$2.74bn; it launched service in Q3 2008. By our estimate Zain has a market share of mobile accounts of 13-14%, although its revenue share is lower at 9-10%. Zain has no presence in the fixed-line market. Zain KSA is an affiliate of the Zain group of Kuwait. Zain Kuwait is an emerging telecom player operating in various markets in the Middle East and Africa.

Share information

Market cap (SAR/US\$) 10.36bn / 2.763bn
52-week range 5.25 - 8.10
Daily avg volume (US\$) 27.07mn
Shares outstanding 1,400mn
Free float (est) 48.3%

Performance: 1M 3M 12M
Absolute 27.6% 32.1% -8.7%
Relative to index 22.6% 22.8% -11.6%

Major Shareholder:
Mobile Telecommunications Co. (Kuwait) 25%
Faden Trading and Contracting 6.8%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/11A	12/12E	12/13E	12/14E
Revenue (SARmn)	6,699	7,401	8,244	9,066
EBITDA (SARmn)	899	1,248	1,601	2,004
Net Profit (SARmn)	(1,925)	(1,466)	(943)	(552)
EPS (SAR)	1.38-	1.05-	0.67-	0.39-
DPS (SAR)	-	-	-	-
EPS Growth	-18.4%	-23.9%	-35.7%	-41.4%
EV/EBITDA (x)	28.4	20.4	15.9	12.4
P/E (x)	na	na	na	na
P/B (x)	2.4	3.7	5.5	7.8
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

Q4 2011: unexciting performance

With regard to Q4, we had believed that Zain would be able to perform better as it announced an aggressive cut in its international call charges just prior to the Hajj period. However, the regulator prevented Zain from reducing its tariffs and hence it lost call volumes in the fourth quarter. Below we present the key details of Zain's Q4 2011 results.

Figure 1 Zain summary of Q4 & FY 2011

(SAR mn)	2010Q4A	2011Q4A	% chg. y-y	2010A	2011A	% chg. y-y
Revenues	1,728	1,715	-0.7%	5,934	6,699	12.9%
Gross profit	826	691	-16.4%	2,530	3,200	26.5%
Gross margin	47.8%	40.3%	(7.5)pp	42.6%	47.8%	5.2pp
EBITDA	209	260	24.2%	331	899	171.9%
EBITDA margin (%)	12.1%	15.1%	3.0pp	5.6%	13.4%	7.8pp
Operating profit	-179	-213	19.2%	-1,164	-811	-30.3%
Net profit	-521	-461	-11.4%	-2,358	-1,925	-18.4%
Capex	503	499	-0.8%	968	711	-26.6%
Capex/sales (%)	29.1%	29.1%	0	16.3%	10.6%	(5.7)pp
Net debt	14,687	15,209	3.6%	14,687	15,209	3.6%
Net debt/annualised EBITDA (x)	17.6	14.6	n/a	44.42	16.92	n/a

Source: Company data, Al Rajhi Capital

Restructuring is the key to future

Zain's proposed restructuring plan is now imminent as we expect accumulated losses to reach 72% of its paid up capital by the end of Q1 2012. Restructuring will allow Zain to eliminate its accumulated losses and pay off around SAR6bn debt. We believe financial costs will decline drastically post restructuring which will provide a major boost to net profits. For detailed discussion of this issue, please read our Telecoms report dated 4th December.

Comparative valuation: Zain has the highest multiples

With regard to multiples analysis, Zain is trading at a premium to its peers Mobily and STC. Considering the uncertainty surrounding the company and current unhealthy financials, we believe that Zain is overvalued and the comparative analysis (Price/Book & EV/Sales ratios) supports our view.

Figure 2 Comparative multiples: STC v/s Mobily v/s Zain

	Price/Book ratio		EV/Sales ratio	
	2012E	2013E	2012E	2013E
STC	1.5X	1.3X	1.7X	1.5X
Mobily	1.9X	1.7X	2.0X	1.7X
Zain	3.7X	5.5X	3.4X	3.1X

Source: Al Rajhi Capital estimates



Q1 2012: Same old story

With Saudi mobile market hovering around 200% penetration, Zain will find it difficult to compete with bigger players. Zain will have to introduce various offers in a bid to gain subscribers and hence boost its revenues. However, this can impact margins and thus we estimate a gross margin of 46.9% in 2012, a decline of 100 bps as compared to last year. We expect Zain to report 10% y-o-y revenue growth in Q1 2012 but to remain unprofitable due to high interest costs. The details of our estimates are below:

Figure 3 Zain summary of Q1 & FY 2012 (our estimates)

(SAR mn)	2012Q1			2012 ARC		
	2011Q1A	ARC est.	% chg. y-y	2011A	est.	% chg. y-y
Revenues	1,484	1,639	10.4%	6,699	7,401	10.5%
Gross profit	716	762	6.4%	3,200	3,469	8.4%
Gross margin	48.2%	46.5%	(1.7)pp	47.8%	46.9%	0.9pp
EBITDA	154	270	75.7%	899	1,248	38.8%
EBITDA margin (%)	10.4%	16.5%	6.1pp	13.4%	16.9%	(3.5)pp
Operating profit	(233)	(205)	-12.1%	-811	-464	-42.8%
Net profit	(532)	(475)	-10.7%	-1,925	-1,466	-23.9%
Capex	121	82	-32.4%	711	410	-42.3%
Capex/sales (%)	8.2%	5.0%	(3.2)pp	10.6%	5.5%	(5.1)pp
Net debt	15,279	15,466	1.2%	15,209	15,077	-0.9%
Net debt/annualised EBITDA (x)	24.8	14.3	n/a	16.9	12.1	n/a

Source: Company data, Al Rajhi Capital



We have cut our sales forecasts by an average 2%. We have also cut EBITDA forecast for 2012 by 18% and for 2013 by 9%.

We do not expect net profit or a dividend till 2015; unless restructuring goes smoothly

We expect a respectable EBITDA growth over 2012-14

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)	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue	5,934	6,699	7,401	8,244	9,066
Cost of Goods Sold	(3,404)	(3,499)	(3,933)	(4,253)	(4,615)
Gross Profit	2,530	3,200	3,469	3,992	4,452
Government Charges					
S.G. & A. Costs	(2,200)	(2,301)	(2,221)	(2,391)	(2,448)
Operating EBIT	(1,164)	(811)	(464)	(2)	409
Cash Operating Costs	(5,604)	(5,800)	(6,153)	(6,643)	(7,063)
EBITDA	331	899	1,248	1,601	2,004
Depreciation and Amortisation	(1,494)	(1,710)	(1,712)	(1,602)	(1,595)
Operating Profit	(1,164)	(811)	(464)	(2)	409
Net financing income/(costs)	(1,195)	(1,114)	(1,002)	(941)	(961)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	-	-	-	-	-
Other Expenses	-	-	-	-	-
Net Profit Before Taxes	(2,358)	(1,925)	(1,466)	(943)	(552)
Taxes	-	-	-	-	-
Minority Interests	-	-	-	-	-
Net profit available to shareholders	(2,358)	(1,925)	(1,466)	(943)	(552)
Dividends	-	-	-	-	-
Transfer to Capital Reserve	-	-	-	-	-
	12/10A	12/11A	12/12E	12/13E	12/14E
Adjusted Shares Out (mn)	1,400	1,400	1,400	1,400	1,400
CFPS (SAR)	(0.617)	(0.153)	0.176	0.471	0.745
EPS (SAR)	(1.685)	(1.375)	(1.047)	(0.673)	(0.394)
DPS (SAR)	0	0	0	0	0
Growth	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue Growth	97.5%	12.9%	10.5%	11.4%	10.0%
Gross Profit Growth	188.5%	26.5%	8.4%	15.1%	11.5%
EBITDA Growth		171.9%	38.8%	28.3%	25.2%
Operating Profit Growth	-52.8%	-30.3%	-42.8%	-99.7%	
Net Profit Growth	-23.9%	-18.4%	-23.9%	-35.7%	-41.4%
EPS Growth	-23.9%	-18.4%	-23.9%	-35.7%	-41.4%
Margins	12/10A	12/11A	12/12E	12/13E	12/14E
Gross profit margin	42.6%	47.8%	46.9%	48.4%	49.1%
EBITDA margin	5.6%	13.4%	16.9%	19.4%	22.1%
Operating Margin	-19.6%	-12.1%	-6.3%	0.0%	4.5%
Pretax profit margin	-39.7%	-28.7%	-19.8%	-11.4%	-6.1%
Net profit margin	-39.7%	-28.7%	-19.8%	-11.4%	-6.1%
Other Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
ROCE	-5.8%	-7.2%	-4.8%	0.0%	5.0%
ROIC	-5.7%	-3.9%	-2.4%	0.0%	2.4%
ROE	-32.0%	-36.9%	-41.2%	-40.0%	-34.3%
Effective Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%
Capex/Sales	16.3%	10.6%	5.5%	9.0%	8.0%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%
Valuation Measures	12/10A	12/11A	12/12E	12/13E	12/14E
P/E (x)	na	na	na	na	na
P/CF (x)	na	na	42.1	15.7	9.9
P/B (x)	1.7	2.4	3.7	5.5	7.8
EV/Sales (x)	4.2	3.8	3.4	3.1	2.7
EV/EBITDA (x)	75.8	28.4	20.4	15.9	12.4
EV/EBIT (x)	na	na	na	na	61.0
EV/IC (x)	1.2	1.3	1.4	1.5	1.6
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital



Balance Sheet (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Cash and Cash Equivalents	702	780	713	595	732
Current Receivables	1,463	1,007	791	1,064	1,088
Inventories	29	44	87	133	145
Other current assets	409	602	602	602	602
Total Current Assets	2,603	2,432	2,193	2,394	2,567
Fixed Assets	4,298	4,059	3,765	3,913	4,051
Investments	-	-	-	-	-
Goodwill	-	-	-	-	-
Other Intangible Assets	21,155	20,253	19,245	18,237	17,229
Total Other Assets	-	-	-	-	-
Total Non-current Assets	25,453	24,312	23,010	22,149	21,280
Total Assets	28,055	26,744	25,203	24,543	23,847
Short Term Debt	2,194	9,748	9,548	9,448	9,048
Trade Payables	5,403	5,691	5,815	6,198	6,454
Dividends Payable	-	-	-	-	-
Other Current Liabilities	457	72	72	72	72
Total Current Liabilities	8,054	15,511	15,436	15,719	15,574
Long-Term Debt	13,196	6,242	6,242	6,242	6,242
Other LT Payables	659	675	675	675	675
Provisions	17	23	23	23	23
Total Non-current Liabilities	13,872	6,940	6,940	6,940	6,940
Minority interests	-	-	-	-	-
Paid-up share capital	14,000	14,000	14,000	14,000	14,000
Total Reserves	(7,871)	(9,707)	(11,173)	(12,115)	(12,668)
Total Shareholders' Equity	6,129	4,293	2,827	1,885	1,332
Total Equity	6,129	4,293	2,827	1,885	1,332
Total Liabilities & Shareholders' Equity	28,055	26,744	25,203	24,543	23,847

Net debt for 2011e stands at 2.2x sales

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Net Debt (SARmn)	14,687	15,209	15,077	15,095	14,557
Net Debt/EBITDA (x)	44.42	16.92	12.08	9.43	7.27
Net Debt to Equity	239.6%	354.3%	533.3%	801.0%	1092.6%
EBITDA Interest Cover (x)	0.3	0.8	1.2	1.7	2.1
BVPS (SAR)	4.38	3.07	2.02	1.35	0.95

Cashflow Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Net Income before Tax & Minority Interest	(2,358)	(1,925)	(1,466)	(943)	(552)
Depreciation & Amortisation	1,494	1,710	1,712	1,602	1,595
Decrease in Working Capital	246	43	297	64	220
Other Operating Cashflow	1,246	85	-	(0)	-
Cashflow from Operations	627	(88)	543	724	1,263
Capital Expenditure	(968)	(711)	(410)	(742)	(725)
New Investments	-	-	-	-	-
Others	2	(9)	-	-	-
Cashflow from investing activities	(966)	(720)	(410)	(742)	(725)
Net Operating Cashflow	(339)	(807)	133	(18)	538
Dividends paid to ordinary shareholders	-	-	-	-	-
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(2,150)	-	-	-	-
Cashflow from financing activities	535	885	(200)	(100)	(400)
Total cash generated	196	78	(67)	(118)	138
Cash at beginning of period	506	702	780	713	595
Implied cash at end of year	702	780	713	595	732

Capex/sales ratio is falling rapidly due to shrinking cash balances and high accumulated losses

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Capex/Sales	16.3%	10.6%	5.5%	9.0%	8.0%

Source: Company data, 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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