SEPTEMBER 2014

KSA TELECOM SECTOR

NCB CAPITAL

ATTRACTIVE SECTOR ON HIGH DIVIDENDS

We believe the growing data segment and ongoing cost-cutting initiatives are the sector's near-term drivers while the attractive dividends yield of 4.3% is the sector's key attraction. We expect the sector to record a revenue growth of 2% in 2014E and 4.7% in 2015E to reach SR82.6bn. Valuations remain attractive for STC and Mobily supported by strong fundamentals, dividend outlook and news on opening the TASI to international investors. We remain Overweight on STC and Mobily and Neutral on Zain.

- **Remain Overweight on STC and Mobily; Neutral on Zain:** The slowdown in the sector is a key concern. The sector top-line is expected to grow 2% in 2014E and 4.7% in 2015E vs 3.8% in 2013. However, attractive valuation and high dividend yield compared to the market are the sector's key strengths. Our top pick is STC, driven by its strong balance sheet, potential of higher dividends and attractive 2015E P/E of 12.0x.
- **Dividends, to drive the sector:** We believe frequent and high dividend yields are the sector's key strength. The current dividend yield for the telecom sector is 4.3% compared to around 2.6% for the TASI. Also, STC and Mobily are among few companies in the market that pays quarterly dividends. Mobily 2014E DPS stands at SR5 representing a divided yield of 5.5% and a pay-out ratio at 59% while STC's pay-out ratio and dividend yield are 52% and 4.1%, respectively.
- **Data continues to drive the sector:** We believe growth in the sector will continue to be driven by the Data segment for the next two years. This is supported by higher penetration of low-cost smartphones. As per CITC, the number of subscribers grew by 42.5% YoY, as data penetration levels increased to 66%. We believe these strong numbers mitigated the impact of the ongoing increase in SIM cancellations.
- **Cost optimization is common in a maturing sector:** Given the overall sector is moving towards maturity, companies are focusing on cost reduction initiatives. These initiatives improved EBIT margins by 232bps and 54bps at STC and Mobily, respectively, while reduced losses for Zain by 11.2% YoY for 2Q14. These measures are expected to help increase the sectors' earnings by 12% YoY in 2014E, despite only 2% growth in revenues.
- **Opening of the TASI impacts valuations positively:** With the opening of the TASI to international investors, we expect a significant inflow of foreign capital to the market. We believe the telecom sector will benefit due to the strong macro-economic outlook. We expect this move to reduce the risk premium assumed, resulting in re-rating and multiple expansion. Therefore, our PT's increased by an average of 9%.

Exhibit 1: Saudi telecom companies – Valuation matrix

	Rating	PT (SR)	MCap $mn	Stock perf (%) Aug	YTD	P/E (x) '15	EV/ EBITDA '15	P/BV (x) '15	DY (%) '15	ROE (%) '15	ROA (%) '15
Saudi Telecom Co.	OW	84.8	39,381	3.5	37.8	12.0	7.6	2.2	5.4	19.0	13.0
Mobily	OW	104.9	18,743	2.6	6.6	10.3	7.1	2.4	5.5	24.3	12.8
Zain KSA	N	10.6	3,118	10.5	16.2	NM	6.8	2.4	0.0	(12.0)	(2.4)

Source: NCBC Research, All prices as of September 22, 2014
N: Neutral, UW: Underweight, OW: Overweight, NC: Not Covered

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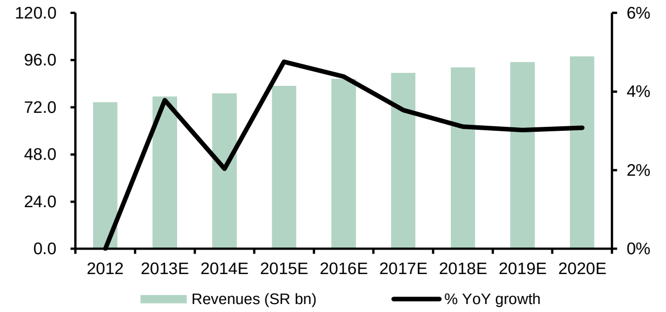
Outlook summary

- **Sector's earnings to grow 12% YoY despite revenue slowdown**

We expect the total revenue for the stocks under coverage to grow 2% YoY in 2014E, lower than the 4% YoY growth in 2013. Mobily has adopted a new strategy which focuses on wholesale (bulk) to mitigate the top-line decline. Although this may not be the company's long-term strategy and its sustainability remains vague, it provides an effective support to the top-line in the near-term. On the other hand, STC's growth came largely from international operations, namely its controlled subsidiaries. On a broader level, all players are focusing on cost optimization to maintain their net margins. We expect net profits for all three stocks to grow 12% for 2014E.

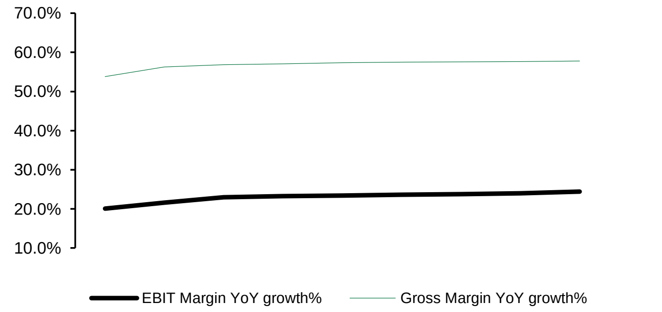
Companies adopting new strategies to mitigate the top-line decline – Mobily is focusing on wholesale (bulk), while STC on international operations

Exhibit 2: Sector revenues and YoY growth %



Source: NCBC Research

Exhibit 3: Gross and EBIT margin (%)



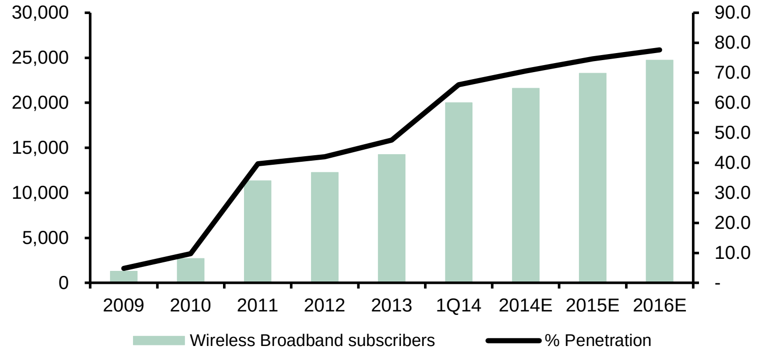
Source: NCBC Research

- **Data segment driving growth, as penetration rates increase**

Although there is marginal room for further strong growth considering the current high penetration levels, we expect data revenues to continue to be the growth driver for the sector in the near term. Mobily, STC, and Zain continue to focus on this segment by building/expanding their capabilities to provide value-added services. According to CITC, data subscribers grew significantly by 42.5% YoY to 20mn by 1Q14 vs. 14.2mn last year. The penetration levels also increased reaching 66.1% vs. 47.6% in 2013. Although there is a marginal room for further strong growth considering the current high penetration levels, we expect data revenues to continue to be the growth driver for the sector in the near term.

Data subscribers grew significantly by 42.5% YoY to 20mn by 1Q14 vs. 14.2mn last year. The penetration levels also increased reaching 66.1% vs. 47.6% in 2013.

Exhibit 4: Wireless broadband subscribers ('000s) and Penetration rates %



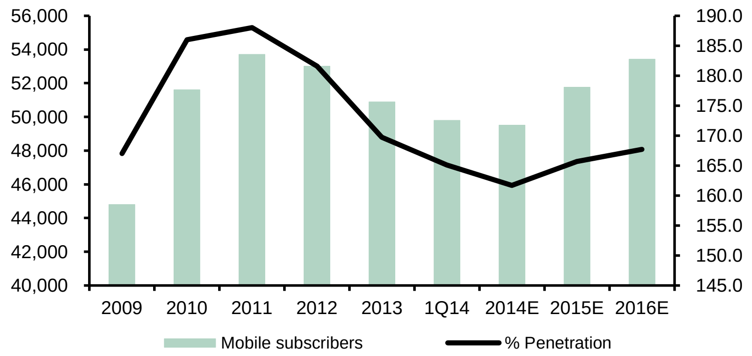
Source: NCBC Research, CITC 1Q 2014 report

- **SIM cancelations from CITC regulations to bottom out**

Strict CITC regulations and stopping free international roaming resulted in the deactivation of a large number of unidentified SIM cards. Mobile subscription declined to 49.8mn as of 1Q14 vs. 53.0mn in 2012 and 53.7mn in 2011. Consequently, the penetration rate declined to 165.1% from a peak of 188% in 2011. However, we believe this impact will ease and the number of subscribers to grow at a CAGR of 3.4% for the period 2014–18E. We expect mobile penetration to stabilize and reach 171% by 2018E.

We expect the number of subscribers to grow at a CAGR of 3.4% for the period 2014–18E.

Exhibit 5: Total mobile subscribers (mn) and Penetration rate %



Source: NCBC Research, CITC 1Q 2014 report

- **Cost savings to support bottom-line growth**

Cost optimization is a key driver for further profitability growth, given the sector is reaching maturity levels. STC's initiatives to control its costs and restructure its businesses led to a significant EBIT margin gain of 232bps in 2013. We expect this to increase by 166bps in 2014E. Mobily's 2013 margins increased 54–99bps across all profit lines. However, we expect margins of Mobily to remain stable in 2014E. Zain's losses declined 11.2% YoY in 2Q14. This trend at Zain is expected to continue, supported by the collaboration with Huawei and Ericsson as part of a cost-optimization program.

Given the sector is reaching maturity, cost reduction is becoming a key theme to support margins

- **Interconnection charges, could it change?**

We believe interconnection charges play an important role in determining the profitability of the sector. Companies such as STC and Mobily, which enjoy large market share, are the main beneficiaries of interconnection charges. On the contrary, these charges represent the bulk of Zain's expenses (55.6% of cost of services), as it currently has the lowest market share and is required to pay a high off-network minute charge of SR0.25. We believe Zain is trying to reduce this price or changing the calculation method. If these changes are implemented, we believe it will have a significant positive impact on Zain, thereby improving the outlook of the company.

Interconnection charges represent the bulk of Zain's expenses (55.6% of cost of services)

- **MVNOs operations to start in 2H14**

The launch of MVNO operations during 2H14 will increase competition in the telecom sector. It will also introduce a diverse range of competitive and innovative services. Recently, Jawraa Lebara (Mobily's partner) and Virgin Mobile (STC's partner) were officially awarded MVNO licenses by the CITC, with Axiom Telecom expected to receive the third license with Zain. We expect the three players to target completely different segments, with STC-Virgin targeting the youth segment, Mobily-Lebara targeting expats through low-cost international services, and Zain-Axiom targeting the mass market segment. Given the "commoditized" nature of telecom services, price competition is the most common method of increasing market share. We expect the impact of MVNOs on existing operators to be mixed. Leasing infrastructure could generate a new revenue source, while the key risk is higher direct competition. Hence, we expect competitive pressure on MNOs (STC, Mobily, and Zain) to lead to some margin pressure.

Leasing infrastructure could generate a new revenue source, while the key risk is higher direct competition

- **Dividend, the sector key attractiveness**

We believe frequent and high dividend yields are the sector's key strength. The current dividend yield for the telecom sector is 4.3% compared to around 2.6% for the TASI. Also, STC and Mobily are among few companies in the market that pays dividends on a quarterly basis. Among the listed players, Mobily pays the highest absolute dividend due to its progressive dividend policy with a payout ratio at 59% and dividend yield at 5.5% for 2014E, while STC's payout ratio and dividend yield is expected to be 52.4% and 4.1%, respectively. We believe high dividend yield will support share prices, providing a support on the downside while dividends growth, mainly for STC, is a key catalyst. We expect STC to increase its dividends to SR4 in 2015E, representing a dividend yield of 5.4%.The high dividend is particularly attractive, given that more than 90% of Tadawul investors are individuals.

The dividend yield for the telecom sector is 4.3% vs. 2.6% for the TASI. STC and Mobily are among few companies in the market that pay dividends on a quarterly basis

- **Investment inflows from FII expected on joining MSCI EM Index**

The CMA has announced in July 2014 that the TASI will open to foreign institutional investors in 1H15. We expect this move to reduce the systematic risk assumed, which may result in a re-rating and multiple expansion. Accordingly, we lowered the additional risk premium of Saudi from 0.90% to 0.75%.

Market opening new reduced valuation's risk premium by 15bps to 0.75% from 0.9%

Changes to estimates

In the table below, we have highlighted the changes to our 2014E and 2015E numbers and price targets since our last update on the sector in June 2014.

Exhibit 6: Changes to estimates

In SR mn, unless otherwise stated

		Old 2014E	New 2014E	% Chg	% Gr	Old 2015E	New 2015E	% Chg	% Gr
Saudi Telecom Co.									
Revenue		45,829	46,513	1.5	2.0	47,006	48,003	2.1	3.2
Gross profit		27,899	28,003	0.4	2.2	28,571	28,951	1.3	3.4
EBITDA		19,531	18,850	(3.5)	2.1	19,900	19,446	(2.3)	3.2
Adjusted EBIT		12,885	11,978	(7.0)	(0.9)	13,005	12,332	(5.2)	2.9
Adjusted net profit		12,261	11,440	(6.7)	4.0	12,815	12,252	(4.4)	7.1
Price target	SR					77.5	84.8	9.5	
Mobily									
Revenue		26,108	26,115	0.0	3.7	27,519	27,756	0.9	6.3
Gross profit		13,327	13,606	2.1	5.1	14,012	14,427	3.0	6.0
EBITDA		9,393	9,541	1.6	3.8	9,838	10,078	2.4	5.6
EBIT		6,526	6,637	1.7	(0.8)	6,818	6,911	1.4	4.1
Net profit		6,401	6,547	2.3	(1.9)	6,727	6,834	1.6	4.4
Price target	SR					95.5	104.9	9.9	
Zain KSA									
Revenue		6,491	6,263	(3.5)	(4.0)	7,072	6,884	(2.7)	9.9
Gross Profit		3,465	3,218	(7.1)	2.6	3,976	3,788	(4.7)	17.7
EBITDA		1,439	1,194	(17.0)	34.1	1,874	1,723	(8.1)	(44.3)
EBIT		(265)	(498)	87.9	(47.5)	77	(32)	NM	NM
Adjusted net profit		(1,038)	(1,272)	22.5	(23.0)	(513)	(621)	21.1	(51.1)
Price target	SR					10.4	10.6	1.5	

Source: NCBC Research estimates

Changes to estimates:

STC

- We revised equity risk premium from 9.98% to 9.18%. This includes a reduction of 15bps in the risk premium due to opening the market to international investors. This revision, in addition to a slight downward revision in RFR, has added SR5.3 or 6.9% to our PT
- Our P/E derived PT is up 11.4% to SR82.2 – equivalent to a 2015E P/E of 13.4x. We have revised the P/E premium over peers to 30%, from 5% to match the current historical and forward average premium, supported by strong balance sheet, improved international portfolio, as well as sustainable high absolute profitability. As a result, our PT has increased by SR2.5 or 3.2%
- Due to weaker than expected 2Q14 results, we have revised down our estimate for 2014-15E. This has reduced our PT by 0.6%.

Mobily

- We revised equity risk premium from 7.98% to 7.68%. This includes a reduction of 15 bps in the Saudi premium due to opening the market to international investors. This revision, in addition to a slight downward revision in RFR, has added SR8.9 or 9.4% to our PT
- We have kept our target P/E multiple for Mobily broadly the same at 11.6x for 2015E, although this implies a 10% premium over peers. This positively impacted the overall price target by 0.1%
- We have marginally revised up our estimates for 2014E and 2015E in line with the better than expected result in 2Q14. This has positively impacted our PT by SR0.4 or 0.4% to our PT.

Zain

- We revised equity risk premium from 8.48% to 8.18%. This includes a reduction of 15 bps in the Saudi premium due to opening the market to international investors. This revision, in addition to a slight downward revision in RFR, has added SR0.1 or 1.3% to our PT
- We have increased our target P/B multiple to match the current and forward average premium. This led to a significant SR1.3 or 12.5% increase in our PT.
- Due to weaker than expected 2Q14 results, we have significantly reduced our estimates for 2014E and 2015E. This negatively impacted our PT by SR1.2 or 11.9%.

SAUDI TELECOM COMPANY

COMPANY UPDATE

Strong cash balance offers opportunities

We remain Overweight on STC with a revised PT of SR84.8. We expect our 2014E net income to increase 16% YoY (4% on adjusted basis), led by lower costs and absence of one-off losses. Lower cost is expected to improve EBIT margin by 166bps in 2014E to 25.8%. Increasing competition and FX exposure remain key risks, while higher dividend potential and better-than-expected performance of international subsidiaries are key catalysts.

- **Profitability to remain high in 2H14:** On YoY basis, profitability is expected to remain high in 2H14, driven by cost-savings initiatives and the absence of one-off losses from selling international investments. We expect net profit to come in at SR6.2bn in 2H14 vs. SR5.2bn in 1H14 , SR3bn in 1H13 and SR7.3bn for full year 2012. Hence, we expect EBIT and net profit to rise 9% and 16%, respectively in 2014E. On adjusted basis, we expect net income to grow 4% YoY to SR11.4bn excluding one-off charges recorded in 2013.
- **International expansion remains an option:** The review of STC's international investments will continue support revenues (revenue of controlled subsidiary grew 65% YoY in 2Q14) and income from associates, as seen in 2Q14. Based on management feedback, we believe STC is continuously looking for M&A opportunities, particularly in the MENA region equipped with a strong cash balance of SR19bn. We believe that international expansion may be a reasonable option to maintain growth as the Saudi telecoms market is maturing.
- **Potential increase in dividends support outlook:** Although STC's plans to use its cash balance to expand internationally, we believe STC has the ability to increase dividends further. STC raised its quarterly dividend to SR0.75/share in 4Q13, thereby increasing its annualized DPS to SR3.0. This represents a payout ratio of 52% and dividend yield of 4.1%. We expect quarterly dividend to increase to SR1.0 representing a payout ratio of 65.3% and a dividend yield of 5.4% for 2015E.
- **Remain Overweight on STC with revised PT of SR84.8:** We maintain our Overweight rating on STC with a PT of SR84.8. The stock is trading at 2015E P/E of 12.0x, a 16.6% premium to regional peers which is justifiable due to the cash balance and the potential increase in dividends. The performance of international subsidiaries, higher competition and FX exposure are the key risks.

Summary Financials

SR mn	2013A	2014E	2015E	2016E	2017E	CAGR (%)
Revenues	45,605	46,513	48,003	49,865	51,462	3.1
Gross profit	27,413	28,003	28,951	30,163	31,268	3.3
EBITDA	18,471	18,850	19,446	20,259	21,092	3.4
EBITDA margin (%)	40.5	40.5	40.5	40.6	41.0	
Adjusted net income	11,001	11,440	12,252	12,945	13,688	5.6
Adj. net margin (%)	24.1	24.6	25.5	26.0	26.6	
EPS (SR)	5.50	5.72	6.13	6.47	6.84	5.6
DPS (SR)	2.25	3.00	4.00	4.00	4.00	15.5

Source: Company, NCBC Research estimates

OVERWEIGHT

Target price (SR)	84.8
Current price (SR)	73.7

STOCK DETAILS

M52-week range H/L (SR)	76/42
Market cap ($mn)	39,381
Shares outstanding (mn)	2,000
Listed on exchanges	TADAWUL

Price perform (%)	1M	3M	12M
Absolute	0.3	10.5	74.7
Rel. to market	0.5	(3.4)	38.9

Avg daily turnover (mn)	SR	US$
3M	66.4	17.7
12M	87.2	23.3

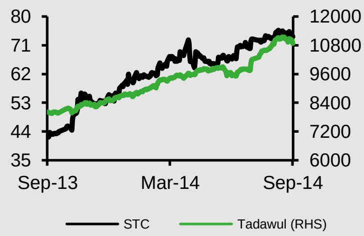
Reuters code	7010.SE
Bloomberg code	STC AB
	www.stc.com.sa

VALUATION MULTIPLES

	13A	14E	15E
Reported P/E (x)	14.9	12.9	12.0
Adjusted P/E (x)	13.4	12.9	12.0
P/B (x)	2.6	2.4	2.2
EV/EBITDA (x)	8.0	7.8	7.6
Div Yield (%)	3.1	4.1	5.4

Source: NCBC Research estimates

SHARE PRICE PERFORMANCE



Source: Bloomberg

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Financials

Exhibit 7: Income Statement

In SR million, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
Revenues	**44,745**	**45,605**	**46,513**	**48,003**	**49,865**	**51,462**
% change	NM	1.9	2.0	3.2	3.9	3.2
Cost of services	(19,483)	(18,191)	(18,510)	(19,052)	(19,701)	(20,194)
Gross profit	**25,262**	**27,413**	**28,003**	**28,951**	**30,163**	**31,268**
Gross margin (%)	56.5	60.1	60.2	60.3	60.5	60.8
Operating expenses	(15,516)	(16,425)	(16,025)	(16,619)	(17,335)	(17,906)
EBITDA	**16,273**	**18,471**	**18,850**	**19,446**	**20,259**	**21,092**
EBITDA margin (%)	36.4	40.5	40.5	40.5	40.6	41.0
Dep. & Amortization	(6,337)	(6,378)	(6,872)	(7,114)	(7,431)	(7,729)
EBIT	9,746	10,989	11,978	12,332	12,828	13,363
EBIT margin (%)	21.8	24.1	25.8	25.7	25.7	26.0
Financing costs	(678)	(143)	(138)	(127)	(115)	(101)
Other inc./expenses, net	313	1,141	1,200	1,391	1,525	1,666
Pre-tax profit	7,378	10,448	12,380	13,028	13,765	14,554
Tax (Zakat)	(215)	(230)	(521)	(352)	(372)	(394)
Reported net income	7,276	9,897	11,440	12,252	12,945	13,688
Adjusted net income	**7,467**	**11,001**	**11,440**	**12,252**	**12,945**	**13,688**
% change	NM	47.3	4.0	7.1	5.7	5.7
Net margin (%)	16.7	24.1	24.6	25.5	26.0	26.6
EPS (SR)	**3.73**	**5.50**	**5.72**	**6.13**	**6.47**	**6.84**

Source: NCBC Research estimates

Exhibit 8: Balance Sheet

In SR million, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
Cash & cash equivalent	1,614	960	4,239	8,962	14,627	21,280
Other current assets	11,148	10,831	11,036	11,430	11,846	12,150
Total current assets	21,432	32,161	32,732	37,849	43,930	50,888
Net fixed assets	39,873	38,402	38,691	38,944	39,139	39,001
Intangible assets, net	5,054	4,608	3,917	3,225	2,534	1,843
Investments	13,394	9,592	9,592	9,592	9,592	9,592
Other assets	1,064	910	939	979	1,027	1,065
Total non-current assets	61,073	55,199	58,825	58,428	57,980	57,189
Total assets	**82,505**	**87,360**	**91,558**	**96,277**	**101,910**	**108,077**
Short-term loans	1,411	1,561	1,707	1,648	1,509	1,368
Other current liabilities	15,376	14,016	13,492	13,637	13,891	13,914
Total current liabilities	16,787	19,650	15,199	15,285	15,400	15,283
Long-term loan	9,953	6,976	6,535	5,898	5,332	4,663
Other liabilities	4,580	4,570	5,196	5,791	6,509	7,357
Total non-current liabilities	14,533	11,547	13,730	13,688	13,841	14,020
Total liabilities	**31,320**	**31,197**	**28,930**	**28,974**	**29,241**	**29,303**
Share capital	20,000	20,000	20,000	20,000	20,000	20,000
Reserves & surplus	21,944	26,889	32,780	37,032	41,951	47,586
Shareholders' funds	51,337	56,230	61,713	65,966	70,885	76,519
Total equity & liabilities	**82,505**	**87,360**	**91,558**	**96,277**	**101,910**	**108,077**

Source: NCBC Research estimates

Exhibit 9: Cash Flow Statement

In SR million, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
Cash flow from op. (a)	15,723	19,636	22,052	19,289	20,409	21,364
Cash flow from inv.(b)	(12,802)	(15,662)	(6,825)	(6,293)	(6,486)	(6,371)
NOPLAT	9,462	10,746	11,475	11,998	12,481	13,001
WC	2,370	(1,043)	(729)	(248)	(162)	(281)
CAPEX	(6,142)	(7,711)	(6,469)	(6,676)	(6,935)	(6,900)
Depreciation	6,337	6,378	6,872	7,114	7,431	7,729
Free cash flow	12,027	8,370	11,148	12,188	12,815	13,549
Cash flow from fin.(c)	(4,989)	(4,427)	(7,875)	(8,273)	(8,258)	(8,339)
Net chg. in cash (a+b+c)	(2,068)	(454)	7,352	4,724	5,665	6,654
Cash at start of the year	3,683	1,614	960	4,239	8,962	14,627
Cash at end of the year	1,614	960	4,239	8,962	14,627	21,280

Source: NCBC Research estimates

Exhibit 10: Key Ratios

Per share, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
EPS	3.6	4.9	5.7	6.1	6.5	6.8
FCF per share	6.0	4.2	5.6	6.1	6.4	6.8
Div per share	2.0	2.3	3.0	4.0	4.0	4.0
Book value per share	25.7	28.1	30.9	33.0	35.4	38.3
Valuation ratios (x)						
P/E	20.3	14.9	12.9	12.0	11.4	10.8
P/FCF	12.3	17.6	13.2	12.1	11.5	10.9
P/BV	2.9	2.6	2.4	2.2	2.1	1.9
EV/sales	3.3	3.2	3.2	3.1	3.0	2.9
EV/EBITDA	9.1	8.0	7.8	7.6	7.3	7.0
Div yield (%)	2.7	3.1	4.1	5.4	5.4	5.4
Profitability ratios (%)						
Gross margins	56.5	60.1	60.2	60.3	60.5	60.8
Operating margin	21.8	24.1	25.8	25.7	25.7	26.0
EBITDA margins	36.4	40.5	40.5	40.5	40.6	41.0
Net profit margins	16.7	24.1	24.6	25.5	25.9	26.5
ROE	30.6	20.5	19.4	19.2	18.9	18.5
ROA	8.4	13.0	12.8	13.0	13.0	13.0
Liquidity ratios						
Current ratio	1.3	1.6	2.2	2.5	2.9	3.3
Quick Ratio	1.1	1.5	1.9	2.3	2.6	3.1
Operating ratios (days)						
Inventory	28	25	26	26	26	26
Receivables outstanding	63	61	61	61	61	60
Payables outstanding	80	55	50	52	54	55
Operating cycle	91	87	87	87	87	86
Cash cycle	11	31	36	35	33	31

Source: NCBC Research estimates

MOBILY

COMPANY UPDATE

High dividend yield offsets growth slowdown

We remain Overweight on Mobily, with our PT increasing 10% to SR104.9. We expect the data segment to be the company's growth driver, given its market-leading presence. Despite short-term challenges from the Atheeb deal failure and rising competition, we are positive on Mobily due to its attractive valuation and high dividend yield of 5.5%, which provides a downside support.

- **Data revenue continues to support growth:** We expect Mobily's revenues to reach SR26.1bn in 2014E (up 3.7% YoY). This is supported primarily by the data segment which contributed 39% to total revenues in 1H14 vs. 27% in 1H13. The increasing levels of smartphone penetration and the availability of advanced LTE (4G) technologies are expected to drive the data segment to grow at a CAGR of 8.7% for 2014E–18E. We expect the data segment to represent around 40% of revenues going forward.
- **High CapEx to support data and corporate segments:** Mobily continues to focus on the broadband services to maintain its leading market share. Therefore, the company expects to maintain a CapEx of SR5bn for 2014E. Moreover, we believe Mobily will continue to focus on the corporate segment, with the market size estimated to reach SR43bn by 2018E. However, the segment is still in its nascent stage, contributing only 9% to Mobily's total revenues and expected to rise to 14% by 2018E. Apart from the normal capex, the company plans to construct a SR2bn office building which will be reflected at the financial statements in 2015E.
- **Dividend yield is a positive, but dividends growth outlook to end:** Mobily's dividends growth was the stock driver in the past . However, given the significant capex plans, Mobily's progressive dividend policy is expected to come to an end. Thus, we estimate DPS to remain flat at SR5 in 2015E after increasing marginally in 2014E with payout ratio of 56% and a dividend yield of 5.5%.
- **Remain Overweight; dividend outlook a key catalyst:** We remain Overweight on Mobily, mainly due to its high dividend yield and attractive valuations. The stock is currently trading at a P/E of 10.3x in 2015E in-line with peers. However, we believe the stock should be traded at a premium due to the attractive dividend yield of 5.5%.

Summary Financials

SR mn	2013A	2014E	2015E	2016E	2017E	CAGR (%)
Revenues	25,191	26,115	27,756	28,991	30,064	4.5
Gross profit	12,948	13,606	14,427	15,037	15,569	4.7
EBITDA	9,190	9,541	10,078	10,510	10,919	4.4
EBITDA margin (%)	36.5	36.5	36.3	36.3	36.3	
Net income	6,677	6,547	6,834	7,003	7,211	1.9
Net margin (%)	26.5	25.1	24.6	24.2	24.0	
EPS (SR)	8.67	8.50	8.88	9.10	9.36	1.9
DPS (SR)	4.80	5.00	5.00	5.00	5.25	2.3

Source: Company, NCBC Research estimates

OVERWEIGHT

Target price (SR)	**104.9**
Current price (SR)	**91.2**

STOCK DETAILS

M52-week range H/L (SR)	98/82
Market cap ($mn)	18,743
Shares outstanding (mn)	770
Listed on exchanges	TADAWUL

Price perform (%)	1M	3M	12M
Absolute	2.3	9.9	8.2
Rel. to market	2.6	(4.0)	(27.7)

Avg daily turnover (mn)	SR	US$
3M	135.2	36.1
12M	110.2	29.4

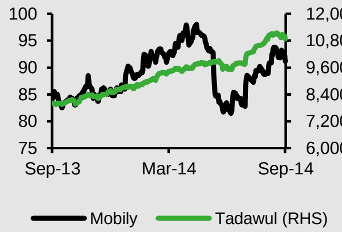
Reuters code	7020.SE
Bloomberg code	EEC AB
	www.mobily.com.sa

VALUATION MULTIPLES

	13A	14E	15E
P/E (x)	10.5	10.7	10.3
P/B (x)	2.9	2.6	2.4
EV/EBITDA (x)	7.9	7.6	7.1
Div Yield (%)	5.3	5.5	5.5

Source: NCBC Research estimates

SHARE PRICE PERFORMANCE



Source: Bloomberg

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Financials

Exhibit 11: Income Statement

In SR million, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
Revenues	**23,585**	**25,191**	**26,115**	**27,756**	**28,991**	**30,064**
% change	17.6	6.8	3.7	6.3	4.4	3.7
Cost of services	(11,608)	(12,243)	(12,509)	(13,330)	(13,953)	(14,495)
Gross profit	**11,977**	**12,948**	**13,606**	**14,427**	**15,037**	**15,569**
Gross margin (%)	50.8	51.4	52.1	52.0	51.9	51.8
Operating expenses	(3,443)	(3,758)	(4,066)	(4,349)	(4,528)	(4,650)
EBITDA	**8,534**	**9,190**	**9,541**	**10,078**	**10,510**	**10,919**
EBITDA margin (%)	36.2	36.5	36.5	36.3	36.3	36.3
Dep. & Amortization	(2,399)	(2,502)	(2,904)	(3,167)	(3,448)	(3,683)
EBIT	6,135	6,688	6,637	6,911	7,062	7,236
EBIT margin (%)	26.0	26.6	25.4	24.9	24.4	24.1
Interest charges, net	(169)	(191)	(237)	(238)	(235)	(212)
Other income	121.7	257.2	257.2	270.1	283.6	297.8
Pre-tax profit	6,088	6,755	6,657	6,943	7,111	7,321
Tax (Zakat)	(70)	(78)	(111)	(108)	(107)	(111)
Net income	**6,018**	**6,677**	**6,547**	**6,834**	**7,003**	**7,211**
% change	18.4	10.9	(1.9)	4.4	2.5	3.0
Net margin (%)	25.5	26.5	25.1	24.6	24.2	24.0
EPS* (SR)	**7.82**	**8.67**	**8.50**	**8.88**	**9.10**	**9.36**

Source: NCBC Research estimates, *Based on 770mn shares

Exhibit 12: Balance Sheet

In SR million, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
Cash & cash equivalents	1,302	1,570	2,086	2,752	2,128	824
Short-term investments	0	0	0	0	0	0
Other current assets	8,798	13,764	15,761	16,530	17,366	17,923
Total current assets	10,100	15,334	17,847	19,282	19,494	18,747
Net fixed assets	17,255	20,733	23,533	26,946	30,199	31,338
License fees	9,412	8,913	8,310	7,707	7,104	6,501
Goodwill	1,530	1,530	1,530	1,530	1,530	1,530
Total non-current assets	28,197	31,181	33,379	36,189	38,838	39,374
Total assets	**38,296**	**46,515**	**51,225**	**55,470**	**58,333**	**58,122**
Short-term loans	0	0	0	0	0	0
Cr. portion of long-term loans	753	782	1,433	1,371	1,071	1,071
Other current liabilities	8,995	11,642	12,388	13,883	14,038	11,723
Total current liabilities	9,748	12,424	13,822	15,255	15,109	12,794
Long-term loan	7,506	9,970	10,577	10,401	10,245	9,173
Other liabilities	137	158	165	168	180	187
Total non-current liabilities	7,643	10,128	10,742	10,570	10,425	9,360
Total liabilities	**17,391**	**22,552**	**24,564**	**25,825**	**25,534**	**22,154**
Share capital	7,000	7,700	7,700	7,700	7,700	7,700
Reserves & surplus	13,906	16,263	18,960	21,944	25,098	28,266
Shareholders' funds	20,906	23,963	26,660	29,644	32,798	35,966
Total equity & liabilities	**38,296**	**46,515**	**51,225**	**55,470**	**58,333**	**58,122**

Source: NCBC Research estimates

Exhibit 13: Cash Flow Statement

In SR million, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
Cash flow from op. (a)	6,173	5,535	8,444	10,969	10,016	8,241
Cash flow from inv.(b)	(4,076)	(3,951)	(5,101)	(5,977)	(6,098)	(4,219)
NOPLAT	6,065	6,611	6,527	6,803	6,955	7,127
WC	(3,549)	(2,320)	(1,251)	726	(682)	(2,872)
CAPEX	(2,762)	(5,424)	(5,101)	(5,977)	(6,098)	(4,219)
Depreciation	2,399	2,502	2,904	3,167	3,448	3,683
Free cash flow	2,152	1,369	3,079	4,719	3,623	3,718
Cash flow from fin.(c)	(2,484)	(1,315)	(2,827)	(4,326)	(4,541)	(5,326)
Net chg. in cash (a+b+c)	(387)	268	516	666	(623)	(1,305)
Cash at start of the year	1,690	1,302	1,570	2,086	2,752	2,128
Cash at end of the year	1,302	1,570	2,086	2,752	2,128	824

Source: NCBC Research estimates

Exhibit 14: Key Ratios

Per share, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
EPS	7.8	8.7	8.5	8.9	9.1	9.4
FCF per share	2.8	1.8	4.0	6.1	4.7	4.8
Div per share	3.9	4.8	5.0	5.0	5.0	5.3
Book value per share	27.2	31.1	34.6	38.5	42.6	46.7
Valuation ratios (x)						
P/E	11.7	10.5	10.7	10.3	10.0	9.7
P/FCF	32.6	51.3	22.8	14.9	19.4	18.9
P/BV	3.4	2.9	2.6	2.4	2.1	2.0
EV/sales	3.0	2.9	2.8	2.6	2.5	2.4
EV/EBITDA	8.2	7.9	7.6	7.1	6.8	6.6
Div yield (%)	4.3	5.3	5.5	5.5	5.5	5.8
Profitability ratios (%)						
Gross margins	50.8	51.4	52.1	52.0	51.9	51.8
Operating margin	26.0	26.6	25.4	24.9	24.4	24.1
EBITDA margins	36.2	36.5	36.5	36.3	36.3	36.3
Net profit margins	25.5	26.5	25.1	24.6	24.2	24.0
ROE	30.6	29.8	25.9	24.3	22.4	21.0
ROA	15.9	15.7	13.4	12.8	12.3	12.4
Liquidity ratios						
Current ratio	1.0	1.2	1.3	1.3	1.3	1.5
Quick Ratio	1.0	1.2	1.2	1.2	1.2	1.4
Operating ratios (days)						
Inventory	23	27	24	24	24	24
Receivables outstanding	86	125	140	138	139	138
Payables outstanding	175	220	231	252	242	174
Operating cycle	109	152	164	161	162	162
Cash cycle	(66)	(68)	(68)	(91)	(79)	(12)

Source: NCBC Research estimates

TELECOM | SEPTEMBER 2014

ZAIN KSA

COMPANY UPDATE

Operating performance improvement to continue

We remain Neutral on Zain with a revised PT of SR10.6. The company is focusing on improving its top-line by increasing its broadband market share and enhancing margins by implementing cost optimization measures. Increasing competition and high depreciation remain key risks, while regulatory changes such as a change in interconnection charges will be a key catalyst.

- **Data segment to support revenues in 2H14:** We expect Zain to report a marginal 1.7% YoY rise in revenues for 2H14, driven mainly by the data segment. However, this is partially offset by rising competition from Saudization issues and lower Umrah & Hajj visas. Despite the 8.2% decline in revenues for 2Q14, the data segment grew 94% YoY. Internet subscribers increased 107% YoY, driven by higher smartphone penetration and higher service levels. We expect this trend to continue and support the expected 6.8% CAGR growth in revenues during 2014E–18E.

- **Cost optimization key catalyst:** Zain entered into an agreement with Huawei and Ericsson as part of its cost-optimization program. We believe this will help the company in reducing losses. Gross margins for 2Q14 came-in at 50.9% vs. 48.7% for 2Q13, while EBITDA margins increased to 16.9% in 2Q14 from 15.1% in 2Q13. On the other hand, we believe Zain is trying to reduce interconnection charges. Interconnection charges are SR0.25 for every off-network minute. Given that Zain has the smallest market share, this item represents around 55.6% of its cost of services. We believe any changes in these charges will be a key turnaround catalyst for the stock.

- **Partnership with Axiom could be a key catalyst:** Zain is expected to partner with Axiom Telecom as part of the MVNO deal, targeting the mass market segment. We believe Axiom Telecom (one of the largest telecom distributor in Saudi) is better placed than the other two MVNOs, considering its strong distribution network and strong brand positioning. We believe the key for Zain is to increase its revenue through market share gains, which will support margins given that most of the costs are relatively fixed. A successful implementation of the deal could help Zain move closer to profitability. Currently, we expect Zain to break-even in 2018E.

- **Maintain Neutral rating with a PT of SR10.6:** We maintain a Neutral rating with our PT increasing 2% to SR10.6. We believe that cost reduction is key for Zain's profitability. Therefore, any progress on this will be a key catalyst.

Summary Financials

SR mn	2013A	2014E	2015E	2016E	2017E	CAGR (%)
Revenues	6,523	6,263	6,884	7,409	7,778	4.5
Gross profit	3,135	3,218	3,788	4,258	4,542	9.7
EBITDA	890	1,194	1,723	2,130	2,421	28.4
EBITDA margin (%)	13.7	19.1	25.0	28.8	31.1	
Net income	(1,651)	(1,272)	(621)	(249)	(46)	NM
Net margin (%)	(25.3)	(20.3)	(9.0)	(3.4)	(0.6)	
EPS (SR)	(1.53)	(1.18)	(0.58)	(0.23)	(0.04)	NM
DPS (SR)	0.00	0.00	0.00	0.00	0.00	0.0

Source: Company, NCBC Research estimates

NEUTRAL

Target price (SR)	**10.6**
Current price (SR)	**10.8**

STOCK DETAILS

M52-week range H/L (SR)	11.4/9.0
Market cap ($ mn)	3,118
Shares outstanding (mn)	1,080
Listed on exchanges	TADAWUL

Price perform (%)	1M	3M	12M
Absolute	2.6	12.6	12.6
Rel. to market	2.8	(1.2)	(23.3)

Avg daily turnover (mn)	SR	US$
3M	249.8	66.7
12M	181.6	48.5

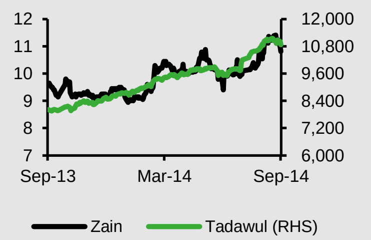
Reuters code	7030.SE
Bloomberg code	ZAINKSA AB
	www.sa.zain.com

VALUATION MULTIPLES

	13A	14E	15E
P/E (x)	NM	NM	NM
P/B (x)	1.7	2.1	2.4
EV/EBITDA (x)	13.1	9.8	6.8
Div Yield (%)	0.0	0.0	0.0

Source: NCBC Research estimates

SHARE PRICE PERFORMANCE



Source: Bloomberg

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Financials

Exhibit 15: Income Statement

In SR million, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
Revenues	**6,171**	**6,523**	**6,263**	**6,884**	**7,409**	**7,778**
% change	(7.9)	5.7	(4.0)	9.9	7.6	5.0
Cost of services	(3,311)	(3,388)	(3,045)	(3,096)	(3,151)	(3,236)
Gross profit	**2,860**	**3,135**	**3,218**	**3,788**	**4,258**	**4,542**
Gross margin (%)	46.3	48.1	51.4	55.0	57.5	58.4
Operating expenses	(1,981)	(2,244)	(2,024)	(2,066)	(2,127)	(2,121)
EBITDA	**879**	**890**	**1,194**	**1,723**	**2,130**	**2,421**
EBITDA margin (%)	14.2	13.7	19.1	25.0	28.8	31.1
Dep. & Amortization	(1,810)	(1,840)	(1,692)	(1,754)	(1,822)	(1,887)
EBIT	(932)	(949)	(498)	(32)	309	534
EBIT margin (%)	(15.1)	(14.6)	(8.0)	(0.5)	4.2	6.9
Financing costs	(823)	(723)	(783)	(601)	(572)	(602)
Other inc./expenses, net	5.6	20.6	9.9	12.0	15.0	22.3
Pre-tax profit	(1,749)	(1,651)	(1,272)	(621)	(249)	(46)
Tax (Zakat)	0.0	0.0	0.0	0.0	0.0	0.0
Net income	**(1,749)**	**(1,651)**	**(1,272)**	**(621)**	**(249)**	**(46)**
% change	(9.1)	(5.6)	(23.0)	(51.1)	(60.0)	(81.6)
Net margin (%)	(28.4)	(25.3)	(20.3)	(9.0)	(3.4)	(0.6)
EPS (SR)	**(1.62)**	**(1.53)**	**(1.18)**	**(0.58)**	**(0.23)**	**(0.04)**

Source: NCBC Research estimates

Exhibit 16: Balance Sheet

In SR million, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
Cash & cash equivalents	2,385	1,293	1,567	1,957	2,909	4,696
Other current assets	1,995	2,022	1,917	2,026	2,106	2,186
Total current assets	4,380	3,315	3,484	3,983	5,016	6,882
Net fixed assets	4,285	4,293	4,417	5,260	5,985	6,114
Other assets – license fees	19,226	18,276	17,327	16,377	15,428	14,479
Other assets – other licenses	49	57	36	39	43	47
Total non-current assets	23,636	22,927	22,080	21,975	21,753	20,937
Total assets	**28,016**	**26,242**	**25,564**	**25,959**	**26,769**	**27,818**
Short-term loans	170	200	190	190	190	74
Other current liabilities	3,980	3,626	3,360	3,475	3,557	3,701
Total current liabilities	15,401	3,826	3,550	3,665	3,747	4,994
Adv. from shareholder non-cr. portion	2,563	3,034	3,057	3,080	3,102	3,125
Long-term loan	0	8,631	8,990	9,365	9,755	8,891
Other liabilities	26	39	41	44	47	50
Total non-current liabilities	4,164	15,657	16,527	17,428	18,405	18,253
Total liabilities	**19,564**	**19,483**	**20,077**	**21,093**	**22,152**	**23,247**
Share capital	10,801	10,801	10,801	10,801	10,801	10,801
Reserves & surplus	(2,349)	(4,001)	(5,272)	(5,893)	(6,142)	(6,188)
Shareholders' funds	8,452	6,759	5,487	4,866	4,617	4,571
Total equity & liabilities	**28,016**	**26,242**	**25,564**	**25,959**	**26,769**	**27,818**

Source: NCBC Research estimates

Exhibit 17: Cash Flow Statement

In SR million, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
Cash flow from op. (a)	(1,150)	229	1,104	1,730	2,157	2,507
Cash flow from inv.(b)	(562)	(803)	(845)	(1,650)	(1,599)	(1,070)
NOPLAT	(932)	(949)	(498)	(32)	309	534
WC	(2,100)	(376)	(134)	(8)	8	61
CAPEX	(1,055)	(860)	(826)	(1,596)	(1,532)	(986)
Depreciation	1,810	1,840	1,692	1,754	1,822	1,887
Free cash flow	(2,276)	(345)	234	119	607	1,496
Cash flow from fin.(c)	3,316	(517)	15	310	395	349
Net chg. in cash (a+b+c)	1,605	(1,092)	274	391	952	1,786
Cash at start of the year	780	2,385	1,293	1,567	1,957	2,909
Cash at end of the year	2,385	1,293	1,567	1,957	2,909	4,696

Source: NCBC Research estimates

Exhibit 18: Key Ratios

Per share, unless otherwise stated

	2012A	2013A	2014E	2015E	2016E	2017E
EPS	(1.6)	(1.5)	(1.2)	(0.6)	(0.2)	(0.0)
FCF per share	(1.7)	(0.3)	0.2	0.1	0.6	1.4
Div per share	0.0	0.0	0.0	0.0	0.0	0.0
Book value per share	7.8	6.3	5.1	4.5	4.3	4.2
Valuation ratios (x)						
P/E	NM	NM	NM	NM	NM	NM
P/FCF	(6.2)	(33.8)	49.9	97.9	19.2	7.8
P/BV	1.4	1.7	2.1	2.4	2.5	2.6
EV/sales	2.3	1.8	1.9	1.7	1.6	1.5
EV/EBITDA	16.1	13.1	9.8	6.8	5.5	4.8
Div yield (%)	0.0	0.0	0.0	0.0	0.0	0.0
Profitability ratios (%)						
Gross margins	46.3	48.1	51.4	55.0	57.5	58.4
Operating margin	(15.1)	(14.6)	(8.0)	(0.5)	4.2	6.9
EBITDA margins	14.2	13.7	19.1	25.0	28.8	31.1
Net profit margins	(28.4)	(25.3)	(20.3)	(9.0)	(3.4)	(0.6)
ROE	(27.5)	(21.7)	(20.8)	(12.0)	(5.2)	(1.0)
ROA	(6.4)	(6.1)	(4.9)	(2.4)	(0.9)	(0.2)
Liquidity ratios						
Current ratio	0.3	0.9	1.0	1.1	1.3	1.4
Quick Ratio	0.3	0.8	0.9	1.1	1.3	1.4
Operating ratios (days)						
Inventory	6	15	16	16	16	16
Receivables outstanding	78	68	65	67	65	64
Payables outstanding	76	53	59	59	59	59
Operating cycle	84	84	81	83	81	80
Cash cycle	8	30	22	24	21	21

Source: NCBC Research estimates

Kindly send all mailing list requests to research@ncbc.com

NCBC Research website	**Brokerage website**	**Corporate website**
http://research.ncbc.com	www.alahlitadawul.com www.alahlibrokerage.com	www.ncbc.com

NCBC Investment Ratings

OVERWEIGHT: Target price represents expected returns in excess of 15% in the next 12 months

NEUTRAL: Target price represents expected returns between -10% and +15% in the next 12 months

UNDERWEIGHT: Target price represents a fall in share price exceeding 10% in the next 12 months

PRICE TARGET: Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon

Other Definitions

NR: Not Rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or in circumstances when NCB Capital is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations

CS: Coverage Suspended. NCBC has suspended coverage of this company

NC: Not covered. NCBC does not cover this company