



US\$3.043bn Market cap
48.1% Free float
US\$10.02mn Avg. daily volume

Target price **8.00** -1.84% over current
 Consensus price **8.40** 3.1% over current
 Current price **8.15** as at 15/1/2011

Research Department
Andrew Haskins, Head of Equity Research
 Tel +966 1 211 9233, haskinsar@alrajhi-capital.com

Existing rating

Underweight **Neutral** Overweight

Zain KSA

More of the same

Flash View

Flash View is an analyst's preliminary interpretation of a results announcement or the impact of a major event. Our investment rating and earnings estimates are not being changed in this report. Any formal changes to our investment rating or earnings estimates will be made in a subsequent report, which may differ from the preliminary views expressed here.

Performance

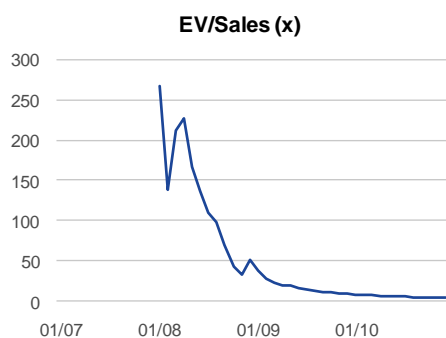


Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (mn)	3,004	5,925	8,225	10,325
Revenue Growth	494.6%	97.2%	38.8%	25.5%
EBITDA (mn)	(1,073)	311	1,374	2,375
EBITDA Growth	-15.2%		342.5%	72.8%
EPS	- 2.21	- 1.66	- 1.09	- 0.36
EPS Growth	36.0%	-25.0%	-34.5%	-66.5%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Zain KSA's Q4 2010 results were similar to those of Q2 and Q3, showing strong growth in sales and gross profit, but a large net loss due to high financial costs on its high debt. We still think it is too risky to invest in Zain KSA ahead of planned financial restructuring. Implementation of restructuring depends in large part on the outcome of Etisalat's bid for Zain KSA's parent, Zain Kuwait.

Earnings vs our forecast	Above	In Line	Below
Likely impact:			
Earnings estimates	Up	No Change	Down
Dividend estimates	Up	No Change	Down
Recommendation	Upgrade	No Change	Downgrade
Long term view	Stronger	Confirmed	Weaker

- Robust accounts and sales growth:** Zain KSA has announced that it ended 2010 with "more than 8mn customers"; this is in line with our estimate of year-end mobile accounts of 8.39mn. As expected, the sales performance was strong: Q4 revenues of SAR1,728mn rose by 93% year-on-year and were a touch above our estimate of SAR1,718mn. For comparison, year-on-year revenue growth in Q3 was 101%.
- Operating performance strong:** Gross profit of SAR826mn was up by 132% year-on-year and 7% above our estimate. EBITDA of SAR209mn was 11% above our estimate; Q4 was Zain KSA's third quarter of positive EBITDA. While high depreciation and amortisation charges continue to depress the operating result, the reported operating loss of SAR179mn was 11% lower than our estimate of an operating loss of SAR201mn.
- High financial costs explain high net loss:** Net financial costs appear to have reached SAR342mn in Q4 compared to our forecast of SAR287mn. This represents a 55% increase year-on-year and an 11% increase quarter-on-quarter. This is the key reason why Zain KSA's reported net loss of SAR521mn was 7% above our forecast of a net loss of SAR488mn despite the strong operating performance. High financial costs reflect high debt. We cannot calculate net debt precisely from the balance sheet data published so far. However, we currently estimate that Zain KSA ended 2010 with net debt of SAR14.68bn, or 2.1x annualised Q4 revenues.
- Conclusion:** In our view, Zain KSA's very high gearing makes financial restructuring essential. However, we still do not know whether or when Zain KSA will be able to implement the financial restructuring plan agreed last year. Implementation depends in large part on the outcome of Etisalat's bid for Zain KSA's parent, Zain Kuwait – an issue that is itself in question after the original deadline for completion of the offer expired yesterday. In the meantime we think it is too risky to invest in Zain KSA as a potential recovery stock. We retain our target price of SAR8.0 and remain Neutral.



Corporate summary

Zain KSA is the third-placed telecoms operator in Saudi Arabia, with a market value of US\$3.0bn; 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 telecoms player operating in various markets in the Middle East and Africa, but it has sold the majority of its African assets to Bharti and now faces a takeover offer from Etisalat of the UAE.

Share information

Market cap (SAR/US\$)	11.41bn / 3.043bn		
52-week range	7.45 - 10.40		
Daily avg volume (US\$)	10.02mn		
Shares outstanding	1,400mn		
Free float (est)	48.1%		
Performance:	1M	3M	12M
Absolute	7.2%	1.2%	-20.9%
Relative to index	3.8%	-5.4%	-28.2%
Major Shareholder:			
Mobile Telecommunications Co. (Kuwait)	25%		
Faden Trading and Contracting	6.9%		

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	3,004	5,925	8,225	10,325
EBITDA (SARmn)	(1,073)	311	1,374	2,375
Net Profit (SARmn)	(3,099)	(2,326)	(1,522)	(510)
EPS (SAR)	- 2.21	- 1.66	- 1.09	- 0.36
DPS (SAR)	-	-	-	-
EPS Growth	36.0%	-25.0%	-34.5%	-66.5%
EV/EBITDA (x)	na	84.0	20.1	11.8
P/E (x)	na	na	na	na
P/B (x)	1.3	1.9	2.5	2.8
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

Figure 1. Zain KSA: preliminary Q4 2010 results

(SAR mn)	Q4 2009 actual	Q3 2010 actual	Q4 2010 actual	% chg. y- y	Q4 2010 ARC est.	Comment
Revenues	895	1,662	1,728	93.0%	1,718	As expected, another strong outcome: y-o-y growth of 93% in Q4 may be compared with 101% in Q3
Gross profit	356	712	826	132.3%	773	Again an impressive performance, and 7% above our estimate
Gross margin (%)	39.7%	42.8%	47.8%		45.0%	The gross margin continues to rise as Zain KSA steadily matures
EBITDA	-70	135	209	-398.1%	189	EBITDA of SAR209mn was 11% above our estimate. This is the third full quarter of positive EBITDA
EBITDA margin (%)	-7.8%	8.1%	12.1%	+4.2pp	11.0%	The EBITDA margin rose by over four percentage points versus Q3. This was a good outcome
Depn. & amortisation	-366	-370	-388	5.9%	-390	High amortisation charges continue to depress operating profit
Operating profit	-437	-235	-179	-59.0%	-201	The operating loss was about 11% below our estimate, but remains substantial
Net financial costs	-221	-309	-342	54.6%	-287	Reflecting high gearing, net financial costs were even higher than we had forecast
Other	0	0	0	-100.0%	0	n/a
Net income before tax	-658	-544	-521	-20.8%	-488	n/a
Tax and zakat	0	0	0		0	We believe that Zain KSA pays no zakat as a loss-making company
Net profit	-658	-544	-521	-20.8%	-488	The net loss is 7% above our estimate despite the strong operating performance; the main reason is very high net financial charges
Capex	727	85	503	n/a	515	Very close to our estimate. Capex appears to be falling towards a more reasonable level of sales
Capex/sales (%)	81.2%	5.1%	0	-52.1pp	30.0%	As above
Net debt	11,902	14,065	n/a	n/a	14,683	We cannot yet calculate net debt, but believe that it amounts to 2.1x annualised Q4 revenues
Net debt/EBITDA (x)	-42.4	26.1	n/a	n/a	19.4	We believe that gearing remains very high, illustrating the necessity of financial restructuring

Source: Company data, Al Rajhi Capital



Disclaimer and additional disclosures for Equity Research

Disclaimer

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

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

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

Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

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

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

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

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

2. Definitions

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

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

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

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

Contact us

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

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

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