



Lower GP margin and higher OPEX led to decline in earnings, despite one-off government grant income worth SAR 52mn

Zain KSA's net income declined 7.9% Y/Y to SAR 105mn in Q2-24, beating AJC's and market estimates of SAR 72mn and SAR 73mn, respectively. The net income was higher than our estimate mainly due to one-off other income related to government grant amounting to SAR 52mn was recorded during the quarter. However, gross margin reduction (-170bps Y/Y), increase in OPEX (+5.4% Y/Y) and higher finance cost dragged the earnings on Y/Y basis. The increase in OPEX is likely to be resulted from full impact of leaseback of tower assets and higher ECL provisions. Excluding the one-off impact, net profit would have been below our expectations as the gross margin of 60.3% was lower than our estimate of 60.8%. Revenue increased by 6.7% Y/Y to SAR 2,552mn, in line with our estimate of SAR 2,548mn. We maintain our TP of SAR 13.5/share and "Neutral" recommendation on Zain KSA.

- Zain KSA's net income fell 7.9% Y/Y to SAR 105mn in Q2-24, above our and consensus estimates of SAR 72mn and SAR 73mn, respectively. The higher-than-expected net income is mainly attributable to one time other income worth SAR 52mn related to government grant. Excluding the one-off impact, net profit would have been below our expectations as the gross margin of 60.3% was lower than our estimate of 60.8%. The Y/Y decline in the company's bottom line was due to contraction of gross margin reduction (-170bps), increase in OPEX (+5.4%) and higher finance cost.
- Revenue increased 6.7% Y/Y to SAR 2,552mn in Q2-24, in line with our estimate of SAR 2,548mn. B2B, 5G, Wholesale and Tamam were the key contributors to revenue growth. Additionally, Hajj season in Q2-24 this year also supported the topline.
- Gross profit rose 3.8% Y/Y to SAR 1,540mn (AJC estimate: SAR 1,549mn), as revenue growth was partially wiped out by contraction of GP margin. The GP margin decreased ~170bps Y/Y to 60.3% from 62.0% in Q2-23 and above our estimate of 60.8%.
- Operating profit declined 4.3% Y/Y to SAR 242mn in Q2-24, in line with our estimate of SAR 249mn, primarily impacted by higher operating expenses (+5.4% Y/Y). The increase in OPEX is likely to be driven by the effect of lease back of tower assets, in addition to higher ECL provisions.

AJC view and valuation: In Q2-24, Zain KSA's operating performance came below our expectations with a slightly weaker-than-expected gross margin. As expected, higher OPEX put pressure on operating profit, as the full impact of the leaseback of the towers will appear in the operating costs. The company's ECLs continue to remain high consistently and we expect it to add to the operating margin pressure in future as well. In Q2-24, revenue growth is likely to be supported by Hajj season. We expect topline growth to moderate a bit in the rest of the year. Moreover, with the company's high leverage level (net debt/EBITDA of 2.34x as Q1-24) finance expenses are anticipated to remain elevated, weighing on the net profit. We expect finance expenses in FY24E to be around the same level as those of FY23. Zain KSA currently trades at an EV/EBITDA ratio of 5.3x and P/E of 17.5x based on our FY25E estimates. FY25E dividend yield is estimated at 4.4%. We maintain our TP to SAR 13.5/share and the "Neutral" recommendation on Zain KSA.

Results Summary

SAR mn	Q2-23	Q1-24	Q2-24	Change Y/Y	Change Q/Q	Deviation from AJC Estimates
Revenue	2,392	2,535	2,552	6.7%	0.7%	0.2%
Gross Profit	1,484	1,545	1,540	3.8%	-0.3%	-0.6%
<i>Gross Margin</i>	<i>62.0%</i>	<i>60.9%</i>	<i>60.3%</i>	-	-	-
EBIT	253	251	242	-4.3%	-3.6%	-2.7%
Net Profit	114	67	105	-7.9%	56.7%	46.7%
EPS	0.13	0.07	0.12	-	-	-

Source: Company Reports, Aljazira Capital

Recommendation Neutral

Target Price (SAR) 13.5

Upside / (Downside)* 19.0%

Source: Tadawul *prices as of 24th of July 2024

Key Financials

SARmn (unless specified)	FY22	FY23	FY24E	FY25E
Revenues	9,075	9,883	10,409	10,902
Growth %	14.9%	8.9%	5.3%	4.7%
Net Income	550	1,267	288	582
Growth %	156.5%	130.5%	-77.3%	102.3%
EPS	0.61	1.41	0.32	0.65
DPS	0.00	0.50	0.50	0.50

Source: Company reports, Aljazira Capital

*FY23E net income does not include additional gains from tower deal

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	58.6%	59.3%	59.6%	59.6%
EBITDA Margin	34.8%	30.1%	29.5%	30.3%
Net Margin	6.1%	12.8%	2.8%	5.3%
ROE	5.6%	12.0%	2.8%	5.5%
ROA	1.9%	4.6%	1.0%	2.1%
P/E (x)	16.4	10.0	35.4	17.5
P/B (x)	0.9	1.2	1.0	1.0
EV/EBITDA (x)	4.8	6.9	5.9	5.3
Dividend Yield	0.0%	3.6%	4.4%	4.4%

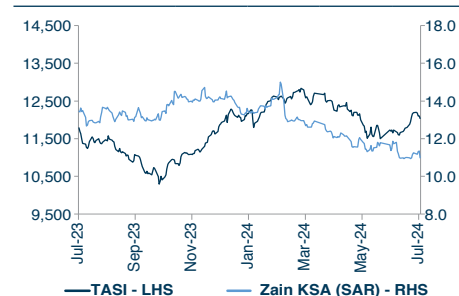
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap(bn)	9.9
YTD%	-19.5%
52 week (High)/(Low)	15.18/10.84
Share Outstanding (mn)	898.7

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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RATING
TERMINOLOGY

1. **Overweight:** This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. **Underweight:** This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. **Neutral:** The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. **Suspension of rating or rating on hold (SR/RH):** This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

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