Mobile Telecommunication Co.(ZAIN KSA)

Results Flash Note Q3-24

Weaker operating performance due to spike in ECL provision and higher OPEX; net income supported by one-offs

Zain KSA's net income grew more than 2x to SAR 150mn in Q3-24 from SAR 70mn in Q3-23, beating AJC's and market estimates of SAR 75mn and SAR 85mn, respectively. The net income was supported by the one-off release of withholding tax on international traffic provision worth SAR 157mn and non-recurring gain of SAR 21mn related to the sale and lease back of 199 sites. Excluding the one-offs, the company would have recorded a net loss of ~SAR 28mn for the quarter. The deviation of normalized net income from our estimate is primarily due to significantly higher than expected credit loss provision (ECL) amounting to SAR 158mn. Normalized gross margin (excluding SAR 157mn reversal of provisions) expanded ~160bps Y/Y to 60.3%, above our expectation of 58.9%. Revenue increased modestly by 2.3% Y/Y to SAR 2,583mn, in-line with our estimate of SAR 2,626mn. Momentum in Tamam business along with growth in B2B, 5G and wholesale help the topline. We revise down our TP on Zain KSA to SAR 11.85/share, while maintaining the "Neutral" recommendation.

- Zain KSA's net income jumped 114.3% Y/Y to SAR 150mn in Q3-24, beating AJC and market estimates of SAR 75mn and SAR 85mn, respectively. The net income was supported by the one-off release of withholding tax on international traffic provision worth SAR 157mn and non-recurring gain of SAR 21mn related to the sale and lease back of 199 sites. Excluding the one-offs, the company would have recorded a net loss of ~SAR 28mn for the quarter. The deviation of normalized net income from our estimate is primarily due to significantly higher than expected credit loss provision (ECL) amounting to SAR 158mn. Additionally, depreciation and amortization expenses also seem to be higher than our expectation. This was partly counteracted by better GP margin.
- Revenue increased 2.3% Y/Y to SAR 2,583mn in Q3-24, in line with our estimate of SAR 2,626mn. B2B, 5G, Wholesale and Tamam were the key contributors to revenue growth. Sequentially, revenue growth of 1.2% was backed by equipment sales and Tamam.
- Gross profit rose 15.7% Y/Y to SAR 1,714mn (AJC estimate: SAR 1,546mn), as cost of sales declined 16.8% Y/Y, reflecting a positive effect of SAR 157mn from release of withholding tax on international traffic provision. Normalized gross profit of SAR 1,557mn was in line with AJC estimate of SAR 1,546mn. Normalized GP margin increased ~160bps Y/Y to 60.3%, above our estimate of 58.9%.
- Operating profit declined 0.3% Y/Y to SAR 318mn in Q3-24, as the positive effect of withholding tax related one-off was nullified by spike in ECL provision (SAR 158mn). Normalized operating profit of SAR 161mn was below our estimate of SAR 258mn. The normalized operating margin fell to 6.2% from 12.6% in Q3-23 (below AJC estimate of 9.8%) due to higher ECL provision as well as OPEX.

AJC view and valuation: Zain KSA's Q3-24 net profit growth was supported by one-offs; core operating performance was under pressure from increased ECL provision and OPEX. Although we do not expect ECL provisioning to sustain Q3-24 level, it is likely to continue to limit operating margin. Moreover, the impact of the leaseback of the towers will appear in higher OPEX. The company's revenue growth slowed down to a modest 2.3% Y/Y in Q3-24, that could be an indication of competitive pressure as peers continue to record healthy topline growth. We expect topline growth to remain moderate in low single digits in the medium term. Moreover, the company's leverage level (net debt/EBITDA of 2.46x as Q2-24) remains the highest in the sector. However, with anticipated rate cuts, we expect finance expenses to ease next year, supporting the net profit growth. Zain KSA currently trades at an EV/EBITDA ratio of 5.3x and P/E of 21.5x based on our FY25E estimates. FY25E dividend yield is estimated at 4.6%. We revise down our TP on Zain KSA to SAR 11.85/share, while maintaining the "**Neutral**". recommendation.

Results Summary

SAR mn	Q3-23	Q2-24	Q3-24	Change Y/Y	Change Q/Q	Deviation from AJC Estimates
Revenue	2,525	2,552	2,583	2.3%	1.2%	-1.7%
Gross Profit	1,481	1,540	1,714	15.7%	11.3%	10.9%
Gross Margin	*58.7%*	*60.3%*	*66.4%*	-	-	-
EBIT	319	242	318	-0.3%	31.4%	23.2%
Net Profit	**70**	**105**	**150**	114.3%	42.9%	99.0%
EPS	**0.08**	**0.12**	**0.17**	-	-	-

Source: Company Reports, Aljazira Capital Research

Recommendation	Neutral
Target Price (SAR)	11.85
Upside / (Downside)*	10.1%

Source: Tadawul *prices as of 28th of October 2024

Key Financials

SARmn (unless specified)	FY22	FY23	FY24E	FY25E
Revenues	9,075	9,883	10,315	10,678
Growth %	14.9%	8.9%	4.4%	3.5%
Net Income	550	1,267	367	450
Growth %	156.5%	130.5%	-71.1%	22.8%
EPS	0.61	1.41	0.41	0.50
DPS	0.00	0.50	0.50	0.50

Source: Company reports, Aljazira Capital Research
*FY23E net income does not include additional gains from tower deal

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	58.6%	59.3%	61.7%	59.6%
EBITDA Margin	34.8%	30.1%	30.8%	30.1%
Net Margin	6.1%	12.8%	3.6%	4.2%
ROE	5.6%	12.0%	3.5%	4.3%
ROA	1.9%	4.6%	1.4%	1.6%
P/E (x)	16.4	10.0	26.4	21.5
P/B (x)	0.9	1.2	0.9	0.9
EV/EBITDA (x)	4.8	6.9	5.6	5.3
Dividend Yield	0.0%	3.6%	4.6%	4.6%

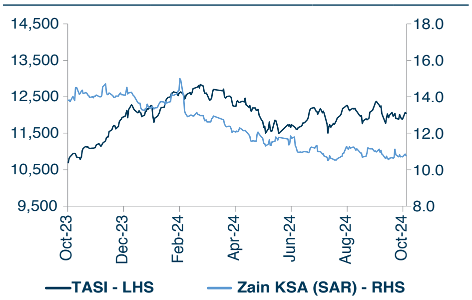
Source: Company reports, Aljazira Capital Research

Key Market Data

Market Cap(bn)	9.7
YTD%	-23.6%
52 week (High)/(Low)	15.18/10.30
Share Outstanding (mn)	898.7

Source: Company reports, Aljazira Capital Research

Price Performance



Source: Tadwaul, Aljazira Capital Research

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RESEARCH DIVISION

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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.

Disclaimer