The Saudi Telecom Sector

Telecom-Report-2018, Saudi Telecom Subscribers

ALJAZIRA CAPITAL الجزيرة كابيتال الجزيرة للأسواق المالية

Saudi telecom subscribers… a possible trend reversal….

After going through a rough patch in 2016 and 2017 due to the finger print registration, decline in expat population and the general slowdown in economy, the telecom sector is expected to show some improvement. Limited growth opportunities due to high saturation levels in voice and data will keep growth muted. However a reversal in trend was seen in the last CITC report for Q1-2018.

According to data released by CITC, mobile subscribers at the end of Q1-2018 stood at 42mn subscribers, a significant improvement over 40.2mn subscriber base towards the end of 2017, depicting a jump of 4.5%QoQ. Since the start of 2015, mobile subscribers have seen a significant drop from a high of 53mn. The current increase can be indicative of the reversal in trend. What is more significant is the mix of customer base. Although Prepaid customers still form the large chunk of total subscribers, postpaid subscribers have started to show an increase. In Q1-2018 postpaid customers stood at 11.2mn, accounting for 27% of the total mobile subscriber base, mounting a jump of 10.9%YoY, whereas in 2017 Postpaid customers showed a jump of 27.9%YoY, depicting a relatively resilient customer mix. A higher number of postpaid customers will also mean that market share of the three operators will remain fairly constant, as is our belief that postpaid customers are more sticky as compared to prepaid.

Internet subscribers going down with an exception

Unlike the mobile subscriber base, internet subscribers have seen a significant drop, Fixed broadband has gone down to 2.2mn subscriber in 1Q-2018, from 2.5mn in 4Q-2017, a QoQ drop of 12.4%. ADSL and Fixed wireless subscribers both have shown a decline of 10.7%QoQ and 50%QoQ respectively. However leased line and FTTX have shown a slight increase of 5.7%QoQ. It should be mentioned that STC is the prime player in the fixed broadband segment of ADSL and leased lines, any loss in subscriber base will have a direct impact on the company.

Mobile broadband has shown an increase of 1.56%QoQ, driven by 4.8%QoQ increase in standard mobile subscriber(Voice+Data), whereas dedicated mobile data subscribers have seen a decline by 3.86%QoQ.

Fixed lines shows steady growth

Fixed line in 1Q-2018 stood at 3.72mn household subscribers, reaching a household penetration level of 35.4%, depicting a QoQ jump of 2.2%. Residential lines growth fared slightly better than business lines with 2.9%QoQ growth. STC is the prime player in the fixed line market, which in our view bodes well for the company.

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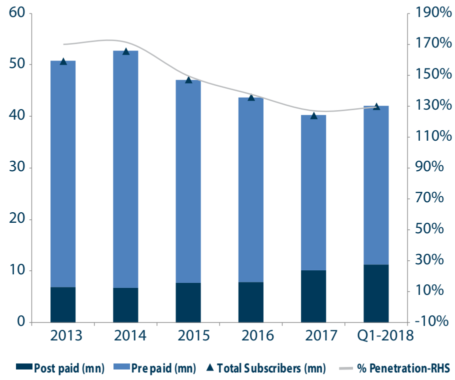
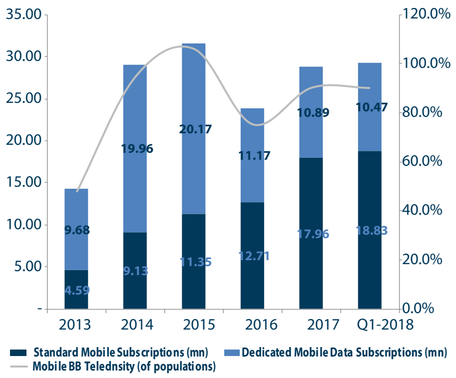
Mobile Subscribers



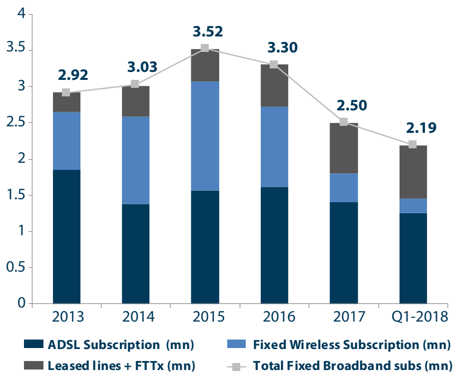
Source: CITC, Aljazira Capital

Mobile Internet Subscribers



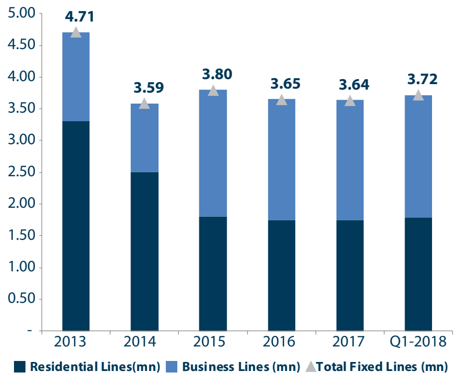
Source: CITC, Aljazira Capital

Fixed Broadband Subscribers



Source: CITC, Aljazira Capital

Fixed Lines



Source: CITC, Aljazira Capital

Market Share

The sector has a total of 42mn subscribers, out of which the market share for the 3 players (STC, Mobily and Zain) is a bit difficult to decipher. What is quite evident is that STC is the largest player in the market and in our view holds somewhere between 52%-54% of the market, the rest is being shared between Zain and Mobily. Zain in its recent announcement highlighted that its subscribers base at the end of Q1-2018 stood at 8.4mn, depicting a market share of 18%. Leaving Mobily with a market share in the range of 28%to 30%.

On the revenue front similar to the subscriber base, in 2017, STC accounts for roughly 60% of the total mobile subscribers revenue, Mobily accounted for 25% of the Mobile subscribers revenue, while Zain's market share in mobile revenues stood at 16%.

ARPU recovering, despite lower interconnect charges

The sector in 2017 witnessed decline in interconnect charges from SAR 0.1 to SAR 0.055 for mobile networks, despite that, the ARPU for the sector in 2017 showed an increase 4.1%YoY after witnessing a decline since 2012. It should however be noted that the operator were allowed to increase the data rates, which has positively impacted the ARPU for the companies.

We expect that the sector will continue to witness some revised pricing in data bundles which will potentially drive the ARPU. This along with the recovery in subscribers base will have a positive impact on the topline growth of the sector.

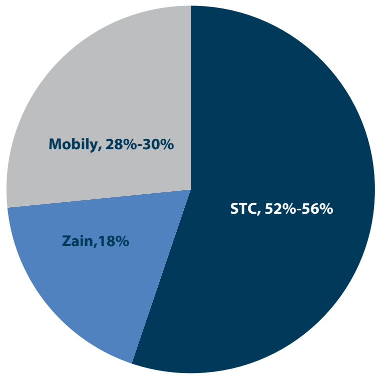
Valuations and Outlook:

STC remain our top pick for the telecom sector. The company has significantly improved it financial performance along with a recovery in the subscriber base and an overall improvement in ARPU. For 2018, we expect the company to post earnings of SAR 10.6bn (4.4%YoY increase). STC currently is trading at a trailing PE and PB of 16.3x and 2.6x,with dividend yield of 4.8%.We maintain our price recommendation of SAR 88.8/share with a neutral recommendation.

Zain KSA continues to suffer from low market share, as it lost nearly a million subscribers in 2017, along with heavy financial burden continued its weak performance. Zain for 2018, is expected to post a loss of SAR 185.0mn, as compared to profit of SAR 11.5mn. The company has announced that it will reduce its capital from SAR 5.8bn to SAR 3.6bn to write-off its accumulated losses of SAR 2.2bn. Subsequently the company plans to issue right shares worth SAR 6.0bn, targeting share capital of SAR 9.6bn. The company plans to reduce its debt obligation through right shares, effectively cutting its debt obligation and finance cost. The lower debt obligation is expected to lower the finance cost by an estimated SAR 400mn. The approval for the capital restructuring is still pending. We downgrade our price target to SAR 6.4/share, with a "**Neutral**" recommendation.

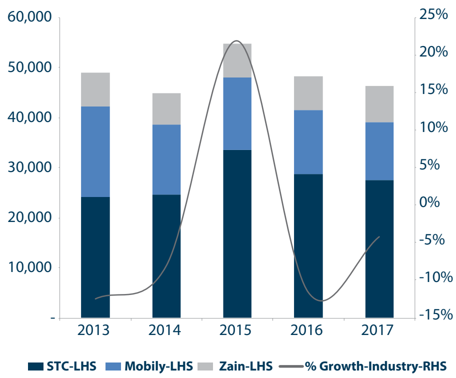
Mobily has also continued its weak performance, although the company did improve its bottom line in Q1-2018, as it posted losses of SAR 93.4mn, as compared to loss of SAR 163.0mn in Q1-2017, however improved performance came from provision reversal. For 2018, we expect the company to post losses of SAR 658mn. We maintain our price target of SAR 13.0/share, with an "**Underweight**" recommendation.

Market Share-extrapolated



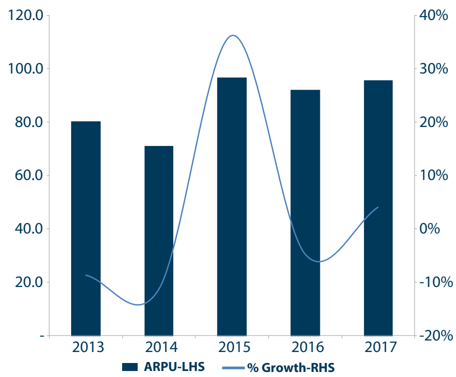
Source: Aljazira Capital

Market Share-2017 Revenues



Source: Company financial, Aljazira capital

ARPU-Industry



Source:CITC, Company financial, Aljaizra capital

	Target Price	Upside	Reccomendation
STC	88.8	5%	Neutral
Zain	6.4	1%	Neutral
Mobily	13.0	52%	Underweight

Source: Tadawul, Aljazira capital Closing price as of 3/7/2018

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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