

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.

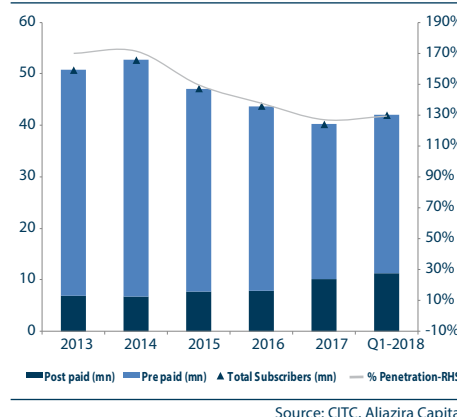
Mobile broadband has shown an increase of 1.56%QoQ, driven by 4.8%QoQ increase in standard mobile subscriber(Voice+Data), whereas dedicated mobile data subscribers have seen a decline by 3.86%QoQ.

Fixed lines shows steady growth

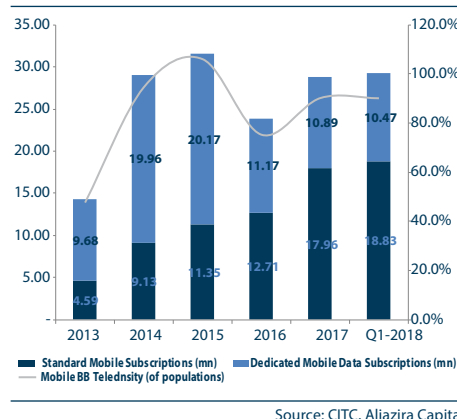
Fixed line in 1Q-2018 stood at 3.72mn household subscribers, reaching a household penetration level of 35.4%, depicting a QoQ jump of 2.2%. Residential lines growth fared slightly better than business lines with 2.9%QoQ growth. STC is the prime player in the fixed line market, which in our view bodes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

Head of Research
Talha Nazar
+966 11 2256250
t.nazar@aljazaracapital.com.sa

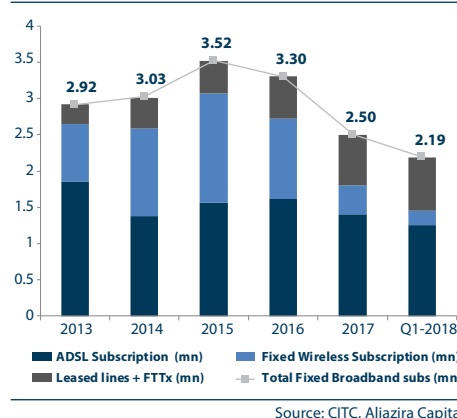
Mobile Subscribers



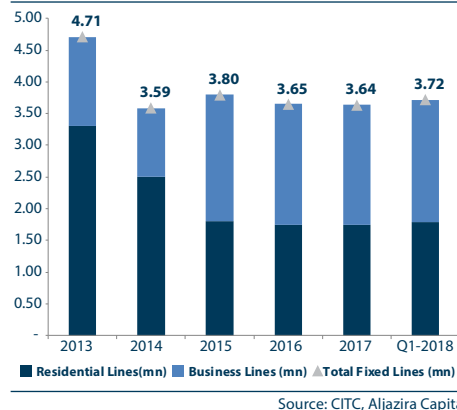
Mobile Internet Subscribers



Fixed Broadband Subscribers



Fixed Lines



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.

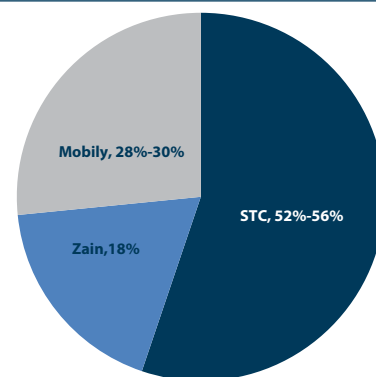
Valuations and Outlook:

STC remain our top pick for the telecom sector. The company has significantly improved its 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.

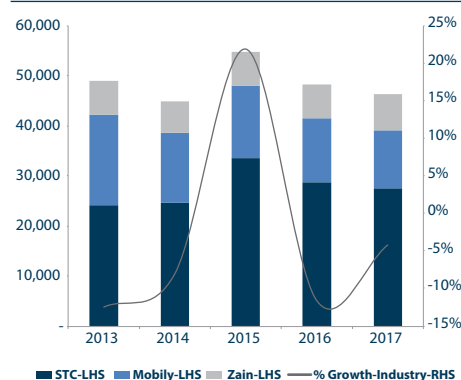
Mobily has also continued its weak performance, although the company did improve its bottom line in Q1-2018, as it posted losses of SAR 93.4mn, as compared to loss of SAR 163.0mn in Q1-2017, however improved performance came from provision reversal. For 2018, we expect the company to post losses of SAR 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, Aljazira 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

RESEARCH DIVISION

Head of Research
Talha Nazar
+966 11 2256250
t.nazar@aljaziracapital.com.sa

Analyst
Waleed Al-jubayr
+966 11 2256146
W.aljubayr@aljaziracapital.com.sa

Analyst
Sultan Al Kadi, CAIA
+966 11 2256374
s.alkadi@aljaziracapital.com.sa

Analyst
Muhanad Al-Odan
+966 11 2256115
M.alodan@aljaziracapital.com.sa

Analyst
Jassim Al-Jubran
+966 11 2256248
j.aljubran@aljaziracapital.com.sa

BROKERAGE AND INVESTMENT CENTERS DIVISION

General Manager – Brokerage Services & sales
Alaa Al-Yousef
+966 11 2256060
a.yousef@aljaziracapital.com.sa

AGM-Head of Sales And Investment Centers
Central Region
Sultan Ibrahim AL-Mutawa
+966 11 2256364
s.almutawa@aljaziracapital.com.sa

AGM-Head of international and institutional brokerage
Luay Jawad Al-Motawa
+966 11 2256277
lalmutawa@aljaziracapital.com.sa

AGM-Head of Qassim & Eastern Province
Abdullah Al-Rahit
+966 16 3617547
aalrahit@aljaziracapital.com.sa

AGM- Head of Western and Southern Region Investment Centers
Mansour Hamad Al-shuaibi
+966 12 6618443
m.alshuaibi@aljaziracapital.com.sa

RESEARCH DIVISION

AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

- 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.
- 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.
- 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.
- 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

The purpose of producing this report is to present a general view on the company/economic sector/economic subject under research, and not to recommend a buy/sell/hold for any security or any other assets. Based on that, this report does not take into consideration the specific financial position of every investor and/or his/her risk appetite in relation to investing in the security or any other assets, and hence, may not be suitable for all clients depending on their financial position and their ability and willingness to undertake risks. It is advised that every potential investor seek professional advice from several sources concerning investment decision and should study the impact of such decisions on his/her financial/legal/tax position and other concerns before getting into such investments or liquidate them partially or fully. The market of stocks, bonds, macroeconomic or microeconomic variables are of a volatile nature and could witness sudden changes without any prior warning, therefore, the investor in securities or other assets might face some unexpected risks and fluctuations. All the information, views and expectations and fair values or target prices contained in this report have been compiled or arrived at by Al-Jazira Capital from sources believed to be reliable, but Al-Jazira Capital has not independently verified the contents obtained from these sources and such information may be condensed or incomplete. Accordingly, no representation or warranty, express or implied, is made as to, and no reliance should be placed on the fairness, accuracy, completeness or correctness of the information and opinions contained in this report. Al-Jazira Capital shall not be liable for any loss as that may arise from the use of this report or its contents or otherwise arising in connection therewith. The past performance of any investment is not an indicator of future performance. Any financial projections, fair value estimates or price targets and statements regarding future prospects contained in this document may not be realized. The value of the security or any other assets or the return from them might increase or decrease. Any change in currency rates may have a positive or negative impact on the value/return on the stock or securities mentioned in the report. The investor might get an amount less than the amount invested in some cases. Some stocks or securities maybe, by nature, of low volume/trades or may become like that unexpectedly in special circumstances and this might increase the risk on the investor. Some fees might be levied on some investments in securities. This report has been written by professional employees in Al-Jazira Capital, and they undertake that neither them, nor their wives or children hold positions directly in any listed shares or securities contained in this report during the time of publication of this report, however, The authors and/or their wives/children of this document may own securities in funds open to the public that invest in the securities mentioned in this document as part of a diversified portfolio over which they have no discretion. This report has been produced independently and separately by the Research Division at Al-Jazira Capital and no party (in-house or outside) who might have interest whether direct or indirect have seen the contents of this report before its publishing, except for those whom corporate positions allow them to do so, and/or third-party persons/institutions who signed a non-disclosure agreement with Al-Jazira Capital. Funds managed by Al-Jazira Capital and its subsidiaries for third parties may own the securities that are the subject of this document. Al-Jazira Capital or its subsidiaries may own securities in one or more of the aforementioned companies, and/or indirectly through funds managed by third parties. The Investment Banking division of Al-Jazira Capital maybe in the process of soliciting or executing fee earning mandates for companies that is either the subject of this document or is mentioned in this document. One or more of Al-Jazira Capital board members or executive managers could be also a board member or member of the executive management at the company or companies mentioned in this report, or their associated companies. No part of this report may be reproduced whether inside or outside the Kingdom of Saudi Arabia without the written permission of Al-Jazira Capital. Persons who receive this report should make themselves aware, of and adhere to, any such restrictions. By accepting this report, the recipient agrees to be bound by the foregoing limitations.

Asset Management | Brokerage | Corporate Finance | Custody | Advisory

Head Office: King Fahad Road, P.O. Box: 20438, Riyadh 11455, Saudi Arabia. Tel: 011 2256000 - Fax: 011 2256068