

**Initiation Coverage**

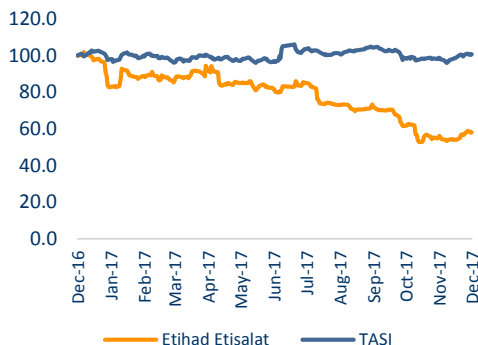
December 21, 2017

| Recommendation      | Underweight |
|---------------------|-------------|
| Current Price (SAR) | 14.45       |
| Target Price (SAR)  | 11.96       |
| Upside/Downside (%) | -17.2%      |

As of December 20, 2017

**Key Data (Source: Bloomberg)**

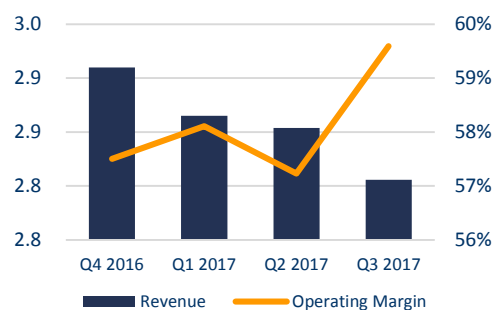
|                                  |       |
|----------------------------------|-------|
| Market Cap (SAR bn)              | 11.0  |
| 52 Wk High (SAR)                 | 25.5  |
| 52 Wk Low (SAR)                  | 12.9  |
| Total Outstanding Shares (in bn) | 0.8   |
| Free Float (%)                   | 60.1% |

**ETIHAD ETISALAT vs. TASI (Rebased)**


| Price Performance (%) | Absolute | Relative |
|-----------------------|----------|----------|
| 1m                    | 3.5      | 1.6      |
| 6m                    | -27.7    | -31.9    |
| 12m                   | -41.9    | -42.6    |

**Major Shareholders (%)**

| Shareholder                      | %     |
|----------------------------------|-------|
| Emirates Telecom Corporation     | 28.0% |
| General Org For Social Insurance | 11.9% |
| MDO Management Co.               | 0.03% |

**Quarterly Sales (SAR bn) and Operating Margin**


Source: Bloomberg, Company Financials, FALCOM Research; Data as of December 20, 2017

Etihad Etisalat's (Mobily) 3Q17 revenues declined by approximately 2% QoQ to SAR 2.8bln. Revenues were impacted by the implementation of the fingerprinting process, a reduction in interconnect rates and higher competition for pricing. Net loss stood at SAR 174mln owing to a decline in EBITDA. Total debt reduced by SAR 1.3bln over its deleveraging strategy.

Mobily's reducing market share, a sharp cut in the capex, higher debt cost and regulatory pressures could push the company down further. However, recent work on government projects and its deleveraging strategy has been favorable. There could still be some way to go before company show some strong signs of positivity.

**Loss of market share to pressurize top line**

Mobily lost its market share of 42% in 2011 and has moved down to 29% in 2016. Furthermore, a decline in market share is expected in the near future, as increased competition from other telecom players could reduce Mobily's market share. Pressure on top line would also be a result of regulatory and governmental changes in the country, such as the fingerprint process implementation and expat additional fees. Another regulatory change that could have a negative impact on revenues is a reduction in mobile termination rates (MTRs) by the Communications and IT Commission (CITC).

**Government projects and lowering capex**

Mobily is working on many government projects. CITC awarded a 2x5 MHz paired block in the 1,800MHz band for SAR 422mln to Mobily, which can help the company enhance its network capacity, improve customer experience and reduce future capex. In the third quarter, the company recorded capex of SAR 438mln, in line to the previous quarter. However, lower capex could result in lower growth during pressure situations in the market.

**High debt cost impacts bottom line**

The company took a refinancing facility of SAR 7.9bln debt in February 2017, which resulted in higher interest cost. Rising finance costs could further pressurize the bottom line. The debt-to-equity ratio remained high at 102% as of Q32017. Although Mobily adopted the deleveraging strategy and is reducing overall debt, it would still face an impact on the bottom line in the coming years due to the pace of deleveraging.

**Exaggerated intangible assets increase book value**

The company's book value as of 3Q2017 stood at SAR 14.4bln, leading to a Price-Book Value (PBV) of 0.75x. The concern is raised when we reduce intangible assets worth SAR 8.8bln, which majorly include goodwill and other intangible assets that resulted from previous acquisitions. After reducing intangibles, the company's PBV shoots up to 1.9x. This indicates that the book value is exaggerated due to intangibles.

**Valuation:** We valued Mobily using the DCF approach to arrive at a fair value of SAR 11.96 per share. We considered WACC at 10.0%, with a terminal growth rate of 1.5%.

|                           | 2016A | 2017E | 2018E | 2019E |
|---------------------------|-------|-------|-------|-------|
| Revenues (SAR bn)         | 12.6  | 11.5  | 11.4  | 11.8  |
| Operating profit (SAR bn) | 0.2   | 0.4   | 0.4   | 0.7   |
| EPS (SAR)                 | (0.3) | (0.2) | (0.0) | 0.4   |
| Operating margin (%)      | 1.9%  | 3.1%  | 3.7%  | 6.3%  |
| RoE (%)                   | -1.4% | -0.8% | -0.1% | 2.2%  |
| D/E (x)                   | 1.0   | 1.0   | 0.9   | 0.8   |
| P/E (x)                   | NM    | NM    | NM    | 32.0  |
| Price/BV (x)              | 0.4   | 0.3   | 0.3   | 0.3   |
| EV/EBITDA (x)             | 8.2   | 6.6   | 6.3   | 5.5   |

Source: Company Financials, FALCOM Research

Note: NM\*- Not Meaningful

Initiation Coverage

December 21, 2017

## Valuation Summary

### Explanation of valuation methodology and assumptions

We valued Mobily using the DCF approach to arrive at a fair value of SAR 11.96 per share. We considered WACC at 10.0%, with a terminal growth rate of 1.5%.

In relative terms, Mobily is trading at a one-year forward EV/EBITDA of 5.7x, showing a discount of 12.3% to its sector peers and nearly 43.6% to the Tadawul All Share Index.

| SAR Mn   | FY 2016A      | FY 2017E                              | FY 2018E     | FY 2019E     | FY 2020E      |
|--|---------------|---------------------------------------|--------------|--------------|---------------|
| EBIT   | 235           | 357                                   | 415          | 741          | 938           |
| Taxes  | 43            | 2                                     | 0            | (7)          | (12)          |
| Depreciation, amortization and impairment        | 3,775         | 3,372                                 | 3,402        | 3,435        | 3,469         |
| Changes in working capital                       | (2)           | 504                                   | (142)        | (156)        | 23            |
| Net capital expenditure                          | (3,209)       | (2,102)                               | (2,300)      | (2,511)      | (2,468)       |
| <b>Free cash flow to firm</b>                    | <b>841</b>    | <b>2,133</b>                          | <b>1,376</b> | <b>1,502</b> | <b>1,952</b>  |
| Discount factor                                  |               | 1.0                                   | 0.9          | 0.8          | 0.8           |
| <b>PV of free cash flow to firm</b>              |               | <b>2,139</b>                          | <b>1,247</b> | <b>1,238</b> | <b>1,463</b>  |
| <b>Net Present Value (A)</b>                     |               |                                       |              |              | <b>6,087</b>  |
| <b>PV Terminal Value (B)</b>                     |               |                                       |              |              | <b>17,465</b> |
| <b>Assumed Terminal Growth Rate</b>              |               |                                       |              |              | <b>1.5%</b>   |
| <b>Discount Rate</b>                             |               |                                       |              |              | <b>10.0%</b>  |
| <b>Enterprise Value (A+B)</b>                    | <b>23,551</b> | <b>WACC Assumptions</b>               |              |              |               |
| <b>Total cash</b>                                | 866           | Risk-free rate                        |              |              |               |
| <b>Total debt</b>                                | 15,209        | Market returns                        |              |              |               |
| <b>Minority interest</b>                         | 2             | Beta                                  |              |              |               |
| <b>Equity value in SAR mn</b>                    | <b>9,207</b>  | <b>Cost of equity</b>                 |              |              |               |
| <b>Number of shares in mn</b>                    | 770           | <b>Post tax cost of debt</b>          |              |              |               |
| <b>Target price in SAR per share</b>             | <b>11.9</b>   | Weight of equity in capital structure |              |              |               |
| <b>CMP in SAR as on December 20, 2017</b>        | <b>14.5</b>   | Weight of debt in capital structure   |              |              |               |
| <b>Upside/(downside) to current market price</b> | <b>-17.2%</b> | <b>WACC</b>                           |              |              |               |
|  |               | <b>10.0%</b>                          |              |              |               |

Source: Company Financials, FALCOM Research  
 Estimates

### Risks

- Easing of competitive pressure and an increase in market share could lead to an upside.
- A successful Tower sales resulting in high cash inflows; low lease-back rates could add to the bottom line.
- ARPU could increase due to the higher-than-expected shift to postpaid subscribers.
- Delays in potential MTR rate cuts and reduced regulatory pressure, such as no MVNO launch without changes in market dynamics, could result in an uptick.

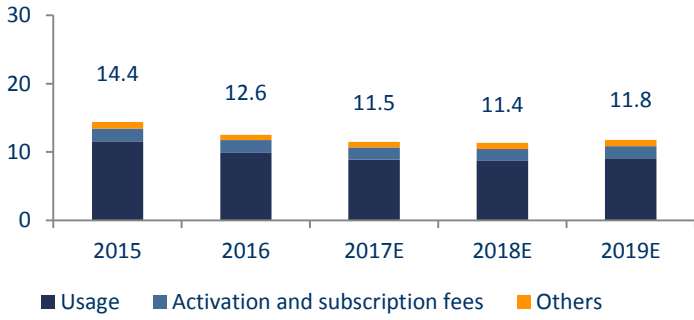


Initiation Coverage

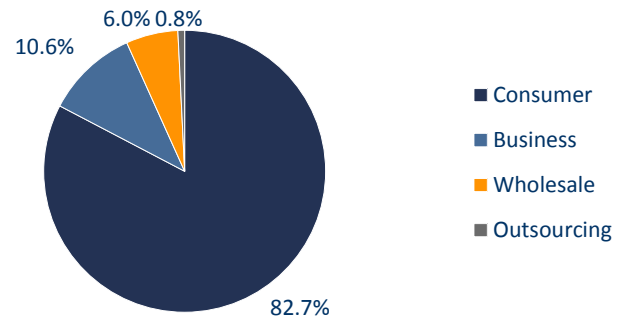
December 21, 2017

### Key Charts

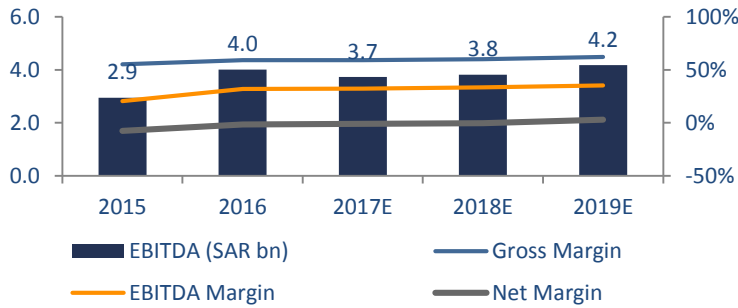
Revenue (SAR bn)



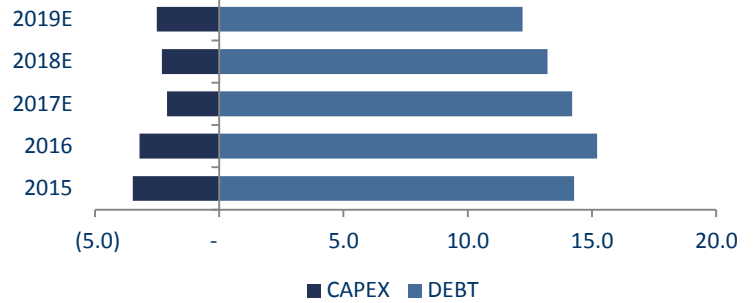
Revenue Split (9 months 2017)



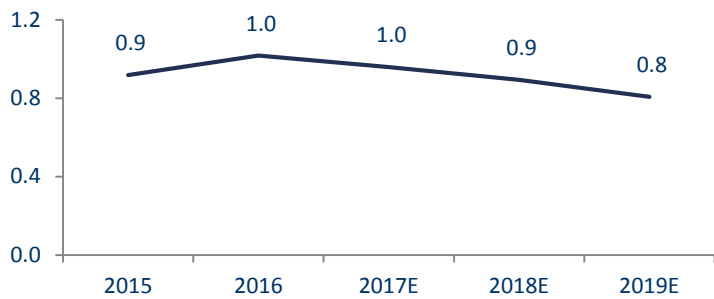
EBITDA & Margins



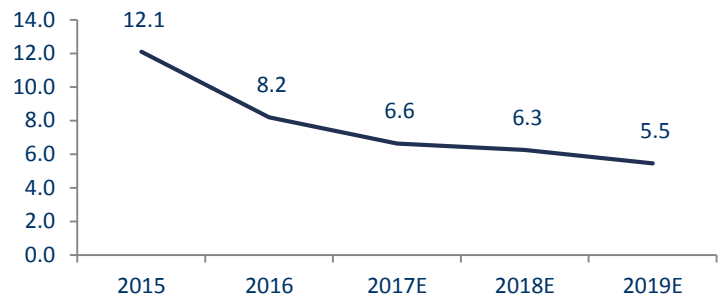
CAPEX and Total Debt



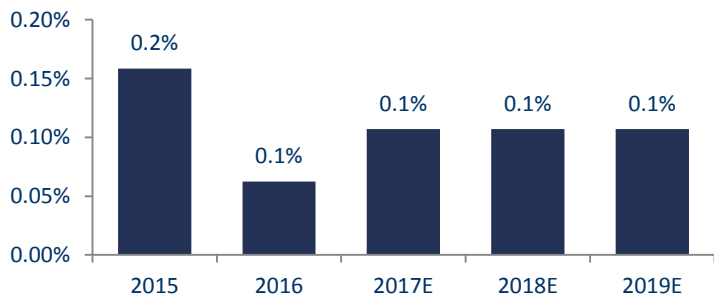
Debt / Equity



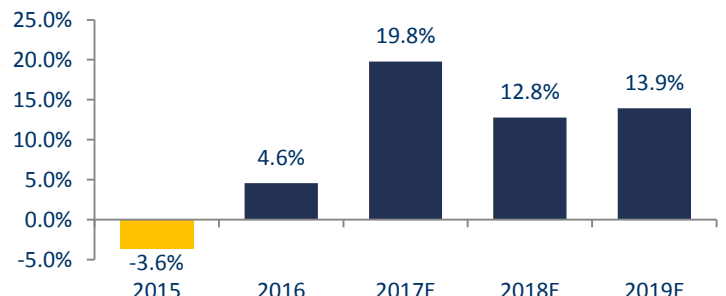
EV/EBITDA



Dividend Yield



Free Cash Flow Yield



Source: FALCOM Research Estimates

Initiation Coverage

December 21, 2017

## Summary Financials

| P&L (SAR mn) | 2016   | 2017E  | 2018E  | 2019E  |
|--------------|--------|--------|--------|--------|
| Sales        | 12,569 | 11,523 | 11,360 | 11,822 |
| Gross Profit | 7,425  | 6,798  | 6,816  | 7,329  |
| EBITDA       | 4,009  | 3,729  | 3,817  | 4,176  |
| EBIT         | 235    | 357    | 415    | 741    |
| Net Interest | (556)  | (520)  | (483)  | (447)  |
| Other        | 75     | 44     | 47     | 50     |
| PBT          | (246)  | (119)  | (21)   | 344    |
| Zakat        | 43     | 2      | 0      | (7)    |
| Net Income   | (203)  | (116)  | (21)   | 337    |
| EPS          | (0.3)  | (0.2)  | (0.0)  | 0.4    |
| DPS          | 0.02   | 0.02   | 0.02   | 0.02   |

| BS (SAR mn)           | 2016   | 2017E  | 2018E  | 2019E  |
|-----------------------|--------|--------|--------|--------|
| Cash                  | 866    | 268    | 104    | 215    |
| Current Assets        | 6,020  | 5,576  | 5,409  | 5,588  |
| Fixed Assets          | 24,495 | 23,481 | 22,635 | 21,967 |
| Intangibles           | 8,988  | 8,732  | 8,476  | 8,220  |
| Total Assets          | 41,271 | 594    | 594    | 594    |
| Current Liabilities   | 17,893 | 38,652 | 37,217 | 36,584 |
| Short Term Debt       | 7,608  | 9,790  | 9,388  | 9,429  |
| Long Term Debt        | 7,601  | 1,000  | 1,000  | 1,000  |
| Shareholders Equities | 14,956 | 13,209 | 12,209 | 11,209 |
| Total Liabilities     | 41,271 | 14,828 | 14,796 | 15,121 |

| CF (SAR mn)                         | 2016    | 2017E   | 2018E   | 2019E   |
|-------------------------------------|---------|---------|---------|---------|
| Operating Cash Flow                 | 4,019   | 2,212   | 3,289   | 3,790   |
| Working Capital Changes             | (2)     | 504     | (142)   | (156)   |
| Cash Flow from Operating Activities | 4,017   | 2,716   | 3,147   | 3,634   |
| Capex                               | (5,573) | (2,074) | (2,272) | (2,483) |
| Cash Flow from Investing Activities | (4,704) | (2,302) | (2,300) | (2,511) |
| Changes in Debt                     | 1,055   | (1,000) | (1,000) | (1,000) |
| Dividends                           | -       | (12)    | (12)    | (12)    |
| Cash Flow from Financing Activities | 1,055   | (1,011) | (1,012) | (1,012) |

Source: Bloomberg, Company Financials, FALCOM Research

| Growth           | 2016   | 2017E | 2018E | 2019E   |
|------------------|--------|-------|-------|---------|
| Revenue          | -12.9% | -8.3% | -1.4% | 4.1%    |
| EBITDA           | 36.3%  | -7.0% | 2.4%  | 9.4%    |
| Operating profit | -6.7%  | -8.4% | 0.3%  | 7.5%    |
| PBT              | 73.3%  | 51.7% | 82.0% | 1708.0% |
| Net Income       | 81.4%  | 42.6% | 82.0% | 1708.0% |

| Ratios (%)      | 2016  | 2017e | 2018e | 2019e |
|-----------------|-------|-------|-------|-------|
| Gross Margin    | 59.1% | 59.0% | 60.0% | 62.0% |
| EBITDA Margin   | 31.9% | 32.4% | 33.6% | 35.3% |
| EBIT Margin     | 1.9%  | 3.1%  | 3.7%  | 6.3%  |
| Net Margin      | -1.6% | -1.0% | -0.2% | 2.8%  |
| ROE             | -1.4% | -0.8% | -0.1% | 2.2%  |
| ROCE            | -0.9% | -0.4% | -0.1% | 1.2%  |
| ROA             | -0.5% | -0.3% | -0.1% | 0.9%  |
| Debt/Equity     | 1.0   | 1.0   | 0.9   | 0.8   |
| Net Debt/EBITDA | 3.6   | 3.7   | 3.4   | 2.9   |
| FCF Yield       | 4.6%  | 19.8% | 12.8% | 13.9% |
| Dividend Yield  | 0.1%  | 0.1%  | 0.1%  | 0.1%  |

| Valuation | 2016   | 2017e  | 2018e   | 2019e |
|-----------|--------|--------|---------|-------|
| PE        | (91.0) | (92.6) | (514.9) | 32.0  |
| PB        | 0.4    | 0.3    | 0.3     | 0.3   |
| EV/EBITDA | 8.2    | 6.6    | 6.3     | 5.5   |
| EV/EBIT   | 139.8  | 69.2   | 57.5    | 30.7  |
| EV/Sales  | 1.5    | 0.9    | 0.9     | 0.9   |

| Peer Valuations           | 12M Fwd PE  | 12m Fwd EV/EBITDA |
|---------------------------|-------------|-------------------|
| Emirates Telecom Group    | 15.9        | 6.3               |
| Saudi Telecom Co          | 13.7        | 6.6               |
| Vodacom Group Ltd         | 14.1        | 7.9               |
| Mtn Group Ltd             | 19.3        | 6.5               |
| Maroc Telecom             | 20.6        | 8.0               |
| Safaricom Ltd             | 18.7        | 8.9               |
| Ooredoo Qpsc              | 9.6         | 3.9               |
| <b>Etihad Etisalat Co</b> | <b>NA</b>   | <b>5.7</b>        |
| <b>Sector Median</b>      | <b>15.9</b> | <b>6.5</b>        |
| <b>TASI</b>               | <b>12.8</b> | <b>10.1</b>       |

Initiation Coverage

December 21, 2017

## FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

**Overweight:** The Target share price exceeds the current share price by  $\geq 10\%$ .

**Neutral:** The Target share price is either more or less than the current share price by 10%.

**Underweight:** The Target share price is less than the current share price by  $\geq 10\%$ .

**To be Revised:** No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

## FALCOM Financial Services

Contact us on the below phone numbers:

Customer Services: **8004298888**

Brokerage Services: **920004711**

Fax or Email us at the below number:

Fax: **+966 11 2032546**

Email: **addingvalue@falcom.com.sa**

Mail us at the following address:

**P.O. Box 884**

**Riyadh 11421**

**Kingdom of Saudi Arabia**

## Disclaimer

This research report provides general information only. Information and opinions contained in this report have been obtained from sources believed to be reliable, but FALCOM Financial Services has not independently verified the contents of this document and such information may be considered 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. The information mentioned here is not considered as an advice to buy, sell, or commit any investment actions. Investors should seek advice from their investment adviser before making investment decision. Investors should note that income from such securities or other investments, if any, may fluctuate and that price or value of such securities and investments may rise or fall. Accordingly, investors may receive back less than originally invested. Any investment action based on the contents of this report is entirely the responsibility of the investor.

All rights reserved.

FALCOM acquired the Saudi Capital Market Authority license number (37-06020) on 27/05/2006, and commenced providing its services to the investors in the Saudi Stock Exchange on 19/02/2007 with CR Number 1010226584 Issued on 04/12/1427H.