Zain Group

Q4 2017

Earnings Conference Call

Feb 21, 2018

Chaired by:
Omar Maher
EFG Hermes

Operator: Good day and welcome to the Zain Group Full Year 2017 Results conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Omar Maher, EFG Hermes. Please go ahead.

Omar Maher: Thank you very much. Good morning and good afternoon, everyone. This is Omar Maher from EFG Hermes. I'm very pleased to welcome everyone to Zain Group's 4Q 2017 Results conference call. As usual, the call will begin with a presentation by management and this will be followed by a Q&A session. Without further ado, I'm going to hand the call over to Aram Dehyan from the Group's Investor Relations team. Thank you.

Aram Dehyan: Thank you, Omar. And welcome everyone to Zain's FY 2017 earnings conference call. I'm joined today by Scott Gegenheimer our Group CEO of Operations and Ossama Matta our Group CFO. In a moment, we will hear brief remark from them followed by a Q&A session.

Before we start, let me remind you that our quarterly Investor Relations update and presentation slides that accompany this call, are available on the Investor Relations page of Zain website.
During this call, we will be making forward-looking statements which are predictions, projections or other statements about future events. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Please refer to our detailed cautionary statement found in slide number 2.

With that, I will now turn the call over to Scott.

Scott Gegenheimer: Thanks, Aram. Good afternoon to everyone and thank you for joining us on today's call. I will start with some of the major highlights that took place in 2017.
I'm proud to say that Zain KSA reported a net profit for the year, the first time in the operation's history, reflecting a significant turnaround in the company's performance. Zain Saudi also announced on October 25th a capital restructuring that will include writing-off accumulated losses

followed by a capital increase of SAR 6 billion through a rights issue. The restructuring plan will go a long way in improving the financial performance, profitability and leverage ratios of the Zain Saudi. We expect to have this completed by the 2nd half of the year.

In Kuwait we also mentioned before, that we signed an agreement to sell towers for USD165 million to IHS and we are expected to have financial closing by the end of Q2 2018.

In Iraq we also returned to profitability, where socio-economic conditions are gradually improving, and we are proactively pursuing many opportunities in this promising market.

Let me start on page 6 of the IR presentation, where you can see an overview of the Q4 2017 Key figures. Our Group customer base stood at 46.6 million customers at the end of 2017, a slight decrease of 1% Y-o-Y, mainly due to the biometric identification requirement in KSA over the past year and the capping the number of prepaid SIMs to two per expat. Competition remains intense across our markets but we continue to maintain our customer leadership in most of our markets.

For Q4 2017, Zain Group recorded consolidated revenues of USD 868 million, up 1% Y-o-Y. EBITDA for the quarter reached USD 326 million, down 19% Y-o-Y, reflecting an EBITDA margin of 38%. Net income for the quarter amounted to USD 124 million, up 17% Y-o-Y reflecting earnings per share of 9 Fils (USD 0.03).

Currency translation impact for the Fourth quarter, cost the company USD 54 million in revenue, USD 20 million in EBITDA and USD 6 million in net income, predominantly due to Sudan currency devaluation from 12.8 to 18.3 (SDG / USD), a 30% decrease.

Moving to Slide 7, for the FY 2017, Zain Group generated consolidated revenues of USD 3.4 billion down 6% Y-o-Y. The Group's consolidated EBITDA for the period was USD 1.4 billion, down 19% Y-o-Y, reflecting an EBITDA margin of 40%. Consolidated net income reached USD 527 million, up 2% Y-o-Y. With Earnings per share 39 Fils (USD 0.13).

Foreign currency translation impact for 2017, predominantly due to the 53% currency devaluation in Sudan from an average of 8.0 to 16.9 (SDG / USD), cost the company USD 494 million in revenue, USD 213 million in EBITDA and USD 82 million in net income. Excluding the above-mentioned currency translation impact, Y-o-Y revenues would have grown by 8% and net income growth would be 17%.

It is unfortunate that one of the main factors outside of our control, the Sudan currency devaluation issue, has impacted overall results for the quarter and year. Nevertheless, we draw confidence from the future prosperity of Sudan given the recent lifting of the US sanctions.

Going to slide 9, total Group CAPEX for the year excluding Zain KSA reached USD 445 million and accounts for 13% of the total Group revenues. CAPEX, including Zain KSA was USD 753 million, representing 14% of the total revenues.

Going to Slide 12, The Board of Directors of Zain Group recommended a cash dividend of 35 Fils per share (which represents 95% dividends payout ratio) subject to the Annual General Assembly approval. Due to the sale of treasury shares the recommend cash dividend is an 11% increase on the distributed amount compared to last year.

And with that I will now handover to Ossama to discuss the results in more detail. Thank you.

Ossama Matta: Thank you, Scott, and good afternoon everyone. Before moving to our key markets, I would like to shed the light on the improving financial position of the Group mainly as a result of the USD 846 million sale of our Treasury Shares to Omantel back in August 2017. If you go to slide number 10 in the presentation, our net debt decreased by 25% to reach USD 2.1 billion compared to USD 2.8 billion in 2016. This represents a current net debt to EBITDA ratio of 1.5

times, compared with 1.6 times last year. This improved range is very healthy and a proof of strong balance sheet that Zain Group possesses.

I will now go through our key markets, providing full-year key financial indicators to speed things up…leaving more time for the Q&A.

Starting on page 14 which is Zain Kuwait:

Operationally, Zain Kuwait remains the most profitable company in the Group representing 32% of total Group revenue. The operation continues to maintain its market lead in both value share and customers as it now serves 2.7 million customers. The operation also obtained CITRA approval for the sale and lease back of the passive infrastructure (Tower sale).

Despite aggressive market competition and price war in the local market, revenues for the year grew by 3% YoY and reached KD 331 million (USD 1.1 billion) up from KD 322 million. The increase is mainly due to higher trading revenues. The launch of B2B activities beyond the mobile only services such as 'hosting, unified communication, disaster recovery, push to talk etc.' and the introduction of new packages life iflix, TV/ Video on mobile, to improve customer loyalty also benefited the top line.

Nevertheless, operating revenues for the year were under pressure, but to minimize the impact we introduced new CVM and BTL activities to retain our customer base, however this has resulted in our high-end package customers moving to lower packages. Our prepaid operating revenue went up by 5% mainly due to several appealing marketing and data monetization initiatives and offers.

EBITDA for the year dropped by 21% YoY reaching KD 127 million (USD 418 million) compared to KD 161 million (USD 531 million) last year, with an EBITDA margin of 38%, mainly due to the benefit we received last year from change in policy for provisions for doubtful debts and increase in cost of handsets on account of the change in the accounting treatment for handset subsidies.

Net income for the year decreased by only 11% Y-o-Y reaching KD 80 million (USD 265 million) mainly affected by the EBITDA performance, partially offset by lower handset subsidy amortization. Data revenues (excluding SMS and VAS) represented 32% of total revenues.

As mentioned previously, the agreement that was signed back in October 2017 to divest the tower infrastructure in Kuwait (for USD 165 million), will unlock value from our fixed infrastructure, creating the opportunity to invest in better yielding investments, as well as enabling management to focus on other core business areas.

Moving to slide 15, Zain Iraq

As Scott mentioned, Zain Iraq is back on track recording profit for 2017 after reporting a loss in 2016. Revenues for the full year grew by 2% Y-o-Y, reaching USD 1.1 billion, supported by successful customer acquisition initiatives and strong data growth. The Zeyara holy season was also a factor as Zain Iraq heavily promoted connections and exclusive deals with roaming partners. EBITDA for the year reached USD 382 million, down 3%, with EBITDA margin standing at 35%, mainly due to additional infrastructure and security costs for network expansion efforts. Notably, the operation reported a net profit of USD 29 million, compared to a loss of USD 5 million in the previous year.

This progress is a result of improving socio-economic conditions in the country and attainment of common ground between operators that has witnessed more logical pricing. The restoration of sites in North and West liberated areas and numerous customer acquisition and retention initiatives, especially in core regions, also resulted in an impressive net addition of two million customers (16% increase) to reach 14.7 million as of December 2017.

Sudan which is on slide 16.

As it has been the case for over a year, the significant currency devaluation (53% in 2017) in Sudan affected the Group’s overall and the operation’s financial results in USD terms. However, in local currency (SDG) terms, the operator continues to perform remarkably well, as revenues grew by 36% Y-o-Y to reach SDG 7.1 billion (USD 419 million, down 41% in USD terms) for the full-year 2017. EBITDA increased by 37% to reach SDG 2.8 billion (USD 166 million, down 43% in USD terms) while net income increased 173% to reach SDG 1.1 billion (USD 65 million, down 29% in USD terms).

The rate change including FX translation impacted the revenue by USD 445 million, EBITDA by USD 208 million and net income by USD 81 million for 2017. Excluding the above-mentioned FX impact, we would see an increase in revenues EBITDA and net income in USD terms.

The operation serves around 13.5 million customers which grew by 8% Y-o-Y due to CVM activities and BTL campaigns reducing churn. The operator's customer base is the second largest within the Group, which represents 29% of the Group's total customer base.

The expansion of 4G and 3G services to key cities across the country combined with data marketing initiatives saw Data revenues (excluding SMS and VAS) grow by an impressive rate of 58%, representing 16% of total revenues.

Saudi Arabia which is on slide 17.

The highlight of the year was the SAR 1 billion net profit turnaround that the operation achieved where the transformation program is taking full effect with Zain KSA reporting its first ever full-year net profit of SAR 12 million (USD 3.1 million) in 2017 compared to loss of SAR 980 million (USD 261 million) in 2016.

For the full year 2017, revenues reached SAR 7.5 billion (USD 2 billion) reflecting a 6% Y-o-Y increase. The cost optimization and company's efficiency drive resulted in an impressive 40% increase in EBITDA to reach SAR 2.5 billion (USD 671 million), reflecting an EBITDA margin of 33.4%. This is a great achievement given the current industry norms.

The introduction of the biometric identification requirement over the past year, capping the number of prepaid SIMs to two for each unique identity saw the operator's total customer base shrink by 23%, to stand at 8.2 million at the end of December 2017. Impressively, the operator witnessed a 30% rise in data revenues (excluding SMS and VAS) Y-o-Y, which now represents 50% of total revenues.

We hope to finalize Zain KSA's Tower Sale soon and this will boost the operation on multiple levels. Also, I would like to reiterate what was covered in Zain KSA's call a few weeks ago regarding a major repayment that happened during the year which was the repayment of its senior debt (SAR 1.7 billion). After these payments Zain KSA still maintains a healthy cash balance that will allow it to meet future financial obligations.

Going to slide 18 which is Zain Jordan.

Although maintaining market leadership, the intensification of price competition resulted in Zain Jordan customer base shrinking by 8% Y-o-Y, to serve 3.9 million customers at the end of 2017.

Revenues for the year increased by 3% to reach USD 497 million, mainly supported by higher interconnect and data revenues. While EBITDA and net income decreased by 6% and 14% respectively. The drop was mainly due to the free off-net calls to customers which led to significantly higher interconnection costs, resulting in a decrease in gross margins. This move was to match the competition in the country. EBITDA margin for the year was maintained at a healthy 45%.

The launch of 4G services in Jordan is proving fruitful as Data revenues (excluding SMS and VAS) grew by a healthy 12% Y-o-Y which now represent 37% of total revenues.

Aram Dehyan: Thank you, Ossama. With that, we will now move to the Q&A session and we ask you that you limit yourself to one question and one follow up. Operator, can you please repeat your instructions?

Operator: Absolutely. Thank you. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, please press star one to ask a question.

We do have our first question from Ziad Itani from Arqaam Capital. Please go ahead.

Ziad Itani: Hi. Thank you for the presentation. I just have one question on Kuwaiti markets, basically. Overall, we've seen that the entire market's mobile penetration has been declining this year and this has been more felt for Zain than the competition with the 10% loss in subscriber base versus 5% for competition. So, can you please comment on this?

Scott Gegenheimer: Sure. Thanks, Ziad. When it comes to this, the total number of subscribers, we've had a lot of auto churn in the market where people use the scratch cards as promotions and they keep using the SIM cards as like a scratch card. So, we've slowed that down quite a bit and looked at the dealer commissions as well. So, it's really hard to look at just because subscribers are coming down. What we do is we really look at the active base and the active base has not been coming down. A lot of the revenue share decline is more because we're moving from customers from the higher packages and locking them into long-term packages and a little bit lower ARPU to match the competition. But the total number of subscribers hasn't really dropped – at least the active subscribers hasn't dropped. It's more of just a wash through because of the washing machine effect with people using SIM cards as scratch cards. Thanks.

Ziad Itani: I see. Interesting, and just one small follow up on as well the Kuwaiti market. Specifically, in Q4, we've seen a very substantial decline in EBITDA across the 23% Q-o-Q with margins close to a historic low of 33%. So, I'm just wondering, what's the reason behind this? I know you guys mentioned that some high-end customers are shifting to lower end packages, but is this low margin here to stay, and our concern is basically if this will further deteriorate once you have to lease back the towers. Thank you.

Scott Gegenheimer: Part of it is the accounting change and how we've been accounting for handsets in the market, and one we've got now in 2018, the change in the policy for handsets as well. So, we'll come back to you in Q1 and tell you what the impact is going forward but it's going to affect all the markets on how we account for the handsets, that was the biggest issue on there. The towers shouldn't necessarily have any impact on our operating margin. I believe the pricing we set for them will be in line with our current pricing levels. So, it's more about capitalising on the gain on the sale of the asset as supposed to bringing down the price for OPEX for managing the towers for us.

Ossama Matta: As I mentioned as compared to last year, we changed the policy related to doubtful debts. This had added a positive impact on 2016, but when you look at it in 2017 compared to 2016, you will see an increase in the provision for doubtful debt because of the change in the policy. Now, on the accounting of the handsets, when you compare it also with the items below EBITDA, you will see that amortisation of customers or handsets has dropped significantly compared to last year. This drop compared to last year is also an increase above EBITDA and the cost compared to last year because of the changes in the accounting treatment. So, these mainly are the two factors that have impacted the –

Ziad Itani: True. But I'm talking about the QoQ drop (Q3 to Q4), not the YOY. You had around 42% operational margins and the drop to around 33%.

Ossama Matta: We'll look at that and then get back to you on this. Is that okay?

Ziad Itani: Okay. Great, sure, thank you.

Operator: We will now take our next question from Baha Makarem from Arqaam Capital. Please go ahead.

Baha Makarem: Hi. Thank you for the call. My question is regarding data monetisation. Over the past two years, data usage had a CAGR of above 30% even through there's been a slight slowdown and – not a slight slowdown, a slowdown in data revenue growth, 3% this year versus last year, 6% before that and 15% before that. So, can you please shed some light on why the slowdown is taking place and where you see potential growth coming from? Thank you.

Scott Gegenheimer: A lot of the reason that it's only growing 3% is because of the devaluation in the Sudan currency that had a big impact on it, and that's one of the reasons. If you look at the three key markets which in Saudi and Iraq the data revenue growth has been significant. I don't have the exact number in front of me. I think it was Sudan market grew at 58% and KSA grew at 50%. Bahrain was actually growing at 23%, but when you take the overall revenue and look at it, even at Sudan at 58% in local currency, the problem is with the devaluation that's offset it and had a major impact of the overall growth. So, it doesn't look like there's a major growth. But if you're looking at individual markets, KSA, the revenue is not actually consolidated. So, even though it had a 50% growth in KSA, it doesn't have an impact in the overall revenue either. So, you had two big factors that don't show the overall growth in revenue. But that's the main reason why you don't see that. Hopefully that answers your question. Thanks.

Baha Makarem: That does. If I can follow up just quickly, there was a provision impairment loss on Q4 on your financials during the year. I think in Q4 it was around KWD 16.5 million. Can you shed some light on what those provisions are for? Thank you.

Ossama Matta: Yeah. This is related to the IAS 29 hyperinflation of South Sudan. Basically, we revalued the assets of South Sudan and we put a part of the exercise and impairment of the increase in the assets. That's what it shows in the net income.

Baha Makarem: That's very helpful. Thank you.

Ossama Matta: Sure. I would like to go back to the first question regarding Q4 to Q3 related question to Kuwait. In USD terms, the revenues increased from USD 269 million to USD 273 million in revenues. But when I look at the gross margin, the gross margin has dropped from USD 192 million to USD 186 million. This is mainly due to the introduction of iPhone X and the huge sales that happened in Q4, which has led to an increase in revenues. But the main increase is mainly coming from the handsets and with a very low margin on it. That's why our costs have reduced and our margins have dropped compared to Q3. So, hopefully this answers the question.

Operator: We will now take our next question from Dana Sahwan from Sico. Please go ahead.

Dana Sahwan: Hi. Yeah, thank you for the call. Just one question from my side. What are your expectations regarding the Sudanese pound? Do you expect a further devaluation or what?

Ossama Matta: Currently what we know is the central bank rate issued direction on the FX. It's around 28 SDG/$. Before it was around 30-31 SDG/$, and the reason they have done this is because the black-market rate was quite high as compared to central bank rate. Now, the black-market rates and central bank rates are quite close, you are talking about like 32 SDG/$. Do we expect further devaluation? Maybe, maybe no. I'm not sure. We asked in the market, we asked also some government officials. The feedback that we got, it will be maintained in this range between 28 to 33 SDG/$.

Dana Sahwan: Okay. Thank you.

Operator: And as a reminder, if you'd like to ask a question via the telephone, please press star one on your telephone keypad. We will now take our next question from Dilya Ibragimova from Citi. Please go ahead.

Dilya Ibragimova: Hello, hi. Thank you for the opportunity. I have three questions, please. One on Kuwait and two on Iraq, please. On Kuwait, could you please update us on the competitive environment? You have mentioned that the market is competitive, but if we look at the second half of last year, it seems like the prices this summer have been improving. The volume of services in the bundles have been declining, you have been introducing extra charges for the calls or social media access. how have things changed between the second half of last year and going into 2018 January, February?

And also, you've mentioned that you are making smaller but it seems like you're making positive margin on device sales. Could you just confirm that the current pricing on the market of the device just implies that you're overall on average making positive gross margin?

And on Iraq, could you – I don't know if you can comment on the – against competition there. Considering that Korek is having some shareholder-related issues, is it a visible competitor, maybe comparing to what they have been doing in the past? And on the regulatory side in Iraq, when do you expect 4G licenced or maybe whether there has been any indication of where it is to come? And also, maybe negotiations on the renewal of the licence 2G, 3G? Maybe some – if you have any expectations in terms of timing, I would appreciate that. Thank you.

Scott Gegenheimer: Okay. We'll start with some of the questions in reverse order. So, for Iraq, we don't have expectations in 2018 that we'll see a 4G licence. Right now, we've been lobbying with the ministry and with the prime minister's office about the extension of a licence for 3G. As you know, the 3G licence was tied to our 2G licence. We had basically a seven-and-a-half-year licence and we're trying to extend that for 15 years. There was some discussions about a year ago about issuing a 4G licence but we've successfully lobbied to slow that down until we get the 3G licence resolved and the extension of it. But probably 2019 is the earliest we'll see a 4G licence coming in.

Ossama Matta: Regarding Kuwait, I'll just give you a summary of the challenges that we have faced and what we have done. If you look at 2017, you will see that the prepaid market has shrunk by 30% and the postpaid market has shrunk also by 10%. This is based on the market model that we do internally. The customers migrated from a higher postpaid plan to a lower plan, and this is mainly to retain the customers so that they don't leave to the competition. What we have a contract agreement where we lock in customers for a period of time. After this lock up period is over, which is at the high ARPU, high packages, they move to lower packages. We keep the customers, but, unfortunately, this has an impact on revenues. Also, we have seen in the market irrational offers by competition, and this has resulted in deteriorating the value as well as the revenue in the market. We have seen also some crazy offers like double-device offers in the market for one SIM. This has also led to increase in revenues but also major increases in cost, and it has reduced the gross margin.

Now, what we have done to tackle all of this is we have introduced a higher entry plan for postpaid offers and this is mainly on the iPhone X. To go away from the competition, we have been working even in 2015 on this, but in 2016, we have seen a major improvement in the B2B activities in Zain and mainly on the non-mobile revenue streams like, as I said in my speech, the hosting unified communication, disaster recovery, push to talk, and we are introducing also other aspects to the business like iflix to make it more attractive and to have more retention and more loyalty from customers. Heavy CVM activities on the postpaid and the prepaid in 2016, this also helped us in retaining the customers and increasing value. So, if you look at all of it, the market in Kuwait was very tough, very competitive. We, I believe, managed properly in these tough times. Hopefully in 2018 we will see better results. I hope I answered your question. Thank you.

Dilya Ibragimova: This is very helpful. Can I just follow up, perhaps, on both Kuwait and Iraq? When you – just to confirm, when you mentioned the postpaid and the prepaid market decline, this is in terms of value or in terms of customer numbers? I presume it's value. And also on the archive tariffs, the higher value archive tariffs, how many of your customers or maybe how much of your revenue is generated from those higher priced archive tariffs, please?

And on Iraq, when you mentioned you're negotiating extension of the licence to a 3G licence, do you think there will be costs associated with that with the renewal?

Scott Gegenheimer: What we're trying to do on 3G is get an extension so that what happened is we paid 307 million for the licence and this was a seven-year licence which should have been a 15-year licence and then we could amortise the cost over 15 years instead of seven and-a-half years. So, what we're trying to do is lobby, get the extension without incremental costs to get an extra eight years on the licence, and this is what we've been lobbying for the last six months or a year on it, and we hopefully will see something in 2018 to extend that. I don't necessarily think there will be any incremental costs to that. But when the licences come up for renewals or 2G licence comes up along with a 3G licence, I think that's another five and-a-half years, then, yeah, there will be a renewal cost for that as normal.

Dilya Ibragimova: Okay. That's perfect. Thank you.

Ossama Matta: Yeah, regarding the markets, when we say like the market shrunk, it's mainly on the customer base as well as on the revenue. It has shrunk by 30% and by 10% on postpaid. Now, we don't disclose how much high ARPU customers represent in terms of revenues, I cannot disclose this, but this impact was due to the competition and the aggressive offers in the market.

Dilya Ibragimova: Okay. Thank you. Thanks.

Operator: And as a reminder, if you would like to ask a question, please press star one on your telephone keypad. That's star one for a question. We do have a further question from Ragap Bagchi from NBK Capital. Please go ahead.

Ragap Bagchi: I had a couple of questions on Iraq and Kuwait. So, Iraq operations have improved significantly. Where do you see EBITDA margins over the next couple of years? I mean, do you see this momentum to continue? And on Kuwait, do you see the pricing is kind of near bottom or we can expect further downside from these levels?

Scott Gegenheimer: Regarding Iraq, I do believe to see that EBITDA will continue to improve and increase. So, as I said, you continue to grow your top line. I think we've done a good job in controlling our cost there and we've done a lot of cost optimisation there. So, I think as we continue to see revenue growth and you'll see that flow through to the EBITDA margins on there.

Regarding Kuwait, it has been very aggressive, especially on the handsets. It looks like cooler heads are prevailing. So, I think we're getting close to the near the bottom. In the past, we've had a major differential between our pricing levels and competition. That is much closer now. So, you won't see – at one point you could have seen more than a 40% increase in our pricing compared to the competitors. That is no more, mainly because we've renewed a lot of our packages and given out handsets to bring them on to lower tariffs in order to retain our customers. So, I don't necessarily think you'll see – there isn't as much of a differential on the pricing levels between us and the competition and I think we're fairly close to the bottom on pricing levels. When you start figuring out how to start uplifting the market, long-term the amount of data that we're giving out, it's very difficult to monetise data properly in Kuwait because of the packages we're offering. So, I think you'll start to slowly see data pricing starting to move up and try to figure out how to monetise this. And if we start to do this, hopefully we can lead the market and the competition will follow us. Thank you. I hope that answers your question.

Ragap Bagchi: Thank you. Thank you so much.

Operator: As a further reminder, if you would like to ask a question, please press star one on your telephone keypad. And it would appear there are no further questions at this time. I would like to turn the call back to our speakers for any additional or closing remarks.

Aram Dehyan: Thank you, operator. Please refer to the Investor Relations website for additional updates and feel free to contact us, the IR team, for further information. We look forward to your future participation in Q1 2018 update, the date for which we will announce in the forthcoming months. Thank you all for joining the call. Have a nice day.

Operator: This concludes today’s call. Thank you for your participation. You may now disconnect.