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Zain KSA 2Q24 results call

Sunday, July 28, 2024

**Omar Maher** Good morning, and good afternoon, everyone. This is Omar Maher from EFG Hermes. I would like to welcome everyone to Zain KSA's 2Q 2024 results conference call. As usual, the conference call will begin with a discussion of the key highlights of the period, and this will be followed by a Q&A session. And I will now hand the call over to Ms [inaudible 00:00:25], Investor Relations general manager at Zain KSA. Thank you very much.

**Najla AlMutairi** Thank you, Omar. Good afternoon, everyone, and thank you for joining us today for the Zain KSA second quarter 2024 earnings call. I'm Najla AlMutairi, GM of Investor Relations, and with me today, our CEO, Mr Sultan Al-Deghaither, and CFO, Mr Mehdi Khalfaoui. We announced our results last Thursday and released our financial statements early this morning, and you can find all related material on our website.

Before we begin, I would like to remind you that during this call, expectations and projections regarding future performance of the company referenced in this presentation are forward-looking statements within the meaning of applicable securities, laws and regulations. These are statements which the management believe are true at the time of their preparation, based on available data and information, and are subject to future events and uncertainties, and to the successful and timely execution of plans and strategies that could cause actual results to differ materially from those anticipated in these forward-looking statements. Now, I will hand it over to Mr Sultan, who will provide an overview of our second quarter performance. After that, Mr Mehdi will discuss our financial results in more detail, and we will then open the call for questions. Mr Sultan, please go ahead.

**Sultan Al-Deghaither** Thank you, Najla. Good afternoon, ladies and gentlemen. Thank you for attending the call and showing interest in Zain KSA. I'm happy to be with you today on this earnings call for H1 2024. As we have reported in our financial result, we achieved a revenue of 5 billion, up from 4.8 billion in H1 2023, reflecting a 6% growth, as well as an increase of EBITDA of 60 million, or 4%, versus H1 last year. We achieved a net profit of 172 million, compared to 108 million, a 60% growth over the same period in 2023, after excluding the gain from the tower infrastructure sales transaction that was 1.1 billion.

These results show stability and operational performance, with sustained growth across all aspects of the company's business, particularly the 5G portfolio. Our services and solutions continue to see high demand from the enterprise sector, alongside a growth in FinTech operations through Tamam and the digital product and services via Yaqoot and increased demand for services during the Hajj season. It's worth to mention that during Q2 we had two Eid holidays that are affecting the consumer segment.

Tamam witnessed a successful first half and expanded its product and services, resulting in a 22% growth versus H1 2023, with the revenue equivalent to 170 million. Our total active customers increased to 8.99 million by the end of Q2 2024, with an ARPU of SAR 62. This quarter, we made headlines when we announced one of our largest investments in the 5G space, when we started our 5G expansion project, worth SAR 1.6 billion, which aims to grow our 5G network footprint to 122 cities and support our B2B growth funding.

As part of this project, Zain KSA was the first operator in the Kingdom to provide 100% 5G coverage across the Masha'ir area and witnessed a successful Hajj season, alhamdulillah. We are delighted to announce that Kain KSA was the only operator recognised in the Saudi Vision 2030 Report for our ESG efforts, related to the launch of the first 5G zero emission network worldwide. During the World Economic Forum, Zain KSA was the proud digital partner of Media Oasis, in collaboration with the Ministry of Media, supporting our objective to be an enabler of Saudi Vision 2030, and allowing us to empower the forum through advanced technologies.

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Given the efforts, we were recognised as one of the top 20 companies, pioneering sustainability in the Kingdom, and signed a Sustainability Champion pledge with the Ministry of Economy and Planning. As one of the nation's leading champion of women empowerment efforts, we won the prestigious "Ghazi Al Gosaibi" Award for the best work environment for women. We are empowering our nation's brightest minds and youth through many avenues, in addition to engaging with them, aiming to attract their talent throughout the kingdoms and across leading universities, like King Fahd University and Princess Nourah University.

ESG goals are at the heart of our operations and organisation, which allow us to remain as the champion of sustainability. We completed phase one of our ongoing partnership with "Kebbar" to empower the elderly by successfully training 555 seniors over 372 hours by Zain employees. As part of our commitment to our nation's youth and empowering the next generation of Saudi talent, our strategic partnership with the Saudi Child Helpline aimed to help children in need, and we have witnessed a growth of 60% in the number of calls.

We confirm our ongoing commitment at Zain KSA to drive innovation, support Saudi Vision 2030, and enhance our services and infrastructure. Our goal is to elevate the quality of life. With that, I would like to hand over the call to Mehdi Khalfaoui, our Chief Financial Officer.

**Mehdi Khalfaoui** Thank you, Sultan. Good afternoon, everyone. In terms of second quarter performance, our revenue reached almost SAR 2.6 billion, marking a notable increase of 7%, or 160 million, compared to Q2 2023. Compared to Q1 2024, the revenue reflected an increase of 1%, or 70 million. Worth to mention that Q2 was a very low season for the consumer segment, especially with the two Eid holidays happening during the same quarter.

A significant part of revenue growth as compared to Q2 last year is driven by the enterprise, digital and wholesale segments, along with inbound roaming and device revenue, contributing almost 100% of the yearly growth. Further, "Tamam", our micro-lending segment, also reflected 21% during the current quarter, reaching 88 million, as compared to 72 million in Q2 last year.

Our gross margin reached 1.54 billion, 60% of revenue, was higher than Q2 2023, gross margin of 1.48 billion, 62% of revenue, by 57 million, or 4%. Compared to Q1 2024, gross margin remained stable. Our gross margin of 1.54 billion witnessed an increase of 57 million, or 4%, against Q2 2023, in line with the revenue uplift. A major portion of the increase was attributed to enterprise, connectivity, wholesale and the micro-lending segment, coupled with a reduction in subscriber acquisition costs resulting from continuous reassessment of commission structure with the objective of better acquisition quality. To conclude on the gross margin, we reported 160 million additional revenue versus Q2 last year, with an additional margin of 57%, equivalent to 36% as a result of incremental costs related to the device revenue.

In terms of OpEx, we reached 760 million, 29.8% of revenue, lower than Q1 OpEx of 722 million, 30% of revenue by 12 million due to saving in advertising and other provision resulting from favourable decision of litigation, offset by a higher bad debt provision, mainly due to an external quality control review of our ECL model, in addition to a seasonal collection slowdown during the second quarter.

Compared to Q2 2023 of 689 million, 29% of revenue, the current OpEx was higher by 71 million, or 10%. The main driver for the variance was inclusion of higher network maintenance costs, owing to the complete transfer of towers

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from Towerco transactions, additional system support in line with the upgrade of the billing system, and an additional provision for doubtful debt, mainly from the B2B government segment.

We continue to operate with the same efficiency as Q1. That is evident from the EBITDA margin of the company of 30.6% in Q2, in line with the previous EBITDA margin. Our EBITDA for the current quarter reached 780 million, slightly higher than Q1 2024 of 773 million, with 30.5% EBITDA margin, compared to Q2 2023 EBITDA of 794 million. Our EBITDA is slightly lower by 14 million or 2%, due to an increase in OpEx as compared to last year by 10%, offset by a higher gross margin of 57 million.

In terms of Q2 2024 EBIT, the company generated 242 million, lower by 4%, or 11 million, as compared to Q2 2023, mainly due to lower EBITDA offset by lower amortisation, as the previous quarter had a one-off impact related to IFRS 16. CapEx amounted to 67 million, equivalent to 3% of revenue, representing a decrease compared to the same period last year. Our CapEx for the first half of 2024 reached 1180

million, equivalent to 2% of H1 revenue. However, Zain's continued commitment towards investment and strategic projects is evident in year-to-date CapEx being in line with the prior year. The total commitment related to projects under implementation amounted to 1.86 billion, as compared to 662 million in December 2023, with 5G expansion, major projects in the pipeline.

Q2 financing costs increased by 12%, equivalent to 12 million, as compared to Q2 last year, due to an increase in the average interest rate, one year SAIBOR from 3.3% to 5.8%, and drawdown of the additional working capital facility. As a result of the proactive hedging arrangement, we have an unrealised gain of 67 million available as a reserve under equity at the end of the quarter.

In terms of debt profile, the total net debt increased by 273 million, while the total debt, excluding lease liability, increased from 42% in December 2023 to 44% at the end of June 2024. Our net debt to EBITDA, excluding any lease liability related to a non-bank, reached 2.46x, an increase compared to 2.3x at the end of the same period last year.

Our debt, including lease liability, today represents 42% of the capital, 48% of the capital structure. The increase in net debt is due to the inclusion of the vendor financing facility that will have future positive cash flow that will be generated from the CapEx payment avoidance. In terms of cash flow, we started the year with 945 million, we closed at 615 million at the end of June, following the major payments during the year of 1.1 billion CapEx, 383 million interest.

During the year, we had a drawdown of 875 and repaid 553 million relating to the MoF loan that was paid on 2nd June this year. In terms of cash flow, our reported free cash flow reached minus 159 million because of the investment in CapEx and reduction in working capital due to the receivable increase, mainly from the B2B segment.

To conclude on the net profit, the company closed with 105 million, lower than Q2 2023 by 8%, or 9 million, in line with the lower EBIT. However, we noted interest expense higher by 20 million, lower interest income by 7 million, offset by lower other expenses from recognition of the government grant from CapEx project closure, and decrease in Zakat by 11 million in line with the latest Zakat regulation. With this, I would like to end the financial part and hand over, back to Najla.

**Najla AlMutairi** Thanks, we can start the questions now.

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**Omar Maher** Sure. Ladies and gentlemen, if you would like to ask any questions, please either use the Raise Hand function to ask you a question verbally, or simply put your question in writing in the Q&A box. And our first question comes from Abdulaziz AlHubaishi Please, go ahead, Abdulaziz. Abdulaziz, we can't hear you. I'm not sure if you're unmuted.

**Abdulaziz AlHubaishi** Subscribers and...

**Omar Maher** Sorry, Abdulaziz, we just started hearing you now, so could I please ask you to repeat the question?

**Abdulaziz AlHubaishi** Yes, for sure. First of all, thank you for taking my questions. I have two questions, one on the consumer. You mentioned that Q2 was weak due to rates taking place, and my question is really on the Hajj season, if you could just comment and provide some colour on the Hajj season this year versus previous years. We see muted growth on the number of subscribers and ARPU, yet there is more investment on the Holy cities and pushing more coverage for 5G. Is the Hajj season profitable right now for the company or not?

And the second question is on the grant that was reported during the second quarter. If you could provide more clarity on what is it related to? I understand that it was related to some CapEx spending, but is this related to Shareek And the spending related to that programme, should we expect more of it to come in the future? Thank you.

**Sultan Al-Deghaither** Thank you, Abdulaziz, for the two questions. For the first one, yes, alhamdulillah, the Hajj season was successful compared to last year. However, our ambition always is to have more. There are so many components when it comes to Hajj. There is the existing base who are going, Zain customers who are going, to perform Hajj. There are the visitors who are coming from outside of the kingdom buying a new line, or there are the visitors who are coming from outside and they are keeping their original number and they are inbound roaming in our network.

The Hajj investment is not happening every year. So every, let's say, three or four years, we are renovating the network. And this year, we took advantage of the latest technology that we have and based on the demand and the deals that we have closed with partners for the inbound roaming, by uplifting our network and making it cover 5G all over Masha'ir, because we saw the capacity of 5G and the huge demand when it comes to data traffic.

For the grant, it is the closure of the old Universal Service Fund project, called "USF", that the company got awarded, I think back in 2018 or 2019. There are five years for the completion of all the liability. So, when you build the project, there is an acceptance, and then there is a five-year warranty, often, to complete all the liability and make sure that there is a good coverage and commitment from the company towards the contract with the Ministry of Telecommunication, which was ended. And then the delta between what was invested and what was given as a subsidy, which was the net amount that the company recorded as another income this quarter.

**Abdulaziz AlHubaishi** If you just allow me for a follow-up on the consumer segment, you mentioned it was a successful season, when we look at the quarter, we see that margins are slightly under pressure, maybe due to the mix but also that suggests to us that consumer was not that strong. At least compared to, for example, STC, we saw the number of subscribers was up, and it seems that they were able to capture a large market share during the Hajj season. If you could just help us view the season, at least for the coming years, to assist the success of the season for the years to come. Thank you.

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**Sultan Al-Deghaither** Thank you, Abdulaziz for the follow-up. As you can see in the slide, we have publicly announced the percentage of growth when it comes to traffic versus last year's Hajj. The number of pilgrims was publicly announced, 1.8 million if I'm not mistaken. Now, don't forget, there is always a dual SIM card that is happening. There are other people in the area, not the pilgrims but whoever is from the military, Ministry of Health, other government entities and volunteers who are helping the pilgrims in the Hajj season.

The Hajj season is only a one-week activity when it comes to Masha'ir. Zain maintained our market share, and we grew a little bit when it comes to the inbound, versus what happened last year. However, the contribution to the margin, overall, as a network in Saudi, for Zain Saudi, all the others, the contribution of Hajj revenue to the total revenue is not that big. When it comes to the gross profit, Zain Saudi, when we have announced our Q2 result, we are growing versus the last year. And when you compare to the others in the market, we are the number two growth when it comes to the gross profit.

**Abdulaziz Alhubaishi** Thank you so much.

**Sultan Al-Deghaither** Thank you, Abdulaziz.

**Omar Maher** Thank you, and our next question comes from Thando. Thando, please go ahead.

**Thando Skosana** Thank you for taking my questions, I'm thando here from UBS. I just had two, questions please, one on the... If you could provide us with any guidance for free cash flow, just for 2024, both from a CapEx and also accounts receivables? I'm just trying to get a sense of whether you have visibility in terms of collection over here. And then the second question is just around fixed wireless subscribers. If you could just comment on what you're seeing on the ground in this segment. Thank you.

**Sultan Al-Deghaither** Thank you. I will take the second point. For the fixed wireless access, we are seeing there is a potential for growth, and we are seeing, month-over-month, there is growth, because it is needed as a home solution, providing a good internet quality, not only in terms of speed but in terms of quality, i.e. with the other component of the streaming applications, entertainment applications, gaming applications. At Zain KSA, we have a home value proposition that we have on our website, and we avail it to our customers in all our digital channels, retail and door-to-door via our partners. For the cash flow, I will ask our CFO to comment on that.

**Mehdi Khalfaoui** In terms of free cash flow, the first six months was impacted by two things. One is the working capital, where basically we had around 700 million there, consumed from the cash flow from operations, and, more importantly, we have a CapEx payment of 1.1 billion. As we highlighted earlier, the vendor financing drawdown will come to replace the CapEx payment for the upcoming nine to 12 months. So definitely, there will be immediate impact on the free cash flow of the company that will be funded through the vendor financing. But we don't give guidance on free cash flow yet. I can give you highlights and the way forward that we will be managing our cash.

This is without saying that we paid successfully the dividend, as we announced during the General Assembly, and the Ministry of Finance installment, and we continue fulfilling all our obligations. Cash flow planning is at the heart of the business model when it comes to financing the company, and we continue managing very carefully our cash for the upcoming remaining period of the year until we fulfil our all our obligations, specifically, the loan instalment that will come in September. And definitely it will be in line, and it is in line, with the five-year business plan that we are working with as a company. Thank you.

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**Omar Maher** Thank you. As a reminder, if anyone would like to ask a question, you can either use the Raise Hand function to ask verbally or put your question in the Q&A box. We'll pause for a moment. Thando, I see your hand is raised. I'm not sure if you have a follow-up question?

**Thando Skosana** Not really. I think it was... Yes, maybe I can ask a question again, just to follow up. Mehdi, just on the accounts receivable. In terms of collection for accounts receivable, what kind of visibility do you have there? We've seen STC and Mobily, getting their payments over the last couple of quarters. Yes.

**Mehdi Khalifaoui** Thando, I can answer you on what we have. So, for example, Q2, we have the slowdown in collection. The majority is coming from the government segment, which we believe is seasonal, because usually the majority of the payments from government come during Q4. Yet, we continue to push to have as much collection as possible during the upcoming quarter as well.

Also, in terms of consumer, there was this Eid period that came in June where basically the collection from consumer for people most likely who are travelling outside the country did not take place. Yet, we are seeing a take-up now happening in the last the last week. But we do believe that this is seasonal, and it will be addressed from now until year-end. However, we continue pushing with our collection channel. Recently, end of June. what we did, we did the receivable discounting for the collection. That will come later, definitely with recourse. That's why you still have the receivable in our books.

However, for us at Zain, the bad debt policy or the bad debt accounting, we account for it differently from the receivable. I don't know what the others are doing, but for us, we show receivables separately and its bad debt separately. However, as I said, collection, low collection, I would say at this point in time, it's a seasonal drop during Q2, yet we expect this to be overcome during the upcoming few months. Thank you.

**Omar Maher** Thank you. And our next question comes from Mohammad Arslan Please, go ahead.

**Mohammad Arslan** Hello?

**Omar Maher** Yes, we can hear you.

**Mohammad Arslan** I have a couple of questions. Number one is related to the CapEx. Basically, in the financials, you mentioned there was CapEx of around 61 million during Q2, but I was just looking at the cash flow, and the cash flow number is quite high. For the first half, it's around 950 million. So can you just elaborate on the difference between these two numbers for more clarity? That's my first question.

And the second is related to the gross margins. So can you please shed some light on the B2B segment gross margins? What's the average B2B segment gross margin at the moment? And how do you see the competition, compared to the other players in the industry, like Mobily, STC? How do you see the government B2B segment margins competition within the industry?

**Mehdi Khalifaoui** Thank you, Mohammad. In terms of CapEx, let me clarify, what is the difference. The CapEx of 118 million that we invested during the first half, this is related to the addition to gross book value for CapEx that are generating, or that started generating, revenue. When it comes to cash flow, we report it on a direct method whereby the 1.1 billion is related to the CapEx that we paid during the first half.

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**Mohammad Arslan** Okay, so just for clarity, that 61 for Q2 is just the differential of the assets at a gross level?

**Mehdi Khalifaoui** Yes. It's 67 million. Yes, indeed, 67 million is the addition to gross book value. You can see it in note six of the financials.

**Mohammad Arslan** All right.

**Sultan Al-Deghaither** For the gross margin, we are reporting the gross margin consolidating for the company. We don't show a breakdown per business unit. However, any B2B deal, we have a standard business case for each opportunity and each deal, and there is an internal threshold that we don't go below a certain threshold, and most of, or I can say all of our, deals are profitable for the company.

**Mohammad Arslan** Just one follow-up question. So, basically, average revenue per user is almost flattish compared to quarter-on-quarter, if you see the Q1 number in the Q2 number, whereas the Mobily subscribers have increased by roughly around 0.2 million as per a new presentation. Plus, there was also a growth in the 5G network as well, and the revenues. So why am I seeing your revenues within the mobile telecom company, quarter on quarter, flattish, even though the subscribers have increased, their average revenue is flat? It's not reflecting on your total revenue number. What's the other item which is actually giving the pressure?

**Sultan Al-Deghaither** If you look into the, as a percentage of growth, H1 this year versus H1 last year, Zain has the highest percentage in terms of growth when it comes to the revenue, the overall consolidated revenue. Now, every operator has its own standard whenever they report the consumers, be it including the handset or without the handset, and these are details that we are focusing here on Zain KSA only.

In terms of the number of customers and the ARPU, this season, considering Hajj, will have a higher number of customers, but definitely it will have an impact on the ARPU. And there is, overall, a spending issue when it comes to the consumer. And this is why we have highlighted in the call that this quarter was the first quarter that we have two Eid holidays coming together during Q2, the Hajj holiday and the Ramadan holiday.

**Mohammad Arslan** Thank you.

**Omar Maher** Thank you. And we have a written question in the Q&A box from Chaitanya. It says, do you believe the company's current cash flow position is sufficient to continue to pay dividends on a regular basis, especially and also considering upcoming the CapEx announced?

**Sultan Al-Deghaither** Thank you for the question. As we have mentioned, we have a five-year business plan that was approved by the board. And as we have highlighted as a management before, we are doing whatever it takes to maximise the shareholder return from investing in Saudi. And what we said last year, that, inshallah, we'll not make the dividends a one-off, and it should be something sustainable, considering all the other liabilities in the company, be it the debt or the CapEx investment. And this is why we have a specific plan for the cash flow management.

And, alhamdulillah, what we have managed to do in the last five years was successful, from reducing the debt and investing in the company and paying dividends.

**Omar Maher** Thank you, Sultan. And the next question, we have a follow-up from Abdulaziz AlHubaishi

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**Abdulaziz AlHubaishi** Hi, thanks for allowing me to have a follow-up. Am I audible? Hello?

**Omar Maher** Yes, we can hear you. We can hear you.

**Sultan Al-Deghaither** Yes, we can hear you. We can hear. Go ahead.

**Abdulaziz AlHubaishi** A question on the tower deal. You mentioned on the last call that you're paying a gross amount of 500 million. In the case that there is more consolidation into the tower space in Saudi, meaning that both the towers of STC and Mobily comes together with the towers of Zain, would there be a role for you to renegotiate the lease-back rate, or is this going to be set and fixed.

**Sultan Al-Deghaither** Thank you, Abdulaziz. Always good to have questions from you. If you remember, Abdulaziz, we mentioned before, when we announced the deal, that with consolidation, we will benefit in terms of discount. So there is a contract and the existing contract, even without a consolidation, if there is more tenancy, we will benefit from a discount, be it the discount in the space or the power or whatever we are using from Towerco.

And this is what we are encouraging, and Zain KSA was the first company to announce, back in 2013 or 2014, that we are pushing for the Towerco concept, because we do believe that the towers are not an area of competition between the players. It's an area of synergy. And the benefits will go as much as there will be a multi-tenancy. And to clarify this point, today, there is an agreement between all the operators when it comes to the in-building solution sharing, where the cost is divided almost equally between the three players. The same goes with Towerco. As much as Towerco can bring more tenancy, be it telecom or non-telecom, to the tower, here will be a cost reduction and the reduction will be passed to Zain.

**Abdulaziz AlHubaishi** Perfect. But the gross amount that Zain, right now, pays, that would not be reduced, but on the additional space, there would be more discounts because of the multi-tenancy, right?

**Sultan Al-Deghaither** Correct.

**Omar Maher** Thank you. And one more reminder, in case anyone would like to ask questions verbally, through the Raise Hand function or in writing in the Q&A box. We have a written question from Abdulaziz Alfouzan and it says, what does management target in terms of profitability in the next three years, or at least what's the management strategy in the upcoming years? Despite management corporate actions, profits haven't been growing, excluding one-offs, in the last three years.

**Sultan Al-Deghaither** Thank you, Abdulaziz, for the question. As always, we are saying our role as management is to maximise shareholder value and create profitability for all investors in the company. We cannot give a forecast about the future. However, alhamdulillah, we are doing whatever it takes to grow the operation and enhancing the efficiency. When it comes to revenue, we are witnessing the growth, maintaining the gross margin at the 60% level and increasing profitability. However, as we all know, there is an inflation across all costs and all aspects, and this is where we have an efficiency programme to maintain the cost from growing within the P&L of the company.

**Omar Maher** All right, it looks like we don't have any more questions in the queue. So back to you, Najla for any closing remarks.



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**Najla AlMutairi** Thank you, all, for joining us today and for your continued interest in Zain KSA. Should you have any additional questions or require further information, please do not hesitate to reach out to our investor relations team. We look forward to updating you on our progress in the next quarter. Thank you again for your time and support. Have a great day.

**Sultan Al-Deghaither** Thank you.

**Omar Maher** Thank you, Eng Sultan, and Mr Mehdi and Ms. Najla and thank you, everyone, for your participation. This concludes the call, and have a nice day.