

1Q 2018 Results Update
June 01, 2018

Recommendation	Neutral
Previous Recommendation	Neutral
Current Price (SAR)	88.6
Target Price (SAR)	82.7
Upside/Downside (%)	(6.6%)

As of May 31st 2018
Key Data (Source: Bloomberg)

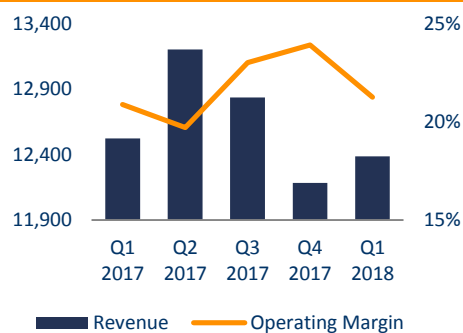
Market Cap (SAR bn)	177.2
52 Wk High (SAR)	89.50
52 Wk Low (SAR)	65.10
Total Outstanding shares (in bn)	2.0
Free Float (%)	16.1%

STC vs. TASI (Rebased)


Price Performance (%)	Absolute	Relative
1m	6.8%	6.8%
6m	26.9%	11.8%
12m	28.9%	10.0%

Major Shareholders (%)

Public Investment Fund	70.0%
General Org For Social Insurance	7.0%
Public Pension Agency	6.8%

Quarterly Sales (SAR mn) and Operating Margin


Source: Bloomberg, Company Financials, FALCOM Research; Data as of 31st May 2018

Strong 1Q18 results, in-line with consensus estimates

Saudi Telecom Co. posted a 2.1% YOY increase in net income to reach SAR 2.6bn in Q1 2018, in line with the average consensus estimate of SAR 2.5bn. The growth in net income was mainly ascribed to the cost reduction resulting from the completion of STC's early-retirement program, continuous cost optimization initiatives and improving operational efficiency.

STC has developed a new strategy named DARE, which focuses on Digitizing the company through technology advancement, Accelerating the performance of core assets, Reinventing customer experience, and Expanding the scale and scope of the company. This strategy is in-line with the current global tech-revolution and supports our positive view on the stock. In the short-term, the data revenues may see an uptick in Q2 2018, as a result of Ramadan and the FIFA World cup (starting mid-June). However, a fall in expatriate population in the country may erode the subscriber base and negatively impact the top line. Given these countervailing factors, we maintain our 'Neutral' rating on the stock.

- STC's revenue declined 1.1% YoY to SAR 12.4bn in Q1 2018, primarily owing to a decline in the consumer segment performance amid tough economic and regulatory environment.
- Revenue from the 'STC segment' declined 10.2% YOY to SAR 9.7bn, whereas, revenues from the 'STC channels segment' and the 'Other operating segment' rose 74.9% YOY and 20.7% YOY to SAR 1.2bn and SAR 1.9bn, respectively.
- Gross profits rose marginally by 1.1% YoY to SAR 7.0bn in Q1 2018 due to 3.8% YOY drop in cost of sales to SAR 5.4bn. Subsequently, gross margins expanded by 120bps to 56.5% in Q1 2018 from 55.3% in Q1 2017.
- Operating income increased slightly by 0.7% YOY to SAR 2.6bn in Q1 2018, as a SAR 116 mn increase in general and administrative expenses and a SAR 76 mn increase in depreciation and amortization, was offset by a SAR 137 mn decline in selling and marketing expense. Consequently, the operating margin rose by 37bps to 21.3% in Q1 2018 from 20.9% in Q1 2017.
- Net income of SAR 2.6bn in Q1 2018 (up 2.1% YOY) was boosted by the elimination of early retirement program costs (SAR 150 mn in Q1 2017). Total other income and expenses advanced to SAR 224mn in Q1 2018 against SAR 154mn in Q1 2017. Earnings per share increased to SAR 1.29 in Q1 2018 from SAR 1.27 in the same quarter last year.
- In May 2018, STC launched its 5G network in KSA. This, along with the recent ban uplift on the VOIP calls is anticipated to increase competition in the KSA's telecom sector.
- STC also signed an MOU with the Saudi Arabian Football Federation and General Sport Authority to obtain broadcast rights for matches in Saudi Arabia, which will positively impact the earnings growth.

Valuation: We upgrade our target price to SAR 82.7, while retaining our 'Neutral' rating on the stock. We anticipate STC's performance to improve on the back of growth in data revenues, diversification through obtaining broadcasting rights, and digitization initiatives. However, we think the risks-rewards are balanced on the stock at the moment, considering the increasing competition and the decline in the subscriber base which may negatively impact the earnings.

	1Q'18	1Q'17	% YoY	FY18E	FY17	% YoY
Revenues (SAR mn)	12,386	12,524	-1.1%	51,111	50,747	0.7%
Gross Profit (SAR mn)	6,997	6,924	1.1%	30,464	29,491	3.3%
EBITDA (SAR mn)	4,644	4,551	2.1%	20,091	19,293	4.1%
Net Profit (SAR mn)	2,588	2,535	2.1%	10,720	10,133	5.8%
EPS basic (SAR)	1.29	1.27	2.1%	5.36	5.07	5.8%
Gross Margin (%)	56.5%	55.3%	1.2%	59.6%	58.1%	1.5%
EBITDA Margin (%)	37.5%	36.3%	1.2%	39.3%	38.0%	1.3%
Net Profit Margin (%)	20.9%	20.2%	0.7%	21.0%	20.0%	1.0%

Source: Company Financials, FALCOM Research

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 and Risks Warning:

The information in this report was compiled from various public sources believed to be reliable and whilst all reasonable care has been taken to ensure that the facts stated in this report are accurate and that the forecasts, opinions, future prices and expectations contained herein are fair and reasonable, FALCOM makes no representations or warranties whatsoever as to the accuracy of the data and information provided and, in particular, FALCOM does not represent that the information or expected future prices in this report is complete or free from any error. This report is not, and is not to be construed as, an offer to sell or solicitation of an offer to buy any financial securities. Accordingly, no reliance should be placed on the accuracy, fairness or completeness of the information or the expected prices contained in this report. FALCOM accepts no liability whatsoever for any loss arising from any use of this report or its contents, and FALCOM shall not be in any way responsible for the contents hereof. Opinions, forecasts or price projections contained in this report represent FALCOM's current opinions or judgment as at the date of this report only and are therefore subject to change without notice. There can be no assurance that future results, prices or events will match any such opinions, forecasts or prices projections which represent only one possible outcome and these price estimates may not occur in the future whatsoever. Further, such opinions, forecasts or price projections are subject to certain risks, uncertainties and assumptions that have not been verified and future actual results or events could differ materially. Any value or price, or income from, any investments referred to in this report may fluctuate and/or be affected by changes. Past performance is not necessarily an indicative of future performance. Accordingly, investors may receive back less than originally invested amount. This report provides information of a general nature and does not address the circumstances, objectives, and risk tolerance of any particular investor. Therefore, the person who obtain a copy of this report should understand that this report is not intended to provide personal investment advice and does not take into account his/her financial situation or any specific investment objectives or particular needs which he/she may have. Before making an investment decision the investors should seek advice from an independent financial, investment and/or other required advisers due to the investment in such kind of securities may not be suitable for all recipients. This research report might not be reproduced, nor distributed in whole or in part, and all information, opinions, forecasts and price estimates contained; are protected by the intellectual property laws, copyright and publishing rules and regulations applied in the Kingdom of Saudi Arabia.

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.