Saudi Telecom Co.

Communication Services | STC|7010

3Q 2018 Results Update

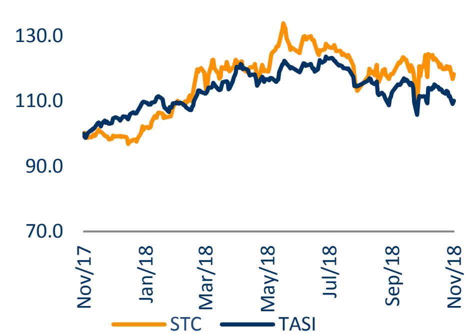
November 20, 2018

Recommendation	**Neutral**
Previous Recommendation	Neutral
Current Price (SAR)	81.9
Target Price (SAR)	82.7
Upside/Downside (%)	1.0%

As of November 19th 2018

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	163.8
52 Wk High (SAR)	93.4
52 Wk Low (SAR)	66.9
Total Outstanding shares (in bn)	2.0
Free Float (%)	16.2%

STC vs. TASI (Rebased)



Price Performance (%)	**Absolute**	**Relative**
1m	(1.3%)	(0.2%)
6m	(1.0%)	4.7%
12m	18.2%	8.2%

Major Shareholders (%)	
Public Investment Fund	70.0%
General Org. For Social Insurance	7.0%
Public Pension Agency	6.8%

Quarterly Revenue (SAR mn) and Operating Margin

Source: Bloomberg, Company Financials, FALCOM Research; Data as of 19th November 2018

Top line grows 5.6% YoY : gross and net margins contract

Saudi Telecom Co. posted 2.9% YoY growth in net income to reach SAR 2.6bn in Q3 2018. This was mainly ascribed to 5.6% YoY increase in revenue. Operating profit of the company grew 11.3% YoY to SAR 3.2bn primarily due to 15.8% YoY reduction in selling and marketing expense, which was offset by 28.3% YoY increase in general and administrative expenses. Higher operating income was offset by increase in cost of early retirement expenses, higher net finance costs, and lower income from associates. Provisions for zakat and taxes also increased during 3Q18.

During the quarter, STC signed a 10 year contract with General Sports Authority (GSA) and Saudi Arabian Football Association (SAFF), for TV and digital broadcasting rights and marketing sponsorship of professional football matches. The deal would cost STC SAR 660mn annually and begins from season 2018-19. It includes matches of Saudi Professional League, Cups Competition and Saudi National Team's football matches. STC has launched a new channel named 'Dawri Plus' to broadcast these matches. Last quarter, the company had launched a new Data Centre in Riyadh, making it the largest provider of infrastructure for cloud computing services in the Middle East. We believe STC's strategy of growth and digital transformation is in-line with the Kingdom's 'Vision 2030', and supports our positive view on the stock. However, a fall in expatriate population in the country may erode the subscriber base and negatively impact top line growth. Given these countervailing factors, we maintain our 'Neutral' rating on the stock.

- STC's 3Q18 revenue grew 5.6% YoY to SAR 13.3bn, which can be attributed to growth in data traffic during the Hajj pilgrimage season.
- Gross profits rose 5.5% YoY to SAR 7.8bn mostly in-line with revenue growth; cost of sales grew 5.9% YoY to SAR 5.5bn. Consequently, gross margins contracted marginally by 10bps YoY to 58.5% in 3Q18.
- Operating income grew 11.3% YoY to SAR 3.2bn, due to 15.8% YoY decline in selling and marketing expense, offset by 28.3% YoY rise in general and administrative expense, and 3.0% YoY increase in depreciation and amortization expense. Consequently, operating margin improved 123bps YoY to 24.3% in 3Q18.
- Net income grew 2.9% YoY to SAR 2.6bn in 3Q18, as operating income growth was largely offset by SAR 132mn YoY rise in cost of early retirement, along with SAR 43mn YoY rise in finance costs. Additionally, provisions for zakat and taxes grew SAR 48mn YoY to SAR 221mn. Consequently, net profit margin contracted 54bps YoY to 19.8%.
- STC's board of directors has recommended a 10% (SAR 1 per share) cash dividend for 3Q18, amounting to SAR 2bn.
- The company recently signed a contract with GSA and SAFF for TV and digital broadcasting rights and marketing sponsorship of football matches. STC's new channel 'Dawri Plus' would broadcast these matches. Content on 'Dawri Plus' would be offered through free (with ads) and paid (ad free) digital subscriptions, in addition to traditional content distribution channels. This deal reflects STC's strategy of growth through digital transformation and is the biggest sports sponsorship contract in Saudi Arabia.

Valuation: We maintain our target price of SAR 82.7, and retain our 'Neutral' rating on the stock. We believe the risks-rewards are balanced on the stock, considering the increasing competition and the decline in the subscriber base, which may negatively impact the earnings.

	3Q'18	3Q'17	% YoY	FY18E	FY17	% YoY
Revenues (SAR mn)	13,333	12,621	5.6%	51,313	50,747	1.1%
Gross Profit (SAR mn)	7,805	7,401	5.5%	30,251	29,491	2.6%
EBITDA (SAR mn)	5,128	4,744	8.1%	19,777	19,293	2.5%
Net Profit (SAR mn)	2,643	2,569	2.9%	10,179	10,133	0.4%
EPS basic (SAR)	1.32	1.28	2.9%	5.09	5.07	0.4%
Gross Margin (%)	58.5%	58.6%	(0.1%)	59.0%	58.1%	0.8%
EBITDA Margin (%)	38.5%	37.6%	0.9%	38.5%	38.0%	0.5%
Net Profit Margin (%)	19.8%	20.4%	(0.5%)	19.8%	20.0%	(0.1%)

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 ≥ 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 ≥ 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.

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.