

2Q20 Results Update

August 18, 2020

Recommendation Neutral

Previous Recommendation	Neutral
Current Price (SAR)	96.7
Target Price (SAR)	101.0
Upside/Downside (%)	4.4%

As of August 12, 2020

Key Data (Source: Bloomberg)

Market Cap (SAR bn)	193.4
52-Wk High (SAR)	113.2
52-Wk Low (SAR)	72.3
Total Outstanding Shares (in bn)	2.0
Free Float (%)	30.0%

STC vs. TASI (Rebased)

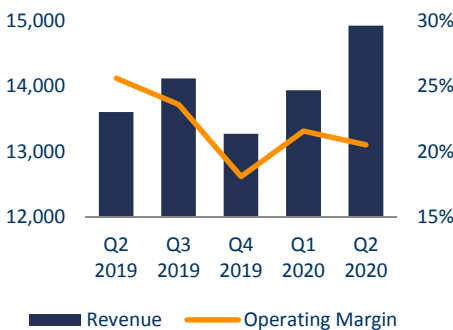


Price Performance (%)	Absolute	Relative
1m	(0.8%)	(3.7%)
6m	12.4%	15.9%
12m	(12.1%)	(1.5%)

Major Shareholders (%)

Public Investment Fund	70.0%
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Quarterly Revenue (SAR mn) and Operating Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of August 12, 2020

Declining trend in margins weighs on STC's 2Q20 bottom line

Saudi Telecom Co. (STC) recorded a 9.7% YoY increase in revenue to SAR 14.9bn in the quarter, aided by growth in the Enterprise Solutions segment and two of its subsidiaries (STC Channels and STC Solutions). Gross profit grew by 1.6% YoY to SAR 8.3bn, due to a sharp increase in cost of revenue (up 21.9% YoY to SAR 6.6bn). However, operating profit fell 11.9% YoY to SAR 3.1bn due to a 22.1% YoY rise in general and administrative expenses. Operating margin contracted to 20.5% in 2Q20 from 25.6% in 2Q19. Owing to the lower gross and operating margins, net profit fell by 4.3% YoY to SAR 2.7bn, with net profit margin being at 18.3% compared with 20.9% in 2Q19.

In addition to the Enterprise Business segment, STC's Consumer Business segment also witnessed a strong quarter on the back of 21.0% YoY and 2.9% YoY increase in fiber optic and broadband customer base, respectively. Top-line was also supported by an 8.6% YoY increase in data revenue. The company is expected to report stable revenue going forward, amid high demand for data services in the pandemic-hit business environment. Moreover, STC, which has more than 3,000 5G towers in the Kingdom, is expected to reap benefits in attracting 5G subscribers by being the first mover in providing 5G services. STC will also benefit from signing a contract with NEOM Co. to build 5G network infrastructure, and provide 5G coverage and related services in the NEOM megacity. Although, the COVID-19 crisis is expected to have limited impact on the telecom sector, the company may face challenges from increasing competition, strict regulations, and higher capex requirements for 5G infrastructure development in the coming years. These issues could also impact the company's margins, which are already on a downward trend. Thus, in view of the countervailing factors, we maintain our "Neutral" rating on the company's stock.

- STC's revenues rose by 9.7% YoY to SAR 14.9bn in 2Q20, primarily due to higher revenue contributions from its Enterprise Business segment and its subsidiaries – STC Channels and STC Solutions. The company also witnessed steady growth in its Consumer Business segment, owing to a 21.0% YoY rise in fiber optic subscribers and 8.6% YoY rise in data revenue.
- Gross profit grew slower than revenue (up 1.6% YoY to SAR 8.3bn), as cost of revenue increased by 21.9% YoY to SAR 6.6bn during 2Q20. Gross margin contracted by 442.8 bps YoY to 55.9%.
- STC reported a 11.9% YoY decline in operating income to SAR 3.1bn, on account of a 13.8% YoY rise in selling and marketing expenses and a 22.1% YoY increase in general and administrative expenses. This resulted in a 503.8 bps YoY contraction in EBIT margin to 20.5%.
- EBITDA fell 5.5% YoY to SAR 5.3bn, due to the factors mentioned above. Moreover, EBITDA margin shrank by 577.2 bps YoY to 35.8%.
- Lower gross and operating margins, due to an increase in costs and higher provisions for bad debts, weighed on the company's net income (attributable to equity holders) for 2Q20, which declined by 4.3% YoY to SAR 2.7bn. Net profit margin contracted by 267.7 bps YoY to 18.3%.
- STC further extended the non-binding memorandum of understanding (MoU) to acquire 55% stake in Vodafone Group's Egyptian business by an additional 60 days, as the company continued to face logistics challenges caused by the COVID-19 pandemic.
- STC signed a contract with NEOM Co. to establish wireless 5G network infrastructure in NEOM megacity, which will enable STC to provide Internet of Things, data analytics, virtual reality, augmented reality, smart homes, and autonomous vehicle services within the smart city.

Valuation: We revise our target price to SAR 101.0 per share and maintain our "Neutral" rating on the stock.

	2Q'20	2Q'19	% YoY	FY20E	FY19	% YoY
Revenues (SAR mn)	14,920	13,604	9.7%	56,356	54,376	3.6%
Gross Profit (SAR mn)	8,341	8,207	1.6%	33,363	32,407	2.9%
EBITDA (SAR mn)	5,342	5,655	(5.5%)	21,832	21,281	2.6%
Net Profit (SAR mn)	2,724	2,848	(4.3%)	11,283	10,755	4.9%
EPS basic (SAR)	1.36	1.42	(4.3%)	5.64	5.38	4.9%
Gross Margin (%)	55.9%	60.3%	(4.4%)	59.2%	59.6%	(0.4%)
EBITDA Margin (%)	35.8%	41.6%	(5.8%)	38.7%	39.1%	(0.4%)
Net Profit Margin (%)	18.3%	20.9%	(2.7%)	20.0%	19.8%	0.2%

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

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