

Saudi Telecom Company

Strong revenue growth and strategic investments supported profitability

1Q23 Net Profit slightly lower than our estimates

Saudi Telecom Company's (STC/the Group) net profit rose 2.4% YOY to SAR 3,109 Mn in 1Q23, slightly lower than our estimate of SAR 3,231 Mn. The increase is primarily attributable to the strong rise in revenue and EBITDA partially offset by an increase in direct cost and increase in depreciation and amortization expenses.

P&L Highlights

STC's revenue rose 5.9% YOY to SAR 17,034 Mn in 1Q23 mainly due to 1.8% YOY growth in commercial unit owing to the rise in the mobility segment revenue. Carrier and Wholesale revenue segment also rose 0.4% due to the 19.9% increase in its national revenue. Direct cost increased 12.5% YOY to SAR 8.8 Bn in 1Q23. Thus, gross profit rose marginally 2.2% YOY to SAR 9,355 Mn in 1Q23 with a decline in gross profit margin from 53.9% in 1Q22 to 51.5% in 1Q23. Selling and overhead expenses declined 6.1% YOY to SAR 1,287 Mn in 1Q23, while, G&A expenses increased from SAR 1,481 Mn in 1Q22 to SAR 1,725 Mn in 1Q23. The increase in expenses was mainly due to the company's strategic initiatives focused on growing and expanding into new industries. Resultantly, EBITDA rose marginally 0.7% YOY to SAR 6,343 Mn in 1Q23 with a 218 bps YOY decline in EBITDA margin to 34.9% in 1Q23. Depreciation and amortization expenses grew 5.5% YOY to SAR 2,612 Mn in 1Q23. Thus, operating profit declined 2.4% YOY to SAR 3,731 Mn in 1Q23 with a 218 bps YOY decline and 259 bps QOQ rise in operating profit margin to 20.5% in 1Q23. Zakat expense increased from SAR 296 Mn in 1Q22 to SAR 377 Mn in 1Q23 dragging profitability.

Balance Sheet Highlights

STC's total equity amounted to SAR 70.4 Bn in 1Q23 as compared to SAR 74.6 Bn in 1Q22. Moreover, STC's gross debt increased from SAR 10.2 Bn in 3Q22 to SAR 10.5 Bn in 4Q22 with a debt to EBITDA ratio of 1.9x in 4Q22. Cash and cash equivalent rose from SAR 12.5 Bn in 3Q22 to SAR 17.8 Bn in 4Q22. STC cash flow from operation also rose from SAR 11,220 Mn in 2021 to SAR 26,354 Mn in 2022. STC issued bonus shares worth SAR 30,000 Mn during 3Q22 leading to an increase in equity to SAR 50,000 Mn to support the group in expansion.

Target price and rating

We maintain our BUY rating on Saudi Telecom Company with a target price of SAR 54.00. STC Group retained its top position as the leading digital enabler in the Middle East's telecommunications sector. The Company reported consistent performance in the top line across all business categories and robust growth in revenue in 1Q23. STC witnessed the highest quarterly revenue of SAR 18.2 Bn in 1Q23 primarily due to strong growth in the Mobility segment. Moreover, the telecom companies in KSA are likely to benefit from the low broadband penetration. STC Mobile subscribers rose 7.02% YOY mainly due to a substantial increase in prepaid and postpaid subscribers. While, the fixed subscribers declined marginally 2.13% YOY in 1Q23. Recently the Company's subsidiary Tawal announced a sale and purchase agreement to acquire 3 tower companies for SAR 5 Bn. The acquisition is likely to boost Tawal's infrastructure growth plans through entering into international markets. In addition, in accordance with the Company's dividend distribution policy

Rating : BUY

First Look Note – 1Q23

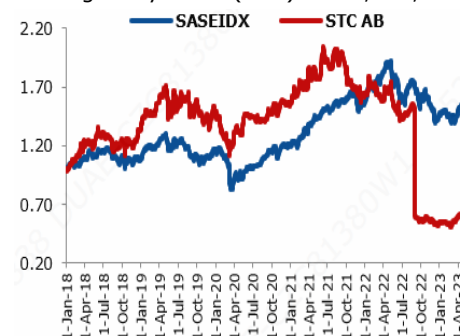
Sector: Telecom

Recommendation

Current Price (17-May-23)	44.30
Target Price (SAR)	54.00
Upside/Downside (%)	+22%

Stock Information

Market Cap (mm)	221,750.00
Paid Up Capital (mm)	50,000.00
52 Week High	46.00
52 Week Low	33.95
3M Avg. daily value (SAR)	156,461,100



Financial Ratios

Dividend Yield (12m)	3.61
Dividend Pay-out (%)	115.03
Price-Earnings Ratio (x)	17.99
Price-to-Book Ratio (x)	2.96
Book Value (SAR)	14.98
Return-on Equity (%)	16.89
Earning Per Share (SAR)	2.45
Beta	0.71

Stock Performance

5 Days	-2.85%
1 Months	4.23%
3 Months	21.67%
6 Months	17.80%
1 Year	5.60%
Month to Date (MTD)	0.00%
Quarter to Date (QTD)	10.86%
Year to Date (YTD)	21.31%

for three years period which started from the 4Q21 the company is going to distribute interim dividend of SAR 1.9 Bn for 1Q23. The company also maintains a strong balance sheet, adequate liquidity, low leverage and stable credit rating further aid in its internal or external expansion through internal accruals. Thus, based on our analysis, we maintain a BUY rating on the stock.

STC- Relative Valuation

(At CMP)	2018	2019	2020	2021	2022	2022F
P/E (x)	20.5	20.8	20.1	19.6	18.2	18.4
P/B (x)	3.4	3.6	3.5	3.2	3.0	2.9
EV/EBITDA	10.5	10.4	9.6	9.5	8.3	8.3
Dividend Yield	5.4%	3.6%	4.5%	3.6%	3.6%	3.6%

FABS Estimates & Co Data

STC - P&L

	1Q22	4Q22	1Q23	1Q23F	VAR	YOY Ch	QOQ Ch	2022	2023F	YOY Ch
SAR mm										
Sales	16,991	17,034	18,179	17,546	3.6%	7.0%	6.7%	67,432	70,945	5.2%
Direct costs	-7,841	-8,005	-8,824	-8,159	8.2%	12.5%	10.2%	-30,038	-31,570	5.1%
Gross profit	9,150	9,029	9,355	9,387	-0.3%	2.2%	3.6%	37,393	39,374	5.3%
Selling & Overhead Exp.	-1,370	-1,814	-1,287	-1,474	-12.7%	-6.1%	-29.0%	-6,110	-7,094	16.1%
General & admin Exp.	-1,481	-1,713	-1,725	-1,553	11.1%	16.5%	0.7%	-6,204	-7,272	17.2%
EBITDA	6,300	5,502	6,343	6,360	-0.3%	0.7%	15.3%	25,079	25,008	-0.3%
Depr & amortisation	-2,476	-2,533	-2,612	-2,747	-4.9%	5.5%	3.1%	-9,990	-10,989	10.0%
Operating profit	3,824	2,969	3,731	3,613	3.3%	-2.4%	25.7%	15,088	14,019	-7.1%
Zakat	-296	-220	-377	-270	39.9%	27.3%	71.2%	-1,083	-1,057	-2.4%
Profit attributable	3,035	2,722	3,109	3,031	2.6%	2.4%	14.2%	12,171	12,049	-1.0%

FABS estimate & Co Data

STC- Margins

	1Q22	4Q22	1Q23	YOY Ch	QOQ Ch	2022	2023F	YOY Ch
Gross Profit	53.9%	53.0%	51.5%	-239	-154	55.5%	55.5%	5
EBITDA	37.1%	32.3%	34.9%	-218	259	37.2%	35.3%	-194
Operating Profit	22.5%	17.4%	20.5%	-198	310	22.4%	19.8%	-262
Net Profit	17.9%	16.0%	17.1%	-76	112	18.0%	17.0%	-106

FABS estimate & Co Data

Valuation:

We use Discounted Free Cash flow (DCF) and Relative Valuation (RV) to value Saudi Telecom Company. We have assigned 70% weight to DCF and 30% to RV.

Valuation Method	Target	Weight	Weighted Value
DCF	58.7	70.0%	41.1
Relative	42.9	30.0%	12.9
Weighted Average Valuation (SAR)			54.0
Current market price (SAR)			44.3
Upside/Downside (%)			21.9%

1) DCF Method:

STC is valued using free cash flow to firm. We have discounted the cash flow using the weighted average cost of capital of 8.5%. It is arrived after using cost of equity of 8.6% and after-tax cost of debt of 6.5%. Cost of equity is calculated by using 10-year government bond yield of 4.3%, adjusted beta of 1.0 and equity risk premium of 4.3%. Government bond yield is calculated after adding KSA 10-year spread over 10-year US risk free rate. Cost of debt is calculated after adjusting a tax rate of 2.5% to arrive at after tax cost of debt of 6.5%. Also, assumed a terminal growth rate of 2.0%.

Sum of PV (SAR, Mn)	60,892
Terminal value (SAR, Mn)	223,327

FV to Common shareholders (SAR, Mn)	293,675
No. of share (Mn)	5,000
Current Market Price (SAR)	44.3
Fair Value per share (SAR)	58.7

DCF method

(All Figures in SAR Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
EBIT	13,599	15,281	16,666	18,131	19,747
Depreciation & Amortization	10,989	12,077	13,179	14,311	15,320
(-) Capex	-12,995	-13,691	-14,630	-15,125	-15,153
(-) Change in net working capital	1,307	-498	-3,554	724	937
Free Cash Flow to Firm (FCFF)	12,899	13,169	11,661	18,041	20,850
Discounting Factor	0.95	0.88	0.81	0.74	0.68
Discounted FCFF	12,259	11,532	9,408	13,411	14,282

2) Relative Valuation:

We have used local and international peers to value STC and it is valued using the EV/EBITDA multiple. We applied premium to peer valuation since it is the largest company and has a strong brand recognition compared to its peers also, we also expect this premium to be maintained. It is valued at EV/EBITDA of multiple of 8.0x compared to peer valuation of 7.0x.

Company	Market (USD Mn)	EV/EBITDA (x)		PE (x)		Dividend Yield (%)	
		2023	2024	2023	2024	2023	2024
Etihad Etisalat Company (Mobily)	7,999	6.2	5.5	20.0	17.0	1.8	1.7
Emirates Telecommunications Group	53,661	8.1	7.8	20.0	19.7	4.1	3.9
Mobile Telecommunications Company –SA	2,997	6.0	5.6	22.3	18.2	1.1	1.0
Emirates Integrated Telecommunications	6,356	4.6	4.3	17.5	17.2	2.6	2.4
Telstra Group Ltd	33,361	7.8	7.5	26.6	23.6	3.2	3.2
Bharti Airtel Ltd	55,278	7.7	6.3	30.5	19.9	4.8	3.8
Average		6.7x	6.2x	22.8x	19.3x	2.9x	2.7x
Median		7.0x	6.0x	21.2x	19.0x	2.9x	2.8x
Max		7.8x	7.2x	25.5x	19.9x	3.9x	3.6x
Min		6.1x	5.5x	20.0x	17.5x	2.0x	1.9x

Research Rating Methodology:

Rating	Upside/Downside potential
BUY	Higher than +15%
ACCUMULATE	Between +10% to +15%
HOLD	Lower than +10% to -5%
REDUCE	Between -5% to -15%
SELL	Lower than -15%

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