

Saudi Telecom Company (STC)

Substantial rise in other expenses and financial charges dragged the bottom-line

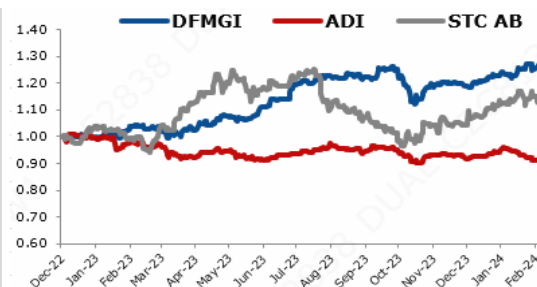
Current Price
SAR 40.55

Target Price
SAR 46.00

Upside/Downside (%)
+13%

Rating
ACCUMULATE

- STC reported the highest-ever full-year revenue of SAR 72.3 Bn in 2023.
- STC's mobile subscribers rose 10.9% to 26.5 Mn owing to increased prepaid, postpaid and M2M subscribers in 2023. While the fixed subscribers marginally grew 0.4% to 5.6 Mn.
- STC margin continued to remain under pressure mainly due to investment in new domains in line with the Company's strategy.
- STC in collaboration with KT and Hyundai E&C plans to construct Internet Data Centers (IDC) in KSA while iot squared's acquisition of Machinestalk and partnership with Huawei strengthens STC's position in IoT and 5G.
- STC delivered 5G network across 90% of its locations in the major cities and plans to make investments that will cover more than 75 cities and governorates in KSA.



Stock Information

Market Cap (SAR, mm)	202,750.00
Paid Up Capital (mm)	50,000.00
52 Week High	46.00
52 Week Low	35.00
3M Avg. daily value (SAR)	142,546,900

4Q23 Result Review (SAR, mm)

Total Assets	159,683
Total Liabilities	78,168
Total Equity	81,515
EBITDA	5,567
Net Profit	2,274

Financial Ratios

Dividend Yield (12m)	3.95
Dividend Pay-out (%)	59.98
Price-Earnings Ratio(x)	15.23
Price-to-Book Ratio (x)	2.56
Book Value (SAR)	15.85
Return-on Equity (%)	17.44

Stock Performance

5 Days	-2.76%
1 Months	-4.70%
3 Months	6.43%
6 Months	4.78%
1 Year	11.10%
Month to Date (MTD%)	-4.48%
Quarter to Date (QTD%)	0.37%
Year to Date (YTD%)	0.37%

4Q23 Net Profit lower than our estimate

STC Group ("STC, "the Company") recorded a 17.5% YOY decline in net profit to SAR 2,274 Mn in 4Q23, lower than our estimate of SAR 2,706 Mn. The decline in profit is mainly attributable to higher direct cost coupled with a significant rise in other expenses and net finance cost partially offset by a rise in revenue and lower operating expenses.

P&L Highlights

STC's revenue grew 2.0% YOY to SAR 17.7 Bn in 4Q23 led by an increase in subscriber base and healthy growth across most of the segments. STC's Mobile subscribers rose 10.9% YOY to 26.5 Mn in 4Q23 whereas the fixed subscriber base expanded marginally 0.4% YOY to 5.6 Mn. Resultantly, STC's business revenue rose 2.8% YOY to 12.2 Bn in 4Q23 while Channels segment revenue grew 14.5% YOY to 3.4 Bn. The Company's revenue is positively impacted by the healthy revenue growth of its subsidiaries. STC's direct cost grew 5.4% YOY to SAR 8.8 Bn in 4Q23 higher than the topline growth. Thus, gross profit declined marginally 1.1% YOY to SAR 8.9 Bn in 4Q23. Gross profit margin declined from 159 bps YOY to 50.4% in 4Q23. Selling and overhead expenses declined 21.4% YOY to SAR 1,4 Bn in 4Q23 due to lower impairment loss and call center expenses. On the other hand, G&A expenses grew 12.2% YOY to SAR 2.0 Bn in 4Q23. However, the Company's EBITDA rose 1.2% YOY to SAR 5.6 Bn in 4Q23 mainly due to lower operating expenses. EBITDA margin declined 26 bps YOY to 31.4% in 4Q23. Depreciation and amortization expenses grew 7.2% YOY to SAR 2.7 Bn in 4Q23. Thus, operating profit declined 4.0% YOY to SAR 2.6 Bn in 4Q23 with a decline in operating margin by 100 bps YOY to 16.1% in 4Q23. The Company recorded a significant rise in other expenses from SAR 76 Mn in 4Q22 to SAR 226 Mn in 4Q23. STC's finance income rose from SAR 253 Mn

in 4Q22 to SAR 431 Mn in 4Q23, while finance cost increased significantly from SAR 186 Mn in 4Q22 to SAR 480 Mn in 4Q23 due to increase in debt. In addition, Zakat's expenses grew 42.2% YOY to SAR 313 Mn in 4Q23 due to growth in profitability. The share of profit attributable to non-controlling interest holders declined 29.65 YOY to SAR 12 Mn in 4Q23.

Balance Sheet Highlights

STC's gross debt grew from SAR 10.5 Bn in 2022 to SAR 14.6 Bn in 2023. Cash and cash equivalent fell from SAR 17.8 Bn in 2022 to SAR 13.4 Bn in 2023. The Company's capex stood at SAR 9.8 Bn in 2023 compared to SAR 7.9 Bn in 9M23. The Company's free cash flow stood at SAR 12.6 Bn in 2023.

Target Price and Rating

We maintain our ACCUMULATE rating on Saudi Telecom Company with an unchanged target price of SAR 46.00. STC's Mobile subscribers rose 10.9% YOY to 26.5 Mn due to the addition of customers across prepaid, postpaid, and m2m segments driven by an increase in the inflow of foreigners in KSA. While fixed subscribers marginally increased 0.4% YOY to 5.6 Mn in 4Q23. The marginal rise in the fixed subscriber base was driven by an increase in fixed-wireless broadband customers partially offset by a decline in wired broadband and telephone lines customers. Under the Company's DARE strategy, its digital capabilities allow it to undertake advanced analytics to make operational decisions. STC accounts for 47.5% of 5G coverage across KSA's population while the Company added more than 200 thousand fiber connections and increased FTTH traffic to 4 Gbps in line with its DARE strategy. In addition, STC Bank's active users rose 23.2% in 180 days during 2023. STC has a total of 25 data centres and 16 submarine cables under operation and construction as of December 2023. On the other hand, Iot squared's acquisition of Machinestalk and partnership with Huawei strengthens STC's position in IoT and 5G. Furthermore, STC successfully delivered 5G network across 90% of its locations in the major cities and plans to make investments that will cover more than 75 cities and governorates in KSA. STC signed a partnership agreement with Diriyah Company to provide technological solutions and specialized services for the development of wireless and wired network for the transformation of Diriyah Gate Project. STC also signed an agreement with Red Sea Global for the digital transformation of tourist destinations along the coast of the Red Sea. In addition, STC in collaboration with KT and Hyundai E&C plans to construct Internet Data Centers (IDC) in KSA developing the digital infrastructure with the help of the combined capabilities of the three companies. Multiple expansion plans of the Company which capitalizes on STC's technology and digital capabilities ensure solid revenue visibility in the upcoming period. The Company expects its investments in startups to positively benefit the Group's financials collectively. STC paid a dividend of SAR 0.4 per share in 4Q23 along with a special dividend of SAR 1 per share resulting in a total annual dividend of SAR 2.6 per share and a solid dividend yield of 6.3% in 2023. Thus, based on our analysis, we maintain an ACCUMULATE rating on the stock.

STC - Relative valuation

(at CMP)	2019	2020	2021	2022	2023	2024F
PE	19.3	18.7	18.2	16.9	15.5	15.0
PB	3.3	3.2	3.0	2.8	2.6	2.4
EV/EBITDA	9.7	8.9	8.8	7.7	8.2	7.5
Dividend yield	3.9%	4.9%	3.9%	3.9%	6.3%	3.9%

FABS Estimates & Co Data

STC – P&L

SAR mm	4Q22	3Q23	4Q23	4Q23F	Var.	YOY Ch	QOQ Ch	2022	2023	YOY Ch
Sales	17,374	18,106	17,724	18,309	-3.2%	2.0%	-2.1%	67,432	72,337	7.3%
Cost of Sales	-8,346	-7,718	-8,796	-8,171	7.6%	5.4%	14.0%	-30,038	-34,533	15.0%
Gross profit	9,029	10,388	8,928	10,137	-11.9%	-1.1%	-14.0%	37,393	37,804	1.1%
Selling & overhead exp.	-1,776	-1,654	-1,396	-1,825	-23.5%	-21.4%	-15.6%	-6,110	-5,914	-3.2%
G&A expenses	-1,751	-1,782	-1,966	-1,833	7.3%	12.2%	10.3%	-6,204	-7,206	16.1%
EBITDA	5,502	6,952	5,567	6,479	-14.1%	1.2%	-19.9%	25,079	24,683	-1.6%
Dep & Amort	-2,533	-2,614	-2,716	-2,758	-1.5%	7.2%	3.9%	-9,990	-10,483	4.9%
Operating profit	2,969	4,338	2,851	3,721	-23.4%	-4.0%	-34.3%	15,088	14,200	-5.9%
Other income/(exp)	-76	956	-226	-134	69.2%	NM	NM	-1,524	353	-123.1%
Finance Income	253	340	431	397	8.4%	69.9%	26.4%	602	1,513	151.1%
Financial charges	-186	-304	-480	-1,104	-56.5%	NM	57.7%	-697	-1,271	82.4%
Profit before zakat	2,960	5,330	2,575	2,880	-10.6%	-13.0%	-51.7%	13,470	14,795	9.8%
Zakat	-220	-354	-313	-146	NM	42.2%	-11.4%	-1,083	-1,375	27.0%
Profit before NCI	2,739	4,976	2,262	2,734	-17.3%	-17.4%	-54.5%	12,387	13,419	8.3%
NCI	-18	72	-12	28	NM	-29.6%	NM	216	124	-42.6%
Net Profit	2,757	4,904	2,274	2,706	-16.0%	-17.5%	-53.6%	12,171	13,295	9.2%

FABS estimate & Co Data

STC – Margins

	4Q22	3Q23	4Q23	YOY Ch	QOQ Ch	2022	2023	YOY Ch
Gross Profit	52.0%	57.4%	50.4%	-159	-700	55.5%	52.3%	-319
EBITDA	31.7%	38.4%	31.4%	-26	-699	37.2%	34.1%	-307
Operating Profit	17.1%	24.0%	16.1%	-100	-787	22.4%	19.6%	-274
Net Profit	15.9%	27.1%	12.8%	-304	-1425	18.0%	18.4%	33

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 Method	48.31	70.0%	33.82
Relative Valuation (RV)	40.60	30.0%	12.18
Weighted Average Valuation (SAR)			46.00
Current market price (SAR)			40.55
Upside/Downside (%)			+13%

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 8.6%. It is arrived after using cost of equity of 8.9% and after-tax cost of debt of 4.9% with debt-to-equity ratio of 4.1%. Cost of equity is calculated by using 10-year government bond yield of 4.7%, beta of 1.00 and equity risk premium of 4.2%. Government bond yield is calculated after adding KSA 10-year CDS spread over 10-year US risk free rate. The cost of debt is calculated using the cost of 5.0% after adjusting a tax rate arriving at after-tax cost of debt of 4.9%. Also, assumed a terminal growth rate of 2.0%.

Sum of PV (SAR, Mn)	57,900
Terminal value (SAR, Mn)	184,155
FV to Common shareholders (SAR, Mn)	241,550
No. of share (Mn)	5,000
Current Market Price (SAR)	40.55
Fair Value per share (SAR)	48.31

DCF Method

(All Figures in SAR Mn)	FY 2024E	FY 2025E	FY 2026E	FY 2027E	FY 2028E
NOPAT	15,830	16,250	16,930	17,860	18,300
Depreciation and Amortization	10,680	11,246	11,670	12,181	12,905
(-) CAPEX	-13,431	-13,611	-13,682	-13,579	-13,628
(-) Change in Net Working Capital	-6,252	3,517	611	2,282	303
Free Cash Flow to Equity (FCFF)	5,614	17,402	15,529	18,744	17,880
Discounting Factor	0.93	0.86	0.79	0.72	0.67
Discounted FCFF	5,238	14,925	12,243	13,584	11,911

Source: FAB Securities

2) Relative Valuation:

We have used local as well as international peers to value STC and it is valued using the EV/EBITDA multiple. It is valued at EV/EBITDA multiple of 7.3x in line with peers.

Company	Market (USD Mn)	EV/EBITDA (x)		P/E (x)	
		2024F	2025F	2024F	2025F
Etihad Etisalat Company (Mobily)	11,115	7.3x	6.4x	17.8x	14.8x
Thaicom	377	12.4x	17.2x	68.3x	NM
Emirates Telecommunications Group Company	43,290	6.5x	6.3x	14.9x	14.5x
Telstra Group Ltd	28,500	7.0x	6.7x	21.3x	19.7x
Bharti Airtel	80,710	10.7x	9.0x	69.8x	32.9x
Average		8.8x	9.1x	38.4x	20.5x
Median		7.3x	6.7x	21.3x	17.3x
Max		10.7x	9.0x	68.3x	23.0x
Min		7.0x	6.4x	17.8x	14.7x

Source: FAB Securities

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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