

Rating
12- Month Target Price
Neutral
SAR 73.00
SAUDI TELECOM COMPANY (STC)
4Q2016 First Look
Expected Total Return

Price as on Jan-24, 2017	SAR 68.50
Upside to Target Price	6.6%
Expected Dividend Yield	5.8%
Expected Total Return	12.4%

Market Data

52 Week H/L	SAR 74.00/51.00
Market Capitalization	SAR 137,000 mln
Shares Outstanding	2,000 mln
Free Float	16.1%
12-Month ADTV	642,884

1-Year Price Performance

Source: Bloomberg

Lower Revenues Offset by Higher Other Income

STC reported flat net income Q/Q but +10% higher Y/Y at SAR 2.2 billion as the Company announced 4Q results. Bottom line matched our SAR 2.2 billion estimates. Revenue decline of -11% Q/Q and -9% Y/Y was surprising; we blame it on the continuing biometric impact, which has reduced subscriber base. Expansion in gross margins through controlling cost of service is a highlight of this quarter. At the same time, the Company was able to post other income of SAR 170 million as compared to other expense of SAR (302) million last year and a meager SAR 42 million in 3Q. Persistent lower revenues would raise business risk for STC. We maintain our Neutral stance with a target price of SAR 73.00 and await further clarity especially on market share and data pricing.

-11% Q/Q decline in revenues

STC posted a -11% Q/Q decline in revenues to SAR 12.0 billion. We justify the decline by the continuously changing revenue mix towards data combined with a loss in subscribers along with a decrease in MTR revenue. On the positive side, management has demonstrated the ability to control its cost of service, gross margins expanded by 10% Q/Q to 62%. Gross profit grew by +5% Q/Q to SAR 7.4 billion, but lower than SAR 8.0 billion last year. We question the sustainability of gross margins as this decline in cost of service is unprecedented.

EBITDA remains flat Q/Q

Improving gross margin was unable to counter double-digit revenue decline. Operating expenses increased by +10% Q/Q while EBITDA remained flat Q/Q, leading to an operating profit of SAR 2.2 billion (-13% Y/Y and -6% Q/Q). In light of the announced figures, the depreciation & amortization expense increased +9% Y/Y and +4% Q/Q adding pressure to operating profit. EBITDA margins have improved by 400 bps Q/Q to 36% as a similar EBITDA level of SAR 4.3 billion was spread over a lower base as revenues declined.

Net income matches our forecast

We are happy to note a +10% Y/Y rise in net income to SAR 2.2 billion, matching our estimates but flat Q/Q. Although we are concerned with the -11% Q/Q decline in revenues, expansion in margins is positive. Net margins have also improved to 18% from 16% last quarter. Improvement in non-core business has helped the Company by boosting commission income and equity investment gains. We are expecting a dividend of at least SAR 1.00 for 4Q (a positive surprise cannot be ruled out), inline with STC's commitment, which they have honored until now. Dividend yield of 6% is attractive for a major telecom operator. Trading at a P/E of 15.1x 2017E, higher than the TASI P/E of 14.4x, we maintain our SAR 73.00 target price and Neutral recommendation.

Key Financial Figures

FY Dec 31 (SAR mln)	2015A	2016A	2017E
Revenue	50,650	51,845	51,389
Gross Profit	30,344	29,065	30,371
Net Profit	9,256	10,193	9,043
EPS (SAR)	4.63	5.09	4.52
DPS (SAR)	4.00	4.00	4.00

Key Financial Ratios

FY Dec31	2015A	2016E	2017E
BVPS (SAR)	30.3	29.8	31.9
ROAE	15.4%	14.9%	14.6%
ROAA	9.6%	10.4%	9.1%
EV/EBITDA	6.4x	6.3x	6.6x
P/E	12.0x	11.0x	15.1x

4Q2016E (SAR mln)	Actual	RC Forecast
Revenue	12,012	13,378
Gross Profit	7,417	6,957
Net Income	2,150	2,184
EPS (SAR)	1.07	1.08

Stock Rating

Buy	Neutral	Sell	Not Rated
Expected Total Return Greater than 15%	Expected Total Return between -15% and +15%	Expected Total Return less than -15%	Under Review/ Restricted

* The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors

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