



US\$55.14bn Market cap
16% Free float
US\$23.11mn Avg. daily volume

Target price **100.0** -3.3% over current
Current price **103.4** as at 20/10/2020

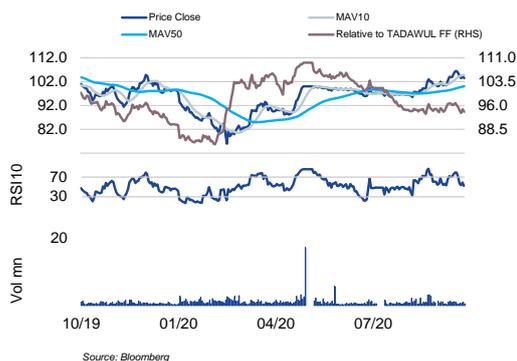
Research Department
Pritish Devassy, CFA

Tel +966 11 836 5464, devassyp@alrajhi-capital.com

Existing rating

Underweight **Neutral** **Overweight**

Performance



Earnings

(SAR mn)	2019	2020e	2021e
Revenue	54,368	57,262	59,553
Y-o-Y	4.6%	5.3%	4.0%
Gross Profit	32,398	33,414	34,893
Gross margin	59.6%	58.4%	58.6%
EBITDA	21,272	21,618	22,387
EBITDA margin	39.1%	37.8%	37.6%
Net profit	10,746	10,841	10,476
EPS (SAR)	5.37	5.42	5.24
DPS (SAR)	4.00	4.00	4.00
EV/EBITDA	9.9	9.8	9.4
P/E	19.2	19.0	19.7

Source: Company data, Al Rajhi Capital

STC

Q3: Slight beat; Maintain Neutral

STC reported a flat top-line (q-o-q), better than Mobily's ~6% q-o-q decline, highlighting its defensive customer base when the sector faced headwinds in the form of limited Hajj/Umrah visitors, lower roaming revenues, MTR cuts, and VAT pre-buying. Though revenue was broadly in-line, margins came better than our expectation, resulting in a slight beat of 5% at the net profit level likely helped by data revenue growth of 10% y-o-y during 9m 2020. STC also reported a dividend of SAR1/share for Q3, in-line with our expectations.

Figure 1 STC Q3 results

(SAR mn)	Q3 2019	Q2 2020	Q3 2020	Y-o-Y	Q-o-Q	ARC est
Revenue	14,114	14,920	14,881	5.4%	-0.3%	14,678
Gross profit	7,921	8,341	8,971	13.3%	7.6%	8,367
Gross margin	56.1%	55.9%	60.3%			57.0%
Operating profit	3,328	3,062	3,460	4.0%	13.0%	3,146
Operating margin	23.6%	20.5%	23.3%			21.4%
Net profit	2,746	2,724	2,766	0.7%	1.5%	2,617
Net margin	19.5%	18.3%	18.6%			17.8%

Source: Company data, Al Rajhi Capital

5G adoption: We believe that STC is likely to be the key beneficiary of 5G, given its infrastructure and ability to spend on capex. For example, as of 2019, capex spends of STC was SAR9.4bn vs SAR2.0bn of Mobily and SAR1.8bn of Zain. Also, the net Debt /Asset of STC was just 11% vs. 38% of Mobily and 26% of Zain as of Q2 2020. This indicates that the company has sufficient ability to fund the 5G expansion plan.

Vodafone Egypt investment: We had previously written that if the deal goes through, it may create SAR1/share in value. Now that the MoU has concluded without reaching an agreement, the company could probably distribute higher dividends or invest elsewhere.

STC solutions IPO: Bloomberg had reported that STC is looking to IPO STC solutions. We believe that this is in the very early stages as the RFP had just been sent to banks. According to Bloomberg, the valuation of STC solutions could be around SAR10bn, which is around 5% of STC's current market cap (~SAR207bn). Some quick facts about the STC solutions are:

- o STC solutions business activity is in the areas of connectivity solutions, outsourcing IT for companies, data cloud services, cloud computing, and mainly business-related areas including that of government.
- o STC Solutions' revenue is more than 10% of group revenues.
- o STC Solutions is a profitable business although margins are much lower than STC telecom services.
- o The capital is SAR100mn.
- o There is high competition in the segment.

Saudi Digital Payments Company (STC pay) is doing well and there may be a likelihood that this could also be listed in the long term. STC pay was earlier a part of the STC solutions segment and got separated from Q3 2019. STC pay is on its way towards profitability and has 2mn subscribers and gaining market share (mainly on remittance business) and has a capital of SAR300mn.



Network for newer cities: NEOM inked an agreement with STC to begin infrastructure work for creating cognitive cities. NEOM Co. has signed a contract with the STC group to establish a 5G network infrastructure as the first step to create the world's leading cognitive cities that rely on cutting-edge technology for digital services. In addition to the one-year contract to develop the network, the partnership also includes the development of an innovation center in NEOM to explore new 5G opportunities. It may be too early to analyze the financial impact, but we believe that this could impact the company positively. Despite Zain KSA has the lead in "marketing 5G" services, as we have mentioned in the past, STC is likely the eventual winner with the ability to invest in 5G. STC would not have to win 5G clients. It would be an automatic upgrade when the ecosystem changes to 5G.

Resolution of receivables: Rising receivables level remains a bit of concern for the company, and we don't expect it to come down this year given the fiscal deficit this year.

Tower company: The company may be able to benefit (limited) by offloading its towers to a tower company and leaseback them generating additional cash. A tower company has already been created for this purpose

Valuation and risks: STC's strength lies in its highly defensive high ARPU postpaid heavy Saudi subscriber base and deep pockets. However, our main concern is that the receivables continue to increase. Our 12m forward-looking target price for the company is arrived at SAR100/share (and previously SAR96/share) using only EV/EBITDA multiple of 8x. Based on our TP, we have a Neutral rating.

Other upside risks to our valuation are, increase in data prices, more benign competition, lower than expected capex spends, payment from Government for receivables, meaningful contributions from other investments, cash from asset/land sales, higher efficiency driving up margins, further material traction in fintech boosting cash flows. Downside risks are impairment of receivables, higher than expected capex, further decline in prices, write-down of goodwill, the unfavorable decision on pending litigations, and increase in SAIBOR.



IMPORTANT DISCLOSURES FOR U.S. PERSONS

This research report was prepared by Al Rajhi Capital (Al Rajhi), a company authorized to engage in securities activities in Saudi Arabia. Al Rajhi is not a registered broker-dealer in the United States and, therefore, is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. This research report is provided for distribution to "major U.S. institutional investors" in reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act").

Any U.S. recipient of this research report wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided in this research report should do so only through Rosenblatt Securities Inc, 40 Wall Street 59th Floor, New York NY 10005, a registered broker dealer in the United States. Under no circumstances should any recipient of this research report effect any transaction to buy or sell securities or related financial instruments through Al Rajhi. Rosenblatt Securities Inc. accepts responsibility for the contents of this research report, subject to the terms set out below, to the extent that it is delivered to a U.S. person other than a major U.S. institutional investor.

The analyst whose name appears in this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA") and may not be an associated person of Rosenblatt Securities Inc. and, therefore, may not be subject to applicable restrictions under FINRA Rules on communications with a subject company, public appearances and trading securities held by a research analyst account.

Ownership and Material Conflicts of Interest

Rosenblatt Securities Inc. or its affiliates does not "beneficially own," as determined in accordance with Section 13(d) of the Exchange Act, 1% or more of any of the equity securities mentioned in the report. Rosenblatt Securities Inc, its affiliates and/or their respective officers, directors or employees may have interests, or long or short positions, and may at any time make purchases or sales as a principal or agent of the securities referred to herein. Rosenblatt Securities Inc. is not aware of any material conflict of interest as of the date of this publication.

Compensation and Investment Banking Activities

Rosenblatt Securities Inc. or any affiliate has not managed or co-managed a public offering of securities for the subject company in the past 12 months, nor received compensation for investment banking services from the subject company in the past 12 months, neither does it or any affiliate expect to receive, or intends to seek compensation for investment banking services from the subject company in the next 3 months.

Additional Disclosures

This research report is for distribution only under such circumstances as may be permitted by applicable law. This research report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient, even if sent only to a single recipient. This research report is not guaranteed to be a complete statement or summary of any securities, markets, reports or developments referred to in this research report. Neither Al Rajhi nor any of its directors, officers, employees or agents shall have any liability, however arising, for any error, inaccuracy or incompleteness of fact or opinion in this research report or lack of care in this research report's preparation or publication, or any losses or damages which may arise from the use of this research report.

Al Rajhi may rely on information barriers, such as "Chinese Walls" to control the flow of information within the areas, units, divisions, groups, or affiliates of Al Rajhi.

Investing in any non-U.S. securities or related financial instruments (including ADRs) discussed in this research report may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the U.S. Securities and Exchange Commission. Information on such non-U.S. securities or related financial instruments may be limited. Foreign companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect within the United States.

The value of any investment or income from any securities or related financial instruments discussed in this research report denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related financial instruments.

Past performance is not necessarily a guide to future performance and no representation or warranty, express or implied, is made by Al Rajhi with respect to future performance. Income from investments may fluctuate. The price or value of the investments to which this research report relates, either directly or indirectly, may fall or rise against the interest of investors. Any recommendation or opinion contained in this research report may become outdated as a consequence of changes in the environment in which the issuer of the securities under analysis operates, in addition to changes in the estimates and forecasts, assumptions and valuation methodology used herein.

No part of the content of this research report may be copied, forwarded or duplicated in any form or by any means without the prior consent of Al Rajhi and Al Rajhi accepts no liability whatsoever for the actions of third parties in this respect. This research document has been prepared by Al Rajhi Capital Company ("Al Rajhi Capital") of Riyadh, Saudi Arabia. It has been prepared for the general use of Al Rajhi Capital's clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Al Rajhi Capital. Receipt and review of this research document constitute your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusion, or information contained in this document prior to public disclosure of such information by Al Rajhi Capital. The information contained was obtained from various public sources believed to be reliable but we do not guarantee its accuracy. Al Rajhi Capital makes no representations or warranties (express or implied) regarding the data and information provided and Al Rajhi Capital does not represent that the information content of this document is complete, or free from any error, not misleading, or fit for any particular purpose. This research document provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other investment products related to such securities or investments. It is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this document.

Investors should seek financial, legal or tax advice regarding the appropriateness of investing in any securities, other investment or investment strategies discussed or recommended in this document and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities or other investments, if any, may fluctuate and that the price or value of such securities and investments may rise or fall. Fluctuations in exchange rates could have adverse effects on the value of or price of, or income derived from, certain investments. Accordingly, investors may receive back less than originally invested. Al Rajhi Capital or its officers or one or more of its affiliates (including research analysts) may have a financial interest in securities of the issuer(s) or related investments, including long or short positions in securities, warrants, futures, options, derivatives, or other financial instruments. Al Rajhi Capital or its affiliates may from time to time perform investment banking or other services for, solicit investment banking or other business from, any company mentioned in this research document. Al Rajhi Capital, together with its affiliates and employees, shall not be liable for any direct, indirect or consequential loss or damages that may arise, directly or indirectly, from any use of the information contained in this research document.

This research document and any recommendations contained are subject to change without prior notice. Al Rajhi Capital assumes no responsibility to update the information in this research document. Neither the whole nor any part of this research document may be altered, duplicated, transmitted or distributed in any form or by any means. This research document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or which would subject Al Rajhi Capital or any of its affiliates to any registration or licensing requirement within such jurisdiction.



Disclaimer and additional disclosures for Equity Research

Disclaimer

This research document has been prepared by Al Rajhi Capital Company ("Al Rajhi Capital") of Riyadh, Saudi Arabia. It has been prepared for the general use of Al Rajhi Capital's clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Al Rajhi Capital. Receipt and review of this research document constitute your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusion, or information contained in this document prior to public disclosure of such information by Al Rajhi Capital. The information contained was obtained from various public sources believed to be reliable but we do not guarantee its accuracy. Al Rajhi Capital makes no representations or warranties (express or implied) regarding the data and information provided and Al Rajhi Capital does not represent that the information content of this document is complete, or free from any error, not misleading, or fit for any particular purpose. This research document provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other investment products related to such securities or investments. It is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this document.

Investors should seek financial, legal or tax advice regarding the appropriateness of investing in any securities, other investment or investment strategies discussed or recommended in this document and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities or other investments, if any, may fluctuate and that the price or value of such securities and investments may rise or fall. Fluctuations in exchange rates could have adverse effects on the value of or price of, or income derived from, certain investments. Accordingly, investors may receive back less than originally invested. Al Rajhi Capital or its officers or one or more of its affiliates (including research analysts) may have a financial interest in securities of the issuer(s) or related investments, including long or short positions in securities, warrants, futures, options, derivatives, or other financial instruments. Al Rajhi Capital or its affiliates may from time to time perform investment banking or other services for, solicit investment banking or other business from, any company mentioned in this research document. Al Rajhi Capital, together with its affiliates and employees, shall not be liable for any direct, indirect or consequential loss or damages that may arise, directly or indirectly, from any use of the information contained in this research document.

This research document and any recommendations contained are subject to change without prior notice. Al Rajhi Capital assumes no responsibility to update the information in this research document. Neither the whole nor any part of this research document may be altered, duplicated, transmitted or distributed in any form or by any means. This research document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or which would subject Al Rajhi Capital or any of its affiliates to any registration or licensing requirement within such jurisdiction.

Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"Overweight": Our target price is more than 10% above the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

Contact us

Mazen AlSudairi
Head of Research
Tel : +966 11 836 5468
Email: alsudairim@alrajhi-capital.com

Al Rajhi Capital
Research Department
Head Office, King Fahad Road
P.O. Box 5561, Riyadh 11432
Kingdom of Saudi Arabia
Email: research@alrajhi-capital.com

Al Rajhi Capital is licensed by the Saudi Arabian Capital Market Authority, License No. 07068/37.