

The company's continues its strong performance, despite declining subscriber base. Margin improvement YoY, albeit falling revenues due to lower subscriber base and lower MTR revenues. Early retirement program seems to be completed, we still have incorporated early retirement payment for 2018. CAPEX to remain above SAR 6.5bn, FCF remains strong. Receivables from government high, low risk profile of these receivables can provide strong cash flows in the future. We maintain our "Neutral" recommendation with revised PT of SAR 88.5.

**Q1-2018 result beats AJC estimates, as the company halted early retirement program:** STC in Q1-2018 posted earnings of SAR 2.6bn as compare to AJC estimates of SAR 2.5bn. Despite lower than expected revenue of SAR 12.4bn as compared to AJC estimate of SAR 12.7bn. The deviation in earnings boiled down to the non-recognition of early-retirement cost, which we expected to carry forward in 2018. On a YoY basis, revenues showed a decline of 1.1%, whereas gross margins expanded by 120bps to 56.5%. The fall in revenue can be ascribed to i) lower subscriber base; ii) lower handset sales; and iii) lower MTR revenues. However, margin expansion is a result of cost optimization by the company and lower MTR expenses.

**Receivables growth concerning, although low risk due to its nature:** The company in 2017, showed total net receivables of SAR 25.6bn as compared to 19.8bn in 2016. Net receivables for STC has grown from SAR 8.5bn in 2014 to its current state. In 2017, the total trade receivables stand at SAR 22.7bn, out of which 18.8bn are held by the government and government related entities. In addition, receivable past due 1 year stand at SAR 12.0bn in 2017, as compared to SAR 5.8bn, a jump of 107% YoY, however the provision charged during the year, did not show a significant increase as it stood at SAR 870.6mn as compared to SAR 775.0. On the other hand write-off stood at SAR 1.1bn in 2017 as compared to SAR 500.8mn in 2016. The company does mention that it has not recognized impairment allowance on some of its receivables, because it considers them recoverable due to its credit quality. We agree with the company in term of the risk profile of the creditor ( Government), on the back of the sovereign rating assumption and stable credit outlook. In light of the recent payments made by the government to other entities, we strongly believe that these payments will be recovered in the future. In our future cash flow assumption, we have not expected a bullet payment by the government which is a possibility. Our expectation is part payments by the government over a period of time.

**Diversification from Telecom operator to technology company to drive revenues :** STC has generated strong cash flow over the last 5 years. In 2018 and onwards, we expect the company to generate Operating cash flow in excess of SAR 18.0bn ( the assumption does not take into account full payment of account receivables by the government). Whereas its FCF is expected to stand above SAR 9.0bn, with SAR 9.0-8.0bn in CAPEX. This leaves the company with sufficient cash to deploy for expansion of its strategic investment in technology companies, that will help the company in diversifying its return base. The company in 2017 announced a USD 500mn ( SAR 1.9bn) fund to finance its investment in digital and technology sector. The fund will be self-financed from the company's internal sources.

**Enterprise Solution the way forward; competition is intense:** The sector seems to have reached a saturation level in term of subscriber data penetration. Mobile Broadband teledensity towards the end of Q3-2017 stood at 89%, with little room for growth as expat population leaves the country. However, growth will arise from enterprise solutions in line with NTP2020 and Vision 2030. The digitization of the Saudi economy is bound to be fruitful for the Telecom sector, there is intense competition amongst the three players, STC being the prime telecom provider can potentially gain respectable market share

**AJC view:** STC face number of challenges on its core operations , on a macro level i) falling subscriber base, ii) implementation of taxes, ii) higher electricity and fuel rates curbing consumer spending and pushing subscribers to rationalize their data bills iv) the general economic slowdown and v) rising lending rates. Whereas on the company level the major issue that the company is facing is non-payment of receivables, although as discussed they are low risk, however they do limit the cash flow of the company. However the company seems to have clear strategy in terms of diversification its revenue base, the foundation is being laid to diversify the company from traditional telecom service provider to a technology company. For 2018, we expect the company to post earnings of SAR 10.6bn ( 4.4%YoY increase). STC currently is trading at a trailing PE and PB of 16.3x and 2.6,with dividend yield of 4.8%.We update our price to SAR 88.5, and maintain our "Neutral" recommendation.

|                      |                |
|----------------------|----------------|
| Recommendation       | <b>Neutral</b> |
| Current Price* (SAR) | 82.95          |
| Target Price (SAR)   | <b>88.5</b>    |
| Upside / (Downside)  | <b>6.7%</b>    |

Source: Tadawul \*prices as of 1<sup>st</sup> of May 2018

## Key Financials

| SARmn (unless specified) | FY16   | FY17   | FY18E  |
|--------------------------|--------|--------|--------|
| Revenue                  | 53,678 | 50,747 | 51,259 |
| Growth %                 | 6.0%   | -5.5%  | 1.0%   |
| Net Income               | 8,899  | 10,133 | 10,577 |
| Growth %                 | -3.9%  | 13.9%  | 4.4%   |
| EPS                      | 4.45   | 5.07   | 5.29   |

Source: Company reports, Aljazira Capital

## Key Ratios

| SARmn (unless specified) | FY16  | FY17  | FY18E |
|--------------------------|-------|-------|-------|
| Gross Margin             | 53.4% | 58.1% | 58.9% |
| Net Margin               | 20.0% | 20.6% | 20.8% |
| P/E                      | 15.40 | 13.54 | 15.69 |
| P/B                      | 2.24  | 2.17  | 2.52  |
| EV/EBITDA (x)            | 7.47  | 7.00  | 8.49  |
| Dividend Yield           | 5.8%  | 5.8%  | 4.8%  |

Source: Company reports, Aljazira Capital

## Key Market Data

|                         |        |
|-------------------------|--------|
| Market Cap (bn)         | 167.0  |
| YTD %                   | 20.8%  |
| 52 Week (High )         | 86.0   |
| 52 Week (Low)           | 65.1   |
| Shares Outstanding (mn) | 2000.0 |

Source: Company reports, Aljazira Capital

## Price Performance



Source: Bloomberg, Aljazira Capital

Head of Research

Talha Nazar

+966 11 2256250

t.nazar@aljaziracapital.com.sa

RESEARCH DIVISION

Head of Research  
**Talha Nazar**  
+966 11 2256250  
t.nazar@aljaziracapital.com.sa

Analyst  
**Waleed Al-jubayr**  
+966 11 2256146  
W.aljubayr@aljaziracapital.com.sa

Analyst  
**Sultan Al Kadi, CAIA**  
+966 11 2256374  
s.alkadi@aljaziracapital.com.sa

Analyst  
**Muhanad Al-Odan**  
+966 11 2256115  
M.alodan@aljaziracapital.com.sa

Analyst  
**Jassim Al-Jubran**  
+966 11 2256248  
j.aljabran@aljaziracapital.com.sa

BROKERAGE AND INVESTMENT CENTERS DIVISION

General Manager – Brokerage Services & sales  
**Alaa Al-Yousef**  
+966 11 2256060  
a.yousef@aljaziracapital.com.sa

AGM-Head of Sales And Investment Centers  
Central Region  
**Sultan Ibrahim AL-Mutawa**  
+966 11 2256364  
s.almutawa@aljaziracapital.com.sa

AGM-Head of international and institutional brokerage  
**Luay Jawad Al-Motawa**  
+966 11 2256277  
lalmutawa@aljaziracapital.com.sa

AGM-Head of Qassim & Eastern Province  
**Abdullah Al-Rahit**  
+966 16 3617547  
aalrahit@aljaziracapital.com.sa

AGM- Head of Western and Southern Region Investment Centers  
**Mansour Hamad Al-shuaibi**  
+966 12 6618443  
m.alshuaibi@aljaziracapital.com.sa

RESEARCH DIVISION

AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. **Overweight:** This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. **Underweight:** This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. **Neutral:** The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. **Suspension of rating or rating on hold (SR/RH):** This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

## Disclaimer

The purpose of producing this report is to present a general view on the company/economic sector/economic subject under research, and not to recommend a buy/sell/hold for any security or any other assets. Based on that, this report does not take into consideration the specific financial position of every investor and/or his/her risk appetite in relation to investing in the security or any other assets, and hence, may not be suitable for all clients depending on their financial position and their ability and willingness to undertake risks. It is advised that every potential investor seek professional advice from several sources concerning investment decision and should study the impact of such decisions on his/her financial/legal/tax position and other concerns before getting into such investments or liquidate them partially or fully. The market of stocks, bonds, macroeconomic or microeconomic variables are of a volatile nature and could witness sudden changes without any prior warning, therefore, the investor in securities or other assets might face some unexpected risks and fluctuations. All the information, views and expectations and fair values or target prices contained in this report have been compiled or arrived at by AlJazira Capital from sources believed to be reliable, but AlJazira Capital has not independently verified the contents obtained from these sources and such information may be condensed or incomplete. Accordingly, no representation or warranty, express or implied, is made as to, and no reliance should be placed on the fairness, accuracy, completeness or correctness of the information and opinions contained in this report. AlJazira Capital shall not be liable for any loss as that may arise from the use of this report or its contents or otherwise arising in connection therewith. The past performance of any investment is not an indicator of future performance. Any financial projections, fair value estimates or price targets and statements regarding future prospects contained in this document may not be realized. The value of the security or any other assets or the return from them might increase or decrease. Any change in currency rates may have a positive or negative impact on the value/return on the stock or securities mentioned in the report. The investor might get an amount less than the amount invested in some cases. Some stocks or securities may, by nature, of low volume/trades or may become like that unexpectedly in special circumstances and this might increase the risk on the investor. Some fees might be levied on some investments in securities. This report has been written by professional employees in AlJazira Capital, and they undertake that neither them, nor their wives or children hold positions directly in any listed shares or securities contained in this report during the time of publication of this report, however, The authors and/or their wives/children of this document may own securities in funds open to the public that invest in the securities mentioned in this document as part of a diversified portfolio over which they have no discretion. This report has been produced independently and separately by the Research Division at AlJazira Capital and no party (in-house or outside) who might have interest whether direct or indirect have seen the contents of this report before its publishing, except for those whom corporate positions allow them to do so, and/or third-party persons/institutions who signed a non-disclosure agreement with AlJazira Capital. Funds managed by AlJazira Capital and its subsidiaries for third parties may own the securities that are the subject of this document. AlJazira Capital or its subsidiaries may own securities in one or more of the aforementioned companies, and/or indirectly through funds managed by third parties. The Investment Banking division of AlJazira Capital maybe in the process of soliciting or executing fee earning mandates for companies that is either the subject of this document or is mentioned in this document. One or more of AlJazira Capital board members or executive managers could be also a board member or member of the executive management at the company or companies mentioned in this report, or their associated companies. No part of this report may be reproduced whether inside or outside the Kingdom of Saudi Arabia without the written permission of AlJazira Capital. Persons who receive this report should make themselves aware, of and adhere to, any such restrictions. By accepting this report, the recipient agrees to be bound by the foregoing limitations.

Asset Management | Brokerage | Corporate Finance | Custody | Advisory

Head Office: King Fahad Road, P.O. Box: 20438, Riyadh 11455, Saudi Arabia, Tel: 011 2256000 - Fax: 011 2256068