

Saudi Telecom Company (STC)'s net income declined 4.4% Y/Y to SAR 2.7bn, below our and consensus estimate of SAR 2.9bn. Deviation from our net income estimates came from higher than expected Cost of sale, OPEX and provisions. Revenue grew 9.7% Y/Y to SAR 14.9bn, above our estimate of SAR 13.8bn, driven by an increase in revenues of STC's Enterprise segment and subsidiaries. We revise our recommendation to **"Neutral"** on the stock, while retaining the TP at **SAR 97.4/share**.

- STC's net income fell 4.4% Y/Y to SAR 2.7bn in Q2-20, below AJC's and consensus estimate of SAR 2.9bn. The deviation of Q2-20 net income from our estimate is primarily attributed to lower-than-expected gross and operating margins due to higher-than-expected expenses and provisions for doubtful debts.
- STC's revenue increased 9.7% Y/Y to SAR 14.9bn, above our estimate of SAR 13.8bn. Revenue growth was driven by strong performance from its Enterprise segment and higher revenue from its subsidiaries such as STC Channels and STC Solutions. Moreover, data revenue grew 8.6% Y/Y in Q2-20. The company's customer base continued to expand during the quarter, with fiber optics subscribers increasing 21% Y/Y and while broadband subscribers rising 2.9% Y/Y. However, revenues from roaming, and Umrah and tourist visitors declined as a result of travel restrictions and suspension of pilgrimages due to the COVID-19 pandemic.
- Gross profit increased to SAR 8.3bn (+1.6% Y/Y), in line with our estimate. However, gross margin contracted significantly by ~440bps Y/Y to 55.9%, despite strong revenue growth, due to higher contribution from lower margin businesses (from subsidiaries). Cost of sales soared 21.9% Y/Y to SAR 6.6bn.
- Operating profit came in at SAR 3.1bn, representing a decline of 11.9% Y/Y. Operating margin was down ~500bps to 20.5%, impacted by contraction of gross margin and increase in OPEX (+11.6%). The increase in OPEX was contributed by higher general and administration expenses (+SAR 254mn Y/Y), selling and marketing expenses (+SAR 193mn Y/Y), and depreciation and amortization (+SAR 101mn Y/Y). Selling and marketing expenses were inflated by rise in provisions for doubtful debt. Provisions were mainly made against business receivables rather than government receivables, due to the adverse impact of the COVID-19 outbreak.

AJC view: STC's Q2-20 results were below our estimate. The drop in the telecom operator's margin is concerning. Given the current situation owing to the COVID-19 pandemic, margins will likely remain under pressure in H2-20 amid an increase in provisions for doubtful debt and higher costs. However, the expanding fiber optics and broadband subscriber base and growth in demand for data would continue to drive STC's revenue. Additionally, with the expansion of 5G and FTTH networks, the company is well-positioned to tap opportunities in the IoT, Cloud, 5G, and Enterprise segments. Furthermore, with license to provide electronic digital wallet services and customer base of 2mn across the MENA region, STC Pay provides great revenue potential to the company in the long term. We revise our recommendation to **"Neutral"** on the stock while keeping the TP unchanged at **SAR 97.4/share**.

Results Summary

SARmn (unless specified)	Q2-19	Q1-20	Q2-20	Change Y/Y	Change Q/Q	Deviation from AJC Estimates
Revenue	13,604	13,935	14,920	9.7%	7.1%	8.1%
Gross Profit	8,207	8,196	8,341	1.6%	1.8%	0.8%
<i>Gross Margin</i>	<i>60.3%</i>	<i>58.8%</i>	<i>55.9%</i>	-	-	-
EBIT	3,477	3,004	3,062	-11.9%	1.9%	-12.5%
Net Profit	2,848	2,913	2,724	-4.4%	-6.5%	-6.7%

Source: Company reports, Aljazira Capital

Neutral

Target Price (SAR) **97.4**

Upside / (Downside)* **0.3%**

Source: Tadawul *prices as of 23rd of July 2020

Key Financials

SARmn (unless specified)	FY18	FY19	FY20E
Revenue	51,963	54,368	55,507
Growth %	2.60%	4.60%	2.10%
Net Income	10,780	10,665	11,100
Growth %	7.60%	-1.10%	4.10%
EPS	5.39	5.33	5.55

Source: Company reports, Aljazira Capital

Key Ratios

	FY18	FY19	FY20E
Gross Margin	58.8%	59.6%	59.4%
Net Margin	20.7%	19.6%	20.0%
P/E	16.9x	19.1x	17.5x
P/B	2.7x	3.2x	2.9x
EV/EBITDA (x)	9.4x	9.5x	9.0x

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap(bn)	194.2
YTD%	-2.6%
52 week (High)/(Low)	113.2/72.3
Share Outstanding (bn)	2.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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- 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.
- 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.
- 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.
- 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.

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