



**US\$54.39bn** Market cap  
**16%** Free float  
**US\$8.04mn** Avg. daily volume

Target price  
Current price **98.0** -3.9% over current as at 23/1/2019  
**102.0**

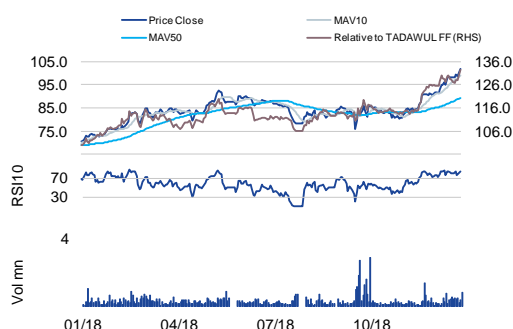
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#### Existing rating

**Underweight** **Neutral** **Overweight**

#### Performance



#### Earnings

(SAR mn)	2017a	2018a	2019e	2020e
Revenue	50,689	52,068	53,101	54,163
Y-o-Y	-3.8%	2.7%	2.0%	2.0%
Gross Profit	28,583	30,565	32,823	33,488
Gross margin	56.4%	58.7%	61.8%	61.8%
EBITDA	18,431	19,857	22,734	23,197
EBITDA margin	36.4%	38.1%	42.8%	42.8%
Net profit	10,016	10,790	14,014	14,257
EPS (SAR)	5.01	5.40	7.01	7.13
DPS (SAR)	4.00	6.00	5.00	5.00
EV/EBITDA (Curr)	10.2	9.9	8.7	8.5
EV/EBITDA (Target)	9.8	9.5	8.3	8.2

Source: Company data, Al Rajhi Capital

## STC

### Q4: Good set of numbers

STC reported a good set of Q4 results beating our net profit estimate by 4% while revenue came inline (Fig 1). The bottom-line beat was helped by better than expected reversal of costs post change in commercial service fee calculation. We revise our target price upwards because of a) structural improvement in EBITDA by ~15% due to future lower commercial fees, b) increase in target valuation multiple to 8x from 7x due to index inclusion as STC has among the largest differences between quantum of possible foreign inflows and daily liquidity among the companies to be included in EM indices, c) possibility of increase in dividend due to lower fees and improvement in receivables. Notably, STC's FCF per share has been more than DPS in the past (Fig 2). Our revised TP is SAR98/share based on equal mix of DCF and EV/2019 EBITDA of 8x. We maintain Neutral rating as the stock already has rallied post the announcement of change in fees.

#### Other take-aways:

- STC previously mentioned a reversal of SAR500mn in Q4 but it came at SAR579mn. Even after adjusting for this COGS came lower by 10%.
- In 2018, domestic data revenue was up 5.6% y-o-y and FTTH subscribers increased 18% y-o-y.
- Bottom-line would have been even higher had it not been for the provision of SAR168mn in Binariang GSM holdings.

**Reversal details:** The commercial fee that was reversed in Q4 2018 was only for 2018, implying SAR200mn (SAR579/3) reversal on a quarterly basis in 2018. For the next three years, we expect reversal of SAR2.3bn annually, which is reversal of the amount (SAR6.9bn) provisioned from 2008 to 2017 as per our understanding. Apart from this reversal, the company will save around SAR750mn per year on Govt. fee as per our assumptions. On the other hand the company will have to invest capex equivalent to the reversed amount each year and assuming 2.8% depreciation of assets (35 years lifetime for the incremental capex), the incremental depreciation would be broadly SAR65mn. In any case the EBITDA would jump to SAR22.7bn in 2019 in our view.

**Figure 1 STC: Summary of Q4 2018 results**

(SAR mn)	Q4 2017	Q3 2018	Q4 2018	% chg y-o-y	% chg q-o-q	ARC est
Revenue	12,503	13,333	13,166	5.3%	-1.3%	13,158
Gross profit	7,348	7,805	8,651	17.7%	10.8%	8,000
Gross profit margin	58.8%	58.5%	65.7%			60.8%
Operating profit	2,880	3,236	3,487	21.1%	7.8%	3,292
Net profit	2,555	2,643	3,116	22.0%	17.9%	2,985

Source: Company data, Al Rajhi Capital

**Figure 2 Per share data**

	12/16a	12/17a	12/18a
EPS	4.45	5.01	5.40
DPS	4.00	4.00	6.00
FCF*	5.21	6.26	6.60

Source: Company data, Al Rajhi Capital, \* EBITDA less Capex



**Valuation:** Given the jump in EBITDA our valuation gets a boost. We use a mix of DCF (FCF) and relative valuation (8x EV/EBITDA, commanding premium on the back of MSCI inclusion). For FCF, we use a WACC of 11.1% based on cost of equity of 11.4%. Our revised target price is SAR98/sh (up from SAR80/sh), average of FCF (SAR90/sh) and relative valuation methods (SAR106/sh).

**Risks:** Upside risks to our estimates are from higher than expected revenues from its newer investments, increase in data prices, resolution of receivables, tower sale/sharing, lower than expected cost of early retirement, hike in quarterly dividends, improvement in valuation of subsidiaries and more transparency in reporting. Downside risks are from unfavourable regulatory changes, aggressive competition leading to lower than expected ARPUs and acquisitions at expensive valuations.



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"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.

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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.

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