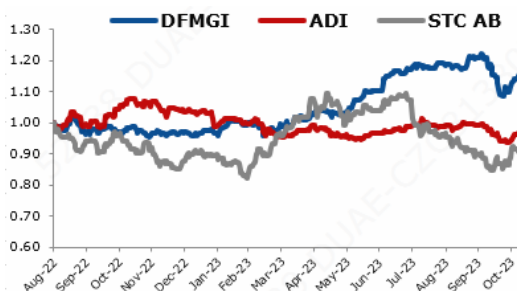


## Saudi Telecom Company

Strong top-line growth of subsidiaries and one-time gain supported profitability

Current Price	Target Price	Upside/Downside (%)	Rating
SAR 38.30	SAR 46.00	+20%	BUY

- STC reported the highest-ever revenue in the nine months of SAR 54.6 Bn in 9M2023.
- STC's mobile subscribers rose 9.1% YOY to 25.6 Mn owing to increased prepaid, postpaid and M2M subscribers. While the fixed subscribers declined marginally 0.2% YOY to 5.5 Mn in 3Q23.
- STC margin continued to remain under pressure mainly due to investment in new domains in line with the Company's strategy
- In September 2023, STC acquired 9.9% stake in Telefonica for a consideration of SAR 8.5 Bn.
- IOT Squared a joint venture between STC and PIF announced the acquisition of 100% stake in Machinestalk, a pioneer provider of IoT solutions and applications in Saudi Arabia in August 2023.



### 3Q23 Net Profit higher than our estimate

STC Group ("STC, "the Company") recorded 10.4% YOY growth in net profit to SAR 4,904 Mn in 3Q23, higher than our estimate of SAR 4,443 Mn. The increase in profit is mainly attributable to growth in revenue supported by a growth in mobile subscribers, finance income partially offset by higher direct costs, G&A expense and finance cost.

### P&L Highlights

STC's revenue grew 11.0% YOY to SAR 18.1 Bn in 3Q23 led by a growth across most of the segments. The strong growth in revenue is supported by an 9.1% YOY growth in mobile subscribers partially offset by marginal 0.2% YOY decline in fixed subscribers. Thus, revenue from Saudi Telecom Company remained flat at AED 12.4 Bn whereas Channels revenue grew 23.8% YOY in 3Q23. The Company's revenue was also positively impacted by the significant revenue growth of its subsidiaries. STC's direct cost grew significantly 23.1% YOY to SAR 7.7 Bn in 3Q23 higher than growth in topline. Hence, gross profit grew marginally 3.5% YOY to SAR 10.4 Bn in 3Q23. Gross profit margin declined from 61.6% in 3Q22 to 57.4% in 3Q23 due to reversal of contingent provision recorded in 3Q22. Selling and overhead expenses grew 10.7% YOY to SAR 1,654 Mn in 3Q23, while, G&A expenses grew from SAR 1,474 Mn in 3Q22 to SAR 1,782 Mn in 3Q23. Thus, the Company's EBITDA declined 1.7% YOY to SAR 6,952 Mn in 3Q23 mainly due to a rise in operating expenses owing to the ongoing investment in new domains aligned with the Company's strategy and one-time reversal of contingent provision recorded in 3Q22. Thus, EBITDA margin decline 498 bps YOY to 38.4% in 3Q23. Depreciation and amortization expenses grew 4.7% YOY to SAR 2,614 Mn in 3Q23. Thus, operating profit declined 5.2% YOY to SAR 4,338 Mn in 3Q23 with a decline in operating margin from 28.1% in 3Q22 to 24.0% in 3Q23. The Company recorded SAR 956 Mn in other

### Stock Information

Market Cap (SAR, mm)	191,500.00
Paid Up Capital (mm)	50,000.00
52 Week High	46.00
52 Week Low	33.95
3M Avg. daily value (SAR)	157,301,100

### 3Q23 Result Review (SAR, mm)

Total Assets	156,034
Total Liabilities	74,652
Total Equity	78,839
EBITDA	6,952
Net Profit	4,904

### Financial Ratios

Dividend Yield (12m)	4.18
Dividend Pay-out (%)	65.73
Price-Earnings Ratio(x)	13.90
Price-to-Book Ratio (x)	2.42
Book Value (SAR)	15.82
Return-on Equity (%)	18.11

### Stock Performance

5 Days	3.23%
1 Months	5.95%
3 Months	-5.32%
6 Months	-14.13%
1 Year	-1.79%
Month to Date (MTD%)	-0.26%
Quarter to Date (QTD%)	1.86%
Year to Date (YTD%)	4.64%

income compared to other expense of SAR 622 Mn in 3Q22 mainly due to gain received from the sale of land and one-time loss recognized in 3Q22 of SAR 722 Mn related to impairments expense of BGSM joint venture. Finance income grew from SAR 126 Mn in 3Q22 to SAR 340 Mn in 3Q23 due to higher benchmark rates. Finance charges also grew from SAR 185 Mn in 3Q22 to SAR 304 Mn in 3Q23. Zakat expense grew from SAR 285 Mn in 3Q22 to SAR 354 Mn in 3Q23 due to growth in profitability.

### Balance Sheet Highlights

STC's gross debt grew from SAR 10.2 Bn in 9M22 to SAR 22.2 Bn in 9M23. Cash and cash equivalent rose from SAR 14.8 Bn in 9M22 to SAR 22.4 Bn in 9M23. STC's capex grew from SAR 5,027 Mn in 9M22 to SAR 6,234 Mn in 9M23. The Company's free cash flow declined from SAR 4,510 Mn in 9M22 to SAR 3,753 Mn in 9M23.

### Target Price and Rating

We maintain our BUY rating on Saudi Telecom Company with a revised target price of SAR 46.00. STC delivered a growth in profitability in 3Q23 primarily due to strong rise in revenue driven by growth in the Mobility segment as well as strong performance of its subsidiary companies and emerging investments. STC Mobile subscribers rose 9.1% YOY to 25.6 Mn due to addition of customers across prepaid, postpaid, and m2m segments. While fixed subscribers declined marginally 0.2% YOY to 5.5 Mn in 3Q23. In September 2023, STC acquired 9.9% stake in Telefonica for a consideration of SAR 8.5 Bn. Telefonica is a telecommunications company with a significant presence in Germany, the UK, Spain, and Brazil. The investment is anticipated to be in accordance with STC's growth strategy, which entails acquiring stakes in strategically valuable assets in promising markets and utilizing the investment returns to facilitate its growth and expansion. Furthermore, STC's subsidiary, TAWAL announced that it started its operations in Europe and now owns and operates around 4,800 sites of United Group across Bulgaria, Croatia, and Slovenia. TAWAL's total tower portfolio now surpassed 21,000 towers spanning across five countries. This also led to an expansion in STC's international footprint and supporting infrastructure expansion plans. Furthermore, IOT Squared the Company's joint venture with PIF announced 100% acquiring of Machinestalk, a pioneer provider of IoT solutions and applications in Saudi Arabia. The acquisition is anticipated to accelerate IOT squared growth and will enable it to become the region's leading provider of iot solutions. STC also continues to monetize its assets in 3Q23 the Company sold its land in Khobar City for SAR 1,378 Mn recording a gain of SAR 1,296 Mn. Asset monetization will help consolidate the asset base and provide funds to invest in core businesses. It will also strengthen the balance sheet and lead to pay a special dividend. Furthermore, as per the Company's dividend distribution policy, STC distributed a quarterly dividend of SAR 0.4 per share for the period 3Q23. Thus, based on our analysis, we maintain a BUY rating on the stock.

### STC - Relative valuation

(at CMP)	2018	2019	2020	2021	2022	2023F
PE	17.5	17.7	17.1	16.7	15.5	13.0
PB	2.9	3.1	2.9	2.7	2.6	2.4
EV/EBITDA	8.9	8.9	8.1	8.0	7.0	7.5
Dividend yield	6.4%	4.2%	5.3%	4.2%	4.2%	4.2%

FABS Estimates & Co Data

**STC – P&L**

SAR mm	3Q22	2Q23	3Q23A	3Q23F	VAR	YOY Ch	QOQ Ch	2022	2023F	YOY Ch
Sales	16,308	18,327	18,106	18,046	0.3%	11.0%	-1.2%	67,432	72,921	8.1%
Cost of Sales	-6,268	-9,194	-7,718	-8,572	-10.0%	23.1%	-16.0%	-30,038	-33,908	12.9%
<b>Gross profit</b>	<b>10,040</b>	<b>9,133</b>	<b>10,388</b>	<b>9,474</b>	<b>9.6%</b>	<b>3.5%</b>	<b>13.7%</b>	<b>37,393</b>	<b>39,013</b>	<b>4.3%</b>
Selling & overhead exp.	-1,494	-1,567	-1,654	-1,624	1.8%	10.7%	5.5%	-6,110	-6,417	5.0%
G&A expenses	-1,474	-1,745	-1,782	-1,624	9.7%	20.9%	2.1%	-6,204	-7,146	15.2%
<b>EBITDA</b>	<b>7,073</b>	<b>5,821</b>	<b>6,952</b>	<b>6,226</b>	<b>11.7%</b>	<b>-1.7%</b>	<b>19.4%</b>	<b>25,079</b>	<b>25,449</b>	<b>1.5%</b>
Dep & Amort	-2,496	-2,540	-2,614	-2,686	-2.7%	4.7%	2.9%	-9,990	-10,525	5.4%
<b>Operating profit</b>	<b>4,576</b>	<b>3,281</b>	<b>4,338</b>	<b>3,540</b>	<b>22.5%</b>	<b>-5.2%</b>	<b>32.2%</b>	<b>15,088</b>	<b>14,924</b>	<b>-1.1%</b>
Other income/(exp)	-622	-37	956	1,262	-24.2%	NM	NM	-1,524	445	-129.2%
Finance Income	126	382	340	361	-5.7%	170.5%	-10.9%	602	1,479	145.5%
Financial charges	-185	-248	-304	-235	29.8%	64.8%	22.9%	-697	-907	30.2%
<b>Profit before zakat</b>	<b>3,896</b>	<b>3,378</b>	<b>5,330</b>	<b>4,927</b>	<b>8.2%</b>	<b>36.8%</b>	<b>57.8%</b>	<b>13,470</b>	<b>15,942</b>	<b>18.4%</b>
Zakat	-285	-331	-354	-443	-20.2%	24.2%	7.0%	-1,083	-1,275	17.7%
<b>Profit before NCI</b>	<b>3,610</b>	<b>3,047</b>	<b>4,976</b>	<b>4,484</b>	<b>11.0%</b>	<b>37.8%</b>	<b>63.3%</b>	<b>12,387</b>	<b>14,667</b>	<b>18.4%</b>
NCI	69	39	72	41	73.6%	3.0%	84.6%	216	165	-23.7%
<b>Net Profit</b>	<b>3,541</b>	<b>3,008</b>	<b>4,904</b>	<b>4,443</b>	<b>10.4%</b>	<b>38.5%</b>	<b>63.0%</b>	<b>12,171</b>	<b>14,502</b>	<b>19.2%</b>

FABS estimate & Co Data

**STC – Margins**

	3Q22	2Q23	3Q23	YOY Ch	QOQ Ch	2022	2023F	YOY Ch
Gross Profit	61.6%	49.8%	57.4%	-420	754	55.5%	53.5%	-195
EBITDA	43.4%	31.8%	38.4%	-498	663	37.2%	34.9%	-229
Operating Profit	28.1%	17.9%	24.0%	-411	606	22.4%	20.5%	-191
Net Profit	21.7%	16.4%	27.1%	537	1067	18.0%	19.9%	184

FABS estimate & Co Data

## Valuation:

We use Discounted Free Cash flow (DCF) and Relative Valuation (RV) to value Saudi Telecom Company. We have assigned 70% weight to DCF and 30% to RV.

Valuation Method	Target	Weight	Weighted Value
DCF Method	50.75	70.0%	35.53
Relative Valuation (RV)	34.90	30.0%	10.47
<b>Weighted Average Valuation (SAR)</b>			<b>46.00</b>
Current market price (SAR)			38.30
Upside/Downside (%)			+20%

### 1) DCF Method:

STC is valued using free cash flow to firm. We have discounted the cash flow using the weighted average cost of capital of 8.7%. It is arrived after using cost of equity of 8.8% and after-tax cost of debt of 6.6% with debt-to-equity ratio of 5.6%. Cost of equity is calculated by using 10-year government bond yield of 4.5%, beta of 0.95 and equity risk premium of 4.6%. Government bond yield is calculated after adding KSA 10-year CDS spread over 10-year US risk free rate. The cost of debt is calculated using the cost of 6.8% after adjusting a tax rate arriving at after-tax cost of debt of 6.6%. Also, assumed a terminal growth rate of 2.0%.

Sum of PV (SAR, Mn)	52,060
Terminal value (SAR, Mn)	207,878
<b>FV to Common shareholders (SAR, Mn)</b>	<b>253,766</b>
No. of share (Mn)	5,000
Current Market Price (SAR)	38.30
<b>Fair Value per share (SAR)</b>	<b>50.75</b>

### DCF Method

(All Figures in SAR Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
NOPAT	14,447	15,529	16,176	16,836	17,743
Depreciation and Amortization	10,525	10,820	11,377	11,801	12,314
(-) CAPEX	-13,094	-13,636	-13,850	-13,917	-13,804
(-) Change in Net Working Capital	182	-561	1,558	1,675	3,125
<b>Free Cash Flow to Equity (FCFF)</b>	<b>2,010</b>	<b>12,152</b>	<b>15,261</b>	<b>16,395</b>	<b>19,378</b>
Discounting Factor	0.99	0.91	0.84	0.77	0.71
<b>Discounted FCFF</b>	<b>1,988</b>	<b>11,046</b>	<b>12,752</b>	<b>12,593</b>	<b>13,682</b>

Source: FAB Securities

## 2) Relative Valuation:

We have used local as well as international peers to value STC and it is valued using the EV/EBITDA multiple. It is valued at EV/EBITDA multiple of 6.9x in line with peers.

Company	Market (USD Mn)	EV/EBITDA (x)		P/E (x)	
		2023F	2024F	2023F	2024F
Etihad Etisalat Company (Mobily)	9,467	6.9	6.2	17.9	15.5
Mobile Telecommunication Company Saudi	3,308	6.4	5.9	11.3	16.1
Emirates Telecommunications Group Company	43,710	6.8	6.7	15.9	15.6
Telstra Group Ltd	27,870	8.2	6.9	25.7	20.3
Bharti Airtel	64,200	7.8	9.0	51.4	57.7
<b>Average</b>		<b>7.2x</b>	<b>6.9x</b>	<b>24.4x</b>	<b>25.0x</b>
<b>Median</b>		<b>6.9x</b>	<b>6.7x</b>	<b>17.9x</b>	<b>16.1x</b>
<b>Max</b>		<b>7.8x</b>	<b>6.9x</b>	<b>25.7x</b>	<b>20.3x</b>
<b>Min</b>		<b>6.8x</b>	<b>6.2x</b>	<b>15.9x</b>	<b>15.6x</b>

Source: FAB Securities

## Research Rating Methodology:

Rating	Upside/Downside potential
BUY	Higher than +15%
ACCUMULATE	Between +10% to +15%
HOLD	Lower than +10% to -5%
REDUCE	Between -5% to -15%
SELL	Lower than -15%

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