Q2, 2020 Earnings Call Transcript

Call Date	23rd July, 2020
Time	11:00 KSA
stc's Attendees	Mr. Ameen Al Shiddi – stc group CFO Mr. Ali Alharbi – Corporate Finance, VP Mr. Turki Alashaikh – Investor Relations, GM

Turki AL Ashaikh (IR General Manager):

Thank you everyone for joining stc's Q2 earning call. Today, we will have Mr. Ameen Al Shiddi – stc group CFO – along with Mr. Ali Al Harbi the Corporate Finance Vice President.

We will start with a 5-10 minutes presentation followed by Q&A session, thank you.

Presentation (Mr. Ameen Al Shiddi – stc group CFO):

Welcome to stc's Q2 2020 financial performance conference call. I hope that everyone is safe and in good health.

As you know, the outbreak of COVID-19 continued to spread at an alarming rate across the globe and has bought almost all economic and social activity to a standstill during Q2, 2020. This has caused unprecedented disruption in everyone's life and Saudi Arabia is not an exception to this. Yet, due to stc's proactive approach, business resilience and strong supply chain; it was able minimize the impact of the pandemic on its business performance, and achieve growth across all business units during the 1st half of 2020.

The company was able to grow its top line by 9.7% in Q2 of 2020 as compared to the same period last year, whereas it grew by 6.9% for the 1st half of 2020 as compared to similar period last year. This growth was mainly driven by the improved performance of Enterprise business unit and other KSA subsidiaries especially STC Channels (thru increased sale of devices) and STC Solution (across the business segments i.e. System integration, Managed Services, outsourcing services, cybersecurity & Cloud Services). We were able to achieve these good results in spite of the overall challenges that the group faced due to: i) the decrease in revenues from stc Kuwait & stc Bahrain, ii) decline in roaming charges iii) ban on Umrah & tourist visa and iv) increase in doubtful debts provisions. Further, it is important to note that the decline in EBITDA was due to multiple factors, such as growth in non-core businesses that are generally lower margins products, along with expenses related to COVID-19 outbreak.

I would also like to highlight that stc DARE strategy involves some long-term investments, which will require an extended period of time to become profitable and contribute positively towards stc's EBITDA. For example during this period, stc Pay was able to improve its business performance and increase its active subscriber base significantly higher than the initially envisioned. It has not become profitable yet due to the long term nature of investment, which requires startup related expenses; nonetheless we are optimistic that it will positively contribute towards group's overall profitability in the near future. Furthermore, stc's investments are not only limited to non-core businesses , as it is equally focusing on its core business as well e.g. investment in 5G and FTTH. Those investments are essential for stc to maintain its leadership position in the market. Besides, other strategic investments, such as infrastructure digitization will enable the company to have seamless operations and bring about efficiencies.

Moreover, one of the main pillars of stc's future growth will come from accelerating the performance of its core assets, such as fiber optic network that currently resulted into a double-digit growth in terms of subscribers' base, real estate monetization, and ICT solutions that we provide to the government and other enterprise customers. Additionally, stc is extremely focused on reinventing its customer experience. It is continuously investing to enhance customers' experience through improved marketing campaigns, call centers upgradation, reskilling employees and attracting the right talent. We believe investment in these areas are crucial to ensure that our customers are served with best in class services and fully satisfied. Finally, with regards to "E" component (i.e. expand in scale and size) of our DARE strategy, we are continuously evaluating the expansion opportunities within MENA region. We are still working on the Vodafone Egypt acquisition transaction that has been extended for the second time due to the logistical challenges caused by COVID-19. Yet, we believe that we will be able to conclude the due diligence by Q4, 2020.

To conclude, I would like to reiterate that on overall basis, while considering global health crisis due to pandemic, economic slowdown, increase in bad debt provisions, and the additional expenses as I have mentioned earlier; stc was able to demonstrate robust business resilience and achieve very good results; in line with its original plan.

We will now start the Q&A session.

Q&A Session:

Person/ Company	Question	Answer
Abdulaziz Alhebaishi **Jadwa**	**Q1:** Please shed some lights on the open access agreement that was signed between the operators in KSA and what are the implications from that on stc's FTTH pricing and profitability. **Q2**: Regarding TAWAL, according to my understanding, the goals of this company are cutting cost and expanding the tower base. Now, we have seen a MOU signed between your two competitors in the market to do the same thing. Is the business still valuable from stc's?	**A1:** CITC's Open Access agreement has recently come into play. One might assumes that this would not be in favor of stc since it owns the largest infrastructure in the Kingdom; however, this is not necessarily the case. So far, stc has witnessed a marginal positive impact post implementation of this agreement. This impact could be attributed to the substantial marketing power that **A2:** Establishment of TAWAL has helped to enhance the overall efficiencies, which are positively contributing towards the group. As you stated, expansion into local and regional markets is one of the main objectives of TAWAL and we are continuously evaluating the potential opportunities. With regards to MoU signed between two competitors, we are evaluating and exploring different options; However, I am afraid, the same cannot be disclosed at this stage.
Nishit Lakhotia **SICO**	**Q1:** What led to growth in revenue? Also, we saw a jump in cost of sales this quarter compared to previous quarter and last year Q2, is it because of stc channels and stc solutions? **Q2:** You mentioned that data revenue grew by around 8.6%, and I believe data consumption have gone up substantially. Is there an issue in monetizing this data growth?	**A1:** The major contribution of topline growth was mainly from two subsidiaries i.e. stc channels and stc solutions. stc channels witnessed increase in devices sales due to massive surge in buying by the customers before the implementation of VAT i.e. July 1, 2020. Further, the increase in stc solutions revenues was accompanied with an increase in cost of sales, since some of the ICT related services have low margins. Moreover, we also booked some bad debt provisions from the business side due to delay in collections. **A2:** As far as data monetization is concerned, it has always been an issue for all operators. We are required to invest heavily in the network to meet the demand, especially during COVID-19 pandemic. This segment has very competitive market and it is price sensitive too; Therefore, the growth in revenues from data is much lower as compared to the overall increase in its consumption. We are continuously trying to optimize our cost structure as much as possible, while maintaining the high-speed levels. We expect the data consumption to normalize post pandemic, and its contribution towards the revenues too. We will continue to invest in our network infrastructure to cope up with the high demand and maintain our leadership position in the market.
Hassan Abdelgelil **CI Capital**	**Q1:** My question is related to the provisions that you are taking away from your receivables or bad debts; is it related to the government receivables? Should we expect that some of the government receivables will not be collected? **Q2:** In regard to Vodafone Egypt, what is the reason for the MoU extension? Is it a matter of stc presence in Egypt to complete the due diligence? Or is it related to the agreement on the price? Or is it with the government? **Q3:** In regard to Ethiopian license, When it is expected to be finalized? **Q4:** How much is the impact of the impairments of the bad debts on this quarter?	**A1:** The provisions are primarily related to the business side, particularly from the SMEs' as we have noticed some delays in their payments. However, there is no default in payment from government. As clearly disclosed in the financial statements, the aging of some of the receivables are beyond 2 years. We have started the calculation of fair value on these receivables and it would have an impact on P&L. However, this will be disclosed by year-end **A2:** There are mainly two important issues w.r.t. extension of MOU in Vodafone transaction. Firstly, the physical presence is very important. Although we were able to complete 80% of the due diligence activities yet the remaining 20%, it requires the team to be physically present in Egypt. The other reason for the delay is to properly assess and review the overall impact of COVID-19 pandemic on the Egypt's macroeconomic environment, and on Vodafone business performance & valuation.

		A3: The Ethiopian license issuance process is at a very early stage. We have requested for some data and information to study and assess the investment proposition before showing any interest. **A4:** We are not disclosing the number.
Adel Muyini **Samba Capital**	**Q1:** What is the growth rate of revenue from your core business? **Q2:** Do you expect similar margins on the following quarters? **Q3:** Any comments on Zain results?	**A1:** Although most of the growth came from the KSA subsidiaries e.g. stcPay, ICT services from stc Solutions and devices sales from stc Channels , yet part of H1, 2020 growth in topline was also contributed by core business i.e. consumer, wholesale and enterprise business segments. **A2:** As far as the margins are concerned, it is important to understand that some of the services have low margins due to the nature of the service itself or due to the fact that some services will take time to mature before start generating higher margins. Part of our DARE strategy pillars is to expand in both core and non-core businesses, therefore we need to invest in them but not heavily; While keeping an eye on the long-term sustainability of the businesses. The margins are expected to be impacted for some time as we are investing and expanding in our subsidiaries. The profits and margins that we are expecting will not be reflected right away. **A3:** No comments on Zain results.
Omar Maher **EFG-Hermes**	**Q1:** You mentioned that most of the revenue growth is coming from non-core business from Channels and Solutions, and device sales as one of the reasons of the growth, and slight decline in margin year on year. It is a bit surprising that most of the operators in Saudi and the region are reporting a decline in device sales. Can you explain that? Also, which of the two have bigger impact on the decline in EBITDA margin, would it be this or provisions you took for bad debts? **Q2:** What is the one element that had the biggest negative impact on EBITDA margin? Would it be stcpay?	**A1:** Though solutions and Channels have contributed majority of the growth; other business units have also performed well towards the increase in topline. Furthermore, other group subsidiaries like stcPay also added its shares towards the revenues growth along with the increase in sale of devices. The sale of devices were high in June due to significant buying before the VAT implementation date i.e. July 1, 2020 **A2:** The negative impact on EBITDA margin is not a result of one item, rather it is a combination of many factors such as: increase in operational expenses, network cost, investments related to some subsidiaries etc.
Abdulaziz Alhebaishi **Jadwa**	**Q1:** More on the core business, since the VAT implementation, have you seen a shift in packages, like consumers switching to lower packages or downgrading packages? **Q2:** In regards to the accounting segmentation, will we see any of the non-core businesses be reported as stand-alone segment or more disclosure in that front anytime soon?	**A1:** We have not noticed any change in consumer spending pattern yet; However, it is too early to conclude anything at this point in time. Historically, we experienced a short-term impact at the time of 5% VAT implementation; though it normalized over time. However, this time it is different, since it is an additional 10% VAT! We are continuously keeping an eye on the consumer purchasing behavior and will act accordingly. **A2:** We are aiming to continuously improve stc transparency and disclosure policy, accordingly, the topline disclosure policy with respect to subsidiaries is being reviewed, as we have seen some demand of the same, you might see a bit of more disclosure at the year end.

Turki AL Ashaikh (IR General Manager):

Thank you all again for participating in stc's Q2, 2020 conference call. If you need anything, please do not hastate to email us at IRU@stc.com.sa,

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