

Rating
12- Month Target Price
Neutral
SAR 73.00
SAUDI TELECOM COMPANY (STC)

3Q2017 First Look

Expected Total Return

Price as on Oct-29, 2017	SAR 67.59
Upside to Target Price	7.4%
Expected Dividend Yield	5.9%
Expected Total Return	13.3%

Market Data

52 Week H/L	SAR 78.90/57.00
Market Capitalization	SAR 135,180 mln
Shares Outstanding	2,000 mln
Free Float	16.14%
12-Month ADTV	483,538
Bloomberg Code	STC AB

1-Year Price Performance


Source: Bloomberg



3Q2017 (SAR mln)	Actual	RC Forecast
Revenue	12,835	13,401
Gross Profit	7,650	7,397
Net Income	2,621	2,339
EPS (SAR)	1.31	1.17

Efficiency Gains Drive Profit

STC reported a net income of SAR 2.62 billion, beating our estimates of SAR 2.34 billion and consensus estimate of SAR 2.33 billion. Bottom line increased +18% Y/Y and +10% Q/Q on the back of boosting operating efficiency. Cost of service declined by -25% Y/Y raising gross margins by 900bps and the reason for the deviation versus our forecasts. Overall operating expenses remained flat Y/Y but operating margins increased from 17% to 23%. Management believes that the current level of operating efficiency is sustainable, however, with lower MTR beginning December 23rd, 4Q would be partially impacted. Net margins of 20% trumped our forecast of 17% and last quarter's 18%. We maintain our Neutral stance with a target price of SAR 73.00 and await further clarity on the subscriber base and the financial impact of the increased focus on enterprise business by the Company.

Top line on a declining trajectory

STC posted a sharp decline in revenues to the tune of -8% Y/Y and -3% Q/Q to SAR 12.8 billion. We attribute revenue decline mainly to declining subscriber base in the overall market and lower weight of data revenue in revenue mix as compared to Zain. However, STC is growing in the enterprise business which has a better risk reward profile than the consumer business. Management has demonstrated the ability to control its cost of service; gross margins stood at 60% versus 51% last year and 55% last quarter. Resultantly, the gross profit grew to SAR 7.6 billion, rising +7% Y/Y and +5% Q/Q. In our view, margins would be threatened by MTR rate reduction to SAR 0.055 which will have a full quarter's impact from 1Q2018.

Operating efficiency program on track

Management has reacted to overall sector changes by an operational efficiency program which has paid off this quarter. Overall operating expenses remained flat Y/Y making cost of service the main driver for higher than expected EBITDA margin. Operating profit recorded a growth of +23% Y/Y and +14% Q/Q despite the usual increase in S&M expenses due to Hajj season. Operating profit stood at SAR 2.9 billion versus our estimates of SAR 2.4 billion. We expect decline in operational expenses as efficiency program execute more initiatives.

Net margins at 20%

Net income of SAR 2.62 billion (+18% Y/Y, +10% Q/Q) beat our estimates of SAR 2.34 billion. Highlight of the quarter revolved around declining revenues, improving cost of service leading to gross margins of 60% coupled with controlling other income and expenses. Cost efficiency program is impacting financials positively. Dividend yield of 5.9% is attractive compared to TASI's 3.3%. Net margins improved to 20% versus 19% last quarter and our estimate of 17%. We maintain our SAR 73.00 target price and Neutral recommendation. Some would argue on the attractiveness of 2017E P/E of 13.4x versus TASI's 13.9x. However, we believe investors are discounting disruption caused by industry changes particularly reduction in subscriber base.

Key Financial Figures

FY Dec 31 (SAR mln)	2016A	2017E	2018E
Revenue	51,833	51,056	52,077
Gross Profit	28,772	29,102	30,204
Net Profit	8,532	10,107	10,968
EPS (SAR)	4.95	5.05	5.48
DPS (SAR)	4.00	4.00	4.00

Key Financial Ratios

FY Dec 31	2016A	2017E	2018E
BVPS (SAR)	30.54	31.96	34.30
ROAE	13.9%	16.3%	16.9%
ROAA	8.6%	10.2%	11.1%
EV/EBITDA	7.7x	6.9x	6.7x
P/E	15.8x	13.4x	12.3x

Stock Rating

Buy	Neutral	Sell	Not Rated
Expected Total Return Greater than 15%	Expected Total Return between -15% and +15%	Expected Total Return less than -15%	Under Review/ Restricted

* The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors

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