Saudi Telecom Co.

Result Flash Note Q2-22

ALJAZIRA CAPITAL الجزيرة للأسواق المالية

Saudi Telecom Company (STC)'s net income edged up 0.6% Y/Y SAR 2.84bn (-6.5% Q/Q) in Q2-22, missing AJC and consensus estimates of SAR 3.11bn and SAR 3.06bn, respectively. The deviation from our estimate was primarily due to one-off impact of impairment provision of SAR 298mn related to investment in BGSM, a joint venture. This was partly offset by higher-than-expected gross margin. Revenue grew 6.5% Y/Y to SAR 16.94bn, in line with our estimate of SAR 17.01bn. We maintain our "Overweight" rating on the stock but lower TP to SAR 124/share.

- STC's net income rose 0.6% Y/Y to SAR 2.84bn in Q2-22, below our and consensus estimates of SAR 3.11bn and SAR 3.06bn, respectively. The variance in net income from our estimate was primarily ascribed impairment provisions amounting to SAR 298mn related to investment in a joint venture, BGSM. The impairment provision was recorded by STC due to deteriorated operating conditions in Malaysian market and decline in share prices of key underlying investment. Total provisioning for this investment stood at SAR 537mn in H1-22. However, better gross margin partially counteracted the impact of impairment provision. The Q/Q decline in net income was due to a slight fall in revenue, higher OPEX and higher impairment provisions.
- Revenue increased 6.5% Y/Y to SAR 16.94bn, in line with our estimate of SAR 17.01bn. Revenue growth was driven by continued momentum Enterprise business unit amid continued demand for digitization, further supported by growth in Wholesale and Consumer segments. The growth in Consumer business unit was aided by increase in fixed wireless access subscribers by 3.4% Y/Y and FTTH subscribers by 13.5% Y/Y. In Wholesale business unit, both local and international revenues increased.
- Gross profit rose 9.8% Y/Y to SAR 9.17bn, as the revenue growth was further supported by expansion of gross margin by 163bps Y/Y to 54.2%, higher than our expectation of 52.6%. On Q/Q basis, gross margin improved by 31bps. The higher contribution of parent company to revenue growth compared to low-margin subsidiaries likely to have supported gross margin during the quarter.
- Operating profit grew 14.5% Y/Y to SAR 3.72bn (AJC estimate: SAR 3.67bn), mainly driven gross profit growth and relatively moderate (+6.9%) OPEX growth. Operating margin expanded to 22.0% from 20.4% in Q2-21, above our expectation of 21.6%.

AJC view: STC's Q2-22 results were negatively impacted by the one-off provision. We believe that there is possibility of some more provisions against revaluation of the company's investments in associated and JVs (SAR 5.3bn as of June 2022), due to the impact of rising interest rates, and assume provisioning of around SAR 200mn in H2-22. However, the operating performance of the company remained sturdy and was largely in line with our estimates. The company recorded improvement in gross margin, which we believe was due to higher growth from parent STC KSA compared to low-margin subsidiaries. But it needs to be seen if this margin level is sustainable, as most of the company's subsidiaries are in growth phase. The continued strength in Enterprise business unit and expanding subscriber base in Consumer business unit would support STC's revenue growth in coming quarters. However, a significantly high and rising amount of government receivables (SAR 28.3bn as of June 2022, up from SAR 21.6bn in December 2021) on the balance sheet is a key risk for the company. We remain "**Overweight**" on the stock but lower TP to **SAR 124.0/share**.

Results Summary

SARmn	Q2-21	Q1-22	Q2-22	Change Y/Y	Change Q/Q	Deviation from AJC Estimates
Revenue	15,899	16,991	16,939	6.5%	-0.3%	-0.4%
Gross Profit	8,352	9,150	9,174	9.8%	0.3%	2.5%
Gross Margin	*52.5%*	*53.9%*	*54.2%*	-	-	-
EBIT	3,250	3,824	3,720	14.5%	-2.7%	1.4%
Net Profit	**2,821**	**3,035**	**2,837**	0.6%	-6.5%	-8.8%
EPS	**1.41**	**1.52**	**1.42**	-	-	-

Source: Company Reports, AlJazira Capital *NM: Not meaningful

Overweight

Target Price (SAR)	124.0
Upside / (Downside)*	19.0%

Source: Tadawul *prices as of 14th of August 2022

Key Financials

SARmn (unless specified)	FY20	FY21	FY22E	FY23E
Revenue	58,953	63,417	68,138	70,931
Growth %	8.4%	7.6%	7.4%	4.1%
Net Income	10,995	11,311	11,867	13,252
Growth %	3.1%	2.9%	4.9%	11.7%
EPS	5.50	5.66	5.93	6.63

Source: Company reports, Aljazira Capital

Key Ratios

	FY20	FY21	FY22E	FY23E
Gross Margin	57.6%	53.3%	53.9%	54.0%
Net Margin	18.7%	17.8%	17.4%	18.7%
P/E (x)	19.3	19.9	17.6	15.7
P/B (x)	3.2	3.1	2.7	2.6
EV/EBITDA (x)	9.6	9.8	8.5	8.3
Dividend Yield	4.7%	3.6%	3.8%	3.8%

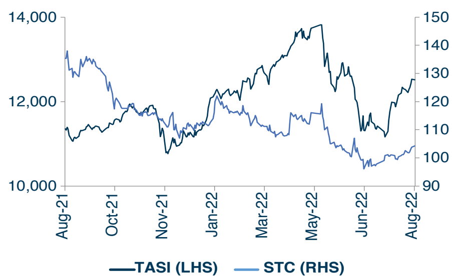
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap(bn)	208.4
YTD%	-7.3%
52 week (High)/(Low)	138.6/95.2
Share Outstanding (bn)	2.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

Head of Sell-Side Research
Jassim Al-Jubran
+966 11 2256248
j.aljabran@aljaziracapital.com.sa

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

RESEARCH DIVISION

Head of Sell-Side Research

Jassim Al-Jubran

+966 11 2256248
j.aljabran@aljaziracapital.com.sa

RESEARCH DIVISION

AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. 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.
2. 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.
3. 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.
4. 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.

Disclaimer