Saudi Telecom Co. (STC)

Results Flash Note Q1-24

A decent net income growth supported by topline and operating efficiency, despite pressure on gross margin

Saudi Telecom Company (STC)'s net income increased 5.7% Y/Y SAR 3.3bn in Q1-24, beating both AJC's and consensus estimate of SAR 3.0bn. The deviation in net profit from our estimate was mainly attributable to lower-than-expected OPEX, depreciation and amortization, and zakat expenses. Revenue of SAR 19.1bn, up 5.1% Y/Y, was in-line with our estimate of SAR 18.7bn. The growth in revenue from the subsidiaries along healthy performance of commercial and carriers and wholesale led the topline growth. The gross margin contracted to 49.1% vs. 50.8% in Q1-23 and was below our estimate of 51.5%. We maintain our "Overweight" rating on the stock with a TP of SAR 45.5/share.

- STC posted a net profit of SAR 3.3bn (+5.7% Y/Y) in Q1-24, above AJC's and market estimate of SAR 3.0bn. The higher-than-expected net profit was supported by lower OPEX, depreciation and amortization, and zakat expense. The Y/Y growth in net income was mainly led by higher revenue coupled with an almost flat OPEX and depreciation and amortization. The contraction in the gross margin limited the bottom line growth.
- Revenue rose 5.1% Y/Y to SAR 19.1bn, in-line with our estimate of SAR 18.7bn. The revenue growth in Q1-24 was mainly driven by a 13.0% Y/Y growth in revenue from subsidiaries. Channels (+10.2% Y/Y) and Tawal (+26.0% Y/Y) were the key contributors to the revenue growth. STC KSA's revenue growth was comparatively slower at 1.2% Y/Y, mainly affected by a decrease in business unit revenue. However, a rise in revenue for commercial (+6.7% Y/Y) and carriers and wholesale (+5.7% Y/Y) units supported the topline.
- Gross profit rose 1.6% Y/Y to SAR 9.4bn (AJC estimate: SAR 9.6bn). The gross margin at 49.1% was ~165bps lower than 50.8% in Q1-23 and was below our expectation of 51.5%.
- Operating profit rose 3.4% Y/Y to SAR 3.9bn (AJC estimate: SAR 3.6bn), as almost flat OPEX (+0.7% Y/Y), despite higher revenue offset the impact of lower gross margin partially. Operating margin contracted to 20.2% from 20.5% in Q1-23. The OPEX to sales ratio decreased to 15.2% from 15.9%.

AJC view: STC's Q1-24 results were mainly driven by continued topline growth and improved operating efficiency. However, the company's gross margin continues to be affected by the growing share of revenue by subsidiaries. However, as the subsidiaries start maturing the gross margin is expected to improve. Moreover, STC's diversification of business through its subsidiaries and investment in modern technologies is likely to pay off in the long term. STC is estimated to receive a cash consideration of SAR 8.7bn from PIF's acquisition of TAWAL, supporting the company's growth strategy. Moreover, the company's other subsidiaries also provide value unlocking potential in future. Additionally, STC's current dividend policy will end in FY24. Thus, a new dividend policy is likely to be announced by the end of this year, which may include an increase in the minimum dividend payment. The stock is currently trading at a P/E of 14.5x to our FY24E EPS, while FY24E dividend yield stands at 4.3%. We keep our TP for STC unchanged at **SAR 45.5/share** and remain "**Overweight**" on the stock.

Results Summary

SAR mn	Q1-23	Q4-23	Q1-24	Change Y/Y	Change Q/Q	Deviation from AJC Estimates
Revenue	18,179	17,724	19,100	5.1%	7.8%	2.0%
Gross Profit	9,234	8,928	9,386	1.6%	5.1%	-2.6%
Gross Margin	*50.8%*	*50.4%*	*49.1%*	-	-	-
EBIT	3,731	2,851	3,856	3.4%	35.3%	7.2%
Net Profit	**3,109**	**2,274**	**3,286**	5.7%	44.5%	9.6%
EPS	0.62	0.45	0.66	-	-	-

Source: Company Reports, AlJazira Capital

Recommendation	Overweight
Target Price (SAR)	45.5
Upside / (Downside)*	21.3%

Source: Tadawul *prices as of 7th of May 2024

Key Financials

SARmn (unless specified)	FY22	FY23	FY24E	FY25E
Revenues	67,432	72,337	76,290	79,965
Growth %	7.0%	7.3%	5.5%	4.8%
Net Income	12,171	13,295	12,929	14,031
Growth %	7.6%	9.2%	-2.8%	8.5%
EPS	2.43	2.66	2.59	2.81
DPS	1.60	2.60	1.60	1.60

Source: Company reports, Aljazira Capital

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	55.5%	52.3%	51.4%	52.3%
Net Margin	18.0%	18.4%	16.9%	17.5%
ROE	16.0%	16.3%	14.9%	14.9%
ROA	8.9%	8.3%	7.8%	8.1%
P/E (x)	15.0	15.2	14.5	13.4
P/B (x)	2.4	2.5	2.2	2.0
EV/EBITDA (x)	7.6	7.8	7.1	7.0
Dividend Yield	4.4%	6.4%	4.3%	4.3%

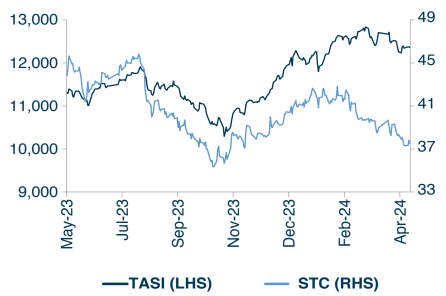
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap(bn)	191.0
YTD%	-7.2%
52 week (High)/(Low)	46.00/35.00
Share Outstanding (bn)	5.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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RESEARCH DIVISION

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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.

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