Saudi Telecom Co. (STC)

Results Flash Note Q2-24

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

Healthy Y/Y earnings growth led by operating margin expansion amid controlled OPEX, despite jump in finance expenses and cost of early retirement

Saudi Telecom Company (STC)'s net income rose 9.8% Y/Y SAR 3.3bn in Q2-24, in line with both AJC's and consensus estimate of SAR 3.2bn. Revenue of SAR 19.2bn, up 4.5% Y/Y, was in line with our estimate of SAR 19.4bn. The topline growth was mainly fueled by revenue from the subsidiaries which grew 13.9% Y/Y. STC KSA's revenue rose marginally by 0.1% Y/Y. The revenue for the commercial unit increased 5.3% Y/Y, while the business unit witnessed a decline in topline. The gross margin expanded to 50.0% vs. 49.2% in Q2-23 and was above our estimate of 49.5%. Revenue growth, gross margin expansion, and decline in OPEX (excl. D&A; -1.2% Y/Y) helped the earnings growth. 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 (+9.8% Y/Y) in Q2-24, in line with AJC's and market estimate of SAR 3.2bn. The net profit growth was supported by higher revenue, expansion of gross margin, and lower OPEX. However, higher non-operating expenses such as finance expenses and cost of early retirement (both rose more than 2x) limited the net profit growth.
- Revenue rose 4.5% Y/Y to SAR 19.2bn, in line with our estimate of SAR 19.4bn. The revenue growth in Q2-24 was mainly driven by a 13.9% Y/Y growth in revenue from subsidiaries. On the other hand, STC KSA managed to increase revenue marginally by 0.1% Y/Y, mainly affected by a decrease in business unit revenue, most likely to be hit by continued cost optimization by government entities. However, the company's commercial maintained its momentum with topline growth of 5.3% Y/Y. The mobile subscribers in KSA grew 9.7% Y/Y in Q2-24, while fixed line subscriber rose 2.5% Y/Y
- Gross profit rose 6.2% Y/Y to SAR 9.6bn (matching AJC's estimate). The gross margin at 50.0% was ~80bps higher than 49.2% in Q2-23 and was above our expectation of 49.5%. An ongoing recovery in the commercial unit might have supported STC's gross margin.
- Operating profit surged 18.4% Y/Y to SAR 3.9bn (AJC estimate: SAR 3.7bn), as lower OPEX (excl. D&A; -1.2% Y/Y) and depreciation & amortization (-0.4% Y/Y) added to the gross margin expansion. As a result, operating margin expanded to 20.3% from 17.9% in Q2-23. The OPEX to sales ratio decreased to 16.5% from 17.4%. EBITDA grew 10.2% Y/Y to SAR 6.4bn (AJC estimate: SAR 6.3bn), as EBITDA margin expanded to 33.5% from 31.8% in Q2-23, supported by lower OPEX despite revenue growth.

AJC view: Consistent topline growth and operating efficiency were key highlights of STC's Q2-24 results. Moreover, the company's gross margin came in better than our expectations. However, pressure on gross margin is likely to persist in the near term due to lower margin growing subsidiary businesses. We believe, as the subsidiaries start maturing, the gross margin will improve. Further, the company's diversification of business through its subsidiaries and investment in advanced technologies bodes well for the company in the long term. PIF's acquisition of TAWAL (STC's tower business) is expected to generate a cash of SAR 8.7bn that will support the company to continue with its growth strategy inside and outside KSA. Moreover, the company's other subsidiaries also provide value unlocking potential in future. STC's stock is currently trading at dividend yield of 4.1% based on FY25E estimates; however, current dividend policy will end in FY24 and there is possibility of company increasing its minimum dividend in new policy. The stock is currently trading at a P/E of 13.9x to our FY25E EPS, FY25E EV/EBITDA of 7.2x. We keep our TP for STC unchanged at **SAR 45.5/share** and remain "**Overweight**" on the stock.

Results Summary

SAR mn	Q2-23	Q1-24	Q2-24	Change Y/Y	Change Q/Q	Deviation from AJC Estimates
Revenue	18,327	19,100	19,155	4.5%	0.3%	-1.0%
Gross Profit	9,015	9,386	9,571	6.2%	2.0%	-0.2%
Gross Margin	*49.2%*	*49.1%*	*50.0%*	-	-	-
EBITDA	5,821	6,474	6,415	10.2%	-0.9%	1.9%
EBIT	3,281	3,856	3,885	18.4%	0.8%	4.9%
Net Profit	**3,008**	**3,286**	**3,304**	9.8%	0.5%	1.7%
EPS	0.60	0.66	0.66	-	-	-

Source: Company Reports, AlJazira Capital

Recommendation	**Overweight**
Target Price (SAR)	**45.5**
Upside / (Downside)*	**17.1%**

Source: Tadawul *prices as of 23rd of July 2024

Key Financials

SARmn (unless specified)	FY22	FY23	FY24E	FY25E
Revenues	67,432	72,337	76,092	79,965
Growth %	7.0%	7.3%	5.2%	5.1%
Net Income	12,171	13,295	13,436	13,979
Growth %	7.6%	9.2%	1.1%	4.0%
EPS	2.43	2.66	2.69	2.80
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%	51.2%	52.3%
EBITDA Margin	37.2%	34.1%	34.3%	33.9%
Net Margin	18.0%	18.4%	17.7%	17.5%
ROE	16.0%	16.3%	15.4%	14.8%
ROA	8.9%	8.3%	8.1%	8.0%
P/E (x)	15.0	15.2	14.5	13.9
P/B (x)	2.4	2.5	2.2	2.1
EV/EBITDA (x)	7.6	7.8	7.3	7.2
Dividend Yield	4.4%	6.4%	4.1%	4.1%

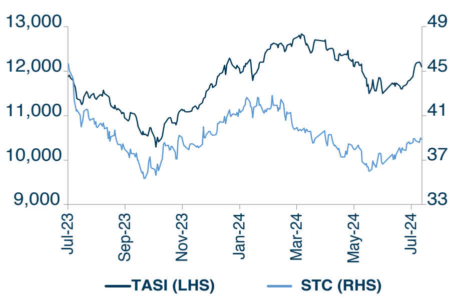
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap(bn)	194.8
YTD%	-3.8%
52 week (High)/(Low)	45.95/35.00
Share Outstanding (bn)	5.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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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