

## What do we think?

Stock	Rating	Price Target	Upside
STC	Neutral	SAR40.0	-1.0%
MOBILY	Overweight	SAR46.0	+11.1%
ZAIN	Neutral	SAR13.0	+3.8%

## Saudi Telecom Sector

### Telecom sector is positioned strongly as fundamentals improve.

The telecom sector has witnessed strong performance in 2022, driven by robust revenue growth by telecom operators, with more potential from the business segment as digitization spreads everywhere. Furthermore, the return of Haji and Umrah season is likely to benefit the consumer segment of the operators, which is growing at a low rate. In 2022, the telecom operators delivered healthy growth; STC sales rose by around 7%, while Mobily saw slightly lower growth of around 5.6%, and Zain registered the highest growth among the operators of around 14.9%. As sales are improving, so are the earnings of the telecom operators. STC's bottom-line increased by 7.6%, while Mobily rose by 54.5% and Zain by 157%. Some positive trends that revived sentiment in the sector were the increase of the dividend for Mobily from SAR0.85/sh to SAR1.15/sh, the third consecutive increase in the DPS for Mobily, which increases the probability of more dividend hikes. Moreover, Zain announced a first-time dividend payment of SAR0.5/sh (4% dividend yield) and a record earnings (EPS of SAR0.61/sh).

Overall, we change our bearish view, which was built on higher SAIBOR, which will impact the profitability of the sector due to the size of leverage the companies have and the limited growth in revenue. However, the recent outperformance of the operators compared to our estimate led us to revise the valuation. Thus, we revise STC target price from SAR34/sh to SAR40/sh and maintain neutral, while for Mobily we revise the target price to SAR46/sh from SAR37/sh and change the rating to overweight with an upside of 11% from the CMP of SAR41.4/sh. Lastly, we also revise our valuation for Zain as the company announced dividend for the first time, with a target price of SAR13/sh from SAR10/sh (3.8% upside from the CMP of SAR12.52/sh). As expectations for the interest rate has changed after the SVP event, we believe repricing is happening for STC and thus we revalue the company given the change in the interest rate outlook.

### STC:

STC in 4Q reported around 9% growth in top-line that was mainly driven by the growth coming from its subsidiaries, which saw a growth of 21% y-o-y reaching SAR5.2bn at the end of 4Q22 compared to SAR4.3bn at the end of 4Q21. Overall, earnings for the quarter came in around our expectations. Given the recent changes in the interest rate outlook, we revise our valuation for STC from SAR34/sh to SAR40/sh. Our DCF target price based on 9.4% cost of capital and a 2% terminal growth rate is SAR44/sh. Our average dividend yield target price is SAR37/sh based on a 4% to 4.5% dividend yield. Our combined target price is SAR40/sh. (a downside of -1%)

#### Figure1: STC's Summary of 4Q22 Results

(SAR mn)	4Q 2022	4Q 2021	Y-o-Y	3Q 2022	Q-o-Q	ARC est	vs ARC
Revenue	17,034	16,087	5.9%	16,468	3.4%	16,719	1.9%
Gross profit	9,029	8,516	6.0%	10,040	-10.1%	8,995	0.4%
Gross margin	53.0%	52.9%		61.0%		53.8%	
Operating profit	2,969	3,204.151	-7.4%	4,576	-35.1%	3,439	-13.7%
Operating margin	17.4%	19.9%		27.8%		20.6%	
Net profit	2,739	2,614	4.8%	3,541	-22.6%	2,774	-1.2%
Net margin	16.1%	16.2%		21.5%		16.6%	

Source: Company data, Al Rajhi Capital

## Mobily:

As the performance of Mobily has been improving year by year, the company again reported solid 4Q numbers with a growth of 6% in sales. Despite the modest growth in top-line, the company's gross profit grew by 10% y-o-y which we believe is due to a favourable product mix. SG&A for the period declined by around 15% to reach SAR748mn compared to SAR883mn, thus reflecting positively on the company's earnings. Also, part of the financing expense is hedged, which would make the company less affected by an increase in SAIBOR. Finally, earnings for the fourth quarter came in at SAR606mn, a growth of 89%, significantly higher than our expectations of SAR368mn (65% deviation). These sets of strong numbers, coupled with an increase in dividend, were the main drivers for revising our target price higher. Our DCF target price is SAR51/sh based on a 9.2% cost of capital and a 2% terminal growth rate, while our EV/EBITDA target price is SAR41/sh. The combined target price is SAR46/sh while the current market price is SAR41.4/sh (11.1% upside).

### Figure2: Mobily's Summary of 4Q22 Results

(SAR mn)	4Q 2022	4Q 2021	Y-o-Y	3Q 2022	Q-o-Q	ARC est	vs ARC
Revenue	4,132	3,897	6.0%	3,828	7.9%	3,980	3.8%
Gross profit	2,492	2,267	9.9%	2,300	8.4%	2,313	7.8%
Gross margin	60.3%	58.2%		60.1%		58.1%	
Operating profit	791	492.027	60.8%	534	48.2%	565	40.1%
Operating margin	19.2%	12.6%		13.9%		14.2%	
Net profit	606	321	88.9%	373	62.4%	368	64.5%
Net margin	14.7%	8.2%		9.7%		9.3%	

Source: Company data, Al Rajhi Capital

## Zain:

Zain Q4 performance exceeded our expectation and consensus, the company reported solid 4Q numbers with a growth of 15% in top-line. Following the growth in top-line, and given telecom companies have high fixed cost, the company's gross profit increased by 25% y-o-y. Operating expenses increased by around SAR100 million year over year but decreased by SAR57 million quarter over quarter. Due to the sale of towers to PIF, depreciation charge fell by around SAR364mn for the full year. Earnings for the fourth quarter came in at SAR251mn, a growth of 253% y-o-y, significantly higher than our expectations of SAR104mn (144% deviation). These sets of strong numbers, coupled with the announcement of dividend, were the main drivers for revising our target price from SAR10/sh to SAR13/sh as we see improvement in the sentiment, while the current market price is SAR12.52/sh. (3.8% upside).

### Figure3: Zain's Summary of 4Q22 Results

(SAR mn)	4Q 2022	4Q 2021	Y-o-Y	3Q 2022	Q-o-Q	ARC est	vs ARC
Revenue	2,404	2,083	15%	2,287	5%	2,352	2%
Gross profit	1,452	1,166	25%	1,376	6%	1,341	8%
Gross margin	60%	56%		60%		57%	
Operating profit	379	193	97%	246	54%	280	35%
Operating margin	16%	9%		11%		12%	
Net profit	251	71	253%	85	195%	103	144%
Net margin	10%	3%		4%		4%	

Source: Company data, Al Rajhi Capital

## Valuation:

After the recent results of the Telecom players, we have revised our valuation given the improvement in the performance.

### Figure4: Changes in estimates and TP

Companies	2023		2024		Prior rating	Current Target New rating	Current Target		Upside/downside
	EPS	EPS	DPS	DPS			Price	Price	
STC	2.60	2.80	1.60	1.60	Neutral	Neutral	40.40	40.00	-1.0%
Mobily	2.30	2.60	1.50	1.80	Neutral	Overweight	41.40	46.00	11.1%
Zain	0.4	0.7	0.5	0.5	Neutral	Neutral	12.52	13.00	3.8%

Source: Company data, Al Rajhi Capital

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