

Saudi Telecommunication Company SJC (STC)

Target Price: SAR 38.4

Upside: 5.0%

Recommendation	Hold
Bloomberg Ticker	STC AB
Current Market Price (SAR)	36.60
52wk High / Low (SAR)	48.8 / 36
12m Average Vol. (mn)	5.9
Mkt.Cap. (SAR bn)	182.7
Shares Outstanding (mn)	4,993
Free Float (%)	36.0%
3m Avg Daily Turnover (SAR mn)	158.5
6m Average Daily Turnover (SAR mn)	215.2
PE 2023e (x)	14.4x
EV/EBITDA 2023e (x)	7.3x
Dividend Yield '23e (%)	5.2%

Price Performance:	
1 month (%)	-4.3%
3 months (%)	-9.0%
12 months (%)	-16.5%

Source: Refinitiv, as of 13th Dec. 2022

Price -Volume Performance



Source: Refinitiv

Valuation method	SAR	Percentage from CMP	Weights
DCF	38.9	6.2%	80%
EV/EBITDA	26.3	-28.2%	10%
PE multiple	47.1	28.8%	10%
Target price	38.4	5.0%	

Source: U Capital Research

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- One of the largest telecom companies in the GCC region
- Diversified operations provide stability to revenues and earnings
- High market share, generating strong free cash flows with low net debt
- We retain our rating on the stock to Hold

STC reported a net profit of SAR 3,541 mn in 3Q22 (our estimate of net profit of SAR 3,078 mn) compared to net profit of SAR 2,924 mn in 3Q21. The bottom line increased mainly due to growth in topline coupled with higher gross margin. The top line grew by 4.7% YoY to SAR 16,468 mn in 3Q22. We believe that the growth could be attributed to growth in the number of subscribers and ARPU. The increase in gross margin is attributed to the reversal of a contingent liability provision amounting to SAR 1,079 mn. Additionally, other expenses increased due to an impairment provision amounting to SAR 776 mn relating to BGSM investment. The impairment was a result of decline in the fair value due to deteriorating conditions coupled with lower share prices of underlying investments in the Malaysian market.

Valuation and risk: STC's higher-than-expected 3Q22 net profit was primarily due to one-off factors such as impairment and reversal of provision. Thus, we revise our bottom-line estimate on STC upward by 1.2% for FY22, although growth in subscribers and ARPU will be muted in 4Q22. Furthermore, we also revise our bottom-line estimates for FY23 and FY24 downward by 4.5% and 5.3% respectively to account for higher interest expenses. Until the EBITDA level, our estimate of EBITDA margins remains broadly same as earlier (36.2% in FY23 and 36.3% in FY24). However, the operating margin is estimated to reduce to 20.6% in FY23 from 20.9% earlier. Similarly, for FY24, we estimate the operating margin to reduce from the earlier expected 20.6% to 20.1%.

However, the major contributor to the lowering of profit estimates is interest expenses. For FY23 and FY24, we expect higher interest expenses due to an increase in interest rates as well as rise in debt. We have increased our interest rate expectations in FY23 and FY24 as the company is expected to refinance at higher rates leading to rising finance costs on the company's debt. Accordingly, the net profit margin is expected to be lower at 18.5% in FY23 (earlier estimate 19.4%) and 18.1% in FY24 (earlier estimate 19.2%). The FY23 EPS estimate is at SAR 2.5 vs SAR 2.7 earlier.

Post adjusting the bottom line and accounting for changes in valuation, we arrive at our revised target price of SAR 38.4 per share compared to SAR 35.5 per share earlier. We retain our rating on the stock to Hold. Currently, the stock trades at 14.4x P/E and 7.3x EV/EBITDA, based on our FY23 estimates. The downside risks to our valuation include economic slowdown leading to a reduction in ARPU, impairment of associates and lower-than-expected operational performance. Key upside risks to our valuation include faster-than-expected growth in ARPU and number of subscribers, faster-than-expected deleveraging, and higher dividends.

Valuation:

Discounted Cash Flow

	FY22	FY23	FY24	FY25	FY26	Terminal Value
Pegged on December 13, 2022						
Time period index	0.57	1.57	2.57	3.57	4.57	4.57
Free cash flow						
PAT	12,222	12,673	12,956	13,394	13,422	
Interest (1-tax rate)	672	760	778	749	751	
Depreciation	10,010	10,970	11,828	12,186	13,059	
Changes in Working Capital	(379)	136	(411)	(389)	(374)	
Less: Capex	(13,369)	(14,498)	(15,124)	(15,637)	(16,167)	
Free cash flow to firm (FCFF)	9,157	10,042	10,027	10,305	10,691	205,867
Discounted FCFF	8,821	9,060	8,471	8,154	7,923	152,574

Enterprise Value	195,004
Less: Net debt	966
Equity Value	194,039
Shares O/S	4,993
Equity Value per share	38.86
Current share price (SR)	36.6
% upside/downside	6.2%

We use DCF methodology with a WACC of 10.9% and a long-term growth rate of 1.0%, giving us a TP of SAR 36.8. Our DCF valuation is based on the following assumptions i) Risk-free rate of 4.7%, ii) Equity risk premium of 5.9%, iii) Beta of 1.46. We have given a weightage of 80% to the DCF valuation.

Peer set

Company	Region	MCap (USD bn)	PE FY23E	EV/EBITDA FY23E
STC	KSA	48.7	14.4	7.3
Etiad Etisalat Company	KSA	6.5	19.1	6.0
Zain KSA	KSA	2.5	17.8	4.7
Emirates Telecommunications	UAE	55.0	20.8	9.5
Emirates Integrated Telecommunications	UAE	7.0	19.4	5.3
Ooredoo	Qatar	7.9	35.0	4.8
Telecom Egypt	Egypt	1.6	4.8	3.6
Singapore Telecommunications	Singapore	32.3	20.0	13.4
Median			19.3	5.2

We have given an equal weightage of 10% each to the P/E and EV/EBITDA multiples. At a median peer P/E multiple of 19.3x and EV/EBITDA multiples of 5.2x, we arrive at a target price of SAR 47.1 and SAR 26.3 per share, respectively.

Sensitivity table

STC AB

		Cost of Equity					ARPU (SAR, 2023e)						
		5%	6%	7%	8%	9%							
Terminal Growth rate	1.00%	48.1	41.1	36.2	32.5	29.7	Subscriber base (mn, 2023e)	28	194	199	204	209	214
	1.25%	50.4	42.6	37.3	33.3	30.3		28	35.5	36.8	38.2	39.6	41.0
	1.50%	53.0	44.3	38.4	34.2	30.9		29	35.6	37.0	38.3	39.7	41.1
	1.75%	56.0	46.2	39.7	35.1	31.6		29	35.7	37.1	38.4	39.8	41.2
	2.00%	59.6	48.4	41.1	36.1	32.4		29	35.8	37.2	38.5	39.9	41.3
								30	35.9	37.3	38.6	40.0	41.4

Key Financials

(SAR mn)	FY19	FY20	FY21	Prev. FY22e	FY22e	Prev. FY23e	FY23e	Prev. FY24e	FY24e
Income Statement									
Sales	54,368	58,953	63,417	66,784	67,151	69,992	70,377	73,015	73,417
COGS	(21,976)	(24,999)	(29,623)	(30,831)	(29,566)	(32,371)	(32,547)	(33,759)	(33,943)
Gross profit	32,391	33,954	33,794	35,953	37,585	37,621	37,830	39,257	39,474
SG&A expenses	(11,126)	(11,864)	(10,953)	(12,051)	(11,804)	(12,363)	(12,383)	(12,840)	(12,860)
Operating profit	12,480	12,731	13,128	14,035	15,771	14,644	14,476	15,025	14,786
Share of results of investments in associates and joint ventures	50	53	(778)	(229)	(1,288)	0	0	0	0
Other income – net	(76)	(43)	50	33	(67)	35	35	37	37
Finance charges	(765)	(624)	(619)	(689)	(736)	(783)	(832)	(744)	(852)
Income before tax	11,687	12,356	12,635	13,544	14,024	14,886	14,253	15,343	14,570
Income tax	(762)	(1,170)	(1,040)	(1,192)	(1,192)	(1,310)	(1,254)	(1,350)	(1,282)
Net income for the period	10,925	11,185	11,595	12,352	12,832	13,576	12,998	13,993	13,288
Balance Sheet									
Cash and bank balances	8,031	9,004	8,281	13,234	11,101	13,689	11,390	12,628	9,431
Financial assets and others	4,474	3,628	3,128	3,128	3,128	3,128	3,128	3,128	3,128
Trade and other receivables	21,372	15,725	25,464	23,786	25,757	24,929	26,994	25,934	28,083
Inventories	1,722	1,009	918	929	891	976	981	1,015	1,020
Property, plant and equipment	45,085	47,848	47,205	49,664	49,578	52,073	52,370	54,382	55,047
Investments in joint ventures	6,619	6,705	5,925	5,696	4,637	5,696	4,637	5,696	4,637
Right of use assets	2,888	2,893	2,952	3,171	3,244	3,381	3,510	3,580	3,755
Total assets	118,326	121,972	127,779	134,057	132,937	138,797	138,079	141,692	140,544
Trade and other payables	18,242	19,711	17,114	18,798	17,002	19,609	18,464	20,371	19,181
Long-term borrowings	8,923	8,638	7,847	7,483	7,810	7,167	7,772	6,660	7,543
Lease liabilities	2,164	2,238	2,354	2,519	2,528	2,748	2,770	2,951	2,978
Share capital	20,000	20,000	20,000	50,000	50,000	50,000	50,000	50,000	50,000
Statutory reserve	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Retained earnings	34,508	37,508	37,985	12,076	12,218	15,368	14,906	17,070	15,879
Total stockholders' equity	61,763	63,946	69,271	73,362	73,504	76,653	76,192	78,355	77,165
Total liabilities & stockholders' equity	118,326	121,972	127,779	134,057	132,937	138,797	138,079	141,692	140,544
Cash Flow Statement									
Cash from operating activities	11,115	29,753	12,682	28,037	26,087	25,762	26,464	27,125	27,195
Cash from investing activities	(1,977)	(17,429)	(1,715)	(12,381)	(12,711)	(12,408)	(13,611)	(12,964)	(14,211)
Cash from financing activities	(8,068)	(9,919)	(10,235)	(8,965)	(8,817)	(10,992)	(10,712)	(13,218)	(13,006)
Net changes in cash	(124)	976	(730)	4,953	2,820	455	288	(1,061)	(1,959)
Cash at the end of the period	8,031	9,004	8,281	13,234	11,101	13,689	11,390	12,628	9,431
Key Ratios									
Current ratio	2.0	1.9	2.3	2.4	2.3	2.4	2.3	2.4	2.2
Inventory turnover ratio	12.8	18.3	30.8	33.4	32.7	34.0	34.8	33.9	33.9
Debtors' turnover ratio	2.5	3.2	3.1	2.7	2.6	2.9	2.7	2.9	2.7
Creditors turnover ratio	1.2	1.3	1.6	1.7	1.7	1.7	1.8	1.7	1.8
Gross profit margin	59.6%	57.6%	53.3%	53.8%	56.0%	53.8%	53.8%	53.8%	53.8%
Operating margin	23.0%	21.6%	20.7%	21.0%	23.5%	20.9%	20.6%	20.6%	20.1%
Net profit margin	20.1%	19.0%	18.3%	18.5%	19.1%	19.4%	18.5%	19.2%	18.1%
EBITDA margin	39.1%	37.5%	36.0%	35.8%	38.4%	36.1%	36.2%	36.2%	36.3%
Average return on equity	17.3%	17.5%	17.0%	16.9%	17.1%	17.7%	16.9%	17.7%	16.9%
Average return on assets	10.5%	10.6%	10.5%	10.7%	12.1%	10.7%	10.7%	10.7%	10.6%
Debt/Equity (x)	0.2x	0.1x	0.2x						
Interest coverage ratio (x)	16.3x	20.4x	21.2x	20.4x	21.4x	18.7x	17.4x	20.2x	17.4x
P/E	18.8x	19.4x	19.9x	16.2x	15.0x	14.7x	14.4x	14.3x	14.1x
EV/EBITDA	9.8x	9.8x	10.1x	8.4x	7.2x	8.0x	7.3x	7.6x	7.0x
EV/Sales	3.8x	3.7x	3.6x	3.0x	2.8x	2.9x	2.6x	2.8x	2.5x
EPS (SAR)	5.3	5.5	5.7	2.4	2.4	2.7	2.5	2.7	2.6
Dividend payout ratio	112.5%	109.0%	70.6%	66.1%	65.4%	75.2%	78.8%	87.6%	92.5%
Dividend yield (%)	6.0%	5.6%	3.6%	4.1%	4.2%	5.1%	5.2%	6.1%	6.2%
Net debt	4,163	2,932	4,245	(832)	1,699	(1,331)	1,711	(576)	3,698
Net debt/ EBITDA	0.20	0.13	0.19	-0.03	0.07	-0.05	0.07	-0.02	0.14
ROCE	17.0%	16.7%	17.2%	17.7%	20.1%	17.8%	17.7%	17.6%	17.4%

Source: Company Reports, U Capital Research

Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%



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