

Saudi Telecom Co. (STC)

Strong top-line and bottom-line growth, but margins tighten.

26 Jan 2021

STC's net income grew by 15.6% Y-o-Y during Q4 2020 thanks to 14.7% revenue growth and lower SG&A, yet net margin contracted to a 4-year low of 17.8% in Q4 2020 and 19.1% for the full year 2020 on the back of higher cost of services and surge in taxes expense during Q4 2020. We expect strong top-line growth in STC's non-core segments and flattish growth in traditional telecom services during 2021, while margins are likely to be under pressure (but rebound from Q4 2020 lows) due to heavy investment in the medium term. We adjusted our discount rate to better reflect current market conditions. We maintain our Neutral recommendation for STC with a 52-week target price of 102.1/share.

STC's revenues jumped by 14.7% Y-o-Y and 2.2% Q-o-Q to SAR15.2bn during Q4 2020 which reflects revenue growth of 8.4% for FY2020; the highest growth rate in 5 years. Strong top-line performance was supported by the double-digit growth in STC Solutions and STC Pay in addition to the 27.5% and 10.6% rise in fiber-optic and broadband subscribers, respectively. Gross profit grew by only 1.5% Y-o-Y during Q4 2020 and fell by 5.4% Q-o-Q despite strong top-line growth due to the rise in government and network access charges during the quarter. Gross margin tightened to 55.8% in Q4 2020 vs 63.0% in Q4 2019 and 60.3% in Q3 2020. SG&A expenses (excluding depreciation) dropped by 17.8% Y-o-Y thanks to lower selling and marketing expenses due to a high base in Q4 2019 due to rebranding in Q4 2019. Accordingly, EBIT jumped by 37.1% Y-o-Y. EBIT margins expanded to 21.6% vs 18.1% in Q4 2019. Net income grew by 15.6% Y-o-Y during Q4 2020 and 3.9% for FY2020. Net margin, however, reached a 4-year low at 17.8% during FY2020. Lower net margin is mainly attributed to significantly higher taxes (+350% Y-o-Y) incurred during the quarter.

STC's continued investment in the ICT and fintech segments and diversification away from traditional telecom services is paying off and reflecting in higher top-line growth. The company entered into multiple agreements and new launches in its non-core segment during Q4 2020 including the launch of a new cybersecurity company and sale of 15% equity stake in STC Pay to Western Union. Going forward, the company is eyeing obtaining a digital banking license for STC Pay and IPO for STC Solutions during 2021 which will further support high growth in non-core segments. We expect stable low single-digit growth from traditional telecom services as catalysts in the segment currently lie in expansion of 5G and fiber optic services coupled with the recovery in roaming revenues during 2021, yet it is likely to be partially offset by flat broadband and mobile revenues due to reduced need for virtual communication during 2021 vs 2020.

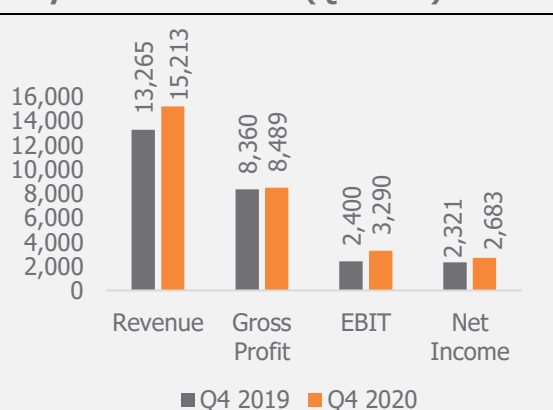
We expect strong top-line growth for STC during 2021 supported by non-core segments, yet margins are likely to be under pressure in the medium term (yet rebound from the low point reported in Q4 2020) and improve gradually on the longer term due to the medium-term high capex requirements in both core and non-core segments. Long term prospects remain promising as non-core segments mature and turn to profitability and capex requirements ease. We maintain our Neutral recommendation for STC with a 52-week target price of SAR102.1/share.

Recommendation	Neutral
Previous Recommendation	Neutral
Current Price (25-01-2021)	SAR111.6
Target Price (52 Weeks)	SAR102.1
Upside/ (Downside)	-8.5%
Shariah Compliance	Pass

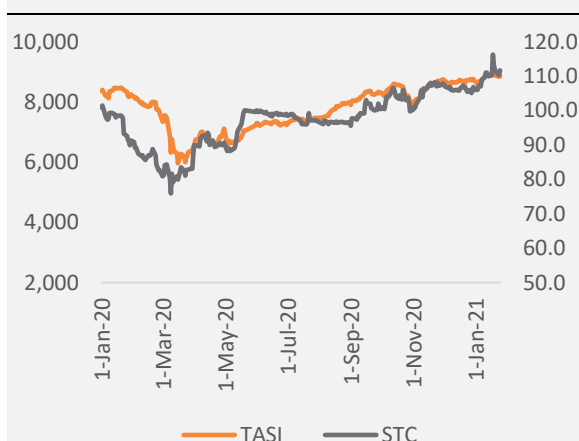
Key Financial Ratios

Ratio	Q4 2020	Q3 2020	Q4 2019
Revenue Growth	2.2%	-0.3%	-6.0%
Gross Margin	55.8%	60.3%	63.0%
EBIT Margin	21.6%	23.2%	18.1%
Net Margin	17.8%	19.0%	18.0%

Key Financial Results (Q4 2020)



Share Price Performance



Results Summary

Q4 Financial Results

	Q4 2020	Q4 2019	Y-o-Y change	Q3 2020	Q-o-Q change
Revenue	15,213	13,265	14.7%	14,881	2.2%
<i>Revenue Growth Q-o-Q</i>	<i>2.2%</i>	<i>-6.0%</i>	-	<i>-0.3%</i>	-
Gross Profit	8,489	8,360	1.5%	8,971	-5.4%
<i>Gross Profit Margin</i>	<i>55.8%</i>	<i>63.0%</i>	-	<i>60.3%</i>	-
EBIT	3,290	2,400	37.1%	3,460	-4.9%
<i>EBIT Margin</i>	<i>21.6%</i>	<i>18.1%</i>	-	<i>23.2%</i>	-
Net Income	2,683	2,321	15.6%	2,766	-3.0%
<i>Net Income Margin¹</i>	<i>17.8%</i>	<i>18.0%</i>	-	<i>19.0%</i>	-

Full Year Financial Results

	2019	2020	Y-o-Y change
Revenue	54,368	58,950	8.4%
<i>Revenue Growth</i>	<i>4.6%</i>	<i>8.4%</i>	-
Gross Profit	32,391	33,997	5.0%
<i>Gross Profit Margin</i>	<i>59.6%</i>	<i>57.7%</i>	-
EBIT	12,480	12,816	2.7%
<i>EBIT Margin</i>	<i>23.0%</i>	<i>21.7%</i>	-
Net Income	10,665	11,086	3.9%
<i>Net Income Margin¹</i>	<i>20.1%</i>	<i>19.1%</i>	-

All values are in SARmn

¹ Calculated based on net income before non-controlling interests.

Guide to Ratings and Disclaimer

Guide to Ratings

Buy	An upside potential of more than 20% in 52-week period
Overweight	An upside Potential of more than 10% in 52-week period
Neutral	Will stay in the range of its value (up/down 10%) in a 52-week period
Underweight	A downside potential of more than 10% in 52-week period
Sell	A downside potential of more than 20% in 52-week period

Itqan Capital

Al Zahraa District, Al Zahraa Commercial Center,

PO Box 8021, Jeddah 21482,

Kingdom of Saudi Arabia

Tel: 966 12 263 8787

Fax: 966 12 263 8789

info@itqancapital.com

www.itqancapital.com

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