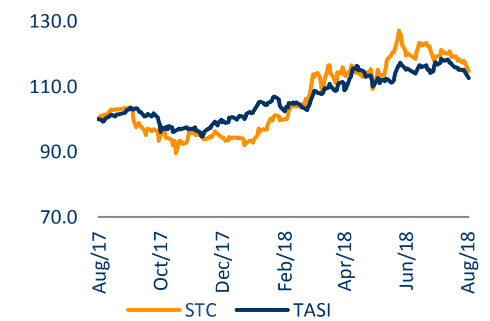
2Q 2018 Results Update — **August 14, 2018**

Recommendation	Neutral
Previous Recommendation	Neutral
Current Price (SAR)	81.6
Target Price (SAR)	82.7
Upside/Downside (%)	1.4%

As of August 13th 2018

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	163.2
52 Wk High (SAR)	93.4
52 Wk Low (SAR)	65.1
Total Outstanding shares (in bn)	2.0
Free Float (%)	16.1%

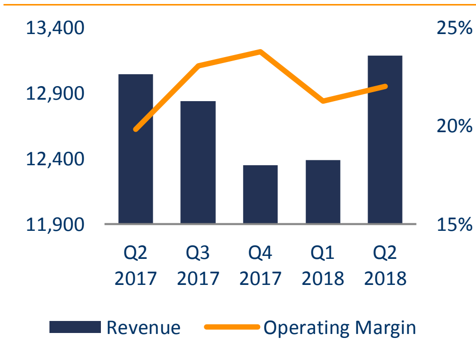
STC vs. TASI (Rebased)



Price Performance (%)	Absolute	Relative
1m	(3.8%)	(0.2%)
6m	14.7%	6.1%
12m	14.8%	2.2%

Major Shareholders (%)	
Public Investment Fund	70.0%
General Org. For Social Insurance	7.0%
Public Pension Agency	6.8%

Quarterly Revenue (SAR mn) and Operating Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 13th August 2018

Bottom line grows 4% YoY; slightly below consensus estimates

Saudi Telecom Co. posted a 3.7% YoY increase in net income to reach SAR 2.4bn in Q2 2018, slightly below average consensus estimates. The growth in net income was mainly ascribed to 1.1% YoY increase in revenue, along with 1.0% YoY reduction in cost of sales and 10.2% YoY decline in selling and marketing expenses resulting from cost optimization initiatives and improving operational efficiency. However, growth in operating results were offset by reduction in profits from associates and JVs, higher net finance costs, and net other losses booked, along with an increase in provisions for zakat and income tax in 2Q18.

During the quarter, STC launched a new Data Centre in Riyadh, as part of its strategy named DARE, to support its digital service offerings in the region. After the launch of Riyadh Data Centre, STC has become the largest provider of infrastructure for cloud computing services in the Middle East, with 12 new Centres to be added over the next three years. In 1H18, STC's data revenue grew 6.7% YoY, supported by increased demand for digital services during the holy monthly of Ramadan and the FIFA world cup. We believe STC's strategy is in-line with the current global tech-revolution, and supports our positive view on the stock. However, a fall in expatriate population in the country may erode the subscriber base and negatively impact the top line. Given these countervailing factors, we maintain our 'Neutral' rating on the stock.

- STC's 2Q18 revenue grew 1.1% YoY to SAR 13.2bn, supported by growth in digital revenues during the holy month of Ramadan and the FIFA world cup.
- Gross profits rose 2.9% YoY to SAR 7.1bn as a result of 1.0% YoY drop in cost of sales. Consequently, gross margins expanded by 96bps to 54.0% in 2Q18.
- Operating income grew 12.3% YoY to SAR 2.9bn, due to 10.2% YoY decline in selling and marketing expense and 0.7% YoY decline in general and administrative expense, partially offset by 3.0% YoY increase in depreciation and amortization expense. Consequently, operating margin improved 219bps YoY to 22.0% in 2Q18.
- Net income grew 3.7% YoY to SAR 2.4bn in 2Q18, as operating income growth was offset by a SAR 91mn YoY decline in net other income and gains, along with SAR 78mn YoY decline in gains from associates and JVs, and SAR 28mn YoY increase in net financing costs. Additionally, provisions for zakat and income taxes grew by SAR 16mn YoY to SAR 192mn. Consequently, net profit margin improved 47bps YoY to 18.5%.
- STC's board of directors has recommended a 10% (SAR 1 per share) cash dividend for 2Q18, amounting to SAR 2bn.
- Recently, the Saudi Communications and Information Technology Commission (CITIC) allowed local telecom operators to sell their transmission towers or set up new spin-off entities; with an aim to increase competition in telecom infrastructure and digital technology. The move is expected to enable wholesale infrastructure providers to focus on retail sector and offer best products at competitive prices.

Valuation: We maintain our target price of SAR 82.7, and retain our 'Neutral' rating on the stock. We believe the risks-rewards are balanced on the stock, considering the increasing competition and the decline in the subscriber base which may negatively impact the earnings.

	2Q'18	2Q'17	% YoY	FY18E	FY17	% YoY
Revenues (SAR mn)	13,182	13,041	1.1%	51,111	50,747	0.7%
Gross Profit (SAR mn)	7,112	6,911	2.9%	30,464	29,491	3.3%
EBITDA (SAR mn)	4,674	4,305	8.6%	20,091	19,293	4.1%
Net Profit (SAR mn)	2,444	2,356	3.7%	10,720	10,133	5.8%
EPS basic (SAR)	1.22	1.18	3.7%	5.36	5.07	5.8%
Gross Margin (%)	54.0%	53.0%	1.0%	59.6%	58.1%	1.5%
EBITDA Margin (%)	35.5%	33.0%	2.4%	39.3%	38.0%	1.3%
Net Profit Margin (%)	18.5%	18.1%	0.5%	21.0%	20.0%	1.0%

Source: Company Financials, FALCOM Research

FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by ≥ 10%.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by ≥ 10%.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company`s performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

FALCOM Financial Services

Contact us on the below phone numbers:
Customer Services: 8004298888
Brokerage Services: 920004711

Fax or Email us at the below number:
Fax: +966 11 2032546
Email: addingvalue@falcom.com.sa

Mail us at the following address:
P.O. Box 884
Riyadh 11421
Kingdom of Saudi Arabia

Disclaimer and Risks Warning:

The information in this report was compiled from various public sources believed to be reliable and whilst all reasonable care has been taken to ensure that the facts stated in this report are accurate and that the forecasts, opinions, future prices and expectations contained herein are fair and reasonable, FALCOM makes no representations or warranties whatsoever as to the accuracy of the data and information provided and, in particular, FALCOM does not represent that the information or expected future prices in this report is complete or free from any error. This report is not, and is not to be construed as, an offer to sell or solicitation of an offer to buy any financial securities. Accordingly, no reliance should be placed on the accuracy, fairness or completeness of the information or the expected prices contained in this report. FALCOM accepts no liability whatsoever for any loss arising from any use of this report or its contents, and FALCOM shall not be in any way responsible for the contents hereof. Opinions, forecasts or price projections contained in this report represent FALCOM's current opinions or judgment as at the date of this report only and are therefore subject to change without notice. There can be no assurance that future results, prices or events will match any such opinions, forecasts or prices projections which represent only one possible outcome and these price estimates may not occur in the future whatsoever. Further, such opinions, forecasts or price projections are subject to certain risks, uncertainties and assumptions that have not been verified and future actual results or events could differ materially. Any value or price, or income from, any investments referred to in this report may fluctuate and/or be affected by changes. Past performance is not necessarily an indicative of future performance. Accordingly, investors may receive back less than originally invested amount. This report provides information of a general nature and does not address the circumstances, objectives, and risk tolerance of any particular investor. Therefore, the person who obtain a copy of this report should understand that this report is not intended to provide personal investment advice and does not take into account his/her financial situation or any specific investment objectives or particular needs which he/she may have. Before making an investment decision the investors should seek advice from an independent financial, investment and/or other required advisers due to the investment in such kind of securities may not be suitable for all recipients. This research report might not be reproduced, nor distributed in whole or in part, and all information, opinions, forecasts and price estimates contained; are protected by the intellectual property laws, copyright and publishing rules and regulations applied in the Kingdom of Saudi Arabia.

All rights reserved.

FALCOM acquired the Saudi Capital Market Authority license number (37-06020) on 27/05/2006, and commenced providing its services to the investors in the Saudi Stock Exchange on 19/02/2007 with CR Number 1010226584 Issued on 04/12/1427H.