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1. Introduction

Saudi Telecom Company Group, STC, is a Saudi telecommunications service provider with a strong presence locally, within the Gulf region, and worldwide. It owns wide investments inside and outside the country presented by its several subsidiaries involved in various technology-related businesses. We sit the following principal affiliates: STC Kuwait, STC Bahrain, Solutions by STC, Channels by STC, specialized by STC, Center 3, Tawal, and STC Pay. The exhaustive subsidiaries list is detailed on the company's official website through the following reference [1].

STC Group's activities comprise the provision of telecommunications, information, media services, and digital payments. It registered continuous business growth and expansion in the past years ending this year 2023 with the acquisition of United Group infrastructure assets across Bulgaria, Croatia, and Slovenia with Euro 1.22bn and 9.9% stake in the Spanish lead firm Telefonica with a total amount of \$2.25bn.

In this assignment, we will be analyzing and evaluating its financial performance recorded in the past four years from 2019 until 2022 based on the company's official published annual reports. We will refer to the figures illustrated in the financial statements of Balance Sheet, Income and Cash Flow as described in the Annex section.

Initially, we will create a performance report breaking down the key measured ratios of profitability, efficiency, short-term solvency, long-term solvency, and market-based ratios. Then, based on the resulting values, we will suggest and recommend some actions in order to improve and enhance STC's business. Next, we will study a new investment proposal for the company using a max of 40% of its own capital. The study will assess the usage of the Net Present Value (NPV) and the Weighted Average Cost of Capital as a common and valuable approach followed widely in one hand. On the other hand, it will indicate whether STC can use its own cash or its retained earnings as an alternate option. Finally, we will decide if STC Group should pay its return earnings, presumably in the form of dividends, to its shareholders.

We will go into further depth about STC Group financial analysis and evaluation as well as the best recommendations in the following sections so that the company's overall business can be developed and improved.

2. STC performance evaluation and analysis

Throughout this section, we will perform a detailed evaluation of the Group's financial performance over the past four years from 2019 until 2022.

2.1. STC financial statements

2019 to 2022 company's annual Balance Sheets, Income Statements, and Cash Flow Statements are described in Annex Section and can be accessed via [2] and [3]. The below table details their summary extracted from STC official website [4].

Statement of Income		2019	2020	2021	2022
Revenues	SAR Thousands	54,367,531	58,953,318	63,007,986	67,431,546
Gross Profit	SAR Thousands	32,391,225	33,954,395	33,794,029	37,393,255
Operating Profit	SAR Thousands	12,480,393	12,731,125	13,127,755	15,088,441
EBITDA	SAR Thousands	21,264,980	22,090,000	22,840,600	25,078,667
Total other expenses and income	SAR Thousands	-793,418	-375,482	-492,692	-1,618,344
Net Profit	SAR Thousands	10,664,666	10,994,875	11,311,342	12,170,537
Balance Sheet		2019	2020	2021	2022
Assets					
Total Non-Current Assets	SAR Thousands	73,484,764	76,113,184	76,311,343	76,286,777
Total Current Assets	SAR Thousands	44,841,492	45,858,916	51,468,074	60,933,209
Total Assets	SAR Thousands	118,326,256	121,972,100	127,779,417	137,219,986
Liabilities					
Total Non-Current Liabilities	SAR Thousands	22,080,958	23,813,902	22,832,886	24,794,230
Total Current Liabilities	SAR Thousands	33,190,252	32,891,183	33,560,552	36,400,164
Total Liabilities	SAR Thousands	55,271,210	56,705,085	56,393,438	61,194,394
Equity					
Issued Capital	SAR Thousands	20,000,000	20,000,000	20,000,000	50,000,000
Statutory reserves	SAR Thousands	10,000,000	10,000,000	10,000,000	11,217,054
Treasury shares	SAR Thousands	0	-300,000	-286,563	-703,838
Other reserves	SAR Thousands	-2,745,608	-3,262,245	1,572,457	2,032,239
Retained earnings	SAR Thousands	34,508,202	37,508,027	37,984,611	10,954,070
Equity attributable to the equity holders of the parent company	SAR Thousands	61,762,594	63,945,782	69,270,505	73,499,525
Non-controlling interest	SAR Thousands	1,292,452	1,321,233	2,115,474	2,526,067
Total Equity	SAR Thousands	63,055,046	65,267,015	71,385,979	76,025,592
Cash Flow		2019	2020	2021	2022
Net cash from operating activities	SAR Thousands	9,920,626	28,324,705	11,220,155	26,354,390
Net cash from investing activities	SAR Thousands	-1,977,126	-17,429,177	-1,714,583	-8,578,939
Net cash from financing activities	SAR Thousands	-8,067,645	-9,919,218	-10,235,177	-8,255,503
Cash and cash equivalents at beginning of the period	SAR Thousands	8,153,865	8,031,010	9,004,286	8,281,301
Cash and cash equivalents at end of the period	SAR Thousands	8,031,010	9,004,286	8,281,301	17,794,393

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2.2. Profitability

Profitability ratios will help us assess STC Group's ability to generate profits from its operations and provide insights into its overall financial performance. The following ratios are essential for investors, creditors, and management to understand how well the company is performing in terms of generating returns for its shareholders. Here are some commonly used profitability ratios and how to evaluate them:

Profitability	Formula
Gross Profit Margin	Gross Profit / Sales Revenues
Profit Margin	Net Profit / Sales Revenues
Return On Assets - ROA	Net Profit / Total Assets
Return on Equity - ROE	Net Profit / Shareholders' Equity

Profitability	2019	2020	2021	2022	Average
Gross Profit Margin	59.58%	57.60%	53.63%	55.45%	56.57%
Profit Margin	19.62%	18.65%	17.95%	18.05%	18.57%
Return On Assets (ROA)	9.01%	9.01%	8.85%	8.87%	8.94%
Return On Equity (ROE)	17.27%	17.19%	16.33%	16.56%	16.84%

Although all figures have shown a slight decline from 2019, regarded as the efficient year in the timeframe, STC Group has managed to maintain a healthy status and competitive results despite the COVID-19 impact. The derived ratios also show that the operation was functioning profitably and made significant gains in comparison to its sales, as illustrated hereafter:

- Gross Profit Margin that exceeded 50% indicating that STC is managing its production costs well and has a good balance between generating revenue and controlling expenses
- Net Profit Margin that floated around 20% shows the company is operating efficiently and generating substantial profits relative to its revenue.
- The positive sign presented by the ROA in comparison telecommunication industry where it shows an effective use of assets to generate profit without excessive inefficiencies
- The ROE reflects that STC is making a reasonable return for its shareholders relative to the equity invested in the business. Also, it indicates that it is profitable and is effectively utilizing the equity provided by its shareholders to get profits and value. Things that can be attractive to investors.

2.3. Efficiency

Activity ratios help assess how well STC utilizes its assets to generate sales and manage its operations. These ratios provide insights into the company's operational effectiveness and can highlight areas where improvements might be needed. Here are some commonly used efficiency ratios:

Efficiency (Activity ratios)	Formula
Inventory Turnover	COGS / Average Inventory
Days' Inventory Outstanding (DIO)	(Inventory / COGS) / 365
Accounts Receivable Turnover	Revenues (Sales) / Account receivable
Accounts Receivable DoH/DSO	365 / Accounts Receivable Turnover
Account payable Turnover	Sales Revenues / Average Account payable
Account payable Days on Hand	365 / Account payable Turnover
Operating Cycle (Cash inflow)	DSR + DIO
Cash Conversion Cycle (CCC)	DIO + DSO – DPO

Efficiency (Activity ratios)	2019	2020	2021	2022	Average
Inventory Turnover	18.82	33.66	36.83	36.57	31.47
Days Inventory Outstanding (DIO)	19.40	10.84	9.91	9.98	12.53
Accounts Receivable Turnover	2.54	3.67	2.53	2.91	2.91
Accounts Receivable (DoH/DSO)	143.48	99.58	144.00	125.46	128.13
Account payable Turnover - APT	2.98	2.90	3.68	3.23	3.20
Account payable Days on Hand	122.47	125.66	99.14	113.13	115.10
Operating Cycle (Cash inflow)	162.88	110.43	153.91	135.45	140.67
Cash Conversion Cycle (CCC)	40.41	-15.24	54.76	22.31	25.56

The resulting measurements stipulate an efficient operation activity performed by STC Group:

- It took only an average of ~13 days to produce its product and it is selling its inventory more quickly with low holding costs and faster cash conversion. Besides, this positive performance is well reflected by the low DIO ratio obtained.
- It improved its receivable collection by ~20 days last year despite the total period being considered high. Therefore, that may display relatively non-efficient management of accounts receivable needing to be improved.
- Although improved in the last year by registering a decrease of ~1 month, the total operation cycle is relatively high and should be enhanced compared to the industry standards.

- Bridging the GAP of the receivables' status, STC shows close indicators related to the accounts payable that had a direct impact on the cash conversion cycle which was enhanced by ~50% (from 40.41 days to 22.31 days) over the past four years.
- Overall, we can say that STC Group presents healthy operation activities and good efficiency.

2.4. Short-term solvency

Liquidity ratios are important and critical to assess STC ability to meet its short-term financial obligations. Short-term solvency ratios focus on STC Group's ability to cover its immediate liabilities. Here are some commonly used short-term solvency ratios and how to evaluate them:

Short-term solvency (Liquidity)	Formula
Current ratio	Current Assets / Current Liabilities
Quick ratio	(Cash + Account Receivable) / Current Liabilities
Cash ratio	Cash / Current Liabilities

Short term solvency	2019	2020	2021	2022	Average
Current ratio	1.35	1.39	1.53	1.67	1.49
Quick ratio	0.89	0.76	0.99	1.13	0.94
Cash ratio	0.24	0.27	0.25	0.49	0.31

STC Group liquidity has increased over the years which indicates a company's good standing, and the resulting ratios fall into standard ranges and benchmarks:

- The current ratio indicates that it has more current assets than current liabilities, suggesting that it's in a good position to cover its short-term obligations.
- It is clear that STC owns and manages an important inventory illustrated by the significant difference between the current and quick ratios. This last one displays a better ability to cover short-term obligations without relying on selling inventory.
- Although the cash ratio is less than 1, that is not a negative indicator and it is well argued by the continuous investment activities (Cash outflow) performed as the one stated in their annual 2022 report, page 58/82, disclosure 20 "Cash and cash equivalent". Which means good cash flow management.

2.5. Long-term solvency

Leverage ratios, also known as debt ratios, help assess a company's ability to meet its long-term financial obligations and manage its debt. These ratios are crucial for understanding a company's capital structure and its capability to handle long-term debt payments. Here are the main long-term solvency ratios and how to evaluate them:

Long-term solvency (Leverage)	Formula
Total Debt ratio	Total Liabilities / Total Assets
Debt to equity ratio	Total Liabilities ÷ Total Owners' Equity
Asset to Equity Ratio	Total Assets / Equity Attributable to Shareholders
Interest Coverage Ratio (times)	EBIT / Interest Expenses
Debt to EBITDA Ratio (times)	Total Liabilities / EBITDA
Cash Coverage Ratio (times)	(EBIT + Depreciation) / Interest

Long term solvency (Leverage)	2019	2020	2021	2022	Average
Total Debt ratio	0.47	0.46	0.44	0.45	0.45
Debt to equity ratio	0.89	0.89	0.81	0.83	0.86
Asset to Equity Ratio	1.92	1.91	1.84	1.87	1.88
Interest Coverage Ratio (times) - TIE	16.31	20.40	21.21	21.66	19.90
Debt to EBITDA Ratio (times)	2.60	2.57	2.47	2.44	2.52
Cash Coverage Ratio (times)	26.75	34.80	36.11	33.68	32.84

As Shown, STC has a clear dependency on its debts indicated by three measured first ratios:

- ~50% of total company assets are financed by debts which provides clear insight into the company's leverage or the extent to which it relies on borrowed funds to finance its operations and investments.
- More than 80% of STC Group financing came from debts compared to equity, which can be considered as a financial risk and dependency on debts. Also, it provides a perception of the company's capital structure and financial leverage.

On another hand, the company indicates a good standing and position in relation to its ability to cover its interest expenses using the operating income (TIE Ratio). Also, the high cash coverage ratio measured shows STC's strong aptitude to cover the interest expenses with the available cash flow obtained. This is generally viewed favorably by lenders, investors, and creditors, as it suggests the firm has a cushion of cash to meet its debt obligations even in challenging financial situations.

2.6. Market-based ratios

Market-based ratios, also known as valuation ratios, assess how the market values STC's stock in relation to its financial performance and fundamentals. These ratios are derived from the company's stock price and are used by investors, analysts, and financial professionals to assess its market performance, investor sentiment, and relative valuation. Here's an elaboration on market-based key ratios, along with their significance:

Market-based ratios	Formula
Earnings Per Share	Net Income / Number of Outstanding Shares
Price to Earnings Ratio P/E	Stock Price / Earnings Per Share
Book Value Per Share	Shareholder's Equity / Number of Outstanding Shares
Price to Book Ratio	P/B Ratio = Stock Price / Book Value Per Share

Market-based ratios	2019	2020	2021	2022	Average
Earnings Per Share	5.33	5.51	2.27	2.44	3.89
Price to Earnings Ratio (P/E)	7.64	7.70	19.85	14.98	12.54
Book Value Per Share	30.88	32.02	13.87	14.75	22.88
Price to Book Ratio (P/B)	1.32	1.32	3.24	2.48	2.09

- Despite the important decrease in the value of the Earnings Per Share attributable to the shareholders, caused mainly by the significant increase in the number of outstanding shares in 2021 and 2022 by ~250% (SAR 2,00,000 to SAR 4,982,178), the company recorded an increase at the end 2022 compared with that one measured in 2021. Also, by referring to the 2019 to 2020 slight increase (3%), we may conclude that the share price is going to face a progressing augmentation again over the coming years (beyond 2022).
- In addition, the Price to Earnings ratio registered over the previous years increased more than double especially in 2021 and 2022 indicating the company stock is overvalued by the market. This can be considered as a positive sign leading to investors' trust in STC's future growth expectation.
- Also, having a P/B ratio higher than 1 may mean that the market has high expectations for the STC's future growth and profitability. It suggests the market values the company's assets at their book value, and provides insights into asset quality, market sentiment, and potential investment opportunities.

3. STC business improvement recommendations

STC Group's financial statements provide valuable insights into various aspects of business. The overall indicators show the company's healthy status and good standing. However, we noted some risky records that need more focus from management and governance bodies to better control and enhance the situation. Here are some improvement recommendations:

❖ STC Group needs to control and reduce its production and operations costs and expenses which are seen as high (COGS and the total operating expenses represent more than 73% of the total sales revenues). Things that can be achieved in many ways like but not limited to:

- Production efficiency: Operations activities automation using technology, process agility, and quality control
- Outsourcing non-core functions
- Supply chain optimization: Supplier negotiation, inventory management, and lean manufacturing adoption (Lean Six Sigma)
- Overhead reduction: Real estate cost reduction and energy-efficient use
- Employee productivity and compensation: Labor Productivity enhancement and compensation structure establishment
- Technology investment: Deployment of ERP and data analytics systems would support streamlining operation activities and taking proactive measures
- Marketing and Sales Efficiency: Train and allocate resources to the most effective marketing channels and strategies

❖ Revision of the pricing strategy in line with the market status and benchmarks can improve STC Group's profitability status by reducing costs and increasing sales respectively.

❖ Unlike inventory turnover and CCC good signs, the company is taking much time to collect its account receivables (average of > 128 days). According, the overall operation cycle was impacted and we recorded an average timeframe of 25 days. Decreasing the Accounts Receivable Days' On Hand would lead to very efficient operation activities by shortening the cash collection time and then having more cash in early time to pay the debts on one hand and that can be used for additional investing activities on the other hand. Following are some measures that can decrease the DoH:

- Credit policies: revisit the company credit policy to ensure customers pay promptly (credit checks, clear credit terms, and more monitoring of customers' payments)

- Invoicing and collection: Invoice customers promptly and establish efficient collections procedures (electronic invoicing and automated reminders)
 - Customer segmentation: Segment customers based on their payment behavior and creditworthiness and Differentiate collection strategies.
- ❖ Based on leverage performance, STC Group should take more care about its long-term solvency management by establishing the needed policies and strategies to decrease the company's dependency on debts. This can be done by adjusting the balance of the cash usage between debt payments and investments. A credit policy update may take place and a close follow-up of the overdue payments should be applied.
- ❖ STC should continue its beneficial politics in regards to cash outflow paid for new investments and business expansion like the cases happening in 2020 and 2022 by injecting respectively 17,429,117 thousand SAR and 8,578,939 thousand SAR. Also, updating the related strategy periodically is highly recommended alongside the accelerated digital market growth worldwide.

4. New investment proposal

In this section, we will provide a detailed study of how STC Group can use the NPV, WACC, or retained earnings to expand its business.

4.1. NPV and WACC analysis

As one of its strategic goals, STC Group is always keen to analyze local and worldwide markets aiming to catch opportunities to expand its business. Accordingly, and due to its median geographical location in GCC surrounded by the three continents Asia, Africa and Europe, I proposed to create a new subsidiary named “STC Optical Links” where all outside plant fiber-based passive infrastructure assets including direct active equipment terminations will be owned by the new established firm. Its ultimate objective is to serve national and international demands ensuring the end-to-end linkage and users’ data transport between each other and their reachability to content locations, named Datacenters. As per the initial business analysis output, STC Group investors and shareholders can see the potential benefits that can be realized through the mentioned investment. Along with this, the project started to be deeply assessed in many aspects including

but not limited to the financial part where I used the Net Present Value (NPV) and the Weighted Average Cost of Capital (WACC) as a structured approach to demonstrate its viability.

Initially, I referred to the company balance sheets and I could ponder these weights of debt and owners' equity respectively:

	2019	2020	2021	2022	Average
Wd = Weight of debt (%)	47.23%	47.00%	44.88%	45.43%	46.13%
Wo/e = Weight of Equity (%)	52.77%	53.00%	55.12%	54.57%	53.87%

Liabilities	Wd = 46.13%	Owner's Equity	Wo/e = 53.87%
KSA Interest Rate (*)	5.95%	KSA Risk-free Rate (*)	4.90%
KSA Tax Rate (*)	20%	Equity risk premium (Ref)	6.07%
Tax saving	4.76%	RRR-Required Rate of Return	10.97%
Cost of debt	2.20%	Cost of equity	5.91%
WACC	= (46.13%*2.20%) + (53.87%*5.91%) = 8.11%		

*: 2023 updated Rates of Interest, Tax, Risk-free,

*: Risk Premium is retrieved from "Aswath Damodaran" website [5]

Additionally, we noted that our projected business capital is equal to 2019, 2020, and 2021 issued capital. We assumed accordingly 2024 to 2027 future cash inflow based on those obtained in the past three years via the calculated coefficient as described below (+1.08% increase).

		2019	2020	2021	2022
Issued Capital	K SAR	20,000,000	20,000,000	20,000,000	50,000,000
Cash Inflow	K SAR	8,031,010	9,004,286	8,281,301	17,794,393
Growth (% 2019)		-	+1.12%	+1.03%	-
Growth Average			+1.08%		

Next, we will consider the +1.08% as the year-to-year cash inflow growth rate and we conclude consequently the following cash prospection in thousands SAR:

	2023	2024	2025	2026	2027	2028
Capital	20,000,000					
Cash Inflow	-	8,438,866	9,081,719	9,773,543	10,518,068	11,319,310
PV	-	7,806,168	7,770,978	7,735,947	7,701,073	7,666,357
Total PV	-	38,680,522				
NPV	-	Total PV - Initial Capital = 18,680,522				

Consequently, we can affirm that the proposed project is estimated to generate a positive Net Present Value of **18,680,522 K SAR** for STC and its investors besides a significant value creation of the newly designed company. Therefore, we suggest proceeding with it.

4.2. Cash and retained earnings usage

Investment decisions using cash and retained earnings involve using a portion of STC Group's profits that has not been yet distributed to the shareholders as dividends to fund new projects, acquisitions, or other investments that can help the company grow and generate additional income. This can be considered as a good practice that would allow less dependencies on debts and liabilities when deciding to commence a new business.

Historically, STC Group is familiar with such applications which happened before and were applied, for example, in 2022Q4 after increasing the company's total capital from SAR 20,000 million to SAR 50,000 million upon directors' board approval of retained earnings usage.

In our case, by consulting the balance sheet and the cash flow statement, as mentioned in the below table, we note the existence of important total cash stocked by STC of around SAR 29,000 million at the end of 2022. This amount represents 144% of the proposed investment's capital, and accordingly, the proposed project can be financed by the earned cash and shareholders' retained earnings.

		2019	2020	2021	2022
Cash	K SAR	8,031,010	9,004,286	8,281,301	17,794,393
Retained earning	K SAR	34,508,202	37,508,027	37,984,611	10,954,070
Total	K SAR	42,539,212	46,512,313	46,265,912	28,748,463

5. Return earnings payment

The decision of whether or not STC Group should pay returns in the form of dividends to its shareholders depends on various factors, including its financial situation, outlook, and capital expenditure requirements. In fact, the company presents enough maturity to manage such topics, and it is familiar with dividend distribution based on the mentioned criteria. On 27 September 2021, STC established a three-year dividends policy based on maintaining a minimum level of dividends of 1 SAR per share per quarter, amended later to 0.40 SAR per share on 30 August 2022 (More details about this policy are described in [2], page 81, section 47 Dividends).

The dividends policy establishment and updating is subject to the board's recommendation and then approval by the Extraordinary General Assembly "EGA". It depends on below factors:

- Any material changes in the company's strategy and business
- Laws, regulations and legislations
- Company timely commitments (banking, funds, or other credits)

Referring to the company's financial good performance as illustrated by the healthy indicators obtained earlier, STC Group is able to pay returns to its shareholders and that was done in 2022Q3 and 2022Q4 by distributing cash dividends at a rate of 0.40 SAR per share in both quarters. It is probable that, according to the company's performance, additional dividends are likely to vary on a quarterly basis.

Generally, return earnings payment depends on the company's financial health, and careful insight should be performed to the below situations:

- ❖ Profitability and Financial Health: Stable earnings and sufficient generated cash flow
- ❖ Maturity: Steady growth and Shareholder Expectations for a reliable income stream
- ❖ Steady Income for Shareholders: Income-Oriented Investors and Dividend Reinvestment Plans
- ❖ Tax Considerations: Pay dividends to shareholders in a tax-efficient manner
- ❖ Shareholder Value and Attractiveness: Enhancing Shareholder Value and Attracting Investors
- ❖ Stable Cash Flow and Financial Flexibility: Diversified Revenue Streams and Financial Flexibility
- ❖ Maintaining Share Price: Investors may be more inclined to buy shares in companies that pay dividends, contributing to stock price stability

6. Conclusion

In conclusion, STC Group displayed good financial performance over the past four years from 2019 until 2022 and it stands as a beacon of financial health and resilience in the Telco business. This is evidenced by the good values of key financial ratios obtained in addition to the important amounts of cash and retained earnings that constitute potential sources for investments and business expansion.

Throughout this exercise, we started by analyzing the financial performance of the company where we measured the key indicators of profitability, efficiency, short-term/long-term solvency, and market-based ratio. As a result, STC presented good health and an efficient way of management in relation to its assets, debts, and collected cash flow. Additionally, at the end of each of those years, the company succeeded in collecting important amounts of cash inflow able to support strategic investments or initiatives like the one announced recently by the Group on 5 September 2023 by the acquisition of 9.9% of Telefonica interest [6]. Lastly, along with this strong status, the company used always to distribute dividends to its shareholders which can be considered as well as a positive sign that can attract investors.

Finally, it's obvious that STC Group is one of the world's mature companies in the telecommunication sector owning a wide and big experience that would help her to maintain steady financial growth throughout upcoming years. Thing that is reflected and detailed in its published 2030 vision and strategic goals to be a pioneer world-class service provider and can be achieved via efficient governance and management of the overall business.

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