



US\$21.60bn Market cap	16.4% Free float	US\$10.33mn Avg. daily volume
Target price	44.10 8.9% over current	
Consensus price	47.40 17.0% over current	
Current price	40.50 as at 18/1/2011	

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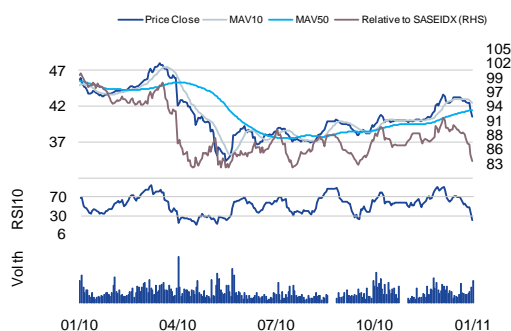
Existing rating

Underweight **Neutral** **Overweight**

Flash View

Flash View is an analyst's preliminary interpretation of a results announcement or the impact of a major event. Our investment rating and earnings estimates are not being changed in this report. Any formal changes to our investment rating or earnings estimates will be made in a subsequent report, which may differ from the preliminary views expressed here.

Performance

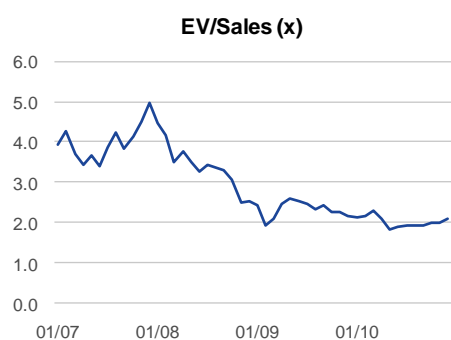


Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (mn)	50,780	51,788	53,693	56,782
Revenue Growth	7.0%	2.0%	3.7%	5.8%
EBITDA (mn)	20,612	19,826	20,996	22,713
EBITDA Growth	-5.2%	-3.8%	5.9%	8.2%
EPS	5.09	4.70	4.80	5.31
EPS Growth	-7.8%	-7.6%	2.1%	10.6%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

STC

Unimpressive Q4 2010 results

STC's Q4 results were unimpressive. Year-on-year sales growth of 3% was respectable, but underlying net profit was flat compared to Q4 2009 and down by 12% compared to Q3. STC still seems to be recovering gradually from the weak period of Q4 2009 to Q2 2010. However, STC is underperforming Mobily, and we do not expect a significant acceleration in growth for a couple of years. On this basis STC's main attraction remains its 7.4% yield. We remain Neutral.

Earnings vs our forecast	Above	In Line	Below
Likely impact:			
Earnings estimates	Up	No Change	Down
Dividend estimates	Up	No Change	Down
Recommendation	Upgrade	No Change	Downgrade
Long term view	Stronger	Confirmed	Weaker

- Respectable sales growth:** Sales of SAR13.44bn were up by 3.2% year-on-year and almost exactly the same as our forecast. Growth of 3.2% follows 2.3% in Q3 and supports our view that STC is picking up gradually from the trough in its growth rates in H1 2010. That said, it is slightly disappointing that Q4 sales grew by only 1.6% compared to Q3 2010 despite the obvious strength of the Saudi broadband market and a robust Hajj season in Q4.
- EBITDA growth uninspiring:** EBITDA of SAR5,245mn was up by 10% compared to a weak Q4 2009, and down by 3% compared to Q3. Again, we think this outcome could have been more impressive given the strength of the domestic broadband market and the Hajj season in Q4. The EBITDA margin of 39.0% was materially stronger than the 36.4% level of Q4 2010. However, the margin contracted by 1.9 percentage points from the level of Q3 and was well below our estimate of 40.5%.
- Operating profit under pressure:** Depreciation and amortisation charges have been rising as STC's overseas investment continues, weighing on operating profit. This quarter was no different. Operating profit of SAR3,028mn was up by 15% year-on-year, showing robust growth but from a depressed base; compared to Q3, operating profit declined by 7%.
- Underlying net profit growth flat to negative:** STC announced net profit of SAR2,290mn for Q4. Reported net profit of SAR2,983mn for Q4 2009 included a capital gain of SAR684mn on the sale of shares in Maxis Malaysia. Excluding this item, underlying net profit growth was essentially flat (-0.4%). Reported net profit of SAR3,317mn for Q3 included a capital gain of SAR728mn on the sale of mobile towers in India. Excluding this item, underlying net profit fell by nearly 12% quarter-on-quarter.
- Conclusion:** We do not anticipate major changes to our forecasts or target price of SAR44.1 after these results. In our view STC is underperforming its rival Mobily operationally, and we do not expect a clear acceleration in profits growth for a couple of years. STC's dividend 7.4% yield is attractive, but we see little prospect of capital gain. Our rating remains Neutral.



Corporate summary	Share information	Valuation																																																							
STC is the largest telecoms operator in the GCC region, with a market value of US\$22bn. STC completely dominates the Saudi fixed-line telecoms market and retains the highest share of the mobile market by revenues. STC is committed to expansion by investment abroad and acquisition, and has made major investments in Turkey, Malaysia, South Africa and elsewhere. These investments account for around one-quarter of its value.	Market cap (SAR/US\$) 81.00bn / 21.60bn 52-week range 34.30 - 48.00 Daily avg volume (US\$) 10.33mn Shares outstanding 2,000mn Free float (est) 16.4% Performance: 1M 3M 12M Absolute -4.3% 3.1% -10.6% Relative to index -6.6% -3.7% -15.4% Major Shareholder: Public Investment Fund 70% Gen. Organisation for Social Insc. 7%	<table border="1"> <thead> <tr> <th>Period End</th> <th>12/09A</th> <th>12/10E</th> <th>12/11E</th> <th>12/12E</th> </tr> </thead> <tbody> <tr> <td>Revenue (SARmn)</td> <td>50,780</td> <td>51,788</td> <td>53,693</td> <td>56,782</td> </tr> <tr> <td>EBITDA (SARmn)</td> <td>20,612</td> <td>19,826</td> <td>20,996</td> <td>22,713</td> </tr> <tr> <td>Net Profit (SARmn)</td> <td>10,863</td> <td>9,401</td> <td>9,595</td> <td>10,611</td> </tr> <tr> <td>EPS (SAR)</td> <td>5.43</td> <td>4.70</td> <td>4.80</td> <td>5.31</td> </tr> <tr> <td>DPS (SAR)</td> <td>3.00</td> <td>3.00</td> <td>3.09</td> <td>3.24</td> </tr> <tr> <td>EPS Growth</td> <td>-7.8%</td> <td>-11.0%</td> <td>2.1%</td> <td>10.6%</td> </tr> <tr> <td>EV/EBITDA (x)</td> <td>5.0</td> <td>5.2</td> <td>5.0</td> <td>4.5</td> </tr> <tr> <td>P/E (x)</td> <td>7.5</td> <td>8.6</td> <td>8.4</td> <td>7.6</td> </tr> <tr> <td>P/B (x)</td> <td>1.9</td> <td>1.8</td> <td>1.6</td> <td>1.5</td> </tr> <tr> <td>Dividend Yield</td> <td>7.4%</td> <td>7.4%</td> <td>7.6%</td> <td>8.0%</td> </tr> </tbody> </table>	Period End	12/09A	12/10E	12/11E	12/12E	Revenue (SARmn)	50,780	51,788	53,693	56,782	EBITDA (SARmn)	20,612	19,826	20,996	22,713	Net Profit (SARmn)	10,863	9,401	9,595	10,611	EPS (SAR)	5.43	4.70	4.80	5.31	DPS (SAR)	3.00	3.00	3.09	3.24	EPS Growth	-7.8%	-11.0%	2.1%	10.6%	EV/EBITDA (x)	5.0	5.2	5.0	4.5	P/E (x)	7.5	8.6	8.4	7.6	P/B (x)	1.9	1.8	1.6	1.5	Dividend Yield	7.4%	7.4%	7.6%	8.0%
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Figure 1. STC: Q4 2010 results

(SAR mn)	Q4 2009 actual	Q3 2009 actual	Q4 2010 actual	Q4 2010 % chg. y-y est.	ARC	Comment
Revenues	13,029	13,232	13,443	3.2%	13,445	Revenue growth of 3.2% y-o-y was slightly stronger than 2.3% in Q3 and almost exactly the same as our forecast. We think STC is picking up gradually from the trough in growth in H1 2010.
Cash operating costs excl. SG&A	-6,187	-6,116	n/a	n/a	-6,252	n/a
SG&A costs	-2,068	-1,699	n/a	n/a	-1,748	n/a
EBITDA	4,773	5,417	5,245	9.9%	5,445	Up by 10% compared to a weak Q4 2009, and down by 3% compared to Q3. We think this outcome could have been more impressive given the strength of the domestic broadband market and the Hajj season in 2010.
EBITDA margin (%)	36.6%	40.9%	39.0%		40.5%	The EBITDA margin is returning to a more normal level; it was very depressed between Q4 2009 and Q2 2010. But still well below our forecast.
Depn. & amortisation	-2,136	-2,162	-2,217	3.8%	-2,233	D&A charges continue to rise, reflecting STC's investments overseas.
Operating profit	2,637	3,255	3,028	14.8%	3,212	Robust y-o-y growth but from a low base, and down by 7% compared to Q3. This is not an impressive outcome.
Financing cost	-230	-543	n/a	n/a	-265	Financial charges in Q3 were unusually high due to one-time factors. We assume that this item declined, but will have to wait for the full results to confirm our view.
Foreign exchange gains/losses	94	254	n/a	n/a	0	n/a
Other	130	47	n/a	n/a	0	n/a
Net income before tax	2,630	3,013	n/a	n/a	2,947	n/a
Tax and zakat	-262	-216	-245	-6.6%	-311	STC's tax charge is trending upwards over time as the contribution from overseas operations increases.
Minority interest	-72	-208	n/a	n/a	-118	Gradually rising as the contribution from overseas operations increases.
Exceptional items	687	728	0	-100.0%	0	The major exceptional positive items of Q4 2009 and Q3 2010 did not recur.
Net profit	2,983	3,317	2,290	-23.2%	2,518	Net profit declined y-o-y and q-o-q due to the non-recurrence of major exceptional profits. Adjusting for these items, net profit was flat y-o-y and down by 12% q-o-q.
Capex	2,673	6,102	1,801	-32.6%	3,913	Capex appears to have been surprisingly low but this followed an unusually high Q3.
Capex/sales (%)	20.5%	46.1%	13.4%		29.1%	As above
Net debt	23,580	24,289	n/a	n/a	25,219	We need to see the full results to calculate net debt.
Net debt/annualised EBITDA (x)	1.2	1.1	n/a	n/a	1.2	STC is financially very healthy, although Mobily appears now to be even stronger on this measure.

Source: Company data, Al Rajhi Capital



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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"**Overweight**": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"**Neutral**": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"**Underweight**": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"**Time horizon**": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"**Fair value**": We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

"**Target price**": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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