Saudi Telecom

Telecom – Industrial
STC AB: Saudi Arabia
20 April 2011

US$20.42bn	16.4%	US$10.86mn
Market cap	Free float	Avg. daily volume

Target price	**44.10**	15.14% over current
Consensus price	**51.70**	35.0% over current
Current price	**38.30**	as at 19/4/2011

Research Department
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Existing rating

Underweight	Neutral	Overweight

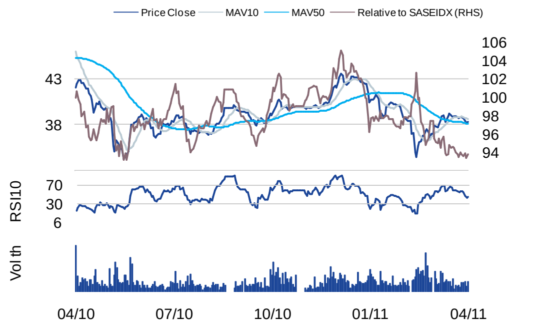
STC
Q1: A mixed bag

Saudi Telecoms Q1 results were mixed. Year-on-year sales growth of 4% is acceptable; while operating profit increased 13%. However, net profit declined 11% which the company attributes mainly to the two month bonus salary payments to all employees complying with the Royal Decree. We think STC is still recovering gradually from a weak H12010 and late 2009 period and we need more evidence to change our view on the company. The overall results are below expectations in terms of profitability, but we need to wait for full results to confirm our view. For the moment, we remain Neutral.

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 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

- **Modest sales growth:** Sales of SAR13.07bn were up by 4.0% year on year and 2% above our forecast. Growth of 4% follows 3.2% in Q4 and 2.3% in Q3 which supports our view that STC is picking up gradually from its declining sales growth in H1 2010. That said, the growth has been coming mainly from international operations which now represents 34% of STC's total revenues.

- **EBITDA & Operating profit growth moderate:** EBITDA of SAR4, 814mn, increased 8% compared to Q1 2010 and operating income of SAR2, 669mn, a year-on-year increase of 13% over Q1 and was 7% below our forecast. As expected and explained in our recent update sector report *Saudi Telecoms Sector: Mobily still our favourite (13th October),* STC has somewhat recovered from a depressing first half of 2010 but the improvement is very gradual. Moreover, as the company has pointed out the recovery is coming from international operations, and not from the domestic operations of STC which is its core business (market).

- **Net profit growth declined:** Net profit of SAR 1,573mn declined by 11% over the two month bonus payment to all employees following the Royal Decree announcement. Excluding the extra salary cost of SAR375mn, the adjusted net profit growth would be 10% year-on-year. This adjusted net profit is again 15% below our estimate.

- **Conclusion:** STC's performance was similar to what we had predicted. We had argued that STC is gradually recovering from a weak period, and the company is taking new initiatives to increase its domestic market share and boost its sales. But this again will take time to materialise and we need more evidence to change our view on the company. For the moment, we like STC's dividend yield of 7.8% and remain Neutral with a target price of SAR44.1.

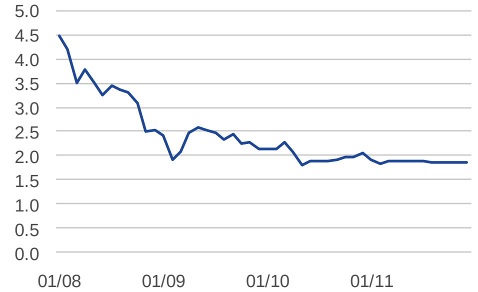
Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	51,787	52,971	55,196	58,039
Revenue Growth	2.0%	2.3%	4.2%	5.2%
EBITDA (mn)	19,625	20,630	21,953	23,506
EBITDA Growth	-4.8%	5.1%	6.4%	7.1%
EPS	4.72	4.59	5.04	5.39
EPS Growth	-13.1%	-2.7%	9.8%	6.9%

Source: Company data, Al Rajhi Capital

Valuation

EV/Sales (x)



Source: Company data, Al Rajhi Capital

Corporate summary

STC is the largest telecoms operator in the GCC region, with a market value of US$21bn. 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.

Share information

Market cap (SAR/US$)	76.60bn / 20.42bn
52-week range	34.30 - 43.60
Daily avg volume (US$)	10.86mn
Shares outstanding	2,000mn
Free float (est)	16.4%

Performance:	1M	3M	12M
Absolute	3.5%	-6.1%	-16.6%
Relative to index	-4%	-4.1%	-11.8%

Major Shareholder:	
Public Investment Fund	70%
Gen. Organisation for Social Insce.	7%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	51,787	52,971	55,196	58,039
EBITDA (SARmn)	19,625	20,630	21,953	23,506
Net Profit (SARmn)	9,440	9,186	10,082	10,777
EPS (SAR)	4.72	4.59	5.04	5.39
DPS (SAR)	3.00	3.09	3.24	3.47
EPS Growth	-13.1%	-2.7%	9.8%	6.9%
EV/EBITDA (x)	5.0	4.8	4.4	4.1
P/E (x)	8.1	8.3	7.6	7.1
P/B (x)	1.7	1.6	1.5	1.4
Dividend Yield	7.8%	8.1%	8.5%	9.1%

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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