



**US\$20.40bn** Market cap  
**16.4%** Free float  
**US\$9.5mn** Avg. daily volume

Target price **44.20** 13.9% over current  
Consensus price **55.60** 44.0% over current  
Current price **38.80** as at 21/7/2010

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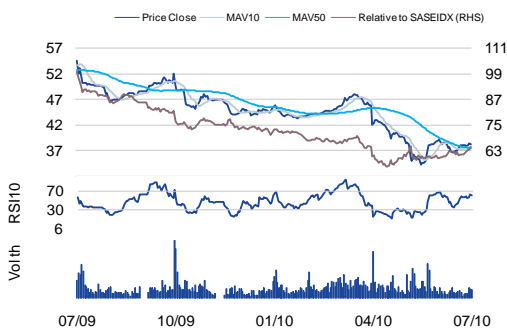
Existing rating

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**

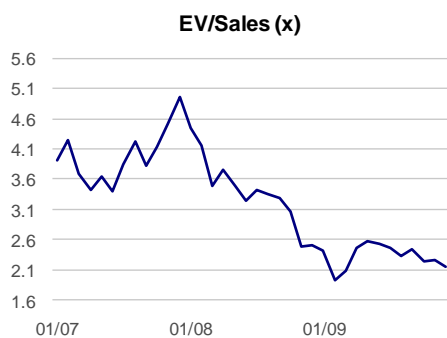


**Earnings**

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	50,780	53,212	56,290	59,578
Revenue Growth	7.0%	4.8%	5.8%	5.8%
EBITDA (SARmn)	20,612	19,916	22,049	24,129
EBITDA Growth	-5.2%	-3.4%	10.7%	9.4%
EPS	5.43	4.58	5.39	5.43
EPS Growth	-1.6%	-15.6%	17.6%	0.6%

Source: Company data, Al Rajhi Capital

**Valuation**



Source: Company data, Al Rajhi Capital

**STC**  
**Uninspiring results for Q2 2010**

STC's Q2 results were hardly inspiring. Year-on-year sales growth was slightly negative, while operating profit fell by 27% and was flat compared to the very weak Q1. Net profit rebounded slightly from Q1 for reasons that are not yet clear to us. We had hoped that prospects in Saudi Arabia would be improving and cost pressures overseas abating by now, but the results do not yet show this. On the other hand, STC remains financially stable with a 7.7% dividend yield. We expect to trim our profit forecasts but to maintain our Neutral rating.

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

- **Revenues weak:** Revenues of SAR12.59bn fell by 0.7% year-on-year but were up by 0.6% from Q1. While strength in the US dollar (to which the Saudi riyal is pegged) over H1 may have held down overseas sales to some extent, we still find it hard to understand why strong market conditions in Saudi Arabia and expansion abroad are not generating better top-line growth for STC. In contrast, STC's smaller rivals Mobily and Zain KSA reported year-on-year sales growth of 24% and 107% respectively for Q2.
- **EBITDA and operating profit:** From STC's preliminary financial data, we calculate that EBITDA was SAR4,504mn in Q1, down by 12% year-on-year but up by 1% from Q1. Operating profit of SAR2,345mn was down by 27% year-on-year and was flat compared to Q1. Combined depreciation and amortisation charges rose by 13% year-on-year in Q2, reflecting the ongoing impact of STC's recent heavy investment overseas.
- **Net profit:** Net profit of SAR2,062mn fell by 31% year-on-year, but rose by 16% from the exceptionally low SAR1,772mn recorded in Q1. We are not sure what factors drove this modest rebound. Historically, STC's results have shown high volatility below the operating line due to exceptional items, foreign exchange gains or losses and similar effects. We should be able to comment further when the full results are published.
- **Financial position stable:** From the preliminary data, we estimate that STC had net debt of SAR22.33bn at the end of Q2, which was little changed from Q1. STC's net debt/EBITDA ratio is around 1.2x, which represents a very healthy gearing level. We believe that STC can maintain its annual dividend of SAR3.0, on which basis it offers a prospective yield of 7.7%.
- **Conclusion:** We will need to trim our near-term forecasts for STC, but the impact on our long-run valuation model should be modest. We thus expect to retain our target price of SAR44.2. We think most potential bad news is now reflected in STC's share price and our rating is likely to remain Neutral.



### Corporate summary

STC is the largest telecoms operator in the GCC region, with a market value of US\$20bn. 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 / 20.40bn  
52-week range 34.30 - 54.50  
Daily avg volume (US\$) 9.50mn  
Shares outstanding 2,000mn  
Free float (est) 16.4%

Performance:	1M	3M	12M
Absolute	-1.6%	-9%	-29.1%
Relative to index	3.8%	0.6%	-35.2%

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

Source: Bloomberg, Al Rajhi Capital

### Valuation

Period End	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	50,780	53,212	56,290	59,578
EBITDA (SARmn)	20,612	19,916	22,049	24,129
Net Profit (SARmn)	10,176	9,167	10,782	10,851
EPS (SAR)	5.43	4.58	5.39	5.43
DPS (SAR)	3.00	3.00	3.09	3.15
EPS Growth	-1.6%	-15.6%	17.6%	0.6%
EV/EBITDA (x)	4.7	4.9	4.4	4.0
P/E (x)	7.1	8.4	7.1	7.1
P/B (x)	1.8	1.7	1.5	1.4
Dividend Yield	7.8%	7.8%	8.1%	8.2%

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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