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Saudi Fransi Capital

Saudi Telecom Company

KSA Telecom Sector | 2Q 2015 Preliminary Results | July 30, 2015

2Q15 review: Mid-term outlook optimistic despite earnings miss; Maintain Buy

2Q15 net profit misses consensus estimate: STC reported 2Q15 net profit of SAR 2.6bn (c.+2% qoq, down c.9% yoy) which was c.15% below consensus. However, reported earnings included an exceptional item of SAR112m (charge related to an early retirement program) meaning clean net profit came in at SAR2.7bn (c.7% qoq, c.-5% yoy) and still missed consensus by c.10%. While revenues of c.SAR12.2bn (c.-2% qoq, c.+4% yoy) were in line with consensus, EBITDA of SAR4.8bn (c.-7% qoq, c.+2% yoy) missed estimate by c.5%. Consequently, EBITDA margin was c.39% vs. consensus of c.41% (1Q15 c.41%).

Solid c.11% yoy topline growth in 1H15; domestic market initiatives seem to be paying off for STC: Domestically, STC's 1H15 revenue grew c.11% yoy while its customer base (post/and pre-paid) increased c.5% yoy (c.1% qoq) which we see as a positive . Furthermore, management commentary accompanying 2Q results indicated that STC's customer base for FTTH services registered a solid c.15% yoy growth (+8% qoq) supported by continued deployment of fiber optic network in both residential and business sectors. STC's overall Enterprise business revenue grew c.17% yoy in 2Q driven by improvement in business sector data services (c.28% yoy). All in all, STC's initiatives in the domestic market seem to be yielding positive results.

Valuation undemanding at 6.6x 2015E EV/EBITDA; Maintain Buy: On a year-to-date basis, STC (+c.9.5%) has performed in line the broader Tadawul index (c.+9.3%) while it outperformed KSA telecom sector (down c.-6%). However, despite the outperformance, the stock trades at 6.6x 2015E EV/EBITDA (c.12% premium to MEA peers and c.9% discount to global peers) coupled with an c.5.6% 2015E dividend yield which we find attractive. All in all, post publication of 2Q15 earnings, we focus on STC's mid-term potential (market share gains post Mobily fiasco, value unlocking opportunities coupled with a narrower risk profile) and maintain our Buy rating with an unchanged SAR82/share target price.

Further rationalization of international operations could act as a key catalyst: In our view, further streamlining of its international operations could act as a key catalyst. So far, while the company has exited PT Axis Indonesia in 3Q13 and amended the shareholders' agreement for its SE Asian telecom assets in 4Q13 (consequent accounting change meant that STC results would no longer be impacted by Aircel India's earnings), the company still holds substantial assets in Malaysia, South Africa, Turkey, Kuwait and Bahrain. While we cannot pre-empt management's strategy, if history is any indication, investors could positively react to further streamlining of international assets.

SAR mn	2Q15A	Cons*	% dev	1Q15	% qoq	2Q14	% yoy
Revenues	12,222	12,361	-1%	12,473	-2%	11,722	4%
Gross Profit	7,164	Na	Na	7,544	-5%	7,024	2%
EBITDA	4,793	5,049	-5%	5,160	-7%	4,680	2%
EBITDA Margin (%)	39%	41%		41%		40%	
Operating Profit	2,963	3,283	-10%	3,380	-12%	2,961	0%
Net Profit	**2,558**	**2,998**	**-15%**	**2,504**	**2%**	**2,803**	**-9%**

*Source: Company, Saudi Fransi Capital analysis, * Bloomberg consensus*

Rating Summary

Recommendation	**Buy**
Target price (SAR)	**82.0**
Upside/ (downside)	**14%**

Stock Details

Closing price*	SAR	71.3
Market capitalization	SAR mn	1,42,600
Shares outstanding	Mn	2,000
52-Week High	SAR	75.8
52-Week Low	SAR	56.4
Price chg. (3 months)	%	4.3
EPS 2015E	SAR	6.3
Ticker (Reuters/ Bloomberg)	7010.SE	STC AB

**Price as of July 29, 2015*

Key Shareholding (%)

Public Investment Fund	70.0
General Organization for Social Insurance	7.0
Public Pension Agency	6.7
Public	16.3

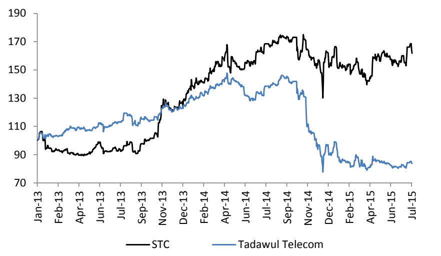
Source: Tadawul

Key Ratios

	2015E	2016E
P/E (x)	11.3	10.5
EV/EBITDA (x)	6.6	6.4
Dividend yield (%)	5.6	6.3

Source: Company, Saudi Fransi Capital analysis

Stock price movement vs. TASI



Source: Tadawul

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Recommendation Framework

BUY: The analyst recommends a BUY when our fair value estimate is at least 10% higher than the current share price.

HOLD: The analyst recommends a HOLD when our fair value estimate ranges within ±10% of the current share price.

SELL: The analyst recommends a SELL when our fair value estimate is lower by more than 10% from the current share price.

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