Equity | Saudi Arabia | Fixed Line Telcos

RASMALA

19 September 2011

STC

Expanding Saudi coverage

We expand our coverage of the Saudi telecommunications market by adding the Saudi Telecom Company (STC). We initiate coverage with a Buy recommendation and a SR47.70 target price.

Initiation of coverage

Buy

Target price
SR47.70

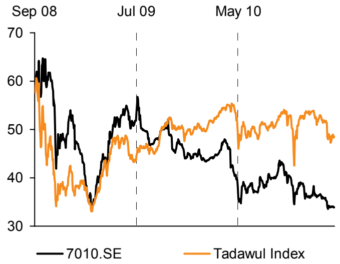
Price
SR33.90

Short term (0-60 days)
n/a

Market view
No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (SR)	34.00	36.40	40.20
Absolute (%)	-0.3	-6.9	-15.7
Rel market (%)	-0.8	0.8	-11.5
Rel sector (%)	-1.7	-6.0	-8.5



Market capitalisation
SR67.80bn (€13.19bn)

Average (12M) daily turnover
SR35.47m (US$9.43m)

Sector: Tadawul Telecoms Index
RIC: 7010.SE, STC AB
Priced SR33.90 at close 14 Sep 2011.
Source: Bloomberg

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (SRm)	50,780	51,787	54,878	56,800	58,789
EBITDA (SRm)	20,612	19,625	20,305	20,732	21,164
Reported net profit (SRm)	10,863	9,440	8,341	8,787	9,448
Normalised net profit (SRm)	10,863	9,440	8,341	8,787	9,448
Normalised EPS (SR)	5.43	4.72	4.17	4.39	4.72
Dividend per share (SR)	3.00	3.00	3.00	3.50	3.50
Dividend yield (%)	8.85	8.85	8.85	10.30	10.30
Normalised PE (x)	6.24	7.18	8.13	7.72	7.18
EV/EBITDA (x)	4.45	4.69	4.26	3.36	2.36
EV/invested capital (x)	1.23	1.18	1.15	0.94	0.70
ROIC - WACC (%)	0.00	0.00	0.00	0.00	0.00

Accounting standard: local GAAP
year to Dec, fully diluted
Source: Company data, Rasmala forecasts

STC branches out of domestic market with key acquisitions across the globe

Saudi Telecom Company (STC) began expanding internationally only in 2007, following a long period of focusing its operations solely on its domestic market. With key acquisitions such as Maxis in Malaysia and Oger, STC was able to extend its geographical footprint to highly populated countries having relatively reasonable mobile penetration levels, such as India, Indonesia, Malaysia, Turkey and South Africa. The company also bought Kuwait's third mobile licence and Bahrain's third mobile licence, allowing STC access to countries with high ARPUs. We forecast that 36% of revenues will be generated from foreign operations by FY12 compared to 30% at end-2010. We expect revenue to grow 6% yoy in FY11 to SR54,878m and 3.5% yoy in FY12 to SR56,800m.

Strong 2Q11 results

STC's 2Q11 results beat Bloomberg consensus estimates across the board. Revenue grew a strong 10% to SR13.9bn from SR13.6bn in 2Q10, beating consensus estimates of SR13.2bn. The company posted 2Q11 net profit of SR2.6bn, an annual increase of 9.4%, ahead of consensus estimates of SR1.96bn. We believe the better-than-expected performance stemmed from higher proceeds from international operations and upbeat data revenues, in particular broadband in the domestic market.

We initiate coverage of STC with a Buy recommendation at a target price of SR47.7

Our target price of SAR47.7 implies upside potential of 41% from the current trading price of SR33.9, leading us to rate the stock Buy. Regional trading multiples imply that STC is trading at discounts of 35% and 24% for FY11F and FY12F, respectively, to regional peers within our coverage universe that are trading at average PE multiples of 12.5x and 10.2x based on our forecasts.

Analyst

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The basics

Versus consensus

EPS	Ours	Cons	% diff
2011F	4.17	4.05	3%
2012F	4.39	4.23	4%
2013F	4.72	4.47	6%

Source: Bloomberg, Rasmala forecasts

Forced ranking*

Company	Rec	Upside/ downside
Mobily	Buy	42%
Etisalat	Buy	25%
Qtel	Buy	27%

*by difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.
Source: Rasmala forecasts

Key events

Date	Event
Oct 11	Interim results announced
Jan 12	Annual results announced
Apr 12	Interim results announced
July 11	Interim results announced

Source: Zawya

Catalysts for share price performance

We believe that further key acquisitions or an increase in minority stakes at reasonable prices would be a strong catalyst for STC because the company continues to express its interest in growing inorganically as part of its overall growth strategy.

Given that the company has provided no detailed analysis of its subsidiaries' performances in the past, we believe that additional and consistent visibility on the performance of its subsidiaries could act as a further catalyst for stock performance.

Earnings momentum

Saudi Arabia remains STC's key market. We forecast that domestic revenues will remain under pressure given our expectations that the market will remain highly competitive, particularly in the provision of broadband services.

STC's 2Q11 results beat consensus estimates on both top and bottom lines (consensus estimate for revenue was SAR13,186m and for net profit was SAR1,955m) as a result of better-than-expected performance in the international subsidiaries' data segment of operations. We believe that if STC continues its upbeat performance in these lines, consolidated revenue for the group should show a comfortable CAGR of 3.4% between 2011 and 2015.

We maintain an average consolidated EBITDA margin of about 36.5% throughout our forecast period, mainly to incorporate the impact of relatively lower margins contributed by STC's international operations.

Valuation and target price

We initiate coverage on STC with a target price of SAR47.7, which we calculate on the basis of a sum-of-the-parts, DCF valuation. Our target price is 41% higher than the current trading price of SAR33.9, leading us to rate the stock a Buy. On the relative valuation front, STC continues to trade favourably at 8.1x FY11F PE and 7.7x FY12F, which are 35% and 24% discounts to regional peers under our coverage, respectively, which trade at averages of 12.5x FY11F PE and 10.2x FY12F.

We also consider STC a value play given continued healthy dividend distribution. The company has a trailing dividend yield of 8.85%; we forecast DPS could be SR3.0 for year-end 2011 and rise to SR3.5 for FY12 given sustained healthy results. Based on current trading prices, this provides healthy dividend yields above 8%.

How we differ from consensus

Our revenue, EBITDA and EPS forecasts are slightly above but generally in line with Bloomberg consensus estimates for both FY11 and FY12.

Risks to central scenario

- Competition in the domestic market is higher than we expected, applying heightened pressure on mobile ARPUs and causing revenue from the domestic market, the key market, to lag our expectations.
- Competition is increasing in the provision of broadband services. We believe that broadband is a key growth driver across all of STC's markets of operations.
- Political events, such as the unprecedented wave of revolutions at the beginning of the year, could have a negative effect on STC if events accelerate in STC's countries of operations.
- Given STC's growing contribution of revenues from its international subsidiaries, FX fluctuations could have a negative effect on consolidated results.

Key assumptions and sensitivities

We value Saudi Telecom Company using a SOTP methodology and arrived at a target price of SR47.7. This leads us to rate the stock Buy.

Table 1 : DCF assumptions

Operations	WACC	Long-term growth rate
Saudi Arabia	10.5%	2.0%
Turkey	15.0%	2.0%
South Africa	14.0%	3.0%
Indonesia	12.0%	3.0%
Kuwait	11.0%	2.0%
Bahrain	11.0%	2.0%

Source: Rasmala estimates

Our target price of SAR47.7 implies upside potential of 41% from the current trading price of SR33.9. This leads us to rate the stock Buy. Regional trading multiples show STC trading at discounts of 35% and 24% to regional peers within our coverage, which are trading at PE multiples of 12.5x and 10.2x for FY11F and FY12F, respectively.

Table 2 : Regional peers

Company	PE 2011F	PE 2012F
Mobily	7.9	7.0
Etisalat	11.7	11.1
Mobinil	27.3	10.9
Qtel	9.3	7.7
Du	20.1	13.1
Jtel	16.0	16.0
Wataniya	12.4	14.1
Telecom Egypt	8.5	8.8
Omantel	8.8	8.8
Nawras	7.8	7.0
STC	8.1	7.7
Average	**12.5**	**10.2**

Prices as of 14 September 2011
Source: Rasmala estimates

We consider STC a value play given continued healthy dividend distribution. STC has a trailing dividend yield of 8.85%; we forecast that DPS could be SR3.0 for year-end 2011 and rise to SR3.5 for FY12 given sustained healthy results. Based on current trading prices, this provides for healthy dividend yields above 8%.

Table 3 : STC sum of parts

(Value in SR m unless stated otherwise)	Enterprise value	Ownership	Equity value	EV/EBITDA (FY1)	EV/EBITDA (FY2)
Saudi Arabia	92,954	100%	92,954	6.18	6.22
Oger	66,517	35%	12,836	5.07	4.65
Maxis	34,065	25%	8,516	5.66	5.27
Kuwait	4,852	26%	1,261	n/m	n/m
Bahrain	2,026	100%	2,026	n/m	n/m
Indonesia	2,693	80%	2,155	6.77	5.79
Total enterprise value	200,414		119,748	5.90	5.78
Net debt			-24,284		
Total equity value			95,393		
Total outstanding shares (m)			2,000		
Value per share (SR per share)			47.7		

Source: Rasmala forecasts

Table 4 : Accounting treatment for STC's major international operations

	Stake	Accounting treatment
Oger Telecom	35%	Proportionate consolidation
Binariang /Maxis – Malaysia	25%	Proportionate consolidation
Viva Kuwait	26%	Full consolidation
Viva Bahrain	100%	Full consolidation
PT Axis Telekom Indonesia*	80.10%	Full consolidation

*STC increased its stake to 80.1% on 6 April 2011 from its previous 51%
Source: STC

Contents

Executive summary

With three of the largest regional telcos operating in Saudi Arabia, all players are fighting to maintain market and revenue share. STC has branched out, currently having a presence in 10 countries with over 139m subscribers on a consolidated basis as at year-end 2010.

Broadband services have been the main areas for revenue growth for telecom operators

Mobile and fixed broadband are areas for growth

As for most of the integrated telecom operators in the region and beyond, mobile and fixed broadband services have been the main areas for revenue growth by STC as opposed to subscriber growth alone. We believe that Saudi Arabia is on the cusp of a broadband boom, stimulated by its high youth population, high GDP per capita, and lack of social and leisure networks in Saudi Arabia.

We fully expect broadband to contribute meaningfully to consolidated revenues

Wireline and data revenues to comprise 41% of consolidated revenues by end-FY11F

We fully expect broadband to contribute meaningfully to revenues, profitability and cash flow because broadband, both fixed and wireless, is a common theme of growth potential in all of STC's countries under operation. We expect wireline and data to reach 41% and 42% of consolidated revenue by FY11 and FY12, respectively. We use the Bass diffusion model (BDM), developed by Frank Bass in 1969, to help develop a framework to forecast broadband penetration in Saudi Arabia. Using the BDM formula, we forecast the wireless or mobile broadband penetration rate will reach 50% by 2015 and a mature or a saturation stage of 60-70% by 2019. At some point between 2012 and 2013, we expect the broadband cycle to hit the sweet spot.

Domestic market remains bread and butter for STC

Saudi Arabia remains key market for STC in terms of revenue generation

Similar to most of the cash-rich telecom operators in the MENA region, STC aspires to become among the leading telecom operators worldwide. With more than 139m customers, 31m of which are based in Saudi, the Saudi market remains key for STC, contributing to the bulk of revenues (about 68% of total revenue at year-end 2010).

A tough home turf leads the way for inorganic growth

Tough competition in Saudi Arabia leads to a shrinking revenue pool

Three of the largest telecoms operators in the Middle East each have a stake in the lucrative Saudi telecoms market – STC faces tough competition and a shrinking domestic revenue pool. This has prompted the Saudi company to branch out of its domestic market and begin acquiring stakes in other telecom operators and licenses in other countries to fuel its expansion strategy.

Key acquisitions across the globe enable STC to diversify is telecom portfolio

International expansion fuels growth and desensitises STC from aggressive domestic competition

We believe that STC's continued investment in its overseas market should bear fruit in the longer term. We forecast that 36% of revenues will be generated from foreign operations by FY12 compared to 30% at year-end 2010. As STC diversifies its asset portfolio away from a highly competitive domestic market, it will become less sensitive to market share fluctuations in Saudi Arabia. We believe that STC's 35% investment in Oger will help it tap into the highly populated Turkish telecommunications market through Oger's 55% stake in Turkish incumbent Turk Telekom, which leads the Turkish telecom industry in terms of broadband services. Furthermore, Turk Telekom has an 81% stake in Turkey's third mobile operator, Avea, allowing STC access to the Turkish mobile market. STC's investment in Maxis Communication is also a strategic expansion, in our view, providing the company exposure to some of the most densely populated countries in the world, including India and Indonesia, which have lower average mobile penetration rates than the MENA region. The company also bought Kuwait's third mobile licence and Bahrain's third mobile licence, allowing STC access to countries with a similar cultural and social fabric, in addition to high ARPUs.

Valuation looks attractive on both the trading perspective and DCF base

Valuation looks attractive on a multiple and DCF basis, in addition to a healthy dividend yield exceeding 8%

The dividend payout ratio for STC was 84% for 2009 and 64% for 2010. We estimate the payout ratio in the absence of any acquisition at 72% for 2011, equivalent to a dividend per share of SR3.0 This implies a dividend yield exceeding 8% for FY11 at current trading prices, one of the highest in the region's telco space. The PE valuations suggest that STC is trading at a significant discount to its regional peer group, which make STC a good value stock, in our view. Our 12-month target price is SR47.7, suggesting 41% upside potential on current trading prices. We initiate our coverage on STC with a Buy recommendation.

Saudi Telecom Company strategy

On the domestic front, STC continues to invest in its broadband arm through DSL and fibre-to-the-home (FTTH) services, which it supplies exclusively. Internationally, STC continues to eye key investment opportunities to fund its inorganic growth plans.

Similar to most of the cash-rich telecom operators in the MENA region, STC aspires to become among the leading telecom operators worldwide. Although STC claims it has exceeded 139m customers in total, the Saudi market remains the most important revenue generator, contributing to about 68% of total revenue at year-end 2010.

Domestically, STC is focusing its investment in its broadband arm and FTTH services, launching the first triple-play bundle package in the kingdom

Domestically, STC continues to invest in its broadband arm through DSL and FTTH services, supplied exclusively by STC, and provide broadband speeds reaching 100 Mbps through FTTH technology. To date, STC has more than 130,000km of fibre-optic networks in Saudi Arabia, allowing for the launch of IPTV services under the brand name of InVision. InVision was the first multimedia triple-play bundle package in the kingdom and includes voice services, broadband and television. It also includes several sports, documentary, news and religious content television channels that have mass appeal. Additionally, subscribers may access videos on demand (VOD), in addition to other features within the service. According to STC management, subscribers of InVision increased eight-fold yoy at end of 1H11. However, management did not disclose actual subscriber numbers for the service.

Internationally, in 2010, STC succeeded in obtaining a 3G license through its Indian operations Aircel. The company also increased its market share via operations in both Viva Kuwait and Viva Bahrain. STC continues to look for investment opportunities, especially in MENA emerging markets, where there is secure economic development and growth.

After concluding its FORWARD business strategy, STC launched its LEAD strategy for 2011

In the past, STC devised its FORWARD business strategy, developed to propel its growth-based plans at home and abroad. In 2011, STC launched its new LEAD strategy, which it believes is a continuation of its FORWARD strategy for 2011 to 2013. It entails six strategic themes.

- **Lead in next-generation broadband:** Become the broadband operator of choice offering ubiquitous access, converged offerings and innovative content and applications.
- **Differentiated customer experience:** Delight customers with an integrated experience, differentiated sakes and service model, tailored offerings and a next-generation customer service.
- **Consolidate international leadership:** Optimise the international investment portfolio, further expand in the MENA region, drive products, technology and supply chain synergies and build up international management capabilities.
- **Invest in people capital:** Invest in leadership and talent development, increase employee empowerment and foster a winning corporate culture.
- **Drive financial performance and agility:** Provide value to shareholders by continuously driving efficiency in operations and investing in long-term profitable growth.
- **Promote leading brand and reputation:** Promote a strong brand and reputation that consistently communicate superior value to shareholders and STC's role as the catalyst for economic and social development.

Table 5 : STC consolidated FY11 forecasts

SR m unless stated otherwise	1Q11	2Q11	1H11	3Q11F	9M11F	FY11F
Revenues	13,076	13,880	26,956	14,543	41,499	54,878
EBITDA	4,814	5,086	9,900	5,468	15,368	20,305
EBITDA margin (%)	36.8%	36.6%	36.7%	37.6%	37.0%	37.0%
Net profit	1,573	2,256	3,829	2,210	6,040	8,341

Source: STC, Rasmala forecasts

Table 6 : STC consolidated forecasts and revenue breakdown

SR m unless stated otherwise	2008	2009	2010	2011F	2012F	2013F
STC consolidated revenues	**47,469**	**50,780**	**51,787**	**54,878**	**56,800**	**58,789**
Wireless	**27,208**	**30,424**	**30,609**	**32,419**	**33,015**	**33,611**
% of total	*57%*	*60%*	*59%*	*59%*	*58%*	*57%*
Wireline & data	**20,261**	**20,356**	**21,178**	**22,460**	**23,785**	**25,178**
% of total	*43%*	*40%*	*41%*	*41%*	*42%*	*43%*
Total domestic % of total revenue	*77%*	*70%*	*68%*	*65%*	*64%*	*62%*
Total International % of total revenue	*23%*	*30%*	*32%*	*35%*	*36%*	*38%*
STC consolidated EBITDA	**21,743**	**20,612**	**19,625**	**20,305**	**20,732**	**21,164**
STC consolidated EBITDA margin (%)	**46%**	**41%**	**38%**	**37%**	**37%**	**36%**

Source: STC, Rasmala estimates

Tough domestic environment

With three of the largest regional telcos operating in Saudi Arabia, competition has become increasingly tough. All three telecom players are fighting to gain and maintain both market and revenue share.

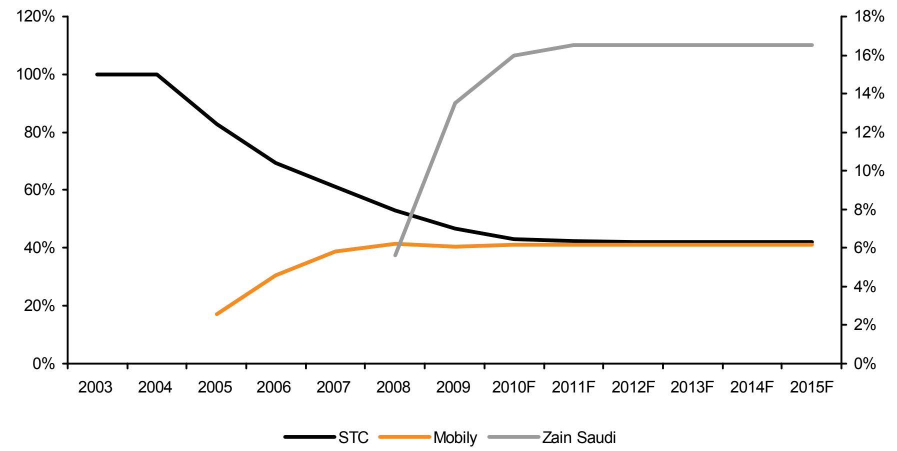
Three of the largest telco operators in the Middle East have operations in the Saudi market

Three of the largest telecoms operators in the Middle East have a stake in the Saudi telecoms market. STC is the state's incumbent player and is the second-largest integrated telecoms operator in the Middle East by market cap (US$18.1bn as of 14 September 2011). Its monopoly ended in 2004 when UAE-based Etisalat, the largest integrated operator in the Middle East by market cap, entered the market with its Mobily brand. Kuwait's Mobile Telecommunications Company (Zain), the third-largest mobile operator by market cap in the Middle East, entered the market in 2008, operating under the brand name of Zain Saudi. In the fixed-line market, Bahrain-based BATELCO entered the KSA market by obtaining a stake in the Etihad-Atheeb operator that launched the Go brand in 2009. While STC and Mobily are integrated players in the market, Zain operates only as a mobile services provider. There are currently no mobile virtual network operators (MVNOs) in the KSA.

Competition has led to heavy market share loss for STC

The operational launch of Mobily in the Saudi Arabian market in 2005 marked the start of a mobile subscriber market share loss for STC. The company lost about 60% of its market share to Mobily and Zain over a five-year period, resulting in a market share of about 43% by the end of 2010. Although STC states that it has 139m customers in all of its markets, the KSA market is still its most important, contributing the bulk of its total revenue. In the KSA, its Al Jawal (mobile) subscriber base was 24m by the end of 2010, reflecting a CAGR of 16% for 2005-10.

Chart 1 : Saudi mobile subscriber market share, 2003-15



Source: CITC, ITU, Companies' data, Rasmala forecasts

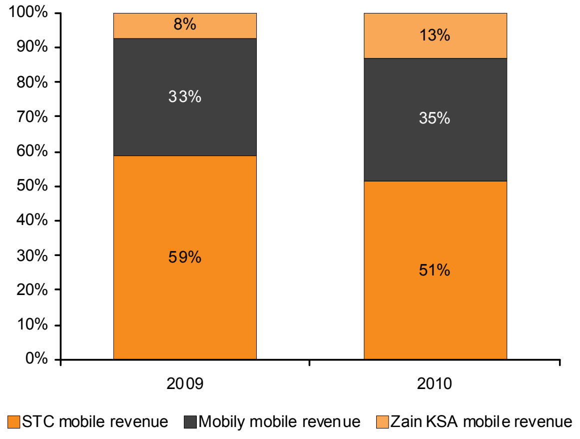
As mentioned previously, the domestic market remains the bread and butter for STC, constituting about 70% and 68% of group revenues by year-end 2009 and year-end 2010, respectively. Of this, approximately 71% and 73% were generated from the mobile arm of operations, according to our calculations.

Steep market share loss in Saudi has negatively affected STC's revenue generation

We believe the loss in local market share has negatively affected STC's revenue generation because revenue from mobile or the wireless segment remains the most dominant factor behind STC's consolidated revenues, for both its domestic and international revenues. To salvage some of its lost market share, during 2009, STC launched over 32 new services and improved on 23 existing ones to attract and retain customers. It also introduced smartphones and media tablets in the KSA to encourage 3G usage within its local markets. These measures contributed to an annual mobile subscriber increase of 10% by year-end 2009 and 14% by year-end 2010. According to our calculations, STC's revenue from its domestic operations fell 6% and 1% for year-end 2009 and 2010, respectively.

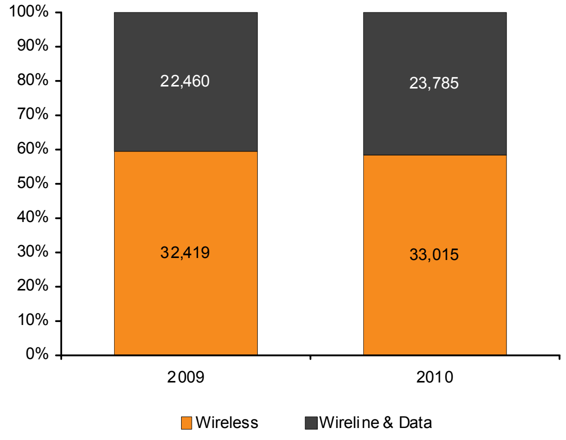
According to STC, revenues from its mobile arm of operations constituted about a 66% share of its overall consolidated revenues by year-end 2010. And according to our estimates, STC's domestic mobile revenue share reached 51% by year-end 2010, as opposed to our estimated 59% revenue share by year-end 2009.

Chart 2 : Mobile revenue share in Saudi Arabia



Source: STC, Companies' data, Rasmala

Chart 3 : STC revenue breakdown by services



Source: STC, Rasmala

STC had a monopoly on fixed-line services until June 2007, when Etihad Atheeb entered the market and began to offer fixed lines for Internet services. It has also launched voice services through fixed lines.

STC's PSTN segment covers fixed line, international calls and interconnect services. Due to the increasing substitution of mobile calls for fixed calls by subscribers and stable household fixed-line penetration rates in the KSA market, STC's revenue growth in the segment has been slow. By the end of 2010, STC had about 4m subscribers for its fixed-line services; this reached 4.3m by the end of 1H11. Going forward, we expect that STC's fixed-line segment will experience little to moderate growth.

To improve its capacity to handle international phone traffic, STC has been increasing the number of international circuits it holds, reaching 160,000 by the end of 2009. While international calls from the STC network falls under the PSTN segment, the leasing out of its circuits is recognised under the Data segment.

Saudi Arabia's broadband potential

Saudi telecom operators are uniquely positioned to take advantage of the current low broadband penetration. Given the lack of social and leisure networks in Saudi, broadband applications could fill this void for the younger generation in Saudi Arabia.

Increasing competition in mobile market leads to data as the natural second growth driver

Mobile headline penetration rates approach 200%

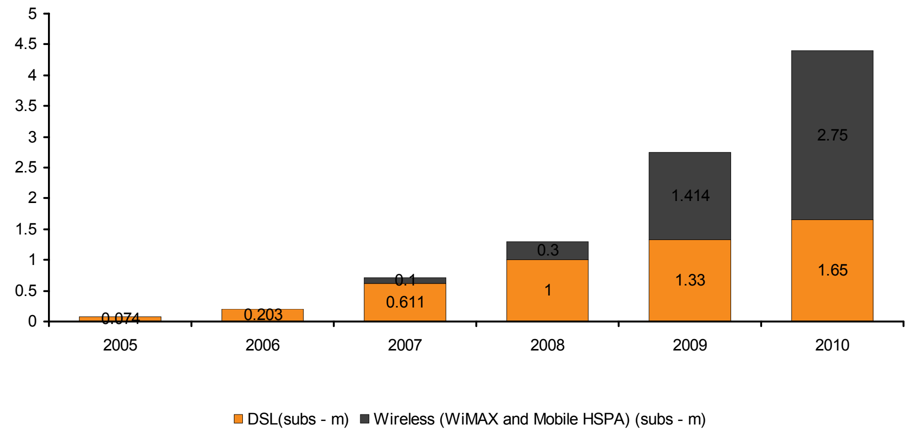
The headline mobile penetration rate in the Saudi market, according to the latest Communications and Information Technology Commission (CITC) report, was 186% for year-end 2010, growing at a CAGR of 28.5% for the past five years. As mobile penetration rates continue to increase in Saudi Arabia, competition has also intensified and the three mobile operators (STC, Mobily and Zain Saudi) are struggling to maintain market share, customer loyalty and revenue growth. In this environment, operators are trying to seek alternative revenue streams, which has led to data as the natural option for increasing revenue streams.

On the cusp of a broadband boom

Growth opportunities lie in data

Despite headline mobile penetration rates being almost double the population size, we still see room for growth in the Saudi telecommunications industry, particularly in terms of high-speed data provision. We believe the telecom sector in Saudi Arabia is on the cusp of a broadband boom, although it is still undergoing further sector liberalisation. According to the CITC, the number of broadband subscribers increased from 64,000 in 2005 to exceed 4.4m at the end of 2010, equivalent to a broadband population penetration rate of 16% and a household penetration rate of 41.6%.

Chart 4 : Broadband subscribers by type in Saudi



Source: CITC, Rasmala

STC had 2m wireless broadband subscribers at the end of December 2010

The broadband market in the KSA has traditionally been dominated by DSL subscriptions. Nevertheless, according to the CITC, wireless broadband – which comprises WiMAX and high-speed packet access (HSPA) – has grown significantly since 2007, at a historical CAGR of 123% over the past five years. By year-end 2010, wireless subscriptions represented approximately 51% of total broadband subscriptions, up from about 25% in 2008. According to STC management, mobile broadband subscribers (including HSDPA+ and Wimax) reached 2m at the end of December 2010. Furthermore, according to STC management, mobile broadband revenue increased by an annual 83% at the end of 1H11 (however, management did not break down the numbers).

Attractive demographics drive uptake of broadband services

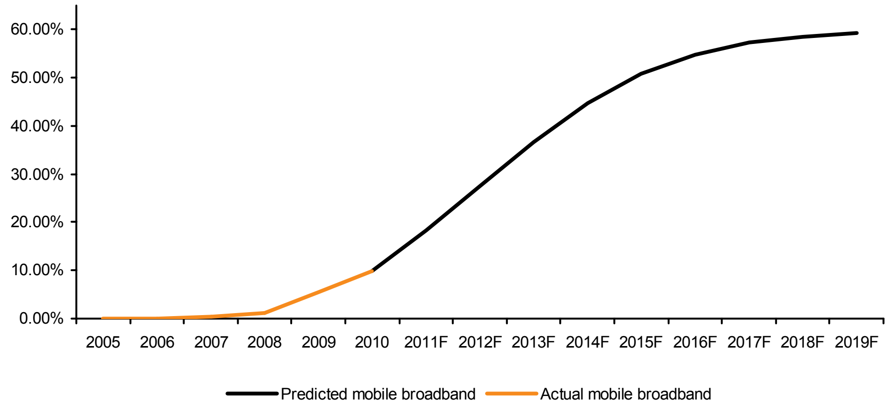
We believe the combination of a youthful population, many expatriates, declining PC/laptop prices, limited entertainment venues and a high GDP/capita constitutes a favourable environment for telecommunications operators.

Wireless broadband should overtake fixed-line broadband

Given our view that high-speed data demand will be the next growth driver for telecom revenues, we believe mobile broadband in particular will yield the highest growth potential. Our premise is based on several assumptions highlighting the limitations of fixed versus wireless broadband.

- **Physical limitation of ADSL:** Due to Saudi Arabia's large land mass, 100% coverage through landlines may be economically unfeasible.
- **Technical installation of ADSL:** This requires several visits from a technician and the scheduling of an appointment, which may take several days or weeks.
- **One house can have several HSPA subscriptions:** Since HSPA is sold to individuals, the bandwidth is not shared by the entire household.
- **The ability to monetise usage:** Operators can charge for usage, which can help them monetise heavy users.

Chart 5 : Predicted mobile broadband penetration rate in Saudi Arabia



Source: CITC, Rasmala forecasts

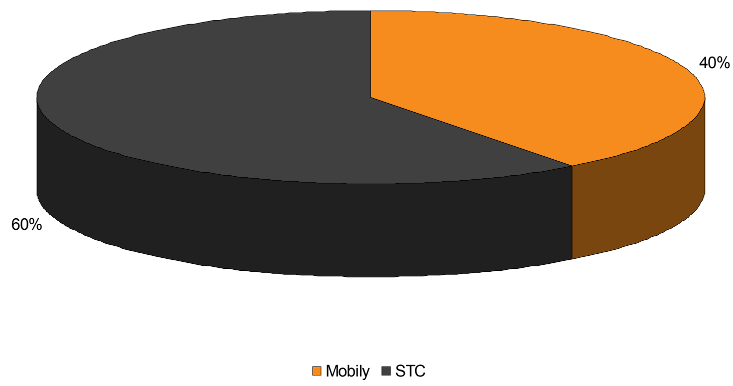
We believe mobile broadband to reach the sweet spot between 2012 and 2013

The Bass diffusion model (BDM) helps us develop a framework to forecast broadband penetration in Saudi Arabia. Using the BDM, we forecast wireless or mobile broadband penetration rate will reach 50% by 2015 and a mature or a saturation stage of 60-70% by 2019. At some point between 2012 and 2013, we expect the broadband cycle to hit the sweet spot.

STC commands broadband market share in Saudi Arabia over its competitors

STC remains the leader in broadband market share in Saudi because it has the advantage of an established fixed network allowing it to offer fixed broadband, unlike its main competitor, Mobily. According to STC, the total subscriber base for both wired and wireless broadband customers reached 3.5m subscribers by year-end 2010, with Wi-Fi services being provided by more than 1,000 sites. Meanwhile, the quantity of data exchanged by the end of 2010 increased by 89% to reach more than 1.150 terabytes per day compared to 610 terabytes at the end of 2009.

Chart 6 : Saudi broadband market share by subscribers in 2010



Source: Company annual reports

Movement towards LTE

To keep up with competition and technology developments, STC is trialling LTE

Competition is increasing within the broadband market, with most operators rapidly rolling out new products and expanding their network. All three mobile operators in the KSA offer competitive broadband packages and have also tested long-term evolution (LTE) networks. According to an article published in www.itp.net in May 2010, LTE will become a significant commercial force by 2013.

STC is trialling LTE. The government only permits trials of LTE since the 2.6 GHz band is not yet cleared for commercial use. Zain Saudi began deployment in 2Q10. Etihad Etisalat (Mobily) completed LTE testing in March 2010 and plans commercial launch by mid-2011 in 33 cities, subject to availability of spectrum.

The KSA already has a 4G operator in Etihad Atheeb, which offers WiMAX services and broadband packages with speeds up to 2mbps and voice over Internet protocol (VoIP) services. Etihad Atheeb, in partnership with Motorola, launched its mobile WiMAX 802.16e network on 8 June 2009, with 800 access points, covering the major cities of Riyadh and Jeddah.

In April 2010, STC launched what it claims is the fastest Internet package in the MENA region – a 100MB/second package using its FTTH technology. The company believes that this will create a breakthrough in the fixed broadband market and lead to an increase in demand. The data sector has been a growing segment for STC, which holds the most extensive network infrastructure in the country, including undersea cables.

STC introduces first triple-play bundle in the kingdom

To date, STC has more than 130,000km of fibre-optic networks in Saudi Arabia, allowing for the launch of IPTV services under the brand name of InVision. InVision was the first multimedia triple-play bundle package in the kingdom and includes voice services, broadband and television. It also includes several sports, documentary, news and religious content television channels that have mass appeal. Additionally, subscribers may access videos on demand (VOD), in addition to many other features within the service. According to STC management, subscribers of InVision have increased eight-fold yoy at end of 1HFY11. However, management did not disclose actual subscriber numbers for the service.

Impact of regional instability on broadband growth

Recent political instability in the region should not affect growth story in Saudi Arabia

In our report *Politics versus fundamentals* dated 12 May 2011, we examined the potential impact of the ongoing geopolitical unrest in the region and its repercussions on the region's telecom development story. We concluded that the negative impact was either temporary or contained with minimal effect, particularly for the oil-wealthy nations.

The ripple effects of the political events in Tunisia and Egypt have spread in varying degrees to the oil exporters in the region, and many of these countries have and are continuing to respond with public spending and job-creation measures to alleviate domestic social tensions. The political unrest has increased the assessment of risk in the region, but the consequential hike in oil prices has brought in a windfall of financial benefits, particularly for the oil-exporting countries. Average spot oil prices, which steadily increased by 25% to US$95 per barrel between August 2010 and January 2011 – underpinned by fundamentals – rose quickly amid greater volatility to more than US$110 per barrel during March 2011, according to the International Energy Agency (IEA). Prices increased further in early April as social and political unrest intensified in Libya, also placing increased emphasis on the role of other oil producers.

For Saudi Arabia in particular, with rising oil prices, the Saudi government has given monetary incentives to stem potential unrest. We believe the prospect of a political crisis in Saudi Arabia is unlikely; accordingly, we believe that the telecommunications sector or broadband growth story in Saudi Arabia has been minimally affected by political events.

Domestic outlook of operations

In our base case, we assume that the long-term fixed-line penetration will reach 15% and STC's market share in the mobile sector will stabilise at 42%.

In our base case, STC experiences a slightly improving ARPL (includes DSL and Internet) yoy in the wireline segment as a result of increased fixed broadband subscribers and higher-value-added services. Given the heightened competition in the mobile market, we expect mobile ARPU to continue following a declining trend throughout our forecast period, from 2011 to 2013.

Table 7 : STC's domestic operations KPIs

Saudi Arabia domestic operations	2008	2009	2010	2011F	2012F	2013F
Wireline						
Penetration	16%	16%	16%	15%	15%	15%
STC market share	100%	100%	100%	100%	100%	100%
Fixed-line subscribers (000s)	4,100	4,200	4,160	4,130	4,110	4,100
ARPL (SAR) inc. DSL and internet	154	144	148	152	157	161
Wireless						
Penetration	142%	175%	199%	217%	227%	232%
Market share	53%	47%	43%	43%	42%	42%
Mobile line subscribers (000s)	19,020	21,000	24,000	24,708	26,048	27,149
Blended ARPU (SAR)	120	96	86	81	77	74
Saudi Arabia consolidated revenue (SAR m)	**37,969**	**35,546**	**35,252**	**35,480**	**36,108**	**36,685**
EBITDA margin (%)	**49%**	**45%**	**43%**	**43%**	**42%**	**41%**

Source: STC, companies' data, industry data, Rasmala estimates

Late international bloomer

STC began to establish its global presence only in 2007, while its regional counterparts began expanding to international markets by early 2000. This was following increasing competition in STC's main market of Saudi Arabia, after the entry of Mobily and Zain.

Global presence established in 2007

STC began to establish its global presence only in 2007, while its regional counterparts began expanding to international markets by early 2000. Following increasing competition in its main market of Saudi Arabia after the entry of Mobily and Zain, STC entered new markets through strategic investments, mergers and acquisitions. It currently has operations in nine international markets: Turkey, South Africa, Indonesia, Malaysia, India, Lebanon, Jordan, Kuwait and Bahrain.

STC to continue international expansion as it enters a 'growth investment' mode

STC pursues opportunities in highly populated countries

STC began its global expansion in 2007, when it entered Indonesia with a 51% stake in NTS (Axis), which holds a 3G licence in the country. It also acquired 25% of Malaysian investment holding company Binariang in September 2007. Binariang held 100% of the operator Maxis and through an IPO of 30% of Maxis's shares in November 2009, STC had a capital gain of SAR687m, with an IRR of 29% through this investment. More importantly, as Binariang also owns 74% of Chennai-based Aircel, it allowed STC to enter the lucrative Indian market. In 2008, it acquired 35% of Dubai-based Oger Telecom, which has operations in Turkey and South Africa.

According to STC, the high population density within these markets enabled it to reach the 100m total subscriber landmark by end-2009. In its May 2009 presentation, STC broke down its total subscriber base as 24.4m for STC and Viva, 30.3m for Maxis and 41.6m for Oger Telecom by end-2008. Nevertheless, STC does not provide a breakdown of its customer base or revenue based on geography.

In April 2010, the CEO of international operations, Ghassan Hasbani, who oversees over US$D7bn of foreign assets, stated to Zawya Dow Jones that 30% of the company's revenue is generated through international operations. He also stated that STC will consider raising its debt this year as it focuses on further acquisitions in markets abroad, mainly in the Middle East, South Asia and Africa. By the end of 2008, the company also attributed about 22% of its net income to its international operations.

STC to continue to seek investment opportunities during the next three years

According to Hasbani, STC is still in a "growth investment" mode and will continue to seek new investments in international markets during the next three years. In June 2010, India's *Business Standard* reported that STC was looking to take a stake of 10-15% in the newly created GTL-Reliance Infratel tower unit. STC denied such a report and said it has no interest in buying a stake in the tower.

On 6 April 2011, STC acquired an additional 29.10% in PT Axis Telekom, known by the Axis brand name, thus making STC's total direct stake in the company 80.1%. The stake increase was based on an agreement signed 9 March 2011 between STC and Maxis Communications Berhad (MCB), one of the wholly owned subsidiaries of Binariang Group. The agreement was to restructure PT Axis Telekom, it was approved by the appropriate regulatory authorities in Indonesia and the conditions necessary for the completion of the agreement were fulfilled 6 April 2011.

STC has been capturing market share in its new Gulf Cooperation Council (GCC) markets

Viva brand in the GCC

Turning its attention to regional markets, STC successfully acquired a third mobile licence in both Bahrain and Kuwait recently. STC was awarded the 26% stake of the Kuwaiti Telecom Company for KWD248.7m in November 2007 and commenced operations in December 2008. It was rebranded Viva in June 2008 and through its competitive pricing and promotions, has been able to capture 15% of market share within one year of operations. It achieved an 18% market share at the end of December 2010, according to STC management. Viva also accounted for 61% of all new subscriptions in Kuwait in 2009.

In January 2009, STC acquired Bahrain's third mobile license with a US$D231m bid. STC started its commercial operations in March 2010 under the Viva Bahrain brand name and again competes with Zain and Bahrain's incumbent BATELCO. Although a new player, by end-1Q10, Zain reported that STC had won market share of 11%.

M&A history of the company

- **STC acquires additional stake in PT Axis Telekom Indonesia:** On 6 April 2011, STC acquired an additional 29.10% in PT Axis Telekom, known by the Axis brand name, based on an agreement signed on 9 March 2011 between STC and Maxis Communications Berhad (MCB), one of the wholly owned subsidiaries of Binariang Group, to restructure PT Axis Telekom. The stake increase effectively increased STC's total stake in the company to 80.1% from a previous 51%. The agreement was approved by the appropriate regulatory authorities in Indonesia and the conditions necessary for the completion of the agreement were fulfilled on 6 April 2011.
- **Intention to acquire BATELCO stake:** In January 2009, STC was speculated to have had interest in acquiring the government of Bahrain's 36.7% stake in Bahrain Telecommunications Co (BATELCO). The stake is currently held by Mumtalakat Holding Co, the investment branch of the Bahraini government.
- **Acquiring Oger stake:** STC acquired a 35% stake in Oger Telecom Ltd on 20 January 2008 for US$2.6bn to gain access to the Turkish and South African markets where Oger operates. Oger Telecom also has a presence in Lebanon and Jordan, providing fixed-line, mobile and Internet services.
- **Entering Asia through Natrindo:** STC acquired a 51% stake in Indonesian operator Natrindo Telepon Seluler PT on 11 September 2007 from its parent company Maxis Communications BHD. Through the deal, STC also acquired a 25% stake in Malaysian operator Binariang GSM Sdn Bhd from Binaring GSM Sdn Bhd. The cumulative deal value was US$3.0bn. Natrindo launched its brand identity Axis in 2008, providing global system for mobile communications (GSM) and 3G services.
- **Offer to purchase 10% stake of Maxis:** In June 2009, STC was speculated to be in negotiations to acquire a 10% stake in Malaysian telco Maxis Communications Bhd. According to sources familiar with the transaction, the deal was valued at US$1bn. It was also speculated that Telstra Corporation Ltd of Australia was in negotiations to acquire a minority stake in Aircel Ltd from Maxis Communications Bhd, while France Telecom SA of France was speculated to be in negotiations to acquire a 20-25% stake in Aircel Ltd from Maxis Communications Bhd. STC holds a stake in Aircel through its stake in Maxis.
- **Third mobile operator in Kuwait:** On 26 November 2007, STC was announced as the winning bidder of a public auction to acquire 26% of Kuwait's third mobile telco, enabling it to enter the market dominated by MTC (Zain) and Wataniya. STC submitted a bid of KWD248.7m (US$907.0m) to the Kuwaiti Investment Authority to beat competitive bids by Etisalat and several Kuwaiti consortiums. STC launched operations under its Viva brand in September 2008.
- **Acquiring local Internet provider AwalNet:** On 19 March 2007, STC acquired a 97% stake in local Internet service provider AwalNet in a deal worth SAR98.9m. AwalNet is one of the largest Internet providers in Saudi Arabia and manages Internet services for both businesses and individuals. It also manages Saudi Arabia's broadband backbone that allows for cross-border and international coverage. (Sources: Reuters Knowledge)
- **Setting up Tejari Saudi Arabia:** In November 2006, STC set up Tejari Saudi Arabia to tap the increasing demand for online trading. The new firm operates and manages electronic transactions and auctions on a business-to-business (B2B) and business-to-consumer (B2C) basis. STC holds 50% of Tejari's shares, while Technical Investments Co and National Company for Information Systems hold the rest.

Oger Telecom

STC owns 35% of Oger Telecom, a UAE-based telecom holding company. Oger is mainly a combination of three assets – Turkish-based Turk Telekom and Avea, and South-African based Cell C.

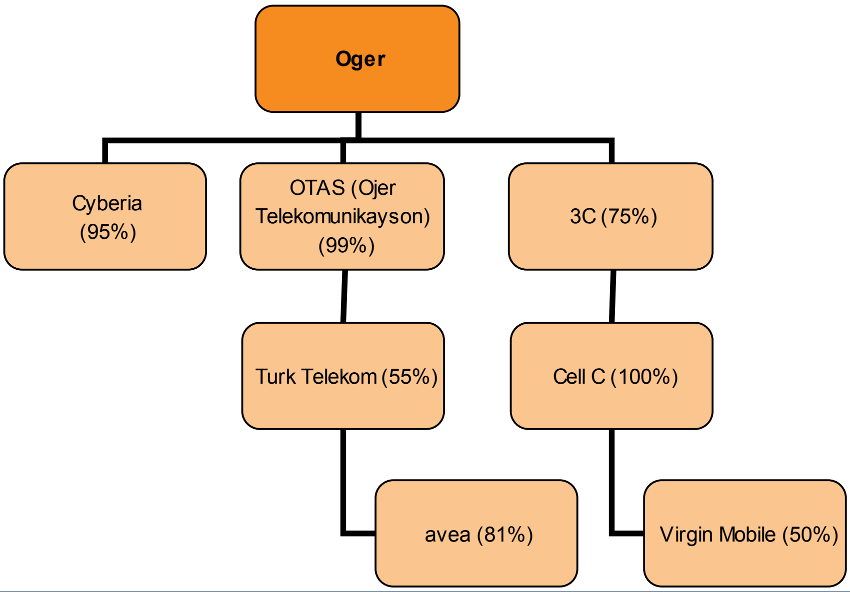
STC bought 35% of Oger for US$2.56bn

In January 2008, STC agreed to buy 35% of Oger Telecom for US$2.56 bn. Oger Telecom, based in Dubai, is 41.9% owned by Saudi Oger Limited, a company wholly owned by the Hariri family and established in Saudi Arabia in 1978. STC owns a 35.0% stake and the remaining 23.1% stake is held by several investors.

The investment in Oger Telecom allows STC access to customers in Turkey, South Africa, Jordan and Lebanon, as the company provides fixed-line, mobile communications and Internet access services in Turkey. It also provides mobile communication services in South Africa and is a major regional Internet service provider (ISP) in Saudi Arabia, Lebanon and Jordan.

Oger Telecom owns controlling stakes in the Turkish fixed-line incumbent (Turk Telekom) and the third GSM player in Turkey (Avea) and South Africa (Cell C). Oger Telecom's effective stake in these investments is as follows.

Figure 1 : Oger Telecom ownership structure



Source: STC

It is worth noting that Oger Telecom is a private company and does not disclose its financials; however, in the event that Oger does disclose its financials allowing for more visibility, this could be a positive trigger for STC.

Turk Telekom Group

This group sells integrated telecommunication services, from PSTN and GSM to broadband Internet. As of 31 March 2011, group companies had 15.8m fixed access lines, 6.7m ADSL connections and 11.8m mobile subscribers, through a 81% majority ownership of Avea.

Sizeable population in Turkey

The Turkish mobile market is one of the largest in the region as a result of the country's sizeable population – about. 70m at year-end 2010. Currently, Turkey has three licensed mobile operators: Turkcell, Vodafone and Avea. Meanwhile, the fixed-line sector (PSTN) of the Turkish telecommunications sector is provided for by Turk Telecom, the incumbent fixed-line operator in Turkey.

Mobile competition intense in Turkey

Competition is fierce in the Turkish mobile sector, with Turkcell dominating the lead market position in terms of subscriber market share – a leading 54% share at the end of 1Q11, while Vodafone had a 27% share and Turk Telekom's Avea (81% stake) had a 19% share for the same period. All three mobile operators offer voice and data services, while 3G licences were awarded to all three operators in 2008 and services subsequently were launched in July 2009. According to the Turkish Information Technologies and Communications Authority (BTK), as of 2010, there were a total of 61.8m mobile subscribers in Turkey, corresponding to a penetration rate of 85.1%, while total fixed-line subscribers reached 16m, equivalent to a 22% penetration rate.

Fixed broadband commands growth

Fixed broadband leads growth in data market

As has been the case recently for most of the integrated telecom operators, mobile and fixed broadband services have been the main areas for revenue growth as opposed to subscriber growth alone. According to Turk Telekom's 2010 annual report, the primary platform used in broadband access in Turkey was copper cable network, followed by mobile broadband Internet. A substantial increase has been seen in the number of broadband subscribers in Turkey, rising from 18,604 subscribers in 2003 to almost 8.7m as of year-end 2010, of which Turk Telekom has 6.7m subscribers. According to the BTK report and based on 4Q10 data, fixed broadband penetration rates in Turkey by population and household were 9.8% and 38.9%, respectively.

Turk Telekom continues investment in FTTN

We expect ADSL or fixed broadband services to be the key area of growth for Turk Telekom, stemming from increased subscriber growth and usage. According to Turk Telekom, the company will continue its investments in fibre-to-the-neighbourhood (FTTN), which at year-end 2010 covered about 3m homes, with the strategy of offering higher quotas and speeds to ADSL users by improving its infrastructure and service quality on the fixed broadband side. This led to an 8% annual increase in average revenue per ADSL line (ADSL ARPL) and 0.5m net subscriber additions by year-end 2010.

Turk Telekom Group outlook

We forecast Turk Telekom's broadband subscribers will grow at a CAGR of 8.6% throughout 2011-13. We expect Turk Telekom's fixed-line subscriber base to continue declining throughout our forecast period, albeit at a slower rate than the past. Overall, we estimate that revenues from the wireline segment of operations will grow at a CAGR of 6% throughout our forecast period between 2011 and 2013.

In terms of overall mobile penetration, we believe that even in the best of circumstances, Turkey is unlikely to reach penetration levels seen in the Gulf countries. It does not have a large expatriate population. The market is not comparable, being a large stable population without the many expatriates seen in the Gulf. The rate of multi-SIM ownership is much lower and declining. Given the ongoing intense competition in the mobile market, we expect Avea to maintain its 19% market share throughout our forecast period, allowing for steady revenue growth.

Table 8 : Turk Telekom Group KPIs

Turk Telekom Group	2008	2009	2010	2011F	2012F	2013F
Wireline						
Penetration	25%	23%	22%	22%	21%	21%
Turk Telekom market share	100%	100%	100%	100%	100%	100%
Fixed-line subscribers (000s)	17,502	16,500	16,020	15,939	15,850	15,753
Fixed broadband subscribers (000s)	5,830	6,200	6,620	7,332	7,925	8,507
Wireless						
Penetration	95%	89%	85%	88%	90%	92%
Avea market share	19%	19%	19%	19%	19%	19%
Mobile line subscribers (000s)	12,195	11,840	11,620	12,375	12,884	13,408
Turk Telekom consolidated revenues (TRY m)	**10,432**	**10,890**	**11,157**	**11,852**	**12,672**	**13,517**
EBITDA margin (%)	**42%**	**40%**	**43%**	**44%**	**44%**	**44%**

Source: Turk Telekom and Rasmala forecasts

Cell C

Cell C is one of four GSM mobile telecommunications companies operating in the Republic of South Africa. After receiving a GSM mobile cellular telecommunications service licence, Cell C began full commercial operations in November 2001 as the third market entrant.

Four mobile operators in South Africa

South Africa has a robust mobile market that has witnessed a rapid uptake since competition was introduced to the sector in the 1990s. With mobile market penetration of about 100% at year-end 2010, the four telecom operators – Vodacom, MTN, Cell C and Telkom SA – all seek methods to distinguish themselves from the competition to gain and retain customers. Furthermore, Virgin entered the market as a mobile virtual network operator (MVNO) in 2006. 3G/HSPA mobile broadband services now rival available DSL fixed-line offerings in terms of both speed and price, and consequently subscriber numbers. Also in 2010, the first trials of the next generation of mobile technology, LTE (also referred to as 4G), were introduced in South Africa.

Cell C was awarded a GSM 1800 licence in early 2001. Cell C is a private company, wholly owned by 3C Telecommunications, which is owned by Oger Telecom (75%) and CellSaf (25%).

15-year roaming agreement on Vodacom's network

Cell C has a 15-year roaming deal on Vodacom's network to complement its area coverage while rolling out its own network infrastructure. In August 2005, Cell C reported it was already carrying over 80% of its traffic through its own network infrastructure; by 2008, less than 15% of Cell C's traffic was carried by the Vodafone's network.

Cell C is the third mobile operator in terms of subscriber market share

Cell C's two major competitors, Vodacom and MTN, both launched in 1994. A fourth mobile telecommunications company, 8ta, was launched by the fixed telecom incumbent Telkom SA during October 2010.

Cell C offered 3G services in late 2010

According to available industry data, Cell C's mobile market share remained less than 15% until year-end 2009.Cell C was the only operator in South Africa that had not launched a 3G service at the time and thus has not been able to exploit the potential of mobile broadband, unlike its lead competitors MTN and Vodacom. Cell C had been testing a 3G system but decided not to pursue a commercial service until it announced in December 2009 that it would roll out a network and services were launched in September 2010.

Cell C turns cash positive in 2008

Cell C announced it turned EBITDA positive on a monthly basis in mid-2004; however, cash flows did not turn positive until 2008. Despite posting an EBITDA of ZAR442m, compared with a loss of ZAR46.6m in 2004, Cell C was downgraded by international credit ratings agency Moody's in 2006 due to the intense competitive environment and pressure on operating margins. Financing costs of almost US$100m weighed heavily on the company's net profits. However, it turned an operating profit for the first time in 2007, reversing a loss of ZAR349m the previous year to a profit of ZAR321m. EBITDA rose 67% in 2009 to ZAR1.4bn on revenues of ZAR9.9bn (up 14%). In April 2010, the shareholders converted a ZAR6.4bn loan (or half of the company's debt) into equity in a bid to reduce the interest burden. The company was also in talks with two companies about selling and leasing back its tower sites. In August 2010, Cell C signed a €240mn loan agreement with the China Development Bank.

Cell C operational outlook

We expect that with the full launch of 3G services, Cell C will be able to take advantage of mobile broadband. Similar to South Africa, where there is limited coverage of the fixed-line network infrastructure, wireless and mobile broadband can rapidly gain traction. Furthermore, prices have now reached a tipping point at which wireless appears set to substitute for fixed-line services in the high-speed data services arena, as it has done in the voice market.

We forecast that Cell C's market share will rise incrementally throughout our forecast period, albeit at a slow pace. We also estimate that EBITDA margins will continue to strengthen throughout our forecast period as Cell C captures a portion of the lucrative high-ARPU mobile broadband business. Accordingly, we expect overall revenues to grow at a CAGR of 6.2% throughout our forecast period.

Table 9 : Cell C South Africa KPIs

Cell C	2008	2009	2010	2011F	2012F	2013F
Wireless						
Penetration	96%	100%	103%	105%	107%	108%
Market share	13%	15%	16%	16%	17%	17%
Mobile line subscribers (000s)	6,400	6,903	7,775	8,991	9,490	10,113
Cell C consolidated revenue (ZAR m)	**8,628**	**9,852**	**10,489**	**11,448**	**12,220**	**12,691**
EBITDA margin (%)	**9%**	**14%**	**13%**	**15%**	**18%**	**19%**

Source: Cell C, ITU, company data, Rasmala forecasts

Viva brand

In an effort to exploit its proximity to neighboring GCC countries and intra-regional tourism, STC launched the Viva mobile operator brand in both Kuwait and Bahrain in 2007 and 2009, respectively.

STC acquires a 26% stake in Viva Kuwait

In November 2007, STC acquired a 26% stake in the third mobile licence in Kuwait, commercially launched under the brand name of Viva, at a bid of US$908m, equivalent to SAR3.37bn. Viva Kuwait's other major shareholder is the Kuwait Investment Authority, which has a 24% stake, while the remaining 50% is held by the public. With its 26% stake in the company, STC retains management control of Viva Kuwait's operations and receives annual fees for its management of the operations.

Despite high mobile penetration rate, Kuwait is a strategic move

STC capitalises on similar cultures and limited geographical area for network deployment

Despite entering the Kuwaiti mobile market at a relatively high mobile penetration rate of about 95%, the move into Kuwait is in our opinion a strategic move made by STC. Both countries share similar cultures. Furthermore, in terms of network deployment, STC has to roll out its network in a relatively limited geographical area – 96% of the population is concentrated in the east of the country in the urban areas, equivalent to 2% of the land mass (380 sq km). Kuwait, like most of the countries in the region, has a young population, while about 70% of the residents are expatriates. Additionally, with one of the highest GDPs per capita (about US$50,000) in the region, the Kuwaiti telecom market retains the potential for relatively high mobile ARPU, particularly with the nascent mobile broadband market in the country.

Table 10 : Viva Kuwait KPIs

Viva Kuwait	2008	2009	2010	2011F	2012F	2013F
Wireless						
Penetration	106%	128%	141%	151%	159%	164%
Market share	10%	15%	18%	19%	19%	19%
Mobile line subscribers (000s)	300	590	694	802	880	941

Source: STC, company data, Rasmala forecasts

Since its commercial launch, Viva Kuwait has been able to rapidly take market share from its two main rivals in the mobile market, Zain and Wataniya. We expect Viva Kuwait's market share to stabilise at 20% beyond 2013.

Technology is the focus of STC's management in Kuwait; next generation networks (NGN) rollout is on the way in Saudi Arabia to support faster mobile access and competition is based on premium services rather than price. The company plans to make the connection on fibre up to the border of Saudi Arabia, then use mobile WiMAX for last-mile connectivity in Kuwait.

In January 2009, STC acquired the third mobile licence in Bahrain

STC was awarded the third mobile licence in Bahrain in January 2009, with a winning bid of US$231m and a promise to give 1% of turnover to social development and to set up a US$300m venture capital fund to develop ICT business in Bahrain and the region.

Bahrain among top destinations for Saudis and STC subscribers

Bahrain is a strategic investment like Kuwait in addition to high shared tourism between Saudi and Bahrain

Like Kuwait, Bahrain is a strategic market for STC because there is a lot of shared tourism between Saudi Arabia and Bahrain (8m-9m Saudis visit Bahrain annually, at a daily average exceeding 50,000 visitors), via the King Fahd causeway bridge, which is only 25km long, in turn making Bahrain among the top destinations for Saudis and STC subscribers.

Similar to Kuwait, Bahrain has a large youth population, which tends to be technologically savvy with a propensity to adopt advanced value added services (VAS) Bahrain has always been at the forefront of Internet penetration in the region, 55% at year-end 2010. Broadband services are almost ubiquitous and according to Bahrain's Telecommunications Regulative Authority (TRA), almost all of the Internet subscribers in the country were broadband subscribers at year-end 2010.

We forecast that Viva Bahrain would be able to gain considerable market share rapidly, given the significant roaming synergies that could be attained between Saudi Arabia and Bahrain. Viva Bahrain's two main rivals are Zain Bahrain and BATELCO. Zain Bahrain's parent company Zain Group is trying to sell off its 25% stake in its Saudi operations (Zain Saudi) to the incumbent, BATELCO, which does not own operations in Saudi yet. We expect Viva Bahrain's market share to stabilise at 35% beyond 2013.

Table 11 : Viva Bahrain KPIS

Viva Bahrain	2008	2009	2010	2011F	2012F	2013F
Wireless						
Penetration	185%	171%	205%	225%	240%	250%
Market share	0%	0%	30%	32%	33%	34%
Mobile line subscribers (000s)	0	0	501	586	659	723

Source: ITU, Companies data, Rasmala forecasts

Maxis Communications

STC began its global expansion in 2007, when it bought a 25% stake in Maxis Communications for US$3.05bn, allowing it access to Indonesia, India and Malaysia. All are densely populated.

STC's 51% stake in NTS marks its first international investment

STC began its global expansion in 2007 when it entered Indonesia with a 51% stake in NTS (Axis), which holds a 3G licence in the country. It also acquired 25% of Malaysian investment holding company Binariang in September 2007 for US$3.05bn. Binariang held 100% of the operator Maxis and through an IPO of 30% of Maxis's shares in November 2009, STC had a capital gain of SAR687m with an IRR of 29% through this investment. More importantly, as Binariang also owns 74% of Chennai-based Aircel, it allowed STC to enter the lucrative Indian market.

Large population base is the attraction behind venture into Asia

According to STC, the high population density within these markets enabled it to reach the 100m total subscriber landmark by end-2009. In its May 2009 presentation, STC broke down its total subscriber base as 24.4m for STC and Viva, 30.3m for Maxis and 41.6m for Oger Telecom by end-2008. Nevertheless, STC does not provide a breakdown of its customer base or revenue based on geography.

Maxis Communications has a presence in the growing Asian economies, which are experiencing an increase in per capita income and mobile penetration. Asian countries, particularly India and Indonesia, are key growth areas for the global mobile market. With their relatively underpenetrated mobile markets, they provide significant room for a potential increase in mobile usage.

Malaysia

Maxis is the largest cellular operator in Malaysia by revenue and in terms of subscribers, with a total of 14m subscribers and an estimated mobile subscriber market share of 41% at the end of 2010. It operates a GSM network and launched 3G services in 2005. The company also operates a small fixed-line business and an international gateway facility.

India

Maxis operate in India through its Chennai-based local subsidiary Aircel, in which it holds a 74% stake. Aircel currently operates across India, with a subscriber base exceeding 50m users at the end of 2010, according to Telecom Regulatory Authority of India (TRAI). This is equivalent to a market share of about 7%, ranking the company as the sixth mobile player in the Indian market in terms of subscribers.

Indonesia

NTS obtained a license to operate a 3G mobile phone network in Indonesia and commenced commercial activity during the first quarter of 2008. STC first acquired 51% of NTS in September 2007, for INR3.2trn, equivalent to approximately SR1.3bn. With STC's 25% stake in Maxis Communications, STC's total effective stake in NTS was 62%. In 2010, STC started competing in the Indonesian telecom market, which is one of the largest markets in the region. Within a highly competitive mobile market (there are four other mobile operators in the country), NTS is the latest entrant, with an estimated mobile market share of 4.4% at year-end 2010 and an estimated 9.7m mobile subscribers.

Table 12 : Maxis Communications KPIS

Maxis Telecommunications	2008	2009	2010	2011F	2012F	2013F
Mobile penetration (%)						
Malaysia	100%	109%	121%	130%	135%	139%
India	29%	43%	61%	81%	102%	124%
Indonesia	57%	69%	92%	110%	125%	137%
Mobile subscribers (000s)						
Maxis – Malaysia	11,234	12,291	13,954	15,396	16,373	17,250
Aircell – India	16,080	31,020	50,170	82,424	119,343	164,815
NTS – Indonesia	3,100	5,600	9,680	13,105	17,803	22,675
Maxis Telecommunications consolidated revenue (MYR m)	**9,801**	**10,681**	**11,570**	**12,513**	**13,517**	**14,761**
EBITDA margin (%)	**43%**	**43%**	**43%**	**43%**	**43%**	**43%**

Source: Source: ITU, Companies data, Industry data, Rasmala forecasts

Saudi Telecom Company profile

STC is Saudi Arabia's leading telecoms service provider, with over 46% of the country's mobile market share. Along with its subsidiaries, STC provides fixed and mobile telephony services and has a presence in 10 countries.

Company description

STC has the largest mobile market share in Saudi Arabia

STC is Saudi Arabia's leading telecoms service provider, with over 46% of the country's mobile market share. Along with its subsidiaries, STC provides fixed and mobile telephony services, and Internet services across Saudi Arabia and several international markets including Kuwait, Indonesia, Malaysia and Bahrain. STC targets individuals and businesses as its two main customer segments. The company also has the largest land and marine transmission network, satellites and international exchanges in the Middle East, which it uses to provide enterprise solutions and wholesale services. Currently the largest telecoms operator in the Middle East, STC had about 31m subscribers in Saudi Arabia and more than 139m subscribers in total across 10 countries by the end of 2010.

Company history

State-owned STC was incorporated in 1998 as Saudi Arabia's only telecoms provider. Its initial 600,000-strong subscriber base increased to 2.5m by 2001, as mobile and fixed-line penetration in the country grew. In 2002, the Saudi government allowed 30% of STC's shares to be released for sale to Saudi citizens and organisations in a bid to partly privatise the company. By the time STC was listed on the Saudi Stock Exchange (Tadawul) by end-2002, its subscriber base had doubled to exceed 5m in a year.

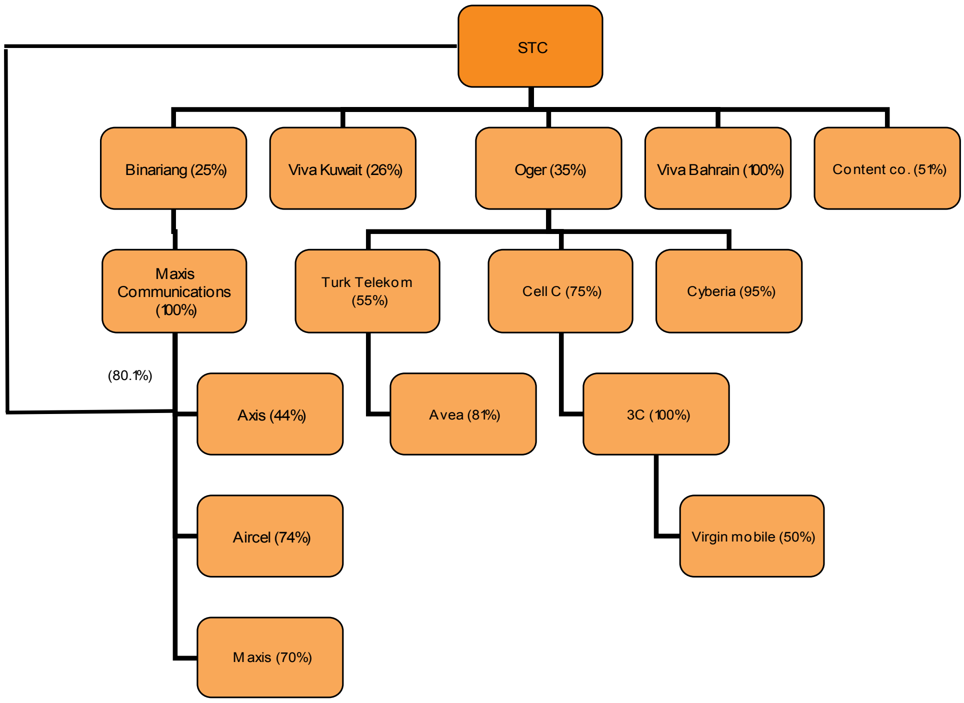
STC enjoyed a monopoly status in Saudi Arabia until 2004, when the telecoms regulator CITC awarded the UAE-based Etisalat licence to enter the market with the Mobily brand. Mobily commenced operations in the KSA in 2005 and introduced competition to the Saudi telecoms market.

The CITC awarded Kuwait's Zain Group the third licence in 2007, and Zain commenced operations in 2008, further intensifying competition.

Given the maturity of its domestic mobile market, STC has turned its focus to fostering growth in emerging markets, like many of the large, cash-rich regional telcos in the MENA region. In 2007, STC purchased a 25% stake in Malaysia's largest mobile operator, Maxis Communications, and an additional 51% stake in its Indonesian unit. The partnership also included an investment in the future expansion plans of Aircel in India, a market STC was eager to enter. In December 2007, STC acquired a 26% stake in Kuwaiti Telecom Company Ltd and in April 2008, it purchased a 35% stake in Oger Telecom Ltd, which operates in Turkey and South Africa. In January 2009, STC successfully bid for the third licence to commence operations in Bahrain. The Viva brand, which STC launched in Kuwait, was also launched in Bahrain in March 2010.

In 2008, STC was the first telco in the Middle East to obtain Standard & Poor's (S&P) A+ long-term rating for foreign currency and an A1 from Moody's. In May 2010, S&P revealed that it had kept STC's foreign currency rating and the overall rating at AA-/Stable/A-1+, given the likelihood of the Saudi government stepping in to provide timely and full financial support to the company in the event of financial distress.

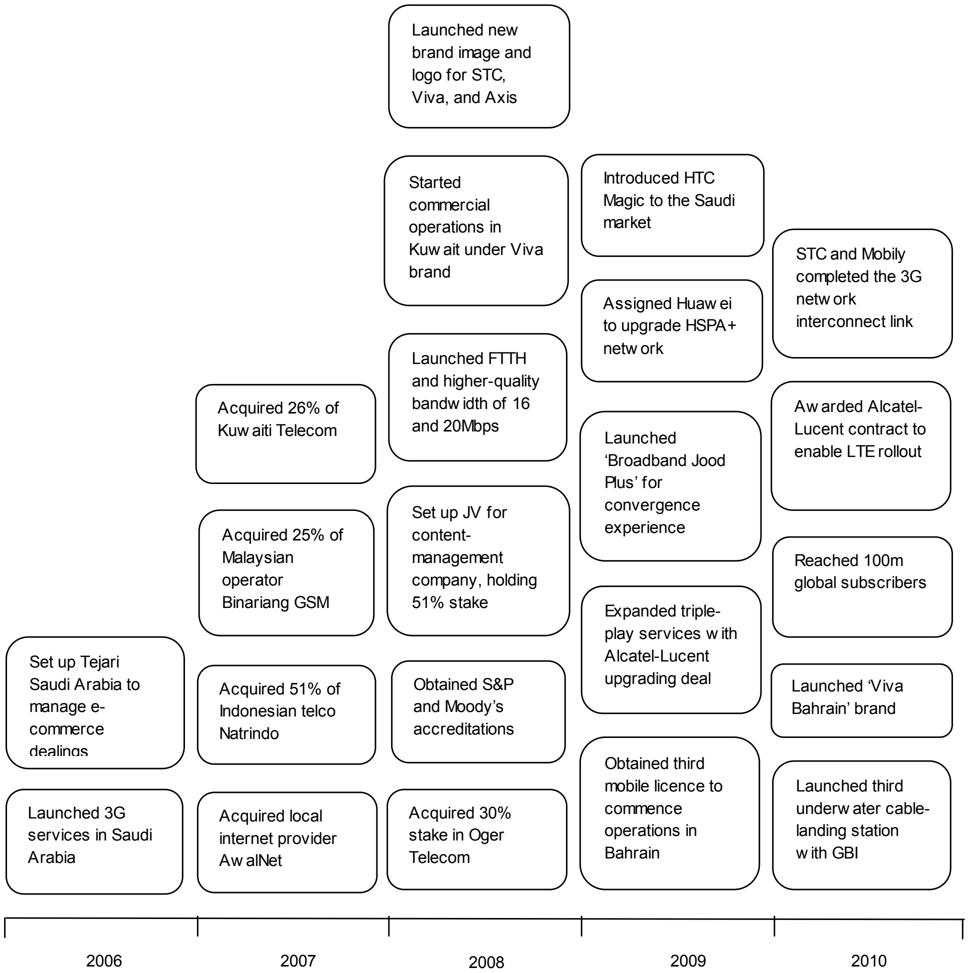
Figure 2 : STC company structure



Source: STC

Major events/milestones

Figure 3 : Major events by year



Source: Company website, Bloomberg

- **Launch of 3G services:** In May 2006, STC was the first operator in Saudi Arabia to launch 3G services on a high-speed packet access (HSPA) platform. The launch was the largest in the region, with almost 1,000 base stations across the country.
- **Initiates international diversification:** Since 2007, STC has been aggressively expanding its presence in emerging markets through various acquisitions and joint ventures, to reach management's objective of generating 10% of operating income through its international operations by 2010. (Source: company filings)
- **Acquires local Internet provider AwalNet:** On 19 March 2007, STC acquired a 97% stake in AwalNet with the aim of increasing its Internet subscribers to 1m. (Source: Reuters Knowledge)
- **Enters Asian market through Maxis:** In a bid to enter Asian markets, STC acquired a 51% stake in Indonesian operator Natrindo Telepon Seluler PT on 9 September 2007 from its parent company Malaysia-based Maxis Communications BHD. Through the deal, STC also acquired a 25% stake in Malaysian operator Binariang GSM Sdn Bhd from Binaring GSM Sdn Bhd, the parent company of Maxis. The cumulative deal value was US$3.05bn. Natrindo launched its brand identity Axis in 2008 and provides GSM and 3G services. (Source: Reuters Knowledge)
- **Third mobile operator in Kuwait:** On 26 November 2007, STC was announced the winning bidder for a 26% stake in Kuwaiti Telecom. STC launched operations under the Viva brand in Kuwait in September 2008. (Source: Reuters Knowledge)
-

- **Acquires Oger stake:** STC acquired a 35% stake in Oger Telecom Ltd on 20 January 2008 to access the Turkish and South African markets. Oger Telecom owns a 55% stake in Turk Telekom, which, in turn, owns 81% of Avea, Turkey's only GSM 1800 provider. In addition, Oger Telecom also owns 75% of South African operator Cell C and 95% of Cyberia, which has operations in Lebanon, Jordan, and Saudi Arabia. (Source: Reuters Knowledge, company website)
- **Obtains first S&P and Moody's accreditation for a MENA telco:** In 2008, STC was the first Middle Eastern telco to obtain Standard & Poor's A+ long-term rating and an A1 from Moody's.
- **Sets up Saudi Arabia's first content-management company:** STC entered into a joint venture with Saudi Research and Marketing Group (SRMG) and Malaysia-based All Asia Networks (ASTRO) to set up a new company for content management in the MENA region. STC holds 51% of the SAR280.0m capital, while SRMG holds 20% and ASTRO the remaining 29%. (Source: company website)
- **Offers better-quality Internet connectivity:** In August 2008, STC launched 16 and 20Mbps bandwidth DSL Internet connections for the first time in Saudi Arabia. STC aimed the new service at customers with advanced devices that require better-quality Internet connectivity. The launch was also part of its new customer-centric approach. (Source: company website)
- **Launches FTTH:** In December 2008, STC was the first in the region to launch a FTTH service, providing its customers the fastest Internet speed (100Mbps) in the country. (Source: Reuters Knowledge)
- **Acquires licence to operate in Bahrain:** In January 2009, STC acquired Bahrain's third mobile license with a bid of USD231.0m. STC started its commercial operations in March 2010 under the Viva Bahrain brand name. (Source: Company website)
- **Launches converged broadband packages:** In September 2009, STC launched its new and unique broadband package, Broadband Jood Plus, which allowed customers to make free internal and local phone calls throughout the country along with both voice and broadband services through its AFAQ DSL Shamel platform for a fixed monthly subscription. (Source: Reuters Knowledge)
- **Upgrades HSPA+ network through Huawei:** In September 2009, STC assigned Huawei to upgrade its high-speed packet access evolution (HSPA+) network in most parts of Saudi Arabia. In line with its promise to provide better services to its customers, this enabled a higher downlink rate of up to 21.6Mbps to its users. (Source: Reuters Knowledge)
- **Expands triple-play services with Alcatel-Lucent deal:** In October 2009, STC signed up with Alcatel-Lucent to expand, extend, and upgrade its existing broadband network to serve an additional 2m residential and enterprise customers by the end of 2010. STC targeted under-served customers in Saudi Arabia by offering innovative triple-play services such as IPTV and converged communications. (Source: Company website)
- **Sets up third landing station:** In February 2010, Gulf Bridge International (GBI) and STC announced a deal on setting up a landing station for GBI's cable in Saudi Arabia that would interconnect all the countries in the Gulf region and provide onward connectivity to the world via Italy in Europe and India in Asia. The GBI cable system has a capacity of up to 5.0Tbps and has been designed to operate for 25 years. (Source: Reuters Knowledge)
- **Launches dual Internet solution Naqaa Net:** In March 2010, STC introduced Naqaa Net, a new feature that allows customers to control network access by switching between the standard Internet network and a 'pure' network filtered by a specialist committee. (Source: Reuters Knowledge)
- **Reaches 100m subscribers:** In March 2010, STC reported that its external investment and expansion strategy helped it reach more than 100m subscribers in 10 countries. (Source: Company website)
- **Chooses Alcatel-Lucent for LTE rollout:** In March 2010, STC awarded Alcatel-Lucent the contract to conduct LTE trials, scheduled for 2H10. The project will enable STC to test the performance of LTE-based services and assess related business models with the new technology. (Source: Telecom Paper)
- **Provides highest Internet speeds in the region (100MB/second) through FTTH technology:** On 3 April 2010, STC launched broadband packages with speeds of 100mbps through the FTTH technology.

- **STC and Mobily announce the completion of the advanced 3G network's technical interconnect link:** In July 2010, STC and Mobily announced the completion of the technical Interconnect link of their two networks, in a step to activate their 3G services to exchange video calling services and multimedia messaging service (MMS) between customers from both providers. More than 40m customers will benefit from the Interconnect link

Income statement

SRm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	50780	51787	54878	56800	58789
Cost of sales	-19779	-21449	-22775	-23572	-24398
Operating costs	-10388	-10712	-11799	-12496	-13228
EBITDA	**20612**	**19625**	**20305**	**20732**	**21164**
DDA & Impairment (ex gw)	-7799	-8645	-9502	-9575	-9672
EBITA	**12814**	**10981**	**10803**	**11158**	**11492**
Goodwill (amort/impaired)	0.00	0.00	0.00	0.00	0.00
EBIT	**12814**	**10981**	**10803**	**11158**	**11492**
Net interest	-1023	-1497	-1421	-1063	-406.1
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	340.1	2053	474.2	287.4	78.1
Reported PTP	**12130**	**11537**	**9856**	**10382**	**11164**
Taxation	-976.6	-1493	-887.0	-934.4	-1005
Minority interests	-290.5	-603.8	-627.8	-661.4	-711.2
Other post-tax items	0.00	0.00	0.00	-0.00	0.00
Reported net profit	**10863**	**9440**	**8341**	**8787**	**9448**
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised EBITDA	20612	19625	20305	20732	21164
Normalised PTP	12130	11537	9856	10382	11164
Normalised net profit	**10863**	**9440**	**8341**	**8787**	**9448**

Source: Company data, Rasmala forecasts — year to Dec

Balance sheet

SRm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	7422	5904	14000	23975	37143
Other current assets	14918	12762	16087	17437	18121
Tangible fixed assets	53026	55135	54916	54272	53138
Intang assets (incl gw)	28916	31806	31806	31806	31806
Oth non-curr assets	4990	5101	5101	5101	5101
Total assets	**109272**	**110709**	**121910**	**132592**	**145309**
Short term debt (2)	0.00	0.00	0.00	0.00	0.00
Trade & oth current liab	29519	26642	30662	32295	34052
Long term debt (3)	22254	21736	25849	19349	13049
Oth non-current liab	6703	8863	8963	9063	9163
Total liabilities	**58475**	**57241**	**65474**	**60707**	**56265**
Total equity (incl min)	50797	53468	56437	71884	89044
Total liab & sh equity	**109272**	**110709**	**121910**	**132592**	**145309**
Net debt	23893	24284	18783	1874	-17794

Source: Company data, Rasmala forecasts — year ended Dec

Cash flow statement

SRm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	20612	19625	20305	20732	21164
Change in working capital	-2570	-110.8	2213	717.0	1274
Net interest (pd) / rec	-695.9	-1102	-1421	-1063	-406.1
Taxes paid	-832.3	-976.6	-938.8	-887.0	-934.4
Other oper cash items	-1110	203.9	-887.0	-934.4	-1005
Cash flow from ops (1)	**15404**	**17640**	**19271**	**18565**	**20093**
Capex (2)	-13542	-13046	-9283	-8931	-8537
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-432.7	326.2	208.7	0.00	0.00
Cash flow from invest (3)	**-13975**	**-12720**	**-9074**	**-8931**	**-8537**
Incr / (decr) in equity	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in debt	0.00	0.00	2404	2465	2371
Ordinary dividend paid	-5943	-6109	-6000	-6000	-7000
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	3874	-328.8	1495	3923	6312
Cash flow from fin (5)	**-2069**	**-6438**	**-2101**	**387.8**	**1683**
Forex & disc ops (6)	0.00	0.00	0.00	-47.4	-70.4
Inc/(decr) cash (1+3+5+6)	**-639.5**	**-1518**	**8096**	**9975**	**13168**
Equity FCF (1+2+4)	1862	4594	9988	9634	11555

Source: Company data, Rasmala forecasts — year to Dec

Standard ratios

Performance	STC FY09A	FY10A	FY11F	FY12F	FY13F	Mobily FY11F	FY12F	FY13F	Saudi Arabia aggregate 2011	2012	2013
Sales growth (%)	6.97	1.98	5.97	3.50	3.50	12.0	10.4	7.08	n/a	n/a	n/a
EBITDA growth (%)	-5.20	-4.79	3.46	2.10	2.08	10.5	10.4	8.49	n/a	n/a	n/a
EBIT growth (%)	-16.4	-14.3	-1.62	3.28	3.00	11.4	11.6	9.73	n/a	n/a	n/a
Normalised EPS growth (%)	-1.58	-13.1	-11.6	5.34	7.53	12.2	13.1	10.9	n/a	n/a	n/a
EBITDA margin (%)	40.6	37.9	37.0	36.5	36.0	38.0	38.0	38.5	n/a	n/a	n/a
EBIT margin (%)	25.2	21.2	19.7	19.6	19.5	27.1	27.3	28.0	n/a	n/a	n/a
Net profit margin (%)	21.4	18.2	15.2	15.5	16.1	26.4	27.0	27.9	n/a	n/a	n/a
Return on avg assets (%)	10.6	8.10	8.02	7.55	7.09	14.0	14.7	15.3	n/a	n/a	n/a
Return on avg equity (%)	27.3	21.7	18.1	16.1	13.4	27.4	25.8	24.2	n/a	n/a	n/a
ROIC (%)	18.8	14.3	13.5	14.5	15.2	21.6	25.4	24.7	n/a	n/a	n/a
ROIC - WACC (%)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	n/a	n/a	n/a
					year to Dec			year to Dec			year to Dec
Valuation											
EV/sales (x)	1.81	1.78	1.58	1.23	0.85	2.17	1.92	1.74	n/a	n/a	n/a
EV/EBITDA (x)	4.45	4.69	4.26	3.36	2.36	5.72	5.04	4.52	n/a	n/a	n/a
EV/EBITDA @ tgt price (x)	5.79	6.10	5.62	4.69	3.67	8.10	7.19	6.51	n/a	n/a	n/a
EV/EBIT (x)	7.16	8.39	8.01	6.24	4.35	8.03	7.00	6.22	n/a	n/a	n/a
EV/invested capital (x)	1.23	1.18	1.15	0.94	0.70	1.87	1.62	1.41	n/a	n/a	n/a
Price/book value (x)	1.61	1.51	1.43	1.09	0.86	1.96	1.64	1.41	n/a	n/a	n/a
Equity FCF yield (%)	2.75	6.78	14.7	14.2	17.0	9.67	8.68	9.80	n/a	n/a	n/a
Normalised PE (x)	6.24	7.18	8.13	7.72	7.18	7.85	6.94	6.26	n/a	n/a	n/a
Norm PE @ tgt price (x)	8.78	10.1	11.4	10.9	10.1	11.3	9.98	9.00	n/a	n/a	n/a
Dividend yield (%)	8.85	8.85	8.85	10.3	10.3	4.46	5.76	7.19	n/a	n/a	n/a
					year to Dec			year to Dec			year to Dec

Per share data	FY09A	FY10A	FY11F	FY12F	FY13F
Tot adj dil sh, ave (m)	2000	2000	2000	2000	2000
Reported EPS (SAR)	5.43	4.72	4.17	4.39	4.72
Normalised EPS (SAR)	5.43	4.72	4.17	4.39	4.72
Dividend per share (SAR)	3.00	3.00	3.00	3.50	3.50
Equity FCF per share (SAR)	0.93	2.30	4.99	4.82	5.78
Book value per sh (SAR)	21.0	22.5	23.7	31.1	39.3
					year to Dec

Solvency	FY09A	FY10A	FY11F	FY12F	FY13F
Net debt to equity (%)	47.0	45.4	33.3	2.61	-20.0
Net debt to tot ass (%)	21.9	21.9	15.4	1.41	-12.2
Net debt to EBITDA	1.16	1.24	0.93	0.09	-0.84
Current ratio (x)	0.76	0.70	0.98	1.28	1.62
Operating CF int cov (x)	24.3	17.9	15.2	19.3	52.8
Dividend cover (x)	1.81	1.57	1.19	1.26	1.35
					year to Dec

Priced as follows: 7010.SE - SR33.90; 7020.SE - SR53.50
Source: Company data, Rasmala forecasts

Valuation methodology

	Enterprise Value	Ownership	Equity Value
Saudi Arabia	**92,954**	**100%**	**92,954**
Oger	**66,517**	**35%**	**12,836**
Maxis	34,065	25%	8,516
Kuwait	4,852	26%	1,262
Bahrain	2,026	100%	2,026
Indonesia	2,693	80%	2,155
Total Enterprise Value	**200,414**		**119,748**
Net Debt			-24,284
Total Equity Value			**95,464**
Total Outstanding shares			2,000
Value per share			**47.7**

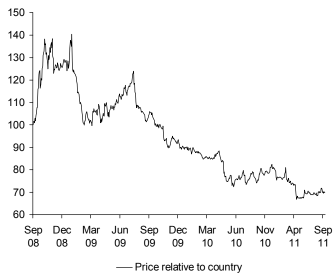
Source: Company data, RBS forecasts

Company description

Buy

Saudi Telecom Company (STC) is Saudi Arabia's leading telecoms service provider with over 46% of the country's mobile market share. Along with its subsidiaries, STC provides fixed and mobile telephony services, and Internet services across Saudi Arabia and several international markets including Kuwait, Indonesia, Malaysia, and Bahrain. STC targets individuals and businesses as its two main customer segments. The company also has the largest land and marine transmission network, satellites, and international exchanges in the Middle East, which it uses to provide enterprise solutions and wholesale services. Currently the largest telecoms operator in the Middle East, STC had about 26m subscribers in Saudi Arabia and over 139m subscribers in total across 10 countries by the end of 2010.

Price relative to country



Strategic analysis

Average SWOT company score: 5

Strengths — 5

STC's strong links to the government of the KSA (which owns 70% of its shares) and its extensive network and infrastructure in the country (one of the largest in the region). Strong cash flow from operations and moderate financial leverage, which will help fund its international expansion.

Weaknesses — 4

STC began expanding to international markets only in 2007 and only after it faced the risks of losing market share and declining revenue in its main market, the KSA.

Opportunities — 5

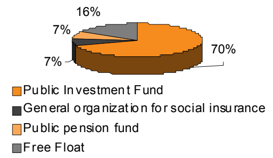
Opportunities include a growing Data segment within the KSA, backed by a young and affluent population. With investments already made in LTE and NGN, STC is able to leverage on its financial clout to capture a large portion of this market with well-positioned products.

Threats — 4

Intensifying competition within the KSA is one of the major threats faced by STC. It has already lost market share in its main GSM segment and will face greater competition when two new fixed-line players, PCCW and Verizon, enter the market.

Scoring range is 1-5 (high score is good)

Shareholder structure



Source: Company data

Market data

Headquarters
King Abdulaziz Complex
Imam Mohammed Bin Saud Street
Al Mursalat Area
P.O. Box 87912
Riyadh 11652
Saudi Arabia

Website
www.stc.com.sa

Shares in issue
2000.0m

Freefloat
16%

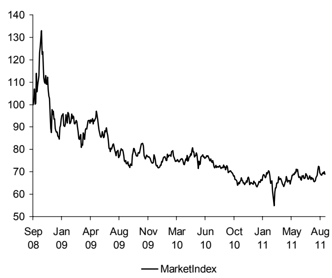
Majority shareholders
Public Investment Fund (70%), General organization for social insurance (7%), Public pension fund (7%)

Country view: Saudi Arabia

MENA markets are showing characteristics of a text book case of loss aversion. This is expected given the magnitude of losses investors experienced since 2008, with 2009 lagging emerging markets by a fairly wide margin. Rising oil prices and budget surpluses drove asset prices across the region higher resulting in a real-estate bubble that has negatively impacted speculators and the banking system. Bubbles do pop and recover over time if there is a legal system in place that enables the transfer of assets. The bad news is such a mechanism did not exist. The good news is that with the creation or RERA and the possibility of Strata Law, this could change and facilitate the transfer of properties from speculators to real investors.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Country rel to M East & Africa



Competitive position

Average competitive score: 4-

Supplier power — 4+

STC is the government-backed, oldest player in the KSA telecoms market, has always had access to spectrum, and it acquires its equipment from several suppliers such as Motorola, Alcatel, and Huawei.

Barriers to entry — 4+

Since Saudi authorities awarded a third licence to Zain to enter the mobile market in 2008 there is no indication that a fourth licence will be available soon.

Customer power — 4-

Customers in the KSA have the option of choosing from among three mobile operators, two fixed-line operators, and several ISPs.

Substitute products — 4-

As an integrated telco, STC offers mobile, fixed-line, and Internet services so it can capture customers who substitute one for another. However, it does face competition from VoIP services

Rivalry — 2-

STC has fared the worst amid increasing competition in the mobile market, as it has lost market share to both Mobily and Zain.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse

Broker recommendations

Source: Bloomberg

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Valuation and risks to target price

STC (RIC: 7010.SE, Rec: Buy, CP: SR33.90, TP: SR47.70): We initiate coverage on STC with a target price of SAR47.7 per share, which is calculated based on a sum-of the-parts, DCF valuation. Risks to our valuation include increased domestic competition in both the mobile and data front, as well as foreign currency fluctuations goven growing revenue contribution from STC's international expansions.

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