

Northern Cement: Q1-2016 earnings below expectation; Despite OPEX decline, higher production cost and zero clinker sales are the most prominent weaknesses factors. "Neutral" recommendation reiterated.

Amount in SAR mn; unless specified	Forecasts 1Q-16	Actual 1Q-16	Deviation (%)
Sales revenues	280.6	NA*	-
Net profit	46.6	42.9	-7.9%
EPS (SAR)	0.26	0.24	-

*Not Available.

Although of domestic cement sales growth, the company bearing higher production costs; along with zero clinker sales in 1Q2016: NRC's 1Q-16 net profit came below our estimates and showed a deviation of 7.9% from our estimates and 4.0% from the market consensus of SAR 44.7mn. Northern Cement Company posted net income of SAR 42.9mn; indicating a fall of 15.3%YoY and an increase of 8.3%QoQ. We believe the YoY profit decline is mainly ascribed to no clinker sales in 1Q2016, despite the 20.1% cement sales growth. As the domestic sales of clinker to Arabian cement in 1Q2015 stood at 209 thousand ton.

During the quarter, the company registered a noticeable volumetric sales growth of 20.1% in cement dispatches, as sales in 1Q-2016 stood at 716 thousand ton vs. 596 thousand ton in 1Q-2015 on the back of higher utilization rate. On the other hand, NRC's sales selling price is expected to stand at SAR 253.5 in 1Q2016, as compared to an average of SAR 252.7 in FY2015. We expect the company's sales in 2016 to continue its growth trajectory with less momentum at 10-12%, this is due to expected higher operating rate. However, the growth story is estimated to be muted in 2016 due to the impact of higher fuel cost and lower clinker sales.

Gross profit stood at SAR 96.0mn, well above our estimates of SAR 92.1mn due to lower than expected COGS. Gross margin in 1Q-2016 is expected to decline to 31.0% from an average of 38.1% in FY2015 due to the reduction in subsidy on fuel. Based on our calculation, we estimate the cost/ton to increase to SAR 175/ton in 1Q2016 vs. average cost/ton of SAR 156.3/ton in FY2015. Operating profit for Q1-2016 stood at SAR 53.8mn depicting a decline of 9.8%YoY, and an increase of 4.7%QoQ; where the company's OPEX (SG & A) has declined by 71.2%QoQ to stand at SAR 22.3mn, as compared to SAR 38.2mn in the previous quarter. (The company is yet to publish detailed financials for 1Q2016).

Higher 3M-2015 sales growth than the market average and market share showing signs of improvement: During 3M-2016, NRC's sales rose by 20.1%YoY to 716 thousand ton from 565 thousand ton in 3M-2015. NRC's accounts for 4.2% of the market in the Saudi cement industry, as compared to 3.6% in the comparable period. During the same period, industry-wide clinker inventory increased by 3.2% to 21.15 MT from 20.5 MT in March-2015, as compared to 61.5% decline in Northern clinker inventory due to higher clinker sales to Arabian cement.

Rising debt limiting attractiveness of the stock: In 2015, NRC's cement sales increased by 27.8%YoY due to higher utilization rate, as revenues increased in 2015 by 13.1%YoY to SAR 1.13bn on higher price realization. However, higher OPEX, interest expenses and negative other income impacted overall profitability, which led to only 3.4% increase in net profit to SAR 206.9mn, with the net profit margin at 18.3%. NRC's debt-to-equity ratio rose to 0.58x at the end of FY2015 from 0.45x a year earlier, with total debt at around SAR 1.2bn. The management announced a total dividend of SAR 1.1/share for 2015 that results in a dividend yield of 7.4%. Based on our estimates, NRC is trading at a forward PE and PB multiple of 14.4x and 1.1x respectively for FY16E. The three-year mean P/E multiple for the cement sector stands at about 14-15x, which indicates that NRC is currently at fair price.

Our estimates and valuation: Northern Cement Co. is expected to post SAR 159.2mn in net income (0.88 EPS) for 2016, recording a decline of 23.1%YoY for the year influenced by higher fuel cost and expected lower clinker sales, therefore, we adjust our recommendation to 'Neutral' for the stock with target price at SAR 12.30/share; indicating a discount of 3.2% over current market price of SAR 12.75/share (as of 14th April 2016).

Recommendation	'Neutral'
Current Price* (SAR)	12.75
Target Price (SAR)	12.30
Upside / (Downside)	-3.5%

*prices as of 24th of April 2016

Key Financials

SARmn (unless specified)	FY14	FY15	FY16E
Revenues	1,001.6	1,129.8	1,111.6
Growth %	17.5%	12.8%	-1.6%
Net Income	200.1	206.9	159.2
Growth %	-14.7%	3.4%	-23.1%
EPS	1.11	1.15	0.88

Source: Company reports, Aljazira Capital.

Key Ratios

SARmn (unless specified)	FY14	FY15	FY16E
Gross Margin	39.5%	38.2%	31.0%
EBITDA Margin	35.3%	30.6%	26.4%
Net Margin	20.0%	18.3%	14.3%
P/E	19.4x	13.0x	14.4x
P/B	1.89x	1.27x	1.07x
ROE	9.7%	9.8%	7.5%
ROA	6.5%	6.5%	5.2%
Dividend Yield	8.8%	7.3%	5.8%

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	2.29
YTD %	-14.7%
52 Week (High)	22.90
52 Week (Low)	10.65
Shares Outstanding (mn)	180.0

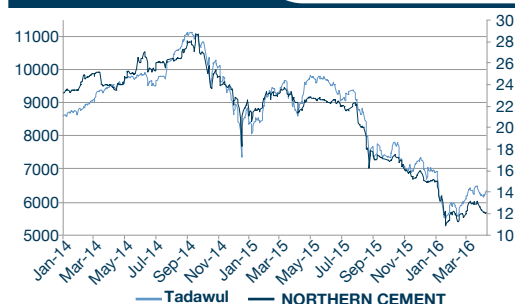
Source: Bloomberg, Aljazira Capital

Shareholders Pattern

Shareholders Pattern	Holding
Public Investment Fund	12.09%
Public	87.91%

Source: Company reports, Aljazira Capital

Price Performance



Source: Bloomberg, Aljazira Capital

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- Underweight:** This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
- Neutral:** The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
- Suspension of rating or rating on hold (SR/RH):** This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

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