



EVENT FLASH

Weak gross margins offset by higher associate income

SAFCO reported an in-line set of 2Q16 results, with net income declining 49.8% YoY to SR299mn. The results came-in line with the NCBC and consensus estimates. We believe higher earnings from Ibn Al-Baytar mitigated the impact of weak operational performance. Based on our calculations, income from associate was SR53mn in 2Q16, higher than our estimate of SR30mn and SR31mn in 1Q16. We believe gross margins came-in at 37.5% in 2Q16, the lowest on record.

- SAFCO reported an in-line set of results with a net income of SR299mn in 2Q16, declining 49.8% YoY. This compares to the NCBC and consensus estimate of SR293mn and SR290mn, respectively. We believe higher income from associate from Ibn Al-Baytar mitigated the impact of weak gross margins.
- Gross profit stood at SR265mn in 2Q16, down 52.2% YoY and 2.2% QoQ. This is 5.3% lower than our estimate of SR280mn and is the lowest reported gross profit on record. The weak performance at the gross level can be attributed to lower than expected gross margins due to 1) weak urea prices which declined 27.2% YoY and 2) 66.7% increase in natural gas prices to US\$1.25/mmbtu (from US\$0.75/mmbtu) on subsidy revisions. Based on our calculations, gross margins came-in at 37.5% in 2Q16, lower than our estimate of 39.5%. We believe this is the lowest gross margins on record.
- According to our calculations, SAFCO facilities operated at 98% in 2Q16, in-line with 2Q15 and our estimate of 98%. This is slightly higher than 96% in 1Q16. We believe SAFCO sold 864,360mt of fertilizers in 2Q16 vs. 846,720mt in 1Q16 and 739,673mt in 2Q15.
- However, higher than expected income from the 50% owned associate Ibn Al-Baytar mitigated the impact of weak operational performance. Based on our calculations, SAFCO's share in Ibn Al-Baytar was SR53mn, higher than our estimate of SR30mn. This is also higher than SR31.1mn in 1Q16 and SR31.6mn in 2Q15. We believe higher operating rates and efficiency could be the key reasons behind improved performance at Ibn Al-Baytar.
- Urea prices remained flat QoQ but declined 27.2% YoY to reach US\$214. Urea price outlook remains muted on higher supply from China. We expect urea prices to decline 26.4% YoY to US\$218 in 2016E.
- We remain Neutral on SAFCO with a PT of SR69.7 with the ongoing weakness in urea prices remaining a key concern. The stock is trading at a 2016E P/E of 18.7x, higher than the sector average of 17.6x.

2Q16 Results Summary

SR mn	2Q16A	1Q16A	% QoQ	2Q15A	% YoY	2Q16E	% Var [^]
Gross income	265	271	(2.2)	554	(52.2)	280	(5.3)
Operating income	248	256	(3.1)	537	(53.8)	264	(6.2)
Net income	299	286	4.6	596	(49.8)	293	2.1
EPS (SR)	0.72	0.69	4.6	1.43	(49.8)	0.70	2.1

Source: Tadawul, NCBC Research, ^ % Var indicates variance from NCBC estimates

NEUTRAL

Target price 69.7

Current price (SR) 59.5

STOCK DETAILS

52-week range H/L (SR)	118/58
Market cap (\$ mn)	6,612
Shares outstanding (mn)	417
Listed on exchanges	TADAWUL

Price perform (%)	1M	3M	12M
Absolute	(1.7)	(8.1)	(49.4)
Rel. to market	(2.4)	(8.3)	(19.8)

Avg daily turnover (mn)	SR	US\$
3M	16.3	4.3
12M	17.3	4.6

Reuters code	2020.SE
Bloomberg code	SAFCO AB
	www.safco.com.sa

VALUATION MULTIPLES

	15A	16E	17E
P/E (x)	11.6	18.7	14.3
P/B (x)	3.3	3.2	3.2
EV/EBITDA (x)	9.3	14.1	11.3
Div Yield (%)	5.0	5.0	6.7

Source: NCBC Research estimates

SHARE PRICE PERFORMANCE



Source: Tadawul

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NCBC Investment Ratings

OVERWEIGHT:	Target price represents an increase in the share price in excess of 15% in the next 12 months
NEUTRAL:	Target price represents a change in the share price between -10% and +15% in the next 12 months
UNDERWEIGHT:	Target price represents a fall in share price exceeding 10% in the next 12 months
PRICE TARGET:	Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon

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