

### A big miss vs. SFC/consensus; Downgrade to Sell

#### A big miss vs. SFC/consensus potentially from weaker volumes and prices

Northern Cement reported 4Q15 net profit of SAR40m (-29% y/y on restated 4Q14, -25% q/q) which missed SFC/consensus by 32%. Operational performance was also weaker than expected with gross profit/EBIT missing our estimate by 23%/27%. At this stage, while no further details are divulged, while weak volume (842k tons, +15% y/y, +2% q/q) that came in 13% lower than our estimate was a key factor for the miss, the remainder could have originated from weaker than expected pricing that is concurrent with the pricing weakness witnessed in the sector. To understand the impact of pricing pressure, we highlight while Northern's 2015 KSA volume (cement+clinker) of 3.46m tons is up 25% y/y, 2015 net profit is down 10% y/y (on 2014 restated number, SAR30m impairment is added back to reported 2014 net profit).

#### Cautious sector outlook; a double whammy of demand slowdown and new capacity

We expect sector wide growth slowdown in cement volume in 2016 (+2% yoy in 2016 vs. 2004-14 volume CAGR of 8%). In our view, while potential demand slowdown in 2016 is certainly an issue, capacity addition seems to be the bigger threat to the sector. While clinker capacity stood at 57.8m tons in 1H15, between 2H15 and 2017 end, 11.7mn tons (20% addition to 1H15 capacity) of new clinker capacity is set to come online. Consequently, we expect clinker production to ramp up as fight for market share intensifies among the players in a weak demand environment. In-all, as clinker production is set to exceed demand (excluding exports which we haven't modeled yet), we expect stock buildup of 4.7m tons in 2016E vs Dec 2015 clinker inventory of 23 mn tons. Historically, cement prices have shown a very tight inverse correlation with clinker stock and if history is any indicator, we expect cement price to fall around 7% in 2016.

#### Locational disadvantage, weak earnings and stretched B/S - Downgrade to Sell

Post publication of 4Q15, in line with our outlook for 2016 and 2017 (volume decline, pricing pressure and negative impact from electricity and fuel cost increase), we have cut Northern's 2016E-17E earnings by 46%. On our revised estimate, the stock trades at 2016E P/E of 15.8x and EV/EBITDA of 10.4x which does not seem appealing. Northern also suffers from a locational disadvantage which means in the face of slowdown in the home market, the company may have to price more competitively in order to more effectively compete in the demand centres (Western and Central regions). In this backdrop, we expect 36% y/y earnings decline in 2016 (company guided to impact from increase in electricity, fuel and transportation costs on earnings at SAR34m implying 26% of 2016 net profit) due to pricing pressure and energy repricing. Furthermore, unlike many mature peers, Northern's B/S is stretched (ST Debt SAR1.15bn, Cash SAR85m, 3Q15 gearing 55%, Net Debt/EBITDA 2.7x) which makes it more susceptible to higher than expected dividend cuts (2016E DPS 0.70, -30% y/y, 6.0% yield) should market condition turns out softer than expected. Given the headwinds ahead, we downgrade the stock to Sell (from Hold) with a target price of SAR9.0/share (from SAR 17.5/share). Having said that, if unfettered exports are allowed, Northern could be a key beneficiary as it can supply clinker to its plant in Jordan, take advantage of the price differential and internalize the margin.

SAR mn	4Q15A	4Q15E	% dev	Cons	% dev	3Q15	% q/q	4Q14	% y/y	2016E	2017E
Volume ('000tons)	842	969	-13%	Na	Na	829	2%	731	15%	3,427	3,443
Revenues	Na	307	Na	307	Na	275	Na	313	Na	1,060	1,029
Gross Profit	90	116	-23%	Na	Na	108	-17%	167	-46%	356	322
EBIT	51	70	-27%	Na	Na	63	-19%	69	-25%	171	137
<b>Net profit</b>	<b>40</b>	<b>59</b>	<b>-32%</b>	<b>59</b>	<b>-33%</b>	<b>53</b>	<b>-25%</b>	<b>56</b>	<b>-29%</b>	<b>132</b>	<b>104</b>

Source: Company, Saudi Fransi Capital, Bloomberg

Rating Summary	
Recommendation	Sell
12-Month Target price (SAR)	9.0
Upside/(Downside)	-22%

Stock Details		
Last Price	SAR	11.6
Market Capitalization	SAR mln	2,088
Shares Outstanding	mln	180
52-Week High	SAR	23.8
52-Week Low	SAR	11.6
Price Change (3M)	%	-32.9
6-Mth ADTV	mln	8.8
EPS 2016E	SAR	0.74
Reuters / Bloomberg	3004.SE	NORTHCEM AB

Source: Tadawul, \*as of 19 Jan 2016

Key Shareholders (%)	
Public	83
Pan Kingdom Investment Co.	12
Abdulqader Al Muhaidib & Sons	5

Source: Tadawul

Price Multiples		
	2016E	2017E
P / E	15.8x	20.2x
EV / EBITDA	10.4x	11.8x
Dividend Yield	6.0%	5.2%

Source: SFC

#### 1-Year Share Performance



Source: Bloomberg

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## Summary Financials

SAR mn, ending Dec 31-st

Income Statement	2014	2015	2016E	2017E	2018E	CAGR	
						2013-15	2015-17
Revenues	1,002	1,122*	1,060	1,029	988	19%	(6%)
Gross profit	396	431	356	322	315	22%	(14%)
EBITDA	377	378*	291	257	250	6%	(18%)
EBIT	265	254	171	137	130	2%	(27%)
Net Income	230	207	132	104	102	(6%)	(29%)
Shares outstanding (mn)	180	180	180	180	180		
EPS (SAR)	1.28	1.15	0.74	0.58	0.57		
DPS (SAR)	1.90	1.00	0.70	0.60	0.60		

\*SFC estimate

SAR mn, ending Dec 31-st

Balance Sheet	2014	2015E	2016E	2017E	2018E	CAGR	
						2013-15	2015-17
Cash and Equivalents	39	151	99	167	143		
Receivables	230	216	247	240	230		
Inventories	504	496	537	550	555		
Other current assets	67	116	123	121	119		
Current assets	840	980	1,007	1,077	1,047	30%	5%
PP&E	1,627	1,604	1,529	1,454	1,379		
Investments	108	77	77	77	77		
Other non-current assets	506	506	506	506	506	5%	(1%)
Total assets	3,082	3,167	3,119	3,115	3,009		
Accounts payable	43	31	31	31	31		
Accrued expenses	13	33	33	33	33		
Current portion of LT Debt	936	1,155	1,100	1,100	1,000		
Other current liabilities	21	14	14	14	14		
Current liabilities	1,014	1,232	1,177	1,177	1,077	64%	(2%)
Long-term Debt	0	0	0	0	0		
Other non-current liabilities	11	10	10	10	10	(78%)	0%
Total non-current liabilities	11	10	10	10	10		
Total equity	2,057	1,924	1,931	1,927	1,921	(7%)	0%
Total liabilities & equity	3,082	3,167	3,119	3,115	3,009	5%	(1%)

SAR mn, ending Dec 31-st

Cash Flow Statement	2014	2015E	2016E	2017E	2018E
CFO+WC change	59	276	174	220	229
Capex	(65)	(48)	(45)	(45)	(45)
Operating FCF	(6)	228	129	175	184
FCF after investing	(7)	234	129	175	184
Dividends	(358)	(342)	(126)	(108)	(108)
Debt Repayment/New debt	341	219	(55)	0	(100)
Others	(13)	1	0	0	0
Net Cash flow	(37)	112	(52)	67	(24)

Grow th (y/y)	2014	2015	2016E	2017E	2018E
Sales	27%	12%	(5%)	(3%)	(4%)
EBITDA	11%	0%	(23%)	(12%)	(3%)
EBIT	9%	(4%)	(33%)	(20%)	(5%)
Net Income	(2%)	(10%)	(36%)	(22%)	(1%)
DPS	(5%)	(47%)	(30%)	(14%)	0%

Margins	2014	2015E	2016E	2017E	2018E
Gross Margin	40%	38%	34%	31%	32%
EBIT Margin	26%	23%	16%	13%	13%
EBITDA Margin	38%	34%	27%	25%	25%
Net Margin	23%	18%	12%	10%	10%

Valuation Multiples	2014	2015E	2016E	2017E	2018E
P/E	18.1	17.4	15.8	20.2	20.4
EV/EBITDA	11.0	12.2	10.4	11.8	12.1
P/Sales	3.6	3.2	2.0	2.0	2.1
P/BV	1.8	1.9	1.1	1.1	1.1
Dividend Yield	9.5%	5.0%	6.0%	5.2%	5.2%

Ratios	2014	2015E	2016E	2017E	2018E
Net Debt/Equity	44%	52%	52%	48%	45%
Net Debt/EBITDA	2.4	2.7	3.4	3.6	3.4
RoE	11%	11%	7%	5%	5%
RoA	8%	8%	5%	4%	4%
Operating FCF/EBITDA	(2%)	61%	44%	68%	74%
Payout Ratio	171%	87%	95%	104%	106%
Working Capital/Sales	69%	64%	75%	78%	80%

Sources: Company, Saudi Fransi Capital



## Research and Advisory Department

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### Rating Framework

#### **BUY**

Shares of the companies under coverage in this report are expected to outperform relative to the sector or the broader market.

#### **HOLD**

Shares of the companies under coverage in this report are expected to perform in line with the sector or the broader market.

#### **SELL**

Shares of the companies under coverage in this report are expected to underperform relative to the sector or the broader market.

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