

May 09, 2017

Rating **Neutral**  
12- Month Target Price **SAR 62.00**

**SOUTHERN PROVINCE CEMENT COMPANY (SOUTHERN)**  
1Q2017 First Look

**Expected Total Return**

Price as on May-08, 2017	SAR 56.18
Upside to Target Price	10.4%
Expected Dividend Yield	7.1%
Expected Total Return	17.5%

**Market Data**

52 Week H/L	SAR 83.5/52.5
Market Capitalization	SAR 7,865 mln
Enterprise Value	SAR 8,176 mln
Shares Outstanding	140.0 mln
Free Float	45.6%
12-Month ADTV (000's)	40.0
Bloomberg Code	SOCCO AB

**1-Year Price Performance**



Source: Bloomberg



Fig in SAR mln	RC. Est	Actuals
Revenue	320	303
Gross Profit	163	122
EBIT	157	107
Net Income	150	105
EPS (SAR)	1.07	0.75

**Negative Surprise**

Southern Cement Company (Southern) announced 1Q2017 results, with a large earnings miss as both RC and street estimates trailed actuals. 1Q numbers were a negative surprise as Southern reported one of its most dreary performances. With cement sector witnessing its toughest year, Southern mimicked industry's dull trends with its EPS of SAR 0.75 missing our estimate of SAR 1.07 and street's SAR 1.06. We revise our outlook and trim our 2017-19 estimates, as demand outlook seems wary of a further slowdown and points to a trough earnings cycle than expected. 2017E P/E of 12.8x is not at deep discount to TASI P/E of 14.2x unlike in the past. With such subdued trends, we revise target price to SAR 62.00 (earlier SAR 65.00) and maintain Neutral.

**1Q2017 key points**

Key points for investors to look at are i) the large drop in margins, which is seen across the board; in a range of 800-950 bps sequentially and 14-17% decline on a Y/Y basis ii) -14% Q/Q and -18% Y/Y decline in realization to lows of SAR 198/ton being the key element iii) surge in clinker inventory to 2.25 MT in 1Q2017 from 610 KT in 1Q2016, a concern and iv) sharp decline in 1Q2017 earnings by -63% Y/Y and -31% Q/Q.

**Realization tumbles to record lows**

Revenue of SAR 303 million came close to our estimate of SAR 320 million, deviating by 5%. It declined by -14% Q/Q and -45% Y/Y on dual impact of large fall in realization, which stood at SAR 198/ton. The most notable is the -33% Y/Y decline in sales volumes, data suggest regional supply-demand imbalance in the Southern region, with Najran Cement, peer producer in the region also saw a -45% Y/Y drop. Southern's poor pricing strategy (trying to prevent from losing its high realization) in its demand centers has led to a loss in market share to peers. As a result, market share dropped to 11.8% in 1Q2017 from 14.5% in 3Q2016. In our view, cement demand in the region has seen noticeable decline since 2H2016, hence adjust 2017-19 estimates further down.

**Margin drop; a case of hard landing**

Gross profit of SAR 122 million missed our estimate of SAR 163 million, declined by -31% Q/Q and -60% Y/Y driven by drop in selling prices, with direct costs increasing +5% Q/Q and +9% Y/Y. As a result, gross margins declined to 40% in this quarter from 51% last quarter and 55% in 1Q2016. The added impact of depreciation and energy prices hikes is accounted for in the comparison, with direct cost/ton increasing to SAR 119/ton. Operating profit of SAR 107 million missed RC and street estimate, declining by -31% Q/Q and -63% Y/Y. Margins declined to 35% from 44% in 4Q2016 despite stable cash costs of SAR 88/ton being in-line with 4Q, suggests fall in realization is the key dampener. EBIT/ton declined to SAR 71/ton in 1Q2017 versus Najran's SAR 31/ton is a relief, when both realized SAR 196/ton. The overall impact led to a decline of -31% Q/Q and -63% Y/Y in earnings, stood at SAR 105 million in 1Q2017. Net margins declined to 35% in 1Q2017 from 44% in last quarter and 52% in 1Q2016.

**Cutting TP to SAR 62.00, maintain Neutral**

We cut DPS to SAR 4.00 for 2017E, yielding 7.1% and believe valuations have not fully accounted the gloominess, hence revise target price to SAR 62.00. Maintain Neutral.

**Key Financial Figures**

FY Dec31 (SAR mln)	2016A	2017E	2018E
Revenue	1,776	1,463	1,411
EBITDA	1,079	824	797
Net Profit	881	615	585
EPS (SAR)	6.29	4.39	4.18
DPS (SAR)	6.00	4.00	4.00
BVPS (SAR)	23.33	23.72	23.90

**Key Financial Ratios**

FY Dec31	2016A	2017E	2018E
ROAA	27%	16%	15%
ROAE	27%	19%	17%
P/E	8.9x	12.8x	13.4x
P/B	2.4x	2.4x	2.4x
EV/EBITDA	7.6x	9.9x	10.3x
EV/Sales	4.6x	5.6x	5.8x

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## Stock Rating

Buy	Neutral	Sell	Not Rated
Expected Total Return Greater than 15%	Expected Total Return between -15% and +15%	Expected Total Return less than -15%	Under Review/ Restricted

\* The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors

For any feedback on our reports, please contact [research@riyadcapital.com](mailto:research@riyadcapital.com)

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