

Saudi Arabian Mining Co-Maaden

Mining – Industrial

MAADEN AB: Saudi Arabia

02 August 2017

الراجحي المالية
Al Rajhi Capital



US\$14.90bn

Market cap

35%

Free float

US\$11.14mn

Avg. daily volume

Target price

38.00 -21.4% over current

Current price

48.40 as at 1/8/2017

Research Department

Pritish K. Devassy, CFA

Tel +966 11 2119370, devassyp@alrajhi-capital.com

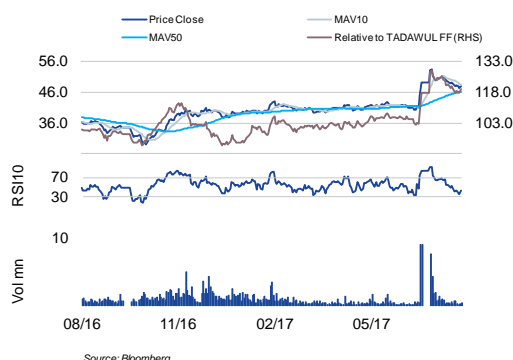
Existing rating

Underweight

Neutral

Overweight

Performance



Earnings estimates

(SARbn)	2016	2017e	2018e
Rev	9.50	12.45	15.28
Gross Profit	2.02	4.20	5.73
Gross Margin	21.3%	33.7%	37.5%
Operating profit	0.61	3.27	4.61
Net income	-0.01	1.47	2.52
Net margin	-0.1%	11.8%	16.5%
EPS (SAR)	-0.01	1.26	2.15
EBITDA	3.14	6.25	7.68
EV/EBITDA	36.3x	18.2x	14.9x

Source: Company data, Al Rajhi Capital

Saudi Arabian Mining Co-Ma'aden UW: Outlook intact. Valuations expensive

With Ma'aden's Q2 production and sales volumes ramping up across most segments, the company's performance remains healthy and outlook remains intact. The company witnessed slightly higher cash costs per ton (as per our estimate) compared to the last quarter, wherein we had seen a remarkable improvement leading to sharp surge in gross margin (34% in Q1 from ~21% in the past) – however cash costs continued to improve on y-o-y basis. Q2 prices across major segments were broadly up. The company's valuation hinges on a) the outcome of its long term projects, which will take around 2-3 years to reach maturity b) improvement in cash costs. Post Q2, we believe the company is on track to achieve these. There was a slight increase in exploration and other costs in Q2, which led to the miss in net profit (SAR356mn vs our SAR393mn estimate), but these are less meaningful for valuations in our view. We slightly lower TP to SAR38/sh. from SAR40/sh. (based on equal mix of DCF and relative valuations -EV/EBITDA of 13.7x by 2022) to factor in marginally lower than expected cash cost improvement. We do not incorporate possible valuation benefit from its planned new phosphate project which could add around SAR4-5/share to its share price– hence any positive development could be an upside risk factor to our TP. We also do not incorporate new projects related to Gold mining that are under feasibility stage, which may add to ~SAR3/share to our TP based on our back of the envelope calculations. Downside risks are mainly related to decline in commodity price and increase in SAIBOR & cash costs per tonne.

Q2 revenue largely in line. Production ramping up. Ma'aden reported Q2 top-line of SAR2,995mn, up 17% y-o-y (slightly above our estimate of SAR2,900mn; consensus: SAR2,890mn), driven by higher sales volume and improved prices for most products..

Figure 1 Q2 results summary

	2Q16	1Q17	2Q17	ARCe	y/y	q/q	vs ARCe
Rev	2552	2717	2995	2900	17%	10%	3%
Gross Profit	581	926	1012	1049	74%	9%	-4%
Margin	23%	34%	34%	36%			
Op profit	369	722	808	836	119%	12%	-3%
Net profit	171	276	356	393	108%	29%	-9%
Margin	7%	10%	12%	14%			

Source: Company data, Al Rajhi Capital

Figure 2 Production highlights

	Q2 2017	Q2 2016	Y-o-Y	Q1 2017	Q-o-Q	ARC	% Miss / Beat
Gold ('000 ounce)	70	63	11.1%	71	-1.4%	71	-1%
Ammonium phosphate fertilizer ('000 tons)	668	669	-0.1%	721	-7.4%	690	-3%
Ammonia ('000 tons)	555	300	85.0%	599	-7.3%	585	-5%
MPC	256	300	-14.7%	314	-18.5%	300	-15%
WAS	299	0	NA	286	4.5%	286	5%
Alumina ('000 tons)	349	324	7.7%	369	-5.4%	383	-9%
Primary aluminium ('000 tons)	219	220	-0.5%	228	-3.9%	222	-1%

Source: Company data, Al Rajhi Capital

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Figure 3 Q2 Sales volume

	Q2 2017	Q2 2016	Y-o-Y	Q1 2017	Q-o-Q	ARC	% Miss / Beat
Gold ('000 ounce)	69	63	9.5%	70	-1.4%	71	-3%
Ammonium phosphate fertilizer ('000 tons)	733	703	4.3%	637	15.1%	690	6%
Ammonia ('000 tons)	393	154	155.2%	467	-15.8%	447	-12%
MPC	111	154	-27.9%	152	-27.0%	161	-31%
WAS	282	0	NA	315	-10.5%	286	-1%
Alumina ('000 tons)	349	324	7.7%	384	-9.1%	383	-9%
External sale('000 tons)	0	0	NA	30	-100.0%	33	-100%
Primary aluminium ('000 tons)	217	219	-0.9%	227	-4.4%	222	-2%

Source: Company data, Al Rajhi Capital

Continued improvement in efficiencies. Ma'aden continued to focus on cost optimization in Q2. The company managed to keep its production costs under control, with cost of sales remaining mostly flat (only ~1% y-o-y increase) despite ~17% rise in top-line. Higher production efficiencies coupled with improved operating leverage helped gross profit to grow 74% y-o-y to SAR1,012mn (34% gross margin) in Q2 but slightly missed our estimate of SAR1,049mn as we anticipated higher gross margin (36%) following a remarkable 120obps y-o-y improvement in gross margin in Q1.

Ammonium Phosphate fertilizer cash costs were down by 7% y-o-y in Q2, owing to lower raw material costs and higher production efficiencies, while gold cash costs reduced 2% y-o-y on account of higher sales volume and improved efficiencies. The company may have benefitted from lower aluminium cash costs in Q2, primarily due to lower input costs following the start of commercial operation of its alumina earlier this year (and fixed costs). Overall Q2 net profit at SAR356mn doubled y-o-y.

Valuation and risks. Although we remain positive on Ma'aden's long term growth prospects, we have revised future estimates for gross margin slightly lower, leading to reduction in TP to SAR38/share based on equal mix of DCF and relative valuation.

For relative valuation, we apply an exit valuation multiple of EV/EBITDA 13.7x (to 2022 estimated EBITDA), which we arrive by using weighted average of EV/EBITDA of peers (weights based on business segment weights). We apply an adjustment factor of 1.55x to the average peer EV/EBITDA multiple to account for the difference in taxes, lower WACC of Ma'aden compared to its peers. The stock is currently trading at an EV/EBITDA of 18.2x and 14.9x on our 2017E and 2018E EBITDA, slightly expensive in our view. Post ~23% steep increase in share price this year, the downside is 21% and hence we revise our rating to Underweight.

Figure 4 Relative valuation methodology

Ma'aden business segments	2022 Gross margin contribution	Target Peer EV/EBITDA multiple
Gold	5%	9.4x
Phosphate	49%	10.4x
Aluminum	46%	7.1x
Relevant peer EV/EBITDA multiple (x)		8.9x
Adjustment factor for lower WACC, debt and Tax		1.55x
Fair EV/EBITDA EV/EBITDA multiple		13.7x

Source: Company data, Al Rajhi Capital

DCF valuations methods (by both Sum of the parts and group DCF methods) give us valuation of SAR38/share for Ma'aden. We use a WACC of 6.3% for the current year and increase it to 9.5% by 2025 as weight of debt declines. We take cost of equity at 12%.



Figure 5 DCF - Sum of the parts

Segment	(SAR/sh)
Equit value of Gold + Ind base metals	5.3
Equity value of Phosphate	14.2
Equity value of Aluminum	11.9
Others	-0.4
Group level cash	6.1
Value of associates and non-core assets	0.8
Total	37.8
Target Price	37.8

Source: Company data, Al Rajhi Capital

Figure 6 Summary of Valuation

Valuation Summary	(SAR/sh)
Sum of the parts (DCF)	37.8
Group DCF	38.3
Relative valuation	37.9
Average	38.0

Source: Company data, Al Rajhi Capital

Projects in feasibility stage not built into our estimates. We do not factor the new projects in feasibility stage due to lack of details into our model. Based on our back of the envelope calculations (on Market cap/ annual production basis), we estimate that the third Phosphate project could be valued at SAR4-5/share. In a similar way, even the new Gold projects in feasibility stage currently could be valued at SAR3/share. In any case, we estimate the terminal value based on average multiple of peers at terminal period (terminal year of 2025) which implies that the company will be able to mine at the current rate even beyond terminal year.

Key risks to estimates are related to commodity price volatility, change in production schedule, movement in SAIBOR and key input prices (such as revision in fuel, electricity prices etc.).



Figure 7: Relative Valuation

Name	Ticker	Market Cap (SAR 'mn)	EV (SAR 'mn)	EV/EBITDA	
				2017E	2018E
Gold Peers					
Barrick Gold Corp	ABX US Equity	73,444	98,049	6.3x	6.9x
Newmont Mining Corp	NEM US Equity	74,011	83,646	8.9x	9.0x
Goldcorp Inc	GG US Equity	42,396	52,574	9.6x	8.6x
Franco-Nevada Corp	FNV US Equity	48,731	47,670	25.2x	23.4x
Newcrest Mining Ltd	NCMAU Equity	46,283	53,776	10.1x	9.2x
Randgold Resources Ltd	RRS LN Equity	32,766	31,516	13.3x	12.2x
Agnico Eagle Mines Ltd	AEM US Equity	41,091	42,683	12.5x	11.8x
Anglogold Ashanti Ltd (Us)	AU US Equity	15,508	23,000	4.7x	3.8x
Kinross Gold Corp	KGC US Equity	19,638	23,212	5.3x	5.1x
Royal Gold Inc	RGLD US Equity	21,172	23,408	19.7x	17.4x
Gold Fields Ltd	GFI SJ Equity	12,188	17,023	4.1x	3.6x
Yamana Gold Inc	AUY US Equity	9,280	15,313	6.7x	4.9x
Detour Gold Corp	DGC CN Equity	8,227	8,900	8.9x	6.7x
Eldorado Gold Corp	EGO US Equity	6,238	5,792	8.9x	4.2x
Yamana Gold	AUY US Equity	9,280	15,313	6.7x	4.9x
Mean				10.1x	8.8x
Median				8.9x	6.9x
Phosphate Peers					
Potash Corp Of Saskatchewan	POT US Equity	56,265	72,897	13.4x	12.0x
Agrium Inc	AGU CN Equity	51,696	69,823	10.3x	9.2x
Yara International Asa	YAR NO Equity	40,416	48,961	8.1x	6.6x
Mosaic Co/The	MOS US Equity	31,855	44,287	10.5x	8.4x
Cf Industries Holdings Inc	CF US Equity	25,560	53,957	14.6x	11.1x
Jordan Phosphate Mines	JOPH JR Equity	1,249	2,304	N/A	N/A
Mean				11.4x	9.4x
Median				10.5x	9.2x
Aluminium Peers					
Bhp Billiton Limited	BHP AU Equity	355,348	474,914	6.3x	6.8x
Rio Tinto Plc	RIO LN Equity	265,547	338,791	5.9x	6.8x
Alcoa Inc	ARNC US Equity	33,190	56,250	9.1x	8.2x
Aluminum Corp Of China Ltd-H	2600 HK Equity	32,580	81,121	10.7x	9.7x
Norsk Hydro Asa	NHY NO Equity	35,938	35,985	6.4x	5.6x
China Hongqiao Group Ltd	1378 HK Equity	24,297	55,839	5.7x	4.9x
Shandong Nanshan Aluminum-A	600219 CH Equity	13,738	15,659	10.2x	8.4x
Kaiser Aluminum Corp	KALU US Equity	5,565	5,920	8.7x	8.0x
Aluminium Bahrain Bsc	ALBH BI Equity	4,464	4,117	5.4x	5.8x
Century Aluminum Company	CENX US Equity	3,302	3,819	9.0x	8.3x
Vedanta Resource	VED LN Equity	10,882	70,895	4.3x	4.2x
Hindalco Industries	HNDL IN Equity	18,892	50,554	6.6x	6.4x
Mean				7.4x	6.9x
Median				6.5x	6.8x

Source: Bloomberg, Al Rajhi Capital. As of July 31, 2017.



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"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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Contact us

Mazen AlSudairi
Head of Research
Tel : +966 1 211 9449
Email: alsudairim@alrajhi-capital.com

Al Rajhi Capital
Research Department
Head Office, King Fahad Road
P.O. Box 5561, Riyadh 11432
Kingdom of Saudi Arabia
Email: research@alrajhi-capital.com

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