SAFCO
Petrochemicals – Industrial
SAFCO AB: Saudi Arabia
30 April 2017

US$7.64bn	40%	US$2.689mn
Market cap	Free float	Avg. daily volume

Target price	62.00	-10% over current
Current price	68.80	as at 27/4/2017

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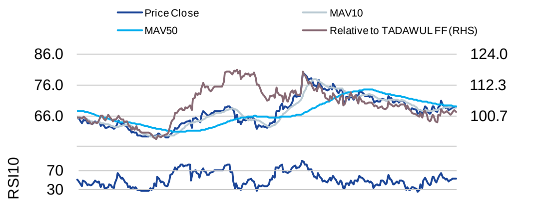
Existing rating

Underweight	Neutral	Overweight

Performance



Source: Bloomberg

Earnings

Period End (SAR)	12/13A	12/14A	12/15A	12/16A
Revenue (mn)	4,240	4,456	3,547	2,856
Revenue Growth	-14.9%	5.1%	-20.4%	-19.5%
EBITDA (mn)	3,171	3,343	2,415	1,428
EBITDA Growth	-18.0%	5.4%	-27.8%	-40.9%
EPS	7.6	7.6	5.1	2.5
EPS Growth	-18.3%	0.4%	-32.9%	-50.4%

Source: Company data, Al Rajhi Capital

SAFCO

Healthy Q1, but likely to tread lower

Sharp increase in urea price combined with SAFCO's high operating leverage resulted in a steep increase in net profit (~52% y-o-y) in Q1, broadly in-line with our estimate. Additionally, SAFCO's associate, Ibn-Al-Baytar contributed positively in Q1 after reporting a loss in Q4 primarily due to maintenance shutdown. Despite overall Q1 financials being healthy, we believe Q2 earnings might decline sequentially as average urea price in April has declined ~18% from Q1 average. Moreover, SAFCO II and III plants could be shut down for 4 and 20 days respectively for planned maintenance in Q2. The stock is down ~7.8% this year and is currently trading at a forward P/E of 21.3x (which we think is unjustified compared to ~15x historical average) on our 2017e EPS. Therefore we reiterate our Underweight rating and maintain our TP at SAR62/share.

Q1 key highlights: **a)** Q1 revenue increased ~22% y-o-y to SAR846.7mn on higher urea price and sales volume. **b)** While urea price (+22% y-o-y) was broadly known already, lower than expected sales volume in Q1 led to the miss at the top-line **c)** SAFCO had earlier announced that its SAFCO II and III plants will be closed in H1 2017 due to planned maintenance shutdown for 4 and 20 days. Given no update on the same, we assume these plants may now be shut down in Q2. **d)** SAFCO may have reclassified certain expenses from gross to operating level, leading to higher gross profit compared to our estimate. **e)** We believe equity income from Ibn-Al-Baytar showed a significant improvement (~SAR30mn) from the previous quarter's loss of SAR13.8mn on account of planned maintenance and largely in line with our expectation. **f)** Net profit came in at SAR423.4mn, up by 51.7% y-o-y, driven by higher top-line coupled with improved operating leverage. **g)** Post migration to IFRS in Q1, net profit in Q4 2016 has been revised lower by ~8%, while gross profit has been revised upwards 18%. We believe this may be because of change in categorization of expenses as mentioned above.

Q2 may witness pressure: Despite an overall healthy Q1, we believe SAFCO could witness sequentially weaker earnings in Q2, primarily due to lower average urea prices (~18% decline in April) coupled with lower sale volumes arising from the planned shutdowns.

Cross-read for SABIC: Aggregate top-line of SABIC's listed subsidiaries which already announced their Q1 results (Yansab, Kayan and SAFCO) came ~6% (SAR320mn) below our estimates (though only ~1% impact on estimated Q1 total revenue for SABIC) while the combined operating/net profit of these subsidiaries was largely in line with our estimate. Therefore we believe SABIC's results are likely to be broadly in-line with our expectations (revenue and net profit at SAR36.4mn and SAR5.6mn, respectively). Per our understanding, Ibn Rushd which reported significant write offs in the last few quarters is likely to have turned profitable this quarter. Downside risks could be downward revision in profit due to IFRS, which has been the case with Yansab, Kayan and SAFCO.

Valuation and risks: SAFCO is currently trading at a forward P/E of 21.3x on our 2017e EPS, which we believe is expensive. We reiterate our Underweight rating with a TP of SAR62/share based on our valuation model (average of relative and DCF valuations). Key upside risk relates to higher Urea price, while downside risks include prolonged unplanned shutdowns, decline in urea price due to lower demand esp. in Asia, and change in feedstock pricing mechanism.

Figure 1 SAFCO: Summary of Q1 2017 results

(SAR mn)	Q1 2016	Q4 2016	Q1 2017	% chg y-o-y	% chg q-o-q	ARC est
Revenue	691.2	765.3	846.7	22.5%	10.6%	896.0
Gross profit	354.1	368.6	479.5	35.4%	30.1%	400.3
Gross profit margin	51.2%	48.2%	56.6%			44.7%
Operating profit	258.2	263.7	394.6	52.8%	49.6%	382.1
Net profit	279.0	264.7	423.4	51.7%	59.9%	440.0

Source: Company data, Al Rajhi Capital

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"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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