Tabuk Cement Co.

Investment Update — April 2016

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

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Tabuk Cement: Q1-2016 net profit was slightly above expectation due to accounted finance cost of SAR 2.5mn in our estimate; however, sales revenue missed expectation due to continued pressure on selling prices. Recommendation adjusted to "Underweight".

Amount in SAR mn; unless specified	Forecasts 1Q-16	Actual 1Q-16	Deviation (%)
Sales revenues	78.8	75.8	**-3.8%**
Net profit	21.6	22.6	**4.6%**
EPS (SAR)	0.24	0.25	

Despite YoY volumetric sales growth, higher production cost/ton and more selling price discount resulted in weak performance in 1Q2016: TCC's 1Q-2016 net profit came in-line with expectation showing a deviation of 4.6% from AJC estimates and 13.0% from the market consensus of SAR 20.0mn. Tabuk Cement company posted net income of SAR 22.6mn; indicating a decline of 31.9%YoY and 1.8%QoQ. The company attributed the weak operational performance to the average selling prices, and higher production cost/ton. We believe higher than expected net profit is mainly ascribed to i) including SAR 2.5mn in our estimates as a finance cost. ii) lower than expected OPEX. iii) lower than expected cost/ton. However, the weaker than our estimates sales revenue was mainly associated to lower realization/ton, as the volumetric sales in 1Q-2016 was in-line with our estimates.

During Q1-2016, the company registered an increase of 2.1% in volumetric sales, as dispatches in Q1-2016 stood at 400 thousand ton vs. 392 thousand ton in 1Q-2015. The company's revenue stood at SAR 75.8mn, as the average price realization/ton is expected to be at SAR 189.5/ton, as compared to SAR 198.7/ton in 4Q2015 and SAR 214.5/ton in 1Q2015. We expect Tabuk Cement company to continue its sales growth in 2016 with around 5-6%YoY. The cement sector's performance in 2016 is likely to mirror that in 2015. This is due to continued oversupply in the market, following high clinker inventory, additional cement capacity which came on stream in 2015.

Gross profit stood at SAR 26.4mn, below our estimates of SAR 29.9mn due to higher discount on selling prices, despite of lower than expected COGS. Gross margin in 1Q-2016 is expected to decline to 34.9% from an average of 41.8% in FY2015 due to higher production cost/ton after the reduction in subsidy on fuel. Based on our calculation, we estimate the cost/ton to increase to SAR 122.7/ton in 1Q2016 vs. SAR 113.7/ton in 4Q-2015. Operating profit for Q1-2016 stood at SAR 22.3mn depicting a decline of 32.6%YoY, and 4.7%QoQ; as the company's OPEX (SG & A) has declined by 18.6%YoY to SAR 4.15mn, as compared to SAR 5.1mn in 1Q2015.

Fuel allocation key for future growth from the "King Salman Bridge" project: Tabuk Cements' new cement production line with a capacity of 1.6 MTPA commenced trial operations in May 2015. The issues of non-availability of fuel allocation from the government led to delay in starting the commercial operations. The commercial operations are expected to commence from 3Q 2016. Recently the KSA and Egypt governments announced building a bridge between Tabuk in KSA and Sharm el-Sheikh resort in Egypt on the Sinai peninsula. The bridge named "King Salman Bridge" is expected to be built over 5 to 7 years. The length of the structure will span 50 km while the bridge over sea will measure about 7 to 10 km. The total cost of the project is estimated at USD 4.0bn. The trade volume realised from the bridge is expected to be over USD 200bn/year.

King Salman Bridge is a major catalyst for Tabuk cement given its proximity to the project. However, uncertainty prevails due to non-availability of fuel allocation. Hence, the potential benefit from this project is not reflected in the financial model. We estimate that this project may add about SAR 10-12 to the value of the stock. Based on the recent increase in stock price from about SAR 15 before the announcement of the King Salman Bridge project and current price of SAR 17.20, we have reduced our recommendation to "**Underweight**". Our TP stand at SAR 13.20 which is at a 23.3% discount from the current market price of Tabuk Cement.

Debt repayment to also lower dividend in 2016: TCC has paid dividends consistently, with an average payout ratio of 90% (SAR1.5 DPS in 2014). We believe due to the company would repay the debt undertaken of SAR558.6mn for expansion by the end of 2020. This would restrict the dividend per share and, accordingly, the company lowers DPS to approximately SAR 0.9 during 2015. We anticipate the company to pay a dividend of SAR 0.75 DPS (4.4% D/Y) in 2016 owing to its debt undertaken. However, we expect the payout ratio and dividend payment to increase gradually after 2020 once the company repays all long-term debt. Without any major expansion in the foreseeable future, the company's cash flow from operations is expected to be sufficient to repay the long-term debt. By 2020, the debt-to-equity ratio would decline to less than 10% from 40% currently.

Recommendation	**'Underweight'**
Current Price* (SAR)	**17.20**
Target Price (SAR)	**13.20**
Upside / (Downside)	**-23.3%**

*prices as of 26th of April 2016

Key Financials

SARmn (unless specified)	FY14	FY15	FY16E
Revenues	322.3	272.4	281.9
Growth %	-9.4%	-15.5%	3.5%
Net Income	137.6	89.8	71.4
Growth %	-20.7%	-34.7%	-20.5%
EPS	1.51	0.99	0.78

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY14	FY15	FY16E
Gross Margin	57.3%	41.8%	35.3%
EBITDA Margin	62.4%	66.7%	60.3%
Net Margin	42.7%	33.0%	25.3%
P/E	16.4x	14.7x	21.9x
P/B	1.93x	1.12x	1.32x
EV/EBITDA (x)	12.6x	9.5x	11.1x
ROE	13.5%	7.9%	6.0%
ROA	8.6%	4.8%	3.8%
Dividend Yield	6.0%	6.2%	4.4%

Source: Company reports, Aljazira Capital

Our estimates and valuation: Tabuk Cement Co. is expected to post SAR 71.4mn in net income (0.78 EPS) for 2016, recording a decline of 20.5%YoY for the year influenced by higher fuel cost and continued selling price discount, Hence, we adjusted our recommendation to '**Underweight**' on the stock with target price of **SAR13.20/share**; indicating a discount of 23.3% over current market price of SAR 13.20/share (as of 26th April 2016). The company is trading at a forward PE and P/B of 21.9x and 1.32x respectively based on our 2016 earnings forecast. We anticipate the company to lower its dividend payment to SAR 0.75 DPS (4.4% D/Y) in 2016 owing to its debt.

Key Market Data

Market Cap (bn)	1.54
YTD %	17.4%
52 Week (High)	27.40
52 Week (Low)	12.95
Shares Outstanding (mn)	90.0

Source: Company reports, Aljazira Capital

Shareholders Pattern

Shareholders Pattern	Holding
Public Pension Agency	5.0%
Khalid Saleh Al-Shithry	12.69%
Public	82.31

Source: Company reports, Aljazira Capital

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RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated “Overweight” will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated “Underweight” would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated “Neutral” is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

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