

Northern Cement: Q4-2015 earnings below expectation with a negative surprise; higher production cost by 11.1%, and lower clinker sales are the most prominent weaknesses factors.

Amount in SAR mn; unless specified	Forecasts 4Q-15	Actual 4Q-15	Deviation (%)
Sales revenues	307.1	277.4	-9.6%
Net profit	65.4	39.61	-39.4%
EPS (SAR)	0.36	0.22	

*Not Available.

Although of domestic cement sales growth, the company bearing higher production costs; along with clinker sales and selling price decline in 4Q2015: NRC's 4Q-15 net profit came below our expectation and showed a deviation of 39.4% from our estimates and 38.2% from the market consensus of SAR 64.1mn. Northern Cement Company posted net income of SAR 39.61mn; indicating an increase of 53.4%YoY and a fall of 24.7%QoQ. The company attributed the YoY profit growth to impairment loss of SAR 30mn in 4Q2014, and despite of higher financial expenses and lower sales price in 4Q2015. We believe the regression of the top line revenues was mainly associated to lower domestic sales of clinker to Arabian cement, where the volumetric sales of clinker stood at 170 thousand ton, as compared to 254 thousand ton in the comparable period. However, the company registered a noticeable volumetric sales growth of 40.9% in cement dispatches, as sales in Q4-2015 stood at 672 thousand ton vs. 477 thousand ton in Q4-2014 on the back of higher utilization rate. On the other hand, NRC's sales selling price is expected to stand at SAR 257 in 4Q2015, as compared to SAR 258.5 in 3Q2015.

Gross profit stood at SAR 89.5mn depicting a fall of 19.1%YoY, and 16.9%QoQ. Gross margin contracted to 32.2% from 44.5% in 4Q14. Operating Profit stood at SAR 51.38mn depicting a decline of 24.7%YoY and 19.1%QoQ; where the managerial expenses (SG & A) has noticeably declined to SAR 38.18mn, as compared to SAR 44.34mn in 3Q15.

We expect the company's sales in 2016 to continue its growth trajectory with less momentum at 5-7%, this is due to expected higher operating utilization rate. However, the growth story is estimated to be muted in 2016 due to weak selling price and higher fuel cost.

Higher subsidized fuel cost to hurt the company's net income by 17.2% in 2016: The Saudi Arabian government recently announced an increase in the prices of all fuels, including natural gas. The price of heavy fuel oil (HFO380) would increase to USD 3.8 per barrel (4.90-8.96 hallah per liter). The price of electricity was also revised upwards. Based on our estimates, cement production cost is expected to increase by SAR 6 - 7 per ton, in addition to the increase in electricity costs. We have reworked our financial model assumptions to incorporate the impact of these changes. The increase in prices of electricity and subsidized fuel is also expected to increase the production costs by about SAR 34mn according to the company. Based on the new assumptions, the increase in cost would be about SAR 34.2mn. Consequently, net income of the company would stand revised from SAR 198.21mn to SAR 164.05mn. The company is trading at 11.9x 1-year forward PE, compared with an average PE of 13.6x for the cement sector during 2013-15.

Higher 2015 sales growth than the market average and signs of improvement on the company's market share: During 2015, NRC's sales rose by 27.8%YoY to 2.38 MT from 1.85 MT in 2014. NRC's accounts for 3.9% of the market in the Saudi cement industry, as compared to 3.3% in the comparable period. During the same period, industry-wide clinker inventory increased by 5.7% to 22.78 MT from 21.55 MT in Dec-2015, as compared to 51.5% decline in Northern clinker inventory due to higher clinker sales to Arabian cement. We expect the company's sales in 2016 to continue its growth trajectory due to expected higher operating utilization rate; however, the growth story is estimated to be muted due to higher production cost and more pressure on selling price.

Recommendation	'Neutral'
Current Price* (SAR)	11.25
Target Price (SAR)	12.30
Upside / (Downside)	9.33%

*prices as of 21th of January 2016

Key Financials

SARmn (unless specified)	FY14	FY15E	FY16E
Revenues	1,001.6	1,129.6	1,099.3
Growth %	17.5%	12.8%	-2.7%
Net Income	200.1	206.4	164.1
Growth %	-14.7%	3.2%	-20.5%
EPS	1.11	1.15	0.91

Source: Company reports, Aljazira Capital

Our estimates and valuation: Northern Cement Co. is expected to post SAR 164.1mn in net income (0.91 EPS) for 2016, recording a decline of 20.5%YoY for the year influenced by higher fuel cost and expected more selling price discount, therefore, we adjust our recommendation to 'Neutral' for the stock with target price at SAR 12.30/share; indicating a potential upside of 9.33% over current market price of SAR 11.25/share (as of 20th January 2015). The company is trading at a forward PE and P/B of 11.9x and 0.98x respectively based on our 2016 earnings forecast. The company proposed SAR 0.6 DPS for 1H-2015, as compared with our expectation of SAR 0.85 DPS for 2015. We anticipate the company to lower its dividend payments to SAR 0.75 DPS (6.9% D/Y) in 2016 owing to a weak operating cash flow and its debt.

Key Ratios

SARmn (unless specified)	FY14	FY15E	FY16E
Gross Margin	39.5%	38.2%	34.8%
EBITDA Margin	35.3%	30.5%	27.0%
Net Margin	20.0%	18.3%	14.9%
P/E	19.4x	13.02x	11.96x
P/B	1.89x	1.31x	0.98x
ROE	9.7%	10.1%	8.2%
ROA	6.5%	6.6%	5.6%
Dividend Yield	8.8%	5.7%	6.9%

Source: Company reports, Aljazira Capital

Shareholders Pattern

Shareholders Pattern	Holding
Pan Kingdom Investment Company	12.09%
Public	87.91%

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap(SAR, bn)	1.96
YTD %	-27.1%
52 Week (High)	23.80
52 Week (Low)	10.65
Shares Outstanding (mn)	180.0

Source: Bloomberg, Aljazira Capital

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