

SAFCO: 2Q-2017 earnings below our estimates with negative surprise due to higher than expected production cost and higher YoY OPEX by SAR 32.7mn. The company reported a 4.2%YoY decline in revenue due to plant maintenance and weak Urea prices. Plants shutdown and 20.4% QoQ decline in Urea led to gross margin of 42.5% in 2Q2017 from 46.4% in 2Q2016. Lower contribution from Ibn-Al-Baytar impacted the bottom line. Revenue to be also under pressure in 2H2017 due to plants maintenance, but 20% expected increase in some production capacity by FY2018. Dividend payment is expected to stand at SAR 2.50/share in FY2017. "Neutral" recommendation on the stock with PT of 65.0/share.

- 2Q2017 net profit came below our estimates showing a deviation of 26.2% from AJC estimates and 28.4% from the market consensus of SAR 285.4mn. SAFCO posted net income of SAR 204.3mn; indicating a fall of 32.4%YoY and 51.7%QoQ. We believe that the YoY weak profitability is mainly attributed to i) lower volumetric sales due to scheduled shutdown for SAFCO2/SAFCO3 in 2Q2017. ii) a decline in Urea prices. iii) higher production cost due to the impact of plant maintenance and inventory change. iv) lower contribution from IBN-ALBAYTAR, where the net profit is expected to stand at SAR 19.0mn, as compared to net profit of SAR 27.2mn in 1Q2017 and SAR 36.2mn in 2Q2016.
- On the other hand, the deviation of 2Q2017 earnings with our estimates is attributed is mainly ascribed to i) higher than expected production cost due to the impact of inventory change. ii) an increase in OPEX by SAR 33.0mn. iii) lower than expected contribution from Ibn Al-Baytar plants by SAR 7.0mn in 2Q2017. We believe that the coming shutdown in 2H2017 would have a positive impact on the overall performance and further improvement in operating rate in FY2017 and onward.
- The company reported a 4.3%YoY decline in revenue for 2Q2017 to SAR 679.48mn, which is in-line with our estimate of 690.1mn. This is mainly ascribed to the impact of plant shutdown and 1.8%YoY decline in Urea average prices. Based on our estimates, SAFCO operated at 88.2% utilization, as compared to 92.3% in 1Q2017. Although we believe the company's sales in FY2017 would witness some recovery due to improvement in operating rate of SAFCO-5, higher average product prices and improved margins; the scheduled maintenance in FY2017 is expected to weigh in on the company's sales volume. However, the company's production capacity from SAFCO2 and SAFCO3 is expected to increase by 20% from its design capacity after completing the maintenance in 2Q2017. For 2Q2017, Urea prices declined by 1.8%YoY, and 20.4%QoQ. Ammonia price declined 6.1%YoY, but recovered by 7.9%QoQ. Despite the short-term improvement in Ammonia prices, we expect ammonia price will start to slide due to a global supply glut. However, Urea prices has been under pressure since last year and is still facing challenges due to oversupply in the market; however, the reduction of value added tax (VAT) on urea fertilizer by Chinese government (starting 1 July 2017), could improve urea consumption. Furthermore, India's fresh import tender, US domestic price improvement and appreciation in Egyptian pound has aided towards a positive sentiment in the market.
- Gross profit stood at SAR 288.65mn depicting a fall of 12.4%YoY and 41.5%QoQ, below our estimates of SAR 339.5mn due to higher than expected production cost. Gross margin contracted to 42.5% in 2Q2017 from 56.6% in 1Q2017. We believe that the margin contraction is mainly attributed to the 20.4% QoQ decline urea prices as compared to fixed feedstock cost. Feedstock cost are be subjected to change in the coming quarters based on the product spreads. On the other hand, operating expenses increased by SAR 32.7mn in 2Q2017 over 2Q2016.

Ajc view: Although the short-term outlook on fertilizers market is bearish, we expect the urea prices to continue rising for the next month as improvement in demand is expected from Europe and the US and lower urea export from China as it concentrates on domestic demand. The company announced scheduled shutdown of SAFCO 4 for 84 days and 25days for SAFCO 5 plants in 2H2017, which will also weigh on earnings in 2017, however improvement is expected in FY2018 due to higher product prices and operating rate. Thus, we maintain our PT at SAR 65.0/share with "Neutral" recommendation on SAFCO, indicating a slight potential upside of 0.2%. SAFCO is expected to post SAR 1,030mn in net income (2.47 EPS) for FY2017, recording a fall of 2.4%YoY for the year impacted by lower sales volume and tighter margins due to plants shutdown. The company is trading at forward PE and P/B of 26.2x and 4.1x respectively based on our FY2017 earnings forecast. The company in 2016 proposed a DPS of SAR 2.50 with payout ratio of 98.8% and a yield of 2.0%. We expect the company to maintain its dividend payment at SAR 2.5 DPS (3.9% D/Y) in 2017.

Results Summary

SARmn (unless specified)	Q2-2016	Q1-2017	Q2-2017	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	709.85	846.65	679.48	-4.3%	-19.8%	-1.6%
Gross Profit	329.53	479.52	288.65	-12.4%	-39.8%	-14.9%
Gross Margin	46.43%	56.6%	42.49%	-	-	-
EBIT	261.31	394.56	187.41	-28.3%	-52.5%	-26.1%
Net Profit	302.32	423.36	204.34	-32.4%	-51.7%	-26.2%
EPS	0.73	1.02	0.49	-	-	-

Source: Company reports, Aljazira Capital

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Recommendation	'Neutral'
Current Price* (SAR)	64.90
Target Price (SAR)	65.00
Upside / (Downside)	0.2%

*prices as of 24th of July 2017

Key Financials

SARmn (unless specified)	FY15	FY16	FY17E
Revenue	3,547	2,856	2,750
Growth %	-20.4%	-19.5%	-3.7%
Net Income	2,130	1,056	1,030
Growth %	-32.9%	-50.5%	-2.4%
EPS	5.11	2.53	2.47

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY15	FY16	FY17E
Gross Margin	58.8%	39.7%	47.8%
Net Margin	60.1%	37.0%	37.5%
P/E	16.07x	30.12x	26.25x
P/B	4.51x	4.55x	4.13x
EV/EBITDA (x)	13.57x	21.57x	19.43x
Dividend Yield	7.3%	2.0%	3.9%

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	27.04
YTD %	-13.7%
52 Week (High)	82.0
52 Week (Low)	58.50
Shares Outstanding (mn)	416.67

Source: Company reports, Aljazira Capital

Price Performance



Source: Bloomberg, Aljazira Capital

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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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