الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

Hail Cement: Q4-2015 operating profits above estimates with a positive surprise; lower than expected cost of sales to support earnings. 'Overweight' recommendation with lower TP.

Amount in SAR mn; unless specified	Forecasts 4Q-15	Actual 4Q-15	Deviation (%)
Sales revenues	91.28	NA*	-
Net profit	23.0	29.9	**30.0%**
EPS (SAR)	0.23	0.18	

*Not Available,

Local demand growth and lower than expected production cost to offset the impact of maintenance costs in 4Q2015: Q4-15 net profit came above estimates and showed a deviation of 30.0% from AJC estimates and 13.3% from the market Consensus of SAR 26.4mn. Hail cement company posted net income of SAR 29.9mn; indicating a decline of 26.7%YoY and an increase of 71.6%QoQ. On the YoY basis, we believe the weak result was mainly associated to i) an increase in the direct costs during the current quarter due to the maintenance costs, in spite of higher volumetric sales growth of 17.4%. ii) decline in selling price due to high inventory level in the sector iii) unrealized investment loss in DPM. The company's revenue is expected to be at around SAR 97.3mn vs. AJC estimates of SAR 91.28mn in Q4-2015, which could be ascribed to an increase of 6.6% in the sales volume. the average price per tonne is expected to be around SAR201.5, as compared to SAR221.5 in the comparison period. During Q4-2015, the company registered a volumetric sales growth of 17.4%, as sales in Q4-2015 stood at 486 thousand ton vs. 414 thousand ton in Q4-2014.

Gross profit stood at SAR 41.91mn depicting a fall of 20.7%YoY, and an increase of 11.6%QoQ. Gross margin in Q4-2015 contracted to 42.9% from 57.6% in 4Q-2014 due to direct cost of maintenance. The cost per ton is expected to be at SAR115 vs. SAR94.1 in Q4-2014. Operating Profit stood at SAR 32.57mn depicting a decline of 26.7%YoY; where the OPEX (SG & A) has increased to SAR 9.35mn from SAR 8.4mn in Q4-2014. Moreover, we expect the company's sales in 2016 to back to its growth trajectory, after the completion of maintenance and expected higher operating utilization rate of 105%, as compared to 102% in 2015. We foresee cement sales growth for Hail Cement company to be between 2 - 3% in 2016.

Higher subsided fuel cost to hurt the company's net income by 16.0% in 2016: The Saudi Arabian government recently announced an increase in prices of all fuels, including natural gas. 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 subsided fuel is also expected to increase the production costs by about SAR 24mn according to the company. Based on the new assumptions, the increase in cost would be about SAR 22.1mn. Consequently, the net income of the company would stand revised from SAR 138.3mn to SAR 116.2mn. Combining all these factors we believe margins could be negatively impacted in 2016.

Strong financials, solid dividend, reasonable valuation offer upside potential: By the end of 3Q15, Hail Cement's debt-to-equity ratio stood at 0.26x, with total debt at around SAR 270mn. In 2014, the management announced a total dividend of SAR 1.1 per share, resulting in a dividend yield of 5.2%. Going forward, we believe strong balance sheet and sustainable cash flows would be sufficient to repay the company's existing debt and maintain a dividend payment of SAR 1.1 DPS in 2015 and SAR 1 DPS in 2016. Based on our forecast estimates, Hail Cement is trading at a PE multiple of 9.6x for FY16E. The last three-years PE multiple for the cement sector is about 13.66x, indicating that Hail Cement is undervalued and offers an upside potential.

Recommendation	'Overweight'
Current Price* (SAR)	11.40
Target Price (SAR)	15.50
Upside / (Downside)	35.9%

*prices as of 19th of January 2016

Key Financials

SARmn (unless specified)	FY14	FY15E	FY16E
Revenues	355.8	362,297	364,495
Growth %	123.7%	1.8%	0.6%
Net Income	147.1	113,398	116,220
Growth %	191%	-22.9%	2.5%
EPS	1.50	1.16	1.19

Source: Company reports, Aljazira Capital

Our estimates and valuation: Hail Cement Co. is expected to post SAR 116.2mn in net income (1.19 EPS) for 2016, recording an increase of 2.5% for the year due to the direct cost of maintenance in 2015, and despite the impact by higher fuel cost and expected lower selling price. However, we remain '**Overweight**' for the stock with lower target price at **SAR 15.50**/share; indicating a potential upside of 35.9% over current market price of SAR 11.40/share (as of 19th January 2016). The company is trading at attractive forward PE and PB of 9.6x and 1.06x respectively based on our 2016 earnings forecast. We anticipate the company to lower its dividend payment in 2016 to stand at SAR 1 DPS (8.8% D/Y) owing to the effects of higher fuel cost.

Key Ratios

SARmn (unless specified)	FY14	FY15E	FY16E
Gross Margin	51.7%	46.3%	44.3%
EBITDA Margin	60.0%	53.0%	49.0%
Net Margin	41.3%	31.3%	31.9%
P/E	15.3x	12.40x	9.60x
P/B	2.12x	1.33x	1.06x
ROE	13.9%	10.7%	11.0%
ROA	10.5%	8.0%	8.4%
Dividend Yield	5.2%	7.7%	8.8%

Source: Company reports, Aljazira Capital

Shareholders Pattern

Shareholders Pattern	Holding
Yamamah Cement Company	6.12%
Saudi Real Estate Co.	6.12%
Al-Mal Investment Co	6.12%
Public	81.64%

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap(SAR, bn)	1.11
YTD %	-20.6%
52 Week (High)	26.70
52 Week (Low)	10.85
Shares Outstanding (mn)	97.90

Source: Bloomberg, 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.

Disclaimer