

October 26, 2017

Rating **Neutral**
12- Month Target Price **SAR 47.00**

SOUTHERN PROVINCE CEMENT COMPANY (SOUTHERN)
3Q2017 First Look

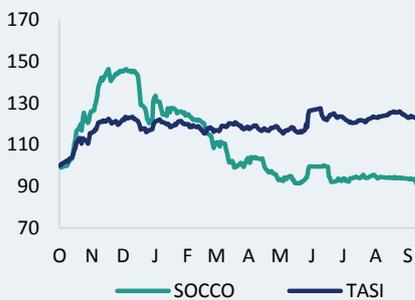
Expected Total Return

Price as on Oct-25, 2017	SAR 41.00
Upside to Target Price	14.6%
Expected Dividend Yield	6.1%
Expected Total Return	20.7%

Market Data

52 Week H/L	SAR 83.5/39.6
Market Capitalization	SAR 5,740 mln
Enterprise Value	SAR 6,276 mln
Shares Outstanding	140.0 mln
Free Float	45.6%
12-Month ADTV (000's)	44.8
Bloomberg Code	SOCCO AB

1-Year Price Performance



Source: Bloomberg



Fig in SAR mln	RC. Est	Actuals
Revenue	232	216
Gross Profit	97	65
EBIT	80	61
Net Income	83	57
EPS (SAR)	0.59	0.41

Bleak Earnings

Southern Cement Company (SOCCO) reported bleak set of 3Q2017 results, with earnings missing our estimates and street by a large margin, though revenue reported a modest miss. At first look, reasons for a large miss are the sharp fall in realization to SAR 170/ton, -29% Y/Y and -9% Q/Q amidst a sharp drop in utilization to 64%. EPS of SAR 0.41 missed our SAR 0.59 estimate and street's SAR 0.61, with an EPS decline of -67% Y/Y and -40% Q/Q. In our view, the bleak earnings in 3Q2017 was due to an one-off attempt to reduce inventories offsetting prices; a strategy devised by Yanbu in 4Q2016 and Yamama in 2Q2017, both came out with a decent set of numbers in the subsequent quarter. However, a slight revision is demanding as we have a change in our view for 2018 outlook. 2018E P/E of 14.1x is at par to TASI's P/E of 13.9x but warrant a higher valuation discount as cement sector trades at 20-25% valuation discount to TASI. We revise our target price to SAR 47.00 from SAR 56.00, but maintain Neutral.

Factors driving the miss

Key factors that drove 3Q2017 results are i) sales volumes drop of -23% Q/Q and -17% Y/Y due to influx of more producers focusing the western and southern region ii) market share improvement of +700 bps to 12.2% is welcome after 2-3 quarters of dullness, Najran lost 700 bps to 2.9% iii) EBIT/ton falls to record lows of SAR 48/ton, low utilization is the key reason, while peers have shown mixed trends (Yamama-SAR 27/ton, Qassim-SAR 54/ton, SACCO-SAR 88/ton) iv) realization drop of -29% Y/Y and -9% Q/Q to SAR 170/ton, but price range of SAR 180-190 is the likely range for the next couple of quarters and lastly v) clinker production decline of -29% Y/Y and -20% Q/Q takes SOCCO to record low utilization (assuming an annualized 8.3 MT of current rated capacity) of 62% versus 76% in 2Q and 91% in 1Q.

Revenue trails estimate

Revenue of SAR 216 million trails our SAR 232 million estimate as we expected SAR 182 versus SAR 170 in selling prices/ton in 3Q, while sales volumes came in-line with our estimate. Revenue dropped by -11% Q/Q and -43% Y/Y due to a mix of volume and price impact. In our view, falling demand in the Southern region has led to a focus on western region despite the impact of overcrowding. SOCCO tried offsetting to low prices with high volumes to minimize the impact of mounting inventory thereby managing its erosion in market share. However, inventory stands comparatively lower at 55% of LTM sales unlike SACCO's 106% and Yamama at 103%.

Margin plunges to record lows

Gross profit of SAR 65 million missed our estimate of SAR 97 million, declined by -35% Q/Q and -65% Y/Y with gross margins at 30% in 3Q2017 versus 41% in last quarter. Operating profit of SAR 61 million missed RC and street estimate, growth declined in similar lines to gross profit, with EBIT margin plunging to 28%. Overall, a tough quarter with earnings of SAR 57 million (-67% Y/Y and -40% Q/Q), missed our SAR 83 million estimate, margins fell to 26% in 3Q2017 (39% in 2Q).

Cutting TP to SAR 47.00, maintain Neutral

We revise our target price to SAR 47.00 but maintain Neutral as industry outlook continues to be bleak and investor sentiments are negative.

Key Financial Figures

FY Dec31 (SAR mln)	2016A	2017E	2018E
Revenue	1,776	1,028	1,178
EBITDA	1,079	520	582
Net Profit	881	342	408
EPS (SAR)	6.29	2.44	2.91
DPS (SAR)	6.00	2.25	2.50
BVPS (SAR)	23.33	23.53	23.94

Key Financial Ratios

FY Dec31	2016A	2017E	2018E
ROAA	25%	8%	9%
ROAE	27%	10%	12%
P/E	6.5x	16.8x	14.1x
P/B	1.8x	1.7x	1.7x
EV/EBITDA	5.8x	12.1x	10.8x
EV/Sales	3.5x	6.1x	5.3x

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Stock Rating

Buy	Neutral	Sell	Not Rated
Expected Total Return Greater than 15%	Expected Total Return between -15% and +15%	Expected Total Return less than -15%	Under Review/ Restricted

* The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors

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