Saudi Arabian Mining Co-Maaden

Mining – Industrial
MAADEN AB: Saudi Arabia
05 August 2018

US$17.91bn	35%	US$3.955mn
Market cap	Free float	Avg. daily volume

Target price	49.50	-13.9% over current
Current price	57.50	as at 2/8/2018

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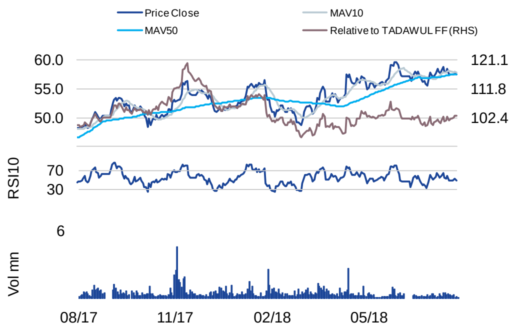
Existing rating		
Underweight	Neutral	Overweight

Performance



Source: Bloomberg

Earnings

(SARmn)	2017	2018e	2019e
Revenue	12,086	15,256	18,323
Y-o-Y	27.7%	26.2%	20.1%
Gross profit	3,932	5,784	6,994
Gross margin	32.5%	37.9%	38.2%
Net profit	715	2,111	2,203
Y-o-Y	NM	195.4%	4.3%
Net margin	5.9%	13.8%	12.0%
EPS (SAR)	0.61	1.81	1.89
EBITDA	5,248	8,011	8,810
EV/EBITDA	21.0x	14.4x	13.1x

Source: Company data, Al Rajhi Capital

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Q2 earnings beat; Raise TP to SAR49.5/sh.

Q2 earnings came in above our estimates, largely due to lower-than-expected increase in power costs at the Aluminium segment and improved production efficiencies at other plants, offsetting top-line miss, which was due to weaker than expected sales volume. We had earlier factored in higher power costs for the Aluminium segment post guidance by the company, which we now reverse till 1H 2019 and thereafter model a gradual increase towards full costs by 1H 2020. We remain positive on Ma'aden's long term growth prospects as MWSPC and MRC plants continue increasing production. Accordingly, we revise our target price to SAR49.5/sh. (core valuation of SAR41.3/sh based on equal mix of DCF and relative valuations - EV/EBITDA of 13.7x by 2022 + estimated value of SAR8.2/sh. for P3 and Mansourah / Massarah Gold mines). The key upside risks could be attributed to higher than expected sales volume and material decline in cash costs, while weak commodity prices, unexpected increase in cash costs and rise in SAIBOR may act as the key downside triggers.

Additional details: Ma'aden reported Q2 revenue at SAR3,414mn, missing our estimate of SAR3,571mn (consensus: SAR3,648mn), primarily attributable to lower-than-expected sales volume across most products, particularly Gold (~-13% q-o-q decline; ~14% miss), Ammonia (~15%; ~16% miss on planned maintenance shutdown) and Primary Aluminium (~7%; ~7% miss). However, the company reported 3% uptick in ammonium phosphate fertilizer sales volume (3% above our estimate). Despite top-line miss, gross profit came above our estimate, mainly due to lower-than-expected power costs. Further, SG&A expenses likely came higher than our expectation, capping the beat at the operating level. Financial costs rose ~10% q-o-q (above our estimate) in Q2, largely on account of rising SAIBOR / LIBOR rates. Overall, net profit reported at SAR518mn, above our estimate of SAR474mn (consensus: SAR588mn).

Figure 1 Ma'aden Q2 2018 results

(SAR mn)	Q2 2017	Q1 2018	Q2 2018	Y-o-Y	Q-o-Q	ARC est	Comments
Revenue	**2,987**	**3,564**	**3,414**	**14.3%**	**-4.2%**	**3,571**	**Missed our and consensus estimates, largely due to lower-than-expected sales volume across most products.**
Gross profit	1,012	1,412	1,318	30.2%	-6.7%	1,191	Beat our estimate, mostly on account of lower-than-anticipated power costs at its Aluminium segment.
Gross margin	33.9%	39.6%	38.6%			33.3%	
Operating profit	808	1,172	1,045	29.5%	-10.8%	939	SG&A expenses could have increased, keeping operating profit under pressure sequentially.
Operating margin	27%	33%	31%			26%	
Net profit	**356**	**638**	**518**	**45.2%**	**-18.9%**	**474**	**Beating our estimate, while missing consensus estimate of SAR588mn.**
Net margin	12%	18%	15%			13%	

Source: Company data, Al Rajhi Capital

Revising our earnings estimates upward on improving cost efficiencies: Commodity prices have remained mixed so far in Q3 with average DAP price rising 2.3% q-o-q QTD, gold prices declining ~5%, weighted down by rising interest rate environment. The industrial metals, Aluminium (-7% q-o-q) and Copper (-9%) prices remained volatile, as global trade war might outweigh industry fundamentals and impact demand. Meanwhile, ammonia prices largely remained stable so far in Q3.

Considering the growing uncertainty over global trade war concerns , we are revising our commodity price estimate slightly lower, while reducing sales volume (except DAP) across the products, post weak sales volume data in Q2. Accordingly, we reduce our top-line estimate, although marginally, to factor in the recent developments at the company and the industry levels.

Figure 2 Ma'aden: Production volume summary of Q2 2018

	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Y-o-Y	Q-o-Q	ARC est
Gold ('000 ounce)	**71**	**70**	**78**	**114**	**118**	**103**	**47.1%**	**-12.7%**	**120**
Phosphate									
Ammonium phosphate fertilizer ('000 tons)	721	668	744	726	753	789	18.1%	4.8%	750
Ammonia ('000 tons)	600	555	620	549	599	507	-8.6%	-15.4%	547
MPC	*314*	*256*	*313*	*316*	*370*	*NA*	NA	NA	*313*
WAS	*286*	*299*	*307*	*233*	*229*	*NA*	NA	NA	*234*
Aluminium									
Alumina ('000 tons)	369	349	363	374	389	455	30.4%	17.0%	401
Primary aluminium ('000 tons)	228	219	240	229	233	236	7.8%	1.3%	235

Source: Company data, Al Rajhi Capital. NA: Ammonia sales volume break-up is not available.

Figure 3 Ma'aden: Sales volume summary of Q2 2018

	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Y-o-Y	Q-o-Q	ARC est
Gold ('000 ounce)	**70**	**69**	**79**	**115**	**118**	**103**	**49.3%**	**-12.7%**	**120**
Phosphate									
Ammonium phosphate fertilizer ('000 tons)	637	733	770	667	728	750	2.3%	3.0%	728
Ammonia ('000 tons)	467	393	490	311	354	301	-23.4%	-15.0%	360
MPC	*152*	*111*	*179*	*149*	*125*	*107*	*-3.6%*	*-14.4%*	*126*
WAS	*315*	*282*	*311*	*162*	*229*	*194*	*-31.2%*	*-15.3%*	*234*
Aluminium									
Alumina ('000 tons)	30	0	0	0	63	63	NA	0.0%	51
Primary aluminium ('000 tons) - external	176	155	NA	174	163	151	-2.6%	-7.4%	162

Source: Company data, Al Rajhi Capital. NA: The company did not report external sales volume for Q3 2017.

We revise our bottom-line estimates upward, largely due to improving cost structure of the company.

Phosphate: We revise our cash cost assumptions downward, on the back of declining sulphur prices and stable ammonia prices (anticipated a rise earlier).

Aluminium: While we do expect cash cost at the aluminium segment to increase from the current level in the coming quarters, due to rising input costs of alumina, pitch and coke prices, the uncertainty surrounding the timing of recognition of higher power cost (from USD 11 to USD 17 per MWh) leads us to revise our cash cost assumptions. We had earlier factored in higher power costs per MWh after the company recognized full power costs (including gas costs, capital costs and depreciation) in Q3 2017. However, the company has again shifted back to low power costs from Q4 2017 onwards. Consequently, we now revise our model, incorporating low power costs for the aluminium segment till its power plant becomes commercial (assuming in 1H 2019) and thereafter assume a gradual shift towards full power costs recognition by 1H 2020, leading to higher gross margin than previously estimated during the forecasted period.

Gold and Copper: Cash costs at the gold and copper mines continued to decline in Q3, primarily driven by higher volume and grades on an annual basis.

Overall, despite downward revision in our top-line estimates, we upgrade our earnings estimates to factor in the changes in our cash cost assumptions, which lead us to revise our TP.

Valuation and Risks: We remain positive on Ma'aden's long term growth prospects, given the likely positive outcome of its future projects, which could take a couple of years to fully materialize. Moreover, the WAS phosphate plant and Aluminium rolling mill continue to ramp up production under the trial period and are expected to begin the commercial production by the end of 2018. We believe that the company's near-term performance will depend on further ramping up production, driven by WAS phosphate plant, aluminium rolling mill (Q4 2018) and better efficiencies amid lower cash costs. Consequently, we revise our fair value (existing businesses) to SAR41.3/share based on equal mix of DCF and relative valuation. As for relative valuation, we apply an exit valuation multiple of EV/EBITDA 13.7x (to 2022 estimated EBITDA), which we arrive by using weighted average of EV/EBITDA of peers (weights based on business segment weights). We apply an adjustment factor of 1.5x (unchanged) to the average peer EV/EBITDA multiple to account for the difference in taxes & lower WACC of Ma'aden compared to its peers. We estimate the terminal value based on average multiple of peers at terminal period (terminal year of 2025) which implies that the company will be able to mine at the current rate even beyond terminal year.

We also add the estimated values of future projects at ~SAR8.2/share. Based on Market cap/ annual production, the third Phosphate project could add around SAR4.0/share to the share price. New projects related to Gold mining such as Mansourah / Massarah mine that are under feasibility stage, may add up to ~SAR4.2/share using the same metric.

Thus we revise our target price upwards to SAR49.5/share (SAR41.3/share + SAR8.2/share for future projects). At our target price of SAR49.5/share, the stock is currently trading at an EV/EBITDA of 13.2x and 12.0x on our 2018E and 2019E EBITDA, respectively.

Figure 4 Relative valuation methodology

Ma'aden business segments	2022 Gross margin contribution	Target Peer EV/EBITDA multiple
Gold	10%	9.1x
Phosphate	53%	10.8x
Aluminum	36%	6.7x
Relevant peer EV/EBITDA multiple (x)		**9.1x**
Adjustment factor for lower WACC, debt and Tax		1.5x
Fair EV/EBITDA EV/EBITDA multiple		**13.7x**

Source: Company data, Bloomberg, Al Rajhi Capita

Figure 5 DCF - Sum of the parts valuation for core business

Segment (SAR/sh)	Current	Earlier	Remarks
Equit value of Gold + Ind base metals	11.3	11.8	Weak gold prices
Equity value of Phosphate	18.6	14.9	Low cash costs
Equity value of Aluminum	5.5	7.5	Low power costs
Others	-0.2	-0.2	
Group level cash	5.2	5.2	
Value of associates and non-core assets	0.9	0.9	
Fair value per share - Core operations	**41.4**	**40.1**	

Source: Company data, Al Rajhi Capital

Figure 6 Valuation methodology for new projects

Valuation for new projects	
Gold	
Fair value of existing mines per share (SAR)	11.3
Total mineral reserves for mines under ops (mt)	183,210
Mansourah / Massarah mineral reserves (mt)	90,500
Fair value of new gold mines per share (SAR)	**5.6**
Uncertainty discount	25%
Implied value of new gold mines per share (SAR)	**4.2**
Phosphate	
Fair value of existing operations per share (SAR)	18.6
Current Phosphate consentrate capacity ('000 tonnes)	10,320
P3 capacity ('000 tonnes)	3,000
Fair value of P3 per share (SAR)	**5.4**
Uncertainty discount	25%
Implied value of P3 per share (SAR)	**4.0**

Source: Company data, Al Rajhi Capital

Figure 7 Summary of Valuation

Valuation Summary (SAR/sh)	Current	Earlier
Core operations		
Sum of the parts (DCF)	41.4	40.1
Group DCF	41.3	40.0
Relative valuation	41.3	40.0
Average fair value per share - Core	**41.3**	**40.0**
Estimated values of future projects	8.2	7.6
Final Target Price	**49.5**	**47.6**

Source: Company data, Al Rajhi Capital

The key upside risks might be attributed to stronger sales volume, commodity prices and lower than expected cash costs and raw material costs (sulphur, coke alumina, coke), while weak commodity prices, higher than expected cash costs, key input prices, improvement in SAIBOR, delay in production schedule may act as the key downside trigger.

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