


Initiation Coverage
March 27, 2018

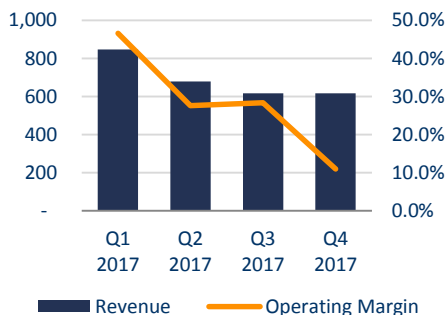
Recommendation	Neutral
Current Price (SAR)	70.7
Target Price (SAR)	65.6
Upside/Downside (%)	(7.2%)
<i>As of March 23, 2018</i>	
Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	27.1
52 Wk High (SAR)	73.10
52 Wk Low (SAR)	57.00
Total Outstanding shares (in mn)	417
Free Float (%)	39.9%

SAFCOVs TASI (Rebased)


Price Performance (%)	Absolute	Relative
1m	8.8%	6.0%
6m	17.1%	19.8%
12m	4.1%	4.4%

Major Shareholders (%)

Saudi Basic Industries Corp.	42.99%
General Organization for Social Insurance	12.24%

Quarterly Sales (SAR mn) and Operating Margin


Source: Bloomberg, Company Financials, FALCOM Research; Data as of 23th March 2018

Saudi Arabian Fertilizer Co. (SAFCO) disclosed its results for FY2017, which registered a decline of 3.4% YoY in revenue, attributed to a 13% drop in sales volume caused by the maintenance shutdown of some plants. However, recovery in urea prices during Q4 2017 helped to partially offset the effect of the drop in sales volume. Net profit for the period declined 15.2% YoY to SAR 879mn. This can be ascribed to an upsurge in fixed costs and depreciation & amortization expenses, driven by the amortization of shutdown and turnaround costs for the period.

SAFCO's sales volumes are expected to recover in 2018 as capacity returns to normal levels. Additionally, steady dividend payouts with zero financial leverage ring well with investors. However, considering countervailing factors such as volatility in urea prices, the effect of subsidy removal on feedstock costs, and possible cash conservation ahead of an acquisition, we assign a 'neutral' rating to the stock, with a target price of SAR 65.6 per share.

Utilization rates to improve on fewer plant shutdowns

In FY2017, SAFCO's utilization rates dropped to 87% (FY2016: 100%) as it halted operations at the SAFCO 4 turnaround enhancement reliability project for ammonia plant; it also scheduled a maintenance shutdown of SAFCO 5 plant. This had a negative bearing on the company's operating margin, which declined by 4.6 percentage points to 29.9% in 2017. However, SAFCO's management said there would be fewer plant shutdowns in 2018, including the shutdown of SAFCO 2 and SAFCO 3 facilities for seven and three days, respectively, during Q2 2018 and a 30-day maintenance scheduled for Ibn Al-Baytar plant during Q4 2018. Utilization rates should therefore recover to 95% with a recovery in sales volumes.

Urea price swings might lead to net income volatility

Urea prices are extremely volatile and highly dependent on Chinese exports, with major demand arising only from India. In December 2017 alone, urea prices declined 11.0% MoM, driven by excess supply, before rising 2.3% MoM in January due to a decline in Chinese production. This volatility in urea prices impacts SAFCO's interim results; in Q2 2017, a 21% QoQ decline in urea prices caused a 19.7% QoQ drop in SAFCO's top line. We believe these price swings would result in greater net income volatility as urea prices remain the key driver to SAFCO's top line.

Lower feedstock prices offer competitive advantage

SAFCO enjoys relatively lower feedstock prices despite an increase in prices due to subsidy removal by the government in 2016. Saudi Arabia has huge reserves of natural gas, a key cost component in production of ammonia. This is available cheaper to SAFCO than its global peers, which endows it a higher operating margin than its global peers. Even though the natural gas prices are anticipated to increase due to second phase of subsidy removal, we expect SAFCO to sustain its cost-leadership position and premium operating margins vis-à-vis its global peers.

Steady dividend payouts bode well for investors, but uncertainties prevail

SAFCO maintained an average payout ratio of 87% over the past four years which has been captured by its share price movement. However, the management might shift its focus to growth and seek investments into new markets thereby hampering the dividend payments. Moreover, if SAFCO decides to use some of its cash in the Ibn Al-Baytar acquisition, dividend payouts might be impacted.

Valuation: We valued SAFCO using the DCF Approach to arrive at a fair value of SAR 65.6 per share. We considered WACC at 8.6%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E
Revenues (SAR bn)	2.8	3.6	3.6	3.9
Operating Profit (SAR bn)	0.8	1.4	1.5	1.8
EPS (SAR)	2.1	3.5	3.7	4.4
Operating Margin (%)	29.9%	39.1%	41.5%	45.4%
D/E (x)	0.0	0.0	0.0	0.0
RoE (%)	12.8%	20.4%	21.1%	23.9%
P/E (x)	30.9	20.3	18.9	16.1
Price/BV (x)	4.0	4.1	4.0	3.8
EV/EBITDA (x)	20.5	16.1	15.1	13.0

Source: Company Financials, FALCOM Research



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Valuation Summary

Explanation of valuation methodology and assumptions

We valued SAFCO using the DCF Approach to arrive at a fair value of SAR 65.60 per share. We considered WACC at 8.6% with a terminal growth rate of 2.0%. In relative terms, SAFCO is trading at 1yr forward P/E of 20.3x, at a premium of 52.4% to its sector peers and premium of 47.1% to the Tadawul All Share Index.

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E	
EBIT	825	1,410	1,515	1,789	1,956	
Taxes	(27)	(53)	(56)	(66)	(72)	
Depreciation, amortization and impairment	487	398	403	418	433	
Changes in working capital	199	(81)	52	16	32	
Net capital expenditure	(725)	(469)	(437)	(434)	(414)	
Free Cash Flow to firm	759	1,205	1,475	1,723	1,935	
<i>Discount Factor</i>		0.9	0.9	0.8	0.7	
PV of free cash flow to firm		1,131	1,275	1,371	1,417	
Net Present Value (A)					5,194	
Terminal Value					29,900	
PV Terminal Value (B)					21,904	
Assumed Terminal Growth Rate					2.0%	
Discount Rate					8.6%	
Enterprise Value (A+B)	27,098	WACC Assumptions				
Total Cash	245	Risk free rate				2.6%
Total Debt	11	Equity Risk Premium				7.0%
Minority Interest	-	Beta				0.9x
Equity Value in SAR mn	27,331	Cost of equity				8.6%
Number of shares in mn	417	Post tax cost of debt				3.8%
Target Price in SAR per share	65.59	Weight of equity in capital structure				99.8%
CMP in SAR as on March 23th, 2018	70.71	Weight of debt in capital structure				0.2%
Upside/(Downside) to current market price	(7.2%)	WACC				8.6%

Source: Company Financials, FALCOM Research Estimates

Risks

Upside Risks:

- Higher-than-expected rise in urea prices will result in stronger than expected revenue growth.
- Delay in the removal of subsidies will bode well for SAFCO's margins.

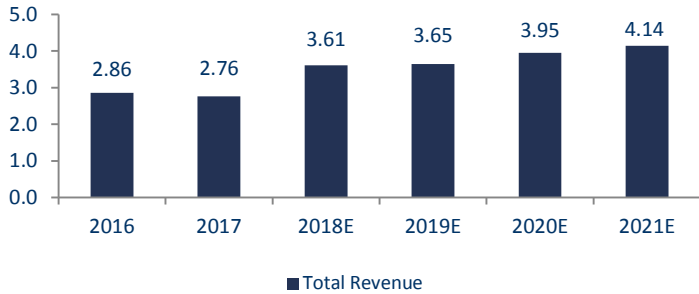
Downside Risks

- In case of unprecedented plant shut downs, the utilization rates would drop thereby having a negative impact on production volumes.
- If the company decides on cash conservation for Ibn Al Bayatar acquisition by cutting down dividends, the investors could be disappointed as SAFCO is known for its steady dividend payouts.
- Lower earnings from Ibn Al Bayatar (50/50 JV between SABIC and SAFCO).

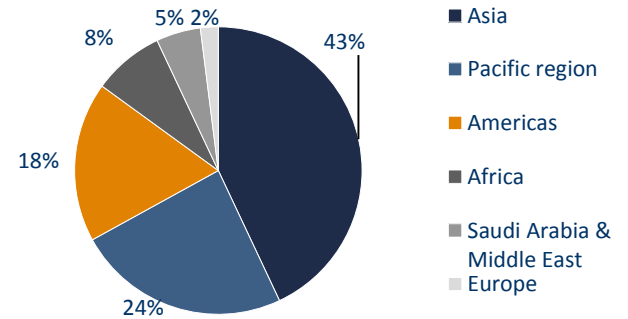


Key Charts

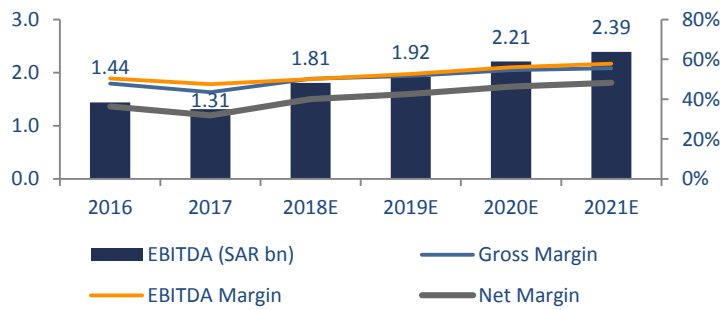
Revenue (SAR bn)



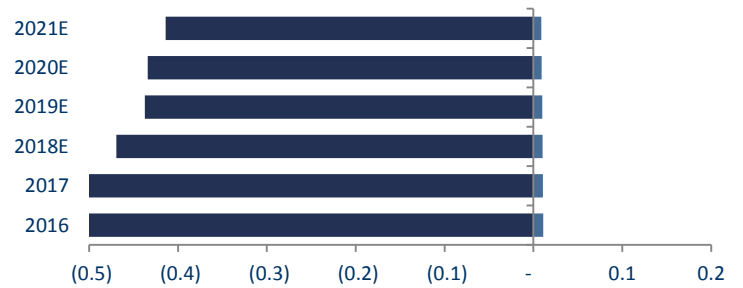
Revenue Split (2017)



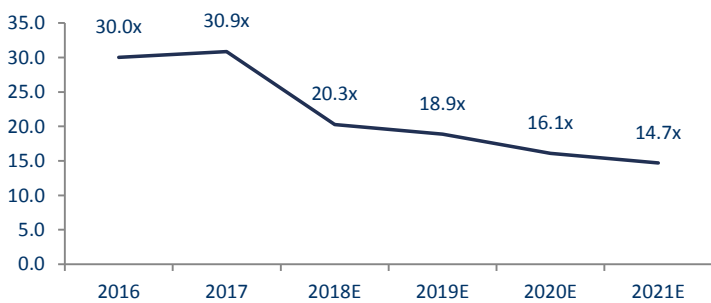
EBITDA & Margins



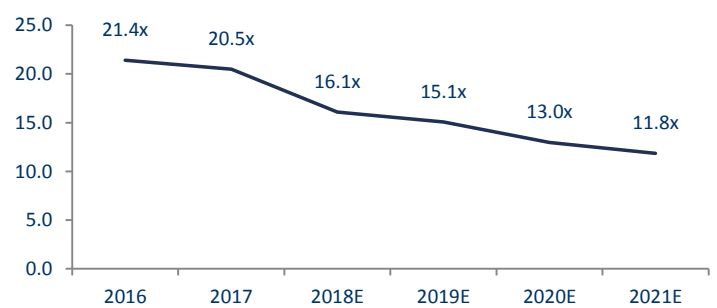
CAPEX and Debt



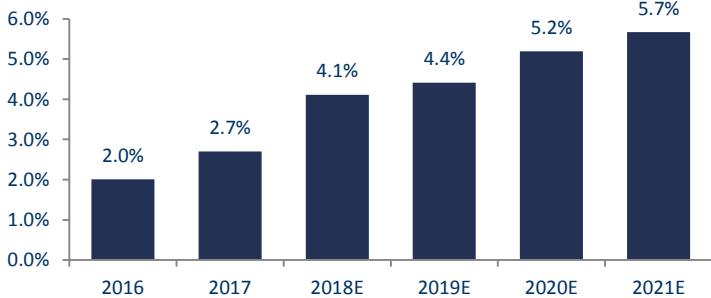
Price to Earnings



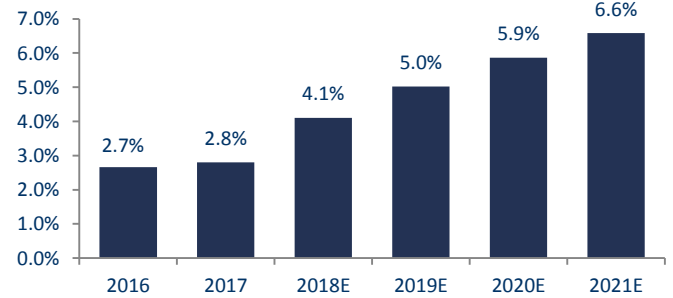
EV/EBITDA



Dividend Yield



Free Cash Flow Yield



Source: FALCOM Research Estimates



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Summary Financials

P&L (SAR mn)	2017	2018E	2019E	2020E
Revenue	2,759	3,610	3,646	3,945
Gross Profit	1,199	1,814	1,886	2,152
EBITDA	1,312	1,808	1,917	2,208
EBIT	825	1,410	1,515	1,789
Earnings from Associates	94	95	101	107
Finance Expense	(23)	(23)	(22)	(21)
Other	10	18	18	20
PBT	906	1,500	1,612	1,895
Zakat	(27)	(53)	(56)	(66)
Minorities	-	-	-	-
Net Income	879	1,448	1,555	1,829
EPS	2.1	3.5	3.7	4.4
DPS	1.8	2.9	3.1	3.7

BS (SAR mn)	2017	2018E	2019E	2020E
Cash and cash equivalents	245	292	523	781
Current Assets (excluding cash)	947	1,094	1,061	1,075
Fixed assets	5,683	5,754	5,789	5,805
Intangibles	53	53	53	53
Total Assets	8,347	8,653	8,930	9,264
Current Liabilities	785	851	869	900
Long Term Debt	11	10	10	9
Shareholders Equities	6,861	7,101	7,360	7,664
Total Liabilities	8,347	8,653	8,930	9,264

CF (SAR mn)	2017	2018E	2019E	2020E
Operating Cash Flow	1,196	1,846	1,958	2,247
Working Capital Changes	199	(81)	52	16
Cash Flow from Operating Activities	1,396	1,765	2,010	2,263
Capex	(725)	(469)	(437)	(434)
Cash Flow from Investing Activities	(703)	(511)	(481)	(480)
Changes in Debt	-	(0)	(0)	(0)
Dividends	(733)	(1,207)	(1,297)	(1,525)
Cash Flow from Financing Activities	(733)	(1,208)	(1,297)	(1,525)

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Revenue	(3.4%)	30.8%	1.0%	8.2%
EBITDA	(8.9%)	37.8%	6.0%	15.1%
Operating profit	(16.4%)	71.0%	7.4%	18.1%
PBT	(14.4%)	65.7%	7.4%	17.6%
Net Income	(15.2%)	64.8%	7.4%	17.6%

Ratios (%)	2017	2018E	2019E	2020E
Gross Margin	43.5%	50.3%	51.7%	54.6%
EBITDA Margin	47.6%	50.1%	52.6%	56.0%
EBIT Margin	29.9%	39.1%	41.5%	45.4%
Net Margin	31.8%	40.1%	42.7%	46.3%
ROE	12.8%	20.4%	21.1%	23.9%
ROCE	10.9%	18.1%	18.8%	21.4%
ROA	10.5%	16.7%	17.4%	19.7%
Debt/Equity	0.00	0.00	0.00	0.00
Net Debt/EBITDA	(0.18)	(0.16)	(0.27)	(0.35)
FCF Yield	2.8%	4.1%	5.0%	5.9%
Dividend Yield	2.7%	4.1%	4.4%	5.2%

Valuation	2017	2018E	2019E	2020E
PE	30.9x	20.3x	18.9x	16.1x
PB	4.0x	4.1x	4.0x	3.8x
EV/EBITDA	32.6x	20.6x	19.1x	16.0x
EV/EBIT	20.5x	16.1x	15.1x	13.0x
EV/Sales	9.7x	8.1x	7.9x	7.3x

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Abu Qir Fertilizers Co.	19.2	14.5
Uralkali PJSC	4.7	8.7
Yara International ASA	13.8	7.1
K+S Aktiengesellschaft	16.4	8.7
PJSC PhosAgro	8.1	6.0
Saudi Arabia Fertilizer Co.	20.3x	16.1x
Sector Median	13.8x	8.1x
TASI	13.8x	11.6x



FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by $\geq 10\%$.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by $\geq 10\%$.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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