SAFCO
Petrochemicals –Industrial
SAFCO AB: Saudi Arabia
28 July 2012

الراجحي المالية
Al Rajhi Capital

US$12.73bn	35.8%	US$5.27mn
Market cap	Free float	Avg. daily volume

Target price	221.4	15.9% over current
Consensus price	202.8	6.2% over current
Current price	191.0	as at 25/7/2012

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Underweight | Neutral | **Overweight**

Saudi Arabian Fertilizers Co.
Q2 affected by maintenance

SAFCO reported weak Q2 2012 earnings of SAR784mn with a flat growth on a q-o-q and a y-o-y basis, due to an undisclosed maintenance shutdown. Consequently, the company failed to capitalize on strong fertilizer prices. Ammonia and urea prices rose by 18.8% and 17.9%, respectively on a q-o-q basis, bucking the declining trend in petrochemical prices. Considering adverse weather conditions globally (drought in mid-west America and Russia as well as late start of kharif season in India) are leading to a steep rise in crop prices, we expect fertilizer prices to remain firm, if not increase, in the near-term. Further, we believe that the company's plant operating rates will improve in Q3. SAFCO remains the only pure-play fertilizer company under our coverage and we like the company's stable operations and healthy financials. We remain Overweight on the stock with a revised target price of SAR221.4.

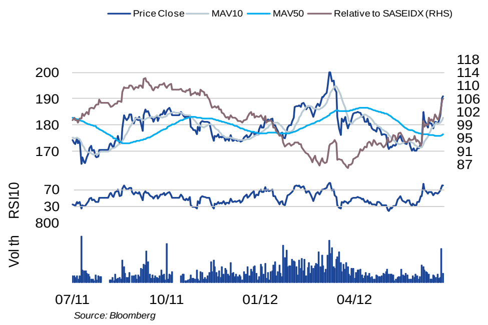
Key themes

We expect Saudi petrochemical producers to outperform global rivals on the back of higher margins, aided by cheap feedstock costs and strong demand growth from emerging Asian economies. We believe the SAFCO V expansion program and recovery in prices of fertilizers will boost the SAFCO's performance.

Implications

We like SAFCO's business model which benefits from low feedstock costs and marketing contracts with the sector giant – SABIC. We are positive on the company given its very low level of gearing, strong financial position and healthy dividend payout policy.

Performance



Q2 results affected by maintenance shutdown: SAFCO reported a net profit of SAR784mn, 22% below our estimate of SAR999mn and 18% below the market estimates of SAR961mn, mainly due to a maintenance shutdown at SAFCO IV. SAFCO IV, with a capacity of 1.1 mtpa of ammonia at Al-Jubail, underwent a scheduled turnaround of 30-40 days from April 7, 2012. This turnaround was not disclosed to us during the management interaction. We believe the company's plant operating rates in Q2 were around 75% as compared to 85% in Q1. Hence, the gross margin declined to 67% from 71% in Q1.

Fertilizer prices remained strong in Q2, further upside possible: Fertilizer prices continued to rise in Q2 on the back of strong demand from the Latin American and Asian markets (source: Potash Corp). Average ammonia and urea prices rose sharply by 18.8% and 17.9% q-o-q reaching USD508/ton and USD506/ton respectively. Even on a y-o-y basis, prices were higher by 6.4% and 20.9%, respectively. We expect the price uptrend to continue in the medium-term on the back of continuing demand from Latin American and Asian markets. Further, as per industry sources, the drought-like conditions in the US & Russia and monsoon deficiency in India are driving crop prices upwards, which we believe will support fertilizer prices at current levels.

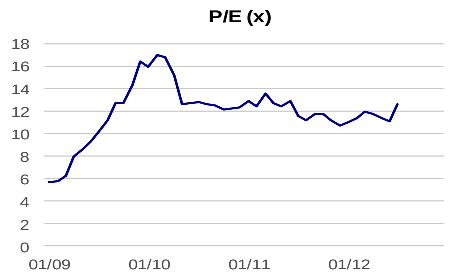
Earnings

Period End (SAR)	12/11A	12/12E	12/13E	12/14E
Revenue (mn)	5,051	4,852	5,704	6,132
Revenue Growth	33.3%	-3.9%	17.6%	7.5%
EBITDA (mn)	3,990	3,677	4,313	4,729
EBITDA Growth	36.6%	-7.9%	17.3%	9.7%
EPS	16.44	14.29	16.89	18.50
EPS Growth	27.1%	-13.0%	18.1%	9.6%

Source: Company data, Al Rajhi Capital

Attractive dividend yield and likely bonus issue: SAFCO declared an interim dividend of SAR6 per share (vs. SAR 13 per share for 2011), which translates into an annualized dividend yield of 6.3% at current market price and the company's board has proposed a 3:1 bonus issue. SAFCO is one of the highest dividend paying companies among Saudi petrochemical producers under our coverage.

Valuation



Source: Company data, Al Rajhi Capital

Valuation and Conclusion: We like SAFCO — the largest fertilizer company in the Kingdom — due to its healthy financials, earnings visibility and above all its dividend yield. The Q2 results came lower than our expectations due to an undisclosed maintenance shutdown. However, considering the stable plant operating rates over the last few years, we believe that it was a one-off exception and the company will improve its operating rates in Q3 and Q4 2012. Moreover, SAFCO is likely to benefit from rising fertilizer prices in the next 1-2 quarters. We remain Overweight on the stock with a revised target price of SAR221.4. The stock currently trades at 2012 P/E and EV/EBITDA multiples of 13.4x and 10.6x, respectively.

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Corporate summary

Established in 1965, SAFCO is the first petrochemical company in Saudi Arabia. SAFCO, which started commercial production in 1970, has emerged as one of the largest fertilizer producers in the world. The company currently has a production capacity of 4.9mtpa of fertilizers. With the SAFCO V expansion program slated to be completed by the end 2014, the total production capacity of the company will increase by 2.7mtpa.

Share information

Market cap (SAR/US$)	47.75bn / 12.73bn
52-week range	165.0 - 200.0
Daily avg volume (US$)	5.27mn
Shares outstanding	250.0mn
Free float (est)	35.8%

Performance:	1M	3M	12M
Absolute	12.2%	5.7%	9.8%
Relative to index	12.5%	17.3%	6.8%

Major Shareholder:	
SABIC	42.9%
GOSI	16.7%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/11A	12/12E	12/13E	12/14E
Revenue (SARmn)	5,051	4,852	5,704	6,132
EBITDA (SARmn)	3,990	3,677	4,313	4,729
Net Profit (SARmn)	4,110	3,574	4,222	4,626
EPS (SAR)	16.44	14.29	16.89	18.50
DPS (SAR)	13.00	13.00	13.00	14.80
EPS Growth	27.1%	-13.0%	18.1%	9.6%
EV/EBITDA (x)	9.3	10.6	9.2	8.3
P/E (x)	11.6	13.4	11.3	10.3
P/B (x)	5.8	5.6	5.0	4.5
Dividend Yield	6.8%	6.8%	6.8%	7.8%

Source: Company data, Al Rajhi Capital

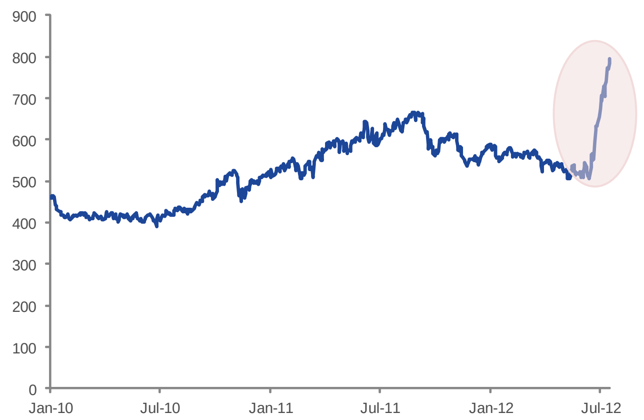
Fertilizer prices likely to remain firm

Adverse weather conditions are driving crops prices upwards

Soybean and corn prices have jumped by more than 50% and 22% in the middle of July, respectively over the last one month, due to drought-like conditions in the US

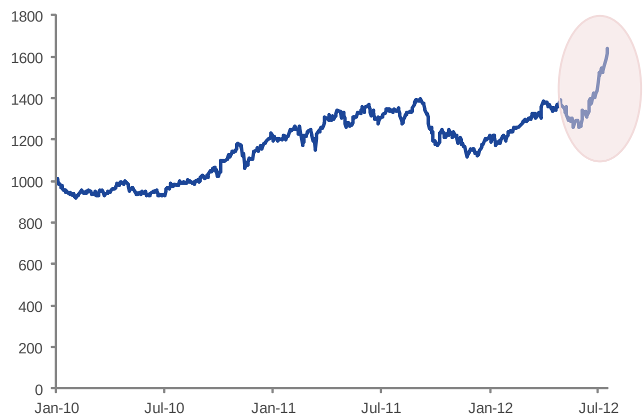
Over the past few months, fertilizer prices have increased on higher demand from Latin America and Asia (source: Potash Corp). Ammonia and urea prices increased by 18.8% and 17.9% q-o-q and were higher as compared to average prices in Q2 2011. We believe that prices will remain stable, if not higher, considering the recent rally in major crops like soybean and corn. The severe heat-wave and drought-like conditions across the US are threatening to significantly reduce the output of these crops. As the US is a major producer and exporter of soybean and corn, prices have jumped by more than 50% and 22% in the middle of July, respectively over the last one month. Apart from soybean and corn, wheat prices have also increased due to the bad weather conditions. We expect the rising agro-commodity prices to support the fertilizer prices in the near-term. We will continue to closely monitor the movement in the fertilizer prices.

Figure 1 Corn (US$/bu)



Source: Bloomberg, Al Rajhi Capital

Figure 2 Soybean (US$/bu)



Source: Bloomberg, Al Rajhi Capital

Performance to improve in Q3 on better utilization rates

SAFCO's weak performance in Q2 was mainly due to loss of production owing to the maintenance shutdown. SAFCO reported a net profit of SAR784mn, 22% below our estimates of SAR999mn and 18% below the market estimates of SAR961mn. We expect the company's performance to improve sequentially in Q3 on improvement in operating rates (~80-85%) as well as stable fertilizer prices. We estimate Q3 revenue and net profit to be SAR1.3bn and SAR944mn respectively, which would imply a 14% and 20% increase q-o-q.

Figure 3 SAFCO: summary of Q2 2012 results

(SAR mn)	Q2 2011 actual	Q1 2012 actual	Q2 2012 ARC est	Q2 2012 actual	% chg y-y	Q3 2011 actual	Q3 2012 ARC est	% chg y-y
Revenues	1,130	1,061	1,383	1,116	-1.2%	1,379	1,275	-7.6%
Gross profit	778	754	968	744	-4.4%	1,084	930	-14.2%
Gross margin	68.9%	71.0%	70.0%	66.6%	-830 bps	78.6%	73.0%	-561 bps
EBITDA	836	815	1,019	809	-3.3%	1,140	974	-14.5%
EBITDA margin (%)	74.0%	76.8%	73.7%	72.5%	-585 bps	82.7%	76.4%	-622 bps
Operating Profit	757	735	943	726	-4.1%	1,062	910	-14.3%
Net profit	790	787	999	784	-0.8%	1,211	944	-22.0%
Capex	(24)	(189)	(249)	(76)	217.0%	(35)	(229)	552.7%
Capex / Sales	2.1%	17.8%	18.0%	6.8%	n/m	2.5%	18.0%	n/m
Net debt	2,760	4,379	3,471	3,454	25.2%	2,047	2,385	16.5%
Net debt / Annualized EBITDA (x)	0.8	1.3	0.9	1.1	n/m	0.4	0.6	n/m

Source: Company data, Al Rajhi Capital

Pricing pressure due to increased global supply results in stable revenue in the short-term

Income Statement (SARmn)	**12/10A**	**12/11A**	**12/12E**	**12/13E**	**12/14E**
Revenue	**3,789**	**5,051**	**4,852**	**5,704**	**6,132**
Cost of Goods Sold	(1,100)	(1,286)	(1,388)	(1,567)	(1,594)
Gross Profit	**2,690**	**3,765**	**3,464**	**4,137**	**4,537**
Government Charges					
S.G. & A. Costs	(68)	(89)	(79)	(91)	(98)
Operating EBIT	**2,622**	**3,677**	**3,385**	**4,045**	**4,439**
Cash Operating Costs	(869)	(1,061)	(1,175)	(1,391)	(1,402)
EBITDA	2,921	3,990	3,677	4,313	4,729
Depreciation and Amortisation	(299)	(314)	(292)	(268)	(290)
Operating Profit	**2,622**	**3,677**	**3,385**	**4,045**	**4,439**
Net financing income/(costs)	8	121	54	57	62
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income	359	-	48	-	-
Other Expenses					
Net Profit Before Taxes	**3,296**	**4,188**	**3,673**	**4,308**	**4,711**
Taxes	(61)	(78)	(99)	(86)	(85)
Minority Interests	-	-	-	-	-
Net profit available to shareholders	**3,235**	**4,110**	**3,574**	**4,222**	**4,626**
Dividends	(3,000)	(3,250)	(3,250)	(3,250)	(3,701)
Transfer to Capital Reserve					

	12/10A	**12/11A**	**12/12E**	**12/13E**	**12/14E**
Adjusted Shares Out (mn)	250.0	250.0	250.0	250.0	250.0
CFPS (SAR)	14.13	17.69	15.46	17.96	19.66
EPS (SAR)	12.94	16.44	14.29	16.89	18.50
DPS (SAR)	12.00	13.00	13.00	13.00	14.80

Growth	**12/10A**	**12/11A**	**12/12E**	**12/13E**	**12/14E**
Revenue Growth	40.4%	33.3%	-3.9%	17.6%	7.5%
Gross Profit Growth	60.7%	40.0%	-8.0%	19.4%	9.7%
EBITDA Growth	58.3%	36.6%	-7.9%	17.3%	9.7%
Operating Profit Growth	62.5%	40.2%	-7.9%	19.5%	9.7%
Net Profit Growth	75.3%	27.1%	-13.0%	18.1%	9.6%
EPS Growth	75.3%	27.1%	-13.0%	18.1%	9.6%

SAFCO has one of the lowest cost structures in the world, supporting margins

Margins	**12/10A**	**12/11A**	**12/12E**	**12/13E**	**12/14E**
Gross profit margin	71.0%	74.5%	71.4%	72.5%	74.0%
EBITDA margin	77.1%	79.0%	75.8%	75.6%	77.1%
Operating Margin	69.2%	72.8%	69.8%	70.9%	72.4%
Pretax profit margin	87.0%	82.9%	75.7%	75.5%	76.8%
Net profit margin	85.4%	81.4%	73.7%	74.0%	75.4%

Other Ratios	**12/10A**	**12/11A**	**12/12E**	**12/13E**	**12/14E**
ROCE	35.9%	44.4%	39.5%	42.4%	41.3%
ROIC	72.2%	91.1%	86.9%	90.5%	83.3%
ROE	45.6%	53.6%	42.7%	46.8%	45.8%
Effective Tax Rate	1.9%	1.9%	2.7%	2.0%	1.8%
Capex/Sales	-7.0%	4.0%	15.4%	18.0%	10.0%
Dividend Payout Ratio	92.7%	79.1%	90.9%	77.0%	80.0%

Valuation Measures	**12/10A**	**12/11A**	**12/12E**	**12/13E**	**12/14E**
P/E (x)	14.8	11.6	13.4	11.3	10.3
P/CF (x)	13.5	10.8	12.4	10.6	9.7
P/B (x)	6.7	5.8	5.6	5.0	4.5
EV/Sales (x)	9.9	7.3	8.0	6.9	6.4
EV/EBITDA (x)	12.8	9.3	10.6	9.2	8.3
EV/EBIT (x)	14.2	10.1	11.5	9.8	8.9
EV/IC (x)	9.4	9.8	8.9	7.5	6.8
Dividend Yield	6.3%	6.8%	6.8%	6.8%	7.8%

Source: Company data, Al Rajhi Capital

Assets base is increasing steadily

Balance Sheet (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Cash and Cash Equivalents	2,256	3,261	3,322	3,443	4,106
Current Receivables	890	875	840	1,034	1,226
Inventories	345	372	448	365	429
Other current assets	146	199	-	-	-
Total Current Assets	**3,637**	**4,708**	**4,610**	**4,842**	**5,762**
Fixed Assets	3,243	3,195	3,662	4,473	4,894
Investments	1,269	1,319	990	990	990
Goodwill	147	85	149	98	-
Other Intangible Assets	-	-	-	-	-
Total Other Assets	82	19	39	39	39
Total Non-current Assets	**4,741**	**4,618**	**4,841**	**5,600**	**5,923**
Total Assets	**8,379**	**9,326**	**9,450**	**10,441**	**11,685**
Short Term Debt	193	80	120	120	120
Accounts Payable	218	227	224	243	276
Accrued Expenses	-	-	-	-	-
Zakat Payable	122	117	65	65	65
Dividends Payable	98	98	-	-	-
Other Current Liabilities	-	-	-	-	-
Total Current Liabilities	**630**	**521**	**409**	**429**	**461**
Long-Term Debt	160	80	40	40	40
Other LT Payables	-	-	-	-	-
Provisions	455	515	468	468	468
Total Non-current Liabilities	**615**	**595**	**508**	**508**	**508**
Minority interests	-	-	-	-	-
Paid-up share capital	2,500	2,500	2,500	2,500	2,500
Total Reserves	4,634	5,710	6,033	7,005	8,216
Total Shareholders' Equity	**7,134**	**8,210**	**8,533**	**9,505**	**10,716**
Total Equity	**7,134**	**8,210**	**8,533**	**9,505**	**10,716**
Total Liabilities & Shareholders' Equity	**8,379**	**9,326**	**9,450**	**10,441**	**11,685**

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Net Debt (SARmn)	(1,903)	(3,101)	(3,162)	(3,283)	(3,946)
Net Debt/EBITDA (x)	(0.65)	(0.78)	(0.86)	(0.76)	(0.83)
Net Debt to Equity	-26.7%	-37.8%	-37.1%	-34.5%	-36.8%
EBITDA Interest Cover (x)	(348.9)	(33.1)	(68.1)	(75.6)	(76.3)
BVPS (SAR)	28.54	32.84	34.13	38.02	42.86

Strong cash flow help to pay higher dividend

Cashflow Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Net Income before Tax & Minority Interest	**3,296**	**4,188**	**3,673**	**4,308**	**4,711**
Depreciation & Amortisation	299	314	292	268	290
Decrease in Working Capital	(610)	(59)	8	(91)	(224)
Other Operating Cashflow	(680)	(329)	(216)	(86)	(85)
Cashflow from Operations	**2,305**	**4,114**	**3,757**	**4,398**	**4,692**
Capital Expenditure	264	(201)	(746)	(1,027)	(613)
New Investments	8	12	-	-	-
Others	201	273	301	-	-
Cashflow from investing activities	**474**	**84**	**(446)**	**(1,027)**	**(613)**
Net Operating Cashflow	**2,778**	**4,198**	**3,311**	**3,371**	**4,079**
Dividends paid to ordinary shareholders	(3,250)	(3,000)	(3,250)	(3,250)	(3,415)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash					
Other Financing Cashflow	-	-	-	-	-
Cashflow from financing activities	**(3,487)**	**(3,193)**	**(3,250)**	**(3,250)**	**(3,415)**
Total cash generated	(708)	1,005	61	121	663
Cash at beginning of period	2,964	2,256	3,261	3,322	3,443
Implied cash at end of year	**2,256**	**3,261**	**3,322**	**3,443**	**4,106**

Capex to remain higher on account of SAFCO V expansion program

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Capex/Sales	-7.0%	4.0%	15.4%	18.0%	10.0%

Source: Company data, Al Rajhi Capital

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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"Overweight": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"Neutral": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"Underweight": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"Time horizon": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"Fair value": We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

"Target price": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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