1Q 2018 Results Update

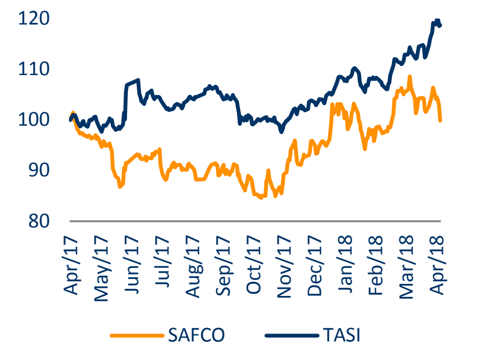
April 27, 2018

Recommendation	**Neutral**
Previous Recommendation	Neutral
Current Price (SAR)	68.7
Target Price (SAR)	64.4
Upside/Downside (%)	(6.3%)

As of April 26th, 2018

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 (%)	41.57%

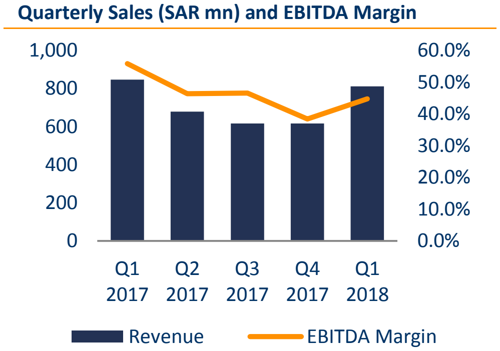
SAFCO vs. TASI (Rebased)



Price Performance (%)	**Absolute**	**Relative**
1m	(5.9%)	(10.9%)
6m	17.0%	(2.4%)
12m	(0.1%)	(18.9%)

Major Shareholders (%)	
Saudi Basic Industries Corp.	42.99%
General Org For Social Insurance	10.54%

Quarterly Sales (SAR mn) and EBITDA Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 26th April 2018

Disappointing 1Q18 results, net income plunged 44% annually

The Saudi Arabian Fertilizer Co (SAFCO) stroked a challenging quarter with -44% YoY drop in net income to SAR237mn in 1Q18 amid rising expenses post restructuring administration and lower contribution from Ibn Al-Baytar's profit. Besides, higher depreciation expenses (+54.8% YoY to SAR122mn) due to the capitalization of few of the reliability projects last year also weighed heavily on the results. Sequentially, the net income more than tripled; backed by a rise in sales given its major shutdowns at SAFCO 4 and SAFCO 5, to perform the reliability project was accomplished in the previous quarter.

During 1Q18, the urea prices have shown weakness driven by decline in China's exports, while the ammonia prices have increased on the back of tightened domestic supply due to increase in prices of natural gas in China. We believe the long-term outlook remains uncertain, however, urea prices are expected to recoup over the coming months since higher demand from Europe and US, may offset decline in China's exports. Besides, lesser plant shutdowns expected in 2018 versus 2017 will support the earnings growth in the coming quarters.

- Sales revenues for the current quarter totalled SAR 811mn (-4.2% YoY, +31.6% QoQ). On a sequential basis, the revenues grew due to better utilization levels as the company recovered from major shutdowns in Q4, despite a -2.6% QoQ decline in urea prices to average USD 255/ton from USD 261/ton in 4Q 2017.
- Gross profit declined by 25% YoY to SAR358mn in 1Q18 (1Q17: SAR480mn), while gross margin dropped to 56.6% in 1Q18 (1Q17: 44.2%), driven by decline in urea prices in comparison with fixed feedstock costs.
- SAFCO's restructuring strategy and lower contribution (by SAR7mn YoY) from Ibn Al-Baytar, dragged down the profitability in 1Q18 as operating margins dipped from 47% last year to 30%, while the expenses rose sharply by 37.4% YoY, thereby impacting the EBIT by -38.8% to SAR242mn.
- Higher D&A expense, due to amortization of maintenance costs, resulted in SAR110mn YoY decline in EBITDA, impacting the EBITDA margins negatively from 56% in 1Q17 to 45% in 1Q18.
- Consequently, the net income narrowed from SAR423mn in 1Q17 to SAR237mn in 1Q18, shrinking net margins to almost half from 50% to 29% over the same period.
- SAFCO's cash flow from operating activities declined 82% YoY to SAR 511mn in Q1 2018 (Q1 2017: SAR 280mn) due to improvement in working capital.
- The outlook for the fertilizer sector remains muted in the light of supply glut in the urea market, however, the slow build up in China and higher coal costs are considered to be the key near term catalysts apart from demand from developed economies.
- The company's production capacity from SAFCO2 and SAFCO3 will improve in 2018; given the completion of maintenance work in 2017. We believe, with the return of the company's production to normal capacity and the improvement in urea prices, the company's operating margins will improve in the upcoming quarters.

Valuation: We have revised our target price slightly downwards with a fair value of SAR64.4 per share post incorporating the subdued 1Q18 results**.** We maintain our 'Neutral' rating on the stock.

	1Q'18	**1Q'17**	**% YoY**	**FY18E**	**FY17**	**% YoY**
Revenues (SAR mn)	811	847	(4.2%)	3,261	2,759	18.2%
Gross Profit (SAR mn)	358	480	(25.3%)	1,507	1,199	25.6%
EBITDA (SAR mn)	363	473	(23.2%)	1,692	1,312	28.9%
Net Profit (SAR mn)	237	423	(44.0%)	1,187	879	35.1%
EPS (SAR)	0.57	1.02	(44.0%)	2.85	2.11	35.1%
Gross Margin (%)	44.2%	56.6%	(12.4%)	46.2%	43.5%	2.7%
EBITDA Margin (%)	44.8%	55.9%	(11.1%)	51.9%	47.6%	4.3%
Net Profit Margin (%)	29.3%	50.0%	(20.7%)	36.4%	31.8%	4.6%

Source: Company Financials, FALCOM Research

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 ≥ 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 ≥ 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.

FALCOM Financial Services

Contact us on the below phone numbers:
Customer Services: 8004298888
Brokerage Services: 920004711

Fax or Email us at the below number:
Fax: +966 11 2032546
Email: addingvalue@falcom.com.sa

Mail us at the following address:
P.O. Box 884
Riyadh 11421
Kingdom of Saudi Arabia

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