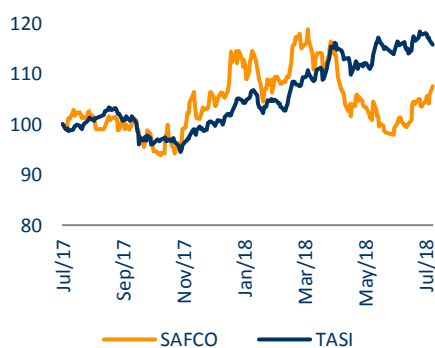


**2Q 2018 Results Update**
**July 31, 2018**

Recommendation	Neutral
Previous Recommendation	Neutral
Current Price (SAR)	66.3
Target Price (SAR)	63.0
Upside/Downside (%)	(5.0%)

*As of July 30<sup>th</sup>, 2018*
**Key Data (Source: Bloomberg)**

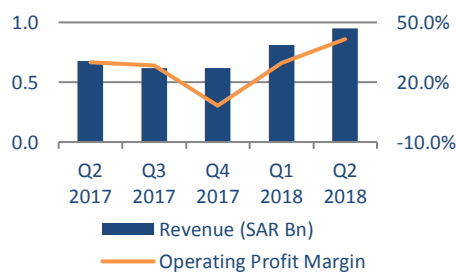
Market Cap (SAR bn)	27.1
52 Wk High (SAR)	73.10
52 Wk Low (SAR)	57.00
Total Outstanding shares (in mn)	417
Free Float (%)	41.57%

**SAFCO vs. TASI (Rebased)**


Price Performance (%)	Absolute	Relative
1m	6.8%	6.9%
6m	(4.5%)	(14.3%)
12m	7.5%	(8.3%)

**Major Shareholders (%)**

Saudi Basic Industries Corp.	42.99%
General Org For Social Insurance	10.54%

**Revenue (SAR bn) and Operating Profit Margin (%)**


Source: Bloomberg, Company Financials, FALCOM Research; Data as of 30<sup>th</sup> July 2018

**Net income doubles over the year; higher urea prices fuel revenues**

The Saudi Arabian Fertilizer Co. (SAFCO)'s revenues expanded 39.9% YoY and 17.2% QoQ in 2Q18, following a disappointing performance in 1Q18. Revenue was driven by higher urea prices and sales volumes. Cost was largely contained and came in flat on a QoQ basis. Gross margins expanded 10.5% YoY and 8.34% QoQ to 52.5% during the quarter. Operating income rose 93.4% YoY and 63.6% QoQ on the back of controlled SG&A expenses (+23.4% YoY, -10.9% QoQ). Dividends received from available-for-sales investments further boosted the bottom line. Net income for the quarter doubled on a YoY basis to SAR 410mn, beating the consensus estimate.

Restructuring undertaken in the last quarter to meet challenges and strengthen the company seems to be paying off. Urea prices recovered in the month of June on decline in Chinese exports amid steady demand. According to the Agricultural Market Information System (AMIS), ammonia prices also recovered during June'2018 owing to a slowdown in global production, coupled with rising demand in East Europe. Also, we expect the lesser plant shutdowns in 2018 versus 2017, which will support the earnings growth in the coming quarters.

- Sales revenues in 2Q18 expanded 39.9% YoY and 17.2% QoQ to SAR 950mn, led by higher urea prices and improved volumes. Average global urea (Urea- US Gulf) prices for June stood at USD 246 per tonne, recovering from USD 228 per tonne in April.
- Gross profit increased 73.0% YoY and 39.3% QoQ to SAR 499mn, driven by controlled cost (+15.4% YoY, -0.3% QoQ). Gross margins thus, expanded to 52.5% (2Q17: 42.5%).
- Depreciation and amortization expenses were limited to SAR 122mn (-2.8% YoY, +2.1% QoQ), resulting in EBITDA margin expansion of 578bps YoY and 987bps QoQ to 54.7% during the quarter.
- Consequently, operating income grew two-fold to SAR 395mn from 2Q17, and increased 63.6% from the previous quarter. The operating profit margin advanced 1200bps YoY and QoQ to 41.6% in 2Q18.
- Other income for the quarter came in at SAR 11mn, driven by dividends received from available-for-sale investments.
- Net income doubled to SAR 410mn on an annual basis (+73.0% QoQ). EPS for the quarter stood at SAR 0.99.
- Despite strong operating income, SAFCO's cash flow from operating activities declined 23% YoY to SAR 390mn in Q2 2018 (Q2 2017: SAR 510mn) due to higher accounts payables and employee benefit expenses.
- As demand for fertilizers recovered following a decrease in urea exports from China, we believe it could add to the company's top line. Moreover, SAFCO's restructuring initiative is likely to contain expenses, thus strengthening margins. However, we maintain 'Neutral' stance on the stock, as we wait for few more quarters of strong operating performance before revisiting our ratings.

**Valuation:** We have revised our target price slightly downwards with a fair value of SAR63.0 per share post incorporating 2Q18 results. We maintain our 'Neutral' rating on the stock.

	2Q'18	2Q'17	% YoY	FY18E	FY17	% YoY
Revenues (SAR mn)	950	679	39.9%	3,309	2,759	19.9%
Gross Profit (SAR mn)	499	289	73.0%	1,583	1,199	32.0%
EBITDA (SAR mn)	519	332	56.4%	1,798	1,312	37.1%
Net Profit (SAR mn)	410	204	100.9%	1,294	879	47.3%
EPS (SAR)	0.99	0.49	100.9%	3.11	2.11	47.3%
Gross Margin (%)	52.5%	42.5%	10.1%	47.8%	43.5%	4.4%
EBITDA Margin (%)	54.7%	48.9%	5.8%	54.4%	47.6%	6.8%
Net Profit Margin (%)	43.2%	30.1%	13.1%	39.1%	31.8%	7.3%

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  $\geq 10\%$ .

**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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