

# Saudi Arabian Mining Co-Maaden

Mining –Industrial

MAADEN AB: Saudi Arabia

01 November 2010

الراجحي المالية  
Al Rajhi Capital



**US\$5.59bn** Market cap  
**35.8%** Free float  
**US\$19.53mn** Avg. daily volume

Target price **28.20** 24.34% over current  
Consensus price **23.96** 5.8% over current  
Current price **22.65** as at 31/10/2010

Research Department  
**Mazhar Khan, Equity Research Analyst**  
Tel 966 12119248, khanm@alrajhi-capital.com

Underweight

Neutral

**Overweight**

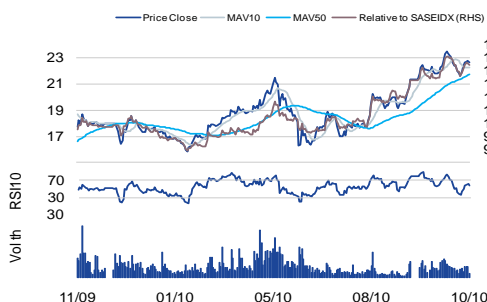
## Key themes

Capitalising on Saudi Arabia's vast mineral wealth, Ma'aden has entered into two new businesses: phosphate to start in 2011, and aluminium to start in 2013. We believe the company will utilise low-cost raw materials and will benefit from the government's support and be a success story in the long run.

## Implications

We rate Ma'aden as Overweight. We believe the company's top line will surge fivefold in 2011 with the commencement of phosphate business. Good and transparent disclosure should add a premium to Ma'aden's share price, and we see it as a good buy for the long term.

## Performance

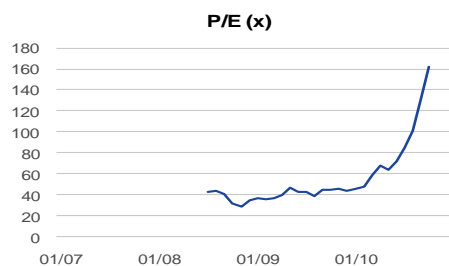


## Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (mn)	634	679	3,190	4,772
Revenue Growth	37.9%	7.0%	370.1%	49.6%
EBITDA (mn)	149	163	1,350	2,462
EBITDA Growth	327.6%	9.3%	727.0%	82.4%
EPS	0.40	0.09	0.69	0.94
EPS Growth	31.3%	-78.0%	687.5%	36.6%

Source: Company data, Al Rajhi Capital

## Valuation



Source: Company data, Al Rajhi Capital

# Ma'aden Timely phosphate launch is crucial

*This report follows our Flash View of 24th October. Ma'aden Q3 results were disappointing, and as a result we have become cautious about its gold business. We remain bullish about the new businesses, phosphate and aluminium, due to be launched from next year onwards. We expect Ma'aden's structure to be transformed through these operations, with gold accounting for only 9.1% of revenues by 2014. While we have cut our forecasts for the gold business, we have lowered our target price only fractionally, to SAR28.2. This target implies 25% upside and we remain Overweight.*

**Gold business likely to be flat in 2011:** Ma'aden's gold production has been declining after touching an all-time high in 2009. This is because two of the existing five mines are either closed or nearing exhaustion. These two are Sukhaybarat (already exhausted) and the Al Hajjar mine (expected to cease operations in 2011). We therefore expect essentially flat production in 2011. However, flat production should be offset by the strong rally in the gold price which has resulted in the company maintaining decent revenue growth in 2010.

**Margins have fallen; we expect a boost after phosphate launch:** The gross margin fell to 52.7% in Q3 2010 compared to 57.2% in Q3 2009 which is mainly due to the fall in gold content with two mines ceasing operation and drilling and processing costs increasing. So far this year the cost of production has increased by 27% to US\$600 per ton from an average of US\$471 per ton in 2009. This increase is hurting the gross margin. However, after the start of phosphate, we expect gross profitability to be boosted significantly. We expect a gross margin of 56% and an operating margin of 37% in 2011.

**North-south railway nearing completion :** According to Meed, the 1,486 kilometre north-south mineral railway intended to carry phosphate rock from the Al Jalamid mine to the plant at Ras Az Zawr is nearing completion. About 1,200km of track is complete and the line is on schedule for opening in early 2011. Due to its importance for Ma'aden, the PIF which is funding construction and which is also a 50% owner in Ma'aden, is giving priority to this project. We regard the railway line as the most crucial reason for the likely success of the phosphate business as it will reduce transport costs and boost margins.

**Debt levels set to rise:** As noted in our initiation of coverage report dated 2nd August 2010 (*Ma'aden: Revenue surge set to drive price*), Ma'aden's debt level is set to rise in order to facilitate the aluminium project due for launch by 2014. Gross debt in Q3 2010 stood at SAR12.14bn versus SAR12.12bn in Q2 2009. We expect gross debt of SAR12.8bn by the end of 2010 and of SAR16.3bn by the end of 2011. However, Ma'aden has a big cushion in its short term investments and cash equivalents which stood at SAR11.3bn as at Q3 2010. We thus predict net debt of SAR1.7bn at the end of 2010, followed by SAR1.1bn at the end of 2011.

**We remain Overweight :** We like Ma'aden's investments in phosphate and aluminium. These are due to start in 2011 and 2013 respectively, and should create the world's cheapest producer of DAP fertiliser and aluminium. Ma'aden trades on an enterprise value/invested capital ratio of 0.8x, suggesting that the market lacks faith in the company's ability to create value from its new projects. We disagree, and think Ma'aden still offers over 25% upside. We have lowered our target price fractionally, to SAR28.2, but remain Overweight.

Disclosures Please refer to the important disclosures at the back of this report.

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### Corporate summary

Ma'aden was formed in 1997 by the Saudi government to facilitate the development of Saudi Arabia's non-petroleum minerals and to diversify the economy away from petroleum based sectors. 50% of Ma'aden is owned by PIF. In July 2008, Ma'aden was listed in the Saudi Stock Exchange. Its business is mainly exploration of gold and it plans to enter into the phosphate and aluminium businesses in 2011 and 2013 respectively.

### Share information

Market cap (SAR/US\$)	20.95bn / 5.59bn		
52-week range	15.85 - 23.45		
Daily avg volume (US\$)	19.53mn		
Shares outstanding	925.0mn		
Free float (est)	35.8%		
Performance:	1M	3M	12M
Absolute	4.1%	21.8%	30.9%
Relative to index	4.7%	20.7%	29.5%
Major Shareholder:			
Public Investment Fund	50%		
GOSI	7.7%		

Source: Bloomberg, Al Rajhi Capital

### Valuation

Period End	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	634	679	3,190	4,772
EBITDA (SARmn)	149	163	1,350	2,462
Net Profit (SARmn)	365	79	991	1,353
EPS (SAR)	0.40	0.09	0.69	0.94
DPS (SAR)	-	-	-	-
EPS Growth	31.3%	-78.0%	687.5%	36.6%
EV/EBITDA (x)	137.1	152.9	18.4	12.3
P/E (x)	56.7	257.9	32.7	24.0
P/B (x)	1.3	1.3	1.2	1.2
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

## Q3 2010 disappointing time to look ahead to 2011

Gold sales volumes have been hit due to the cessation or near-cessation of operations of two of the five mines.

Ma'aden's Q3 2010 results were disappointing with revenues down 3% year-on-year to SAR159.4mn despite a 28% year-on-year increase in the gold price. We expect sales to improve to SAR168m in Q4 2010, a 5.7% quarter-on-quarter increase. This would translate into a 7% year-on-year increase in sales for 2010 to SAR679mn. We have cut our production forecasts for gold for the next quarter and for 2011 and 2012; however the improved gold price partly offsets a gloomy outlook for sales volumes. Only after H1 2012 do we expect some improvement in volumes, as this is when we expect one of Ma'aden's proposed new mines to become operational.

### Revenue shift in 2011 to drive growth going forward

We expect a major shift in revenues after the launch of Ma'aden's phosphate business. We expect 79% of the revenues in 2011 to come from the phosphate business. The proportion of revenues from phosphate should improve further in 2012 and 2013. We expect gold to account for only 9% of revenues in 2014 after the launch of the aluminium business.

### Margins to improve next year

In Q3, Ma'aden surprisingly recorded a negative net operating margin of 1.5%. This reflected not only the weak gross margin, but also a surge in operating costs like selling, general and administrative costs and depreciation costs. According to the company, this surge partly reflects additional costs incurred on staff recruited for phosphate marketing. We believe the company will find it difficult to control its operating costs in the next quarter as well. We estimate a operating profit margin of 8.0% for Q4 2010. In 2011, when the phosphate business commences, we expect Ma'aden's low-cost business model to drive a jump in the operating margin to 37%. We expect Ma'aden to report a net profit margin of 20% in 2011.

### Gearing will increase rapidly from now on

Ma'aden needs cash to execute one of its huge projects – the aluminium business to be launched by the end of 2013. We expect gross debt to increase to SAR12.8bn in Q4 2010. By 2011, we think the gross debt will rise to SAR16.3bn, mostly to finance the construction of the aluminium plant. However, Ma'aden's cash position is very strong. As of Q3 2010, it has cash and equivalents worth SAR11.3bn which should rise to SAR15.2bn by end of 2011, mainly due to the earnings from phosphate. On a net basis, we predict net debt of SAR1.7bn at the end 2010 and of SAR1.1bn at the end of 2011. Since this year EBITDA comes solely from the gold business, we expect Ma'aden's net debt/EBITDA ratio to surge to 10.2x by the end of 2010; with the phosphate business pushing up EBITDA next year, however, we expect the ratio to fall right back down to 0.8x by the end of 2011. In 2012, we expect the debt level to rise again due to investment in aluminium. We predict net debt of SAR6.1bn but a reasonable net debt/EBITDA ratio of 2.5x for the end of that year.

Shift in revenues to phosphate will help drive growth.

Ma'aden's debt level to surge in the near term in order to facilitate the aluminium project.



## We have revised our target price to SAR28.2

We have lowered our gold production estimates for the next quarter and for 2011 and 2012 because we assume Ma'aden will struggle to maintain the high production level of 2009. However, this decline in production has been partly offset by the sharp rally in the gold price. As a result, we have lowered our estimate of fair value per share on a long-run discounted economic profit basis by only 1%, to SAR28.2. This estimate remains our target price, and implies 25% upside potential. Hence we retain our Overweight rating.



Revenue surge in 2011 will help drive profitability.

Income Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
<b>Revenue</b>	<b>460</b>	<b>634</b>	<b>679</b>	<b>3,190</b>	<b>4,772</b>
Cost of Goods Sold	(233)	(289)	(311)	(1,395)	(1,845)
<b>Gross Profit</b>	<b>227</b>	<b>346</b>	<b>367</b>	<b>1,795</b>	<b>2,927</b>
Government Charges					
S.G. & A. Costs	(321)	(304)	(301)	(618)	(878)
<b>Operating EBIT</b>	<b>(94)</b>	<b>42</b>	<b>67</b>	<b>1,178</b>	<b>2,049</b>
Cash Operating Costs	(425)	(485)	(515)	(1,841)	(2,310)
EBITDA	35	149	163	1,350	2,462
Depreciation and Amortisation	(129)	(108)	(97)	(172)	(413)
<b>Operating Profit</b>	<b>(94)</b>	<b>42</b>	<b>67</b>	<b>1,178</b>	<b>2,049</b>
Net financing income/(costs)	290	314	174	73	(357)
Forex and Related Gains					
Provisions	(0)	-	-	-	-
Other Income					
Other Expenses	4	302	1	-	-
<b>Net Profit Before Taxes</b>	<b>195</b>	<b>628</b>	<b>205</b>	<b>1,251</b>	<b>1,692</b>
Taxes	-	(264)	(127)	(260)	(338)
Minority Interests	6	5	3	(351)	(480)
<b>Net profit available to shareholders</b>	<b>202</b>	<b>369</b>	<b>81</b>	<b>640</b>	<b>874</b>
Dividends	-	-	-	-	-
Transfer to Capital Reserve					
	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Adjusted Shares Out (mn)	925.0	925.0	925.0	925.0	925.0
CFPS (SAR)	0.490	0.511	0.189	1.257	1.909
EPS (SAR)	0.304	0.399	0.088	0.692	0.944
DPS (SAR)	0	0	0	0	0
<b>Growth</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Revenue Growth	88.5%	37.9%	7.0%	370.1%	49.6%
Gross Profit Growth	162.5%	52.5%	6.3%	388.5%	63.0%
EBITDA Growth	114.8%	327.6%	9.3%	727.0%	82.4%
Operating Profit Growth	198.9%		59.9%	1665.7%	74.0%
Net Profit Growth	-9.3%	83.3%	-78.0%	687.5%	36.6%
EPS Growth	-72.6%	31.3%	-78.0%	687.5%	36.6%
<b>Margins</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Gross profit margin	49.3%	54.5%	54.2%	56.3%	61.3%
EBITDA margin	7.6%	23.5%	24.0%	42.3%	51.6%
Operating Margin	-20.5%	6.6%	9.8%	36.9%	42.9%
Pretax profit margin	42.4%	99.0%	30.2%	39.2%	35.4%
Net profit margin	43.8%	58.2%	12.0%	20.1%	18.3%
<b>Other Ratios</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
ROCE	-0.5%	0.2%	0.2%	3.3%	4.9%
ROIC	-1.7%	0.1%	0.1%	3.0%	4.6%
ROE	1.9%	2.3%	0.5%	3.8%	4.9%
Effective Tax Rate	0.0%	42.0%	61.7%	20.8%	20.0%
Capex/Sales	1191.1%	1129.4%	459.8%	101.6%	71.3%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%
<b>Valuation Measures</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
P/E (x)	74.5	56.7	257.9	32.7	24.0
P/CF (x)	46.3	44.4	119.7	18.0	11.9
P/B (x)	1.3	1.3	1.3	1.2	1.2
EV/Sales (x)	17.5	32.3	36.8	7.8	6.3
EV/EBITDA (x)	231.0	137.1	152.9	18.4	12.3
EV/EBIT (x)	na	490.7	374.2	21.0	14.7
EV/IC (x)	0.6	0.8	0.8	0.7	0.7
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

EBITDA should surge over the next few years; however, net profit growth will be constrained by financial costs.

We expect the capex/sales ratio to remain very high till the aluminium business is completed

P/E and EV/EBITDA will decline sharply once the phosphate business has commenced



<b>Balance Sheet (SARmn)</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Cash and Cash Equivalents	11,335	11,519	11,175	15,228	14,405
Current Receivables	114	53	322	1,036	2,267
Inventories	167	206	222	1,255	2,624
Other current assets	910	383	555	555	555
<b>Total Current Assets</b>	<b>12,430</b>	<b>12,131</b>	<b>12,155</b>	<b>17,954</b>	<b>19,731</b>
Fixed Assets	7,053	14,144	17,182	20,252	23,243
Investments	-	-	-	-	-
Goodwill	-	-	-	-	-
Other Intangible Assets	1,810	2,936	3,743	3,744	3,742
Total Other Assets	66	19	31	31	31
<b>Total Non-current Assets</b>	<b>8,929</b>	<b>17,098</b>	<b>20,956</b>	<b>24,027</b>	<b>27,015</b>
<b>Total Assets</b>	<b>21,358</b>	<b>29,230</b>	<b>33,111</b>	<b>41,981</b>	<b>46,747</b>
Short Term Debt	-	-	-	-	-
Accounts Payable	1,263	621	573	2,544	2,624
Accrued Expenses	1,144	969	842	3,222	2,386
Dividends Payable	-	-	-	-	-
Other Current Liabilities	16	45	37	37	37
<b>Total Current Liabilities</b>	<b>3,573</b>	<b>1,906</b>	<b>1,552</b>	<b>5,903</b>	<b>5,147</b>
Long-Term Debt	820	8,783	12,847	16,373	20,544
Other LT Payables	-	-	1	2	-
Provisions	139	176	194	194	194
<b>Total Non-current Liabilities</b>	<b>959</b>	<b>8,959</b>	<b>13,042</b>	<b>16,569</b>	<b>20,738</b>
Minority interests	639	1,782	1,853	2,205	2,684
Paid-up share capital	9,250	9,250	9,250	9,250	9,250
Total Reserves	6,938	7,332	7,414	8,053	8,927
<b>Total Shareholders' Equity</b>	<b>16,188</b>	<b>16,582</b>	<b>16,664</b>	<b>17,303</b>	<b>18,177</b>
<b>Total Equity</b>	<b>16,827</b>	<b>18,365</b>	<b>18,517</b>	<b>19,508</b>	<b>20,861</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>21,358</b>	<b>29,230</b>	<b>33,111</b>	<b>41,981</b>	<b>46,747</b>

Net debt/EBITDA will jump this year but should then fall after a surge in EBITDA in 2011

<b>Ratios</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Net Debt (SARmn)	(10,515)	(2,736)	1,672	1,145	6,139
Net Debt/EBITDA (x)	(301.14)	(18.33)	10.24	0.85	2.49
Net Debt to Equity	-62.5%	-14.9%	9.0%	5.9%	29.4%
EBITDA Interest Cover (x)	(0.1)	(0.5)	(0.9)	(18.5)	6.9
BVPS (SAR)	17.50	17.93	18.01	18.71	19.65

<b>Cashflow Statement (SARmn)</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
<b>Net Income before Tax &amp; Minority Interest</b>	<b>195</b>	<b>628</b>	<b>205</b>	<b>1,251</b>	<b>1,692</b>
Depreciation & Amortisation	129	108	97	172	413
Decrease in Working Capital	2,962	(310)	(526)	2,605	(3,357)
Other Operating Cashflow	(271)	(319)	(347)	(260)	(338)
<b>Cashflow from Operations</b>	<b>3,015</b>	<b>107</b>	<b>(571)</b>	<b>3,768</b>	<b>(1,591)</b>
Capital Expenditure	(5,481)	(7,166)	(3,121)	(3,242)	(3,403)
New Investments	(6,394)	(573)	(1,467)	-	-
Others	(959)	(1,136)	(821)	-	-
<b>Cashflow from investing activities</b>	<b>(12,834)</b>	<b>(8,874)</b>	<b>(5,408)</b>	<b>(3,242)</b>	<b>(3,403)</b>
<b>Net Operating Cashflow</b>	<b>(9,819)</b>	<b>(8,767)</b>	<b>(5,979)</b>	<b>526</b>	<b>(4,994)</b>
Dividends paid to ordinary shareholders	-	-	-	-	-
Proceeds from issue of shares	10,500	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(271)	243	74	-	-
<b>Cashflow from financing activities</b>	<b>11,229</b>	<b>8,206</b>	<b>4,138</b>	<b>3,526</b>	<b>4,171</b>
Total cash generated	1,410	(561)	(1,841)	4,053	(823)
Cash at beginning of period	2,695	11,335	11,519	11,175	15,228
<b>Implied cash at end of year</b>	<b>4,105</b>	<b>10,773</b>	<b>9,678</b>	<b>15,228</b>	<b>14,405</b>

<b>Ratios</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Capex/Sales	1191.1%	1129.4%	459.8%	101.6%	71.3%

Source: Company data, Al Rajhi Capital



## Disclaimer and additional disclosures for Equity Research

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#### 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.

### Contact us

**Dr. Saleh Alsuhaibani**  
Head of Research  
Tel : +966 1 2119434  
alsuhaibanis@alrajhi-capital.com

**Al Rajhi Capital**  
Research Department  
Head Office, King Fahad Road  
P.O. Box 5561  
Riyadh 11432  
Kingdom of Saudi Arabia  
Email: [research@alrajhi-capital.com](mailto:research@alrajhi-capital.com)

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