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Turbulent times

Saudi Arabia's 2016 budget unveiled a few days back marked initial disenchantment but is positive for economic development of the country over the long term. Though capital spending may temporarily decline alongside reforms on subsidy but the government was left with few other options. However, King Salman has assured in his speech prior to the budget that the government would continue to spend in priority sectors. The country is set to focus on developing its human resources mainly enhancing its needs to social sectors. Additionally, the budget has provisions of SAR183 billion as a cushion to spend either on current or capital expenditure on a need basis, which we believe may include spending on housing. Overall, we expect the growth in the sector to be marginal.

The subsidy cuts and limited project spending comes in at a time when the sector is already faced with issues on pricing and declining demand. We do not believe that producers can pass-through the higher cost as demand is feeble with global supply-demand factors influencing local pricing. Cheap Chinese imports are one of the key factors which results in such a scenario. With vague quantification and minimal information in hand currently, we await detailed clarification and will revisit estimates soon.

The Saudi project market has witnessed subdued growth in 4Q2015 with the government restricting certain project awards and extending project cycles for additional 1-2 years. We believe capital spending has dropped drastically, evident from the SAR 370 billion spending in 2014 and expected to be at SAR 250 billion in 2015E. This was reflected with MEED project awards data reflecting a decline with 1H2015 project awards reaching SAR 142 billion versus SAR 171 billion in 1H2014.

Globally, prices of commodities fell further with oil prices correcting by -24%, Q/Q while base metals also corrected in 4Q2015. Over the quarter, aluminum moderately fell by -3% Q/Q (-18% in 2015) while copper corrected by -8% Q/Q (-25% in 2015). Notably, iron ore prices retreated by -23% Q/Q (-39% in 2015). However, the strengthening of the dollar versus most currencies has affected local producers pricing competency versus Chinese exporters.

Our outlook on the sector is neutral to slightly negative on impact of subsidy cuts from 2016. We are revisiting our assumptions but for now we maintain a cautious stance as more clarity is awaited for estimates revision or ratings downgrade. We maintain our target prices with a Buy on all except Amiantit. Although upside is significant, it has more unknowns than knowns. The large upsides are due to market meltdown.

Table 1: Recommendation and Target Price Summary

Company	TASI Code	Rating New	CMP (SAR)	12-Month Target price (SAR)	Upside to Target price
Saudi Ceramics Company	2040	Buy	46.59	74.00	59%
Baw an Company	1302	Buy	23.49	44.00	87%
United Wire Factories Company	1301	Buy	22.62	32.00	41%
National Company for Glass	2150	Buy	26.12	42.00	61%
Saudi Arabian Amiantit Company	2160	Hold	8.99	12.50	39%

Source: Bloomberg and Riyad Capital

4Q2015 should be the last ride

We await further clarity on the expected cost impact on companies as a result of hike in fuel cost and electricity tariffs. We believe 4Q2015 would be the last quarter for higher margins and from 2016 margins would depend on efficiency. We expect 4Q2015 to register a decline of -7% Y/Y in topline and flat earnings on yearly basis for the companies under our coverage. We expect Bawan to witness a large decline of -48% Y/Y in earnings owing to product prices pressure, while SCC to witness a +17% Y/Y growth despite competition and weak demand outlook. Zoujaj is expected to witness an underperformance and register Y/Y EPS decline of -11%, while Amiantit is likely to see some improvement with +21% Y/Y growth in earnings. Our view on Aslak is positive for 4Q2015 as margins are likely to grow with earnings growth of +41%.

Table 2: 4Q15E Estimates

	Revenue			EBITDA			Net Income			EPS	
	4Q14A	4Q15E	Y/Y	4Q14A	4Q15E	Y/Y	4Q14A	4Q15E	Y/Y	4Q14A	4Q15E
Saudi Ceramics Company	374	385	3%	98	110	12%	60	70	17%	1.20	1.40
Bawan Company	654	552	-16%	51	39	-23%	37	19	-48%	0.62	0.32
United Wire Factories Company	206	201	-2%	18	26	46%	13	18	41%	0.29	0.41
National Company for Glass	25	22	-12%	9	8	-8%	16	14	-11%	0.52	0.47
Saudi Arabian Amiantit Company	688	652	-5%	92	85	-8%	20	24	21%	0.17	0.21

Source: Company Reports and Riyad Capital

Stocks to find new valuation spots

The sector has underperformed the TASI by -9% as a result of ongoing concerns which has affected the sector while the index was finding historical lows during the quarter. TASI fell by -18% while TBMCI fell by -27% being the third largest underperformer among TASI sectors. Valuations across stocks have found their historical lows as stocks reacted strongly to the market fall adding to the concerns. Stocks under our coverage witnessed large volatility with Bawan witnessing the largest Q/Q fall of -41% for 4Q2015.

Table 3: TASI Building Materials Sector Stocks Trailing Multiples

Company NMme	Price (SAR)	Mcap		P/E	P/B	P/S	EV/Sales	EV/EBITDA	Div.Yld (%)	YTD	52 Wk- 52 Wk-Lo	
		SAR Min	EV SAR Min								Hi (SAR)	Lo (SAR)
Saudi Ceramic Co	46.59	2,330	3,086	8.1x	1.3x	1.4x	2.3x	8.1x	4.3	(0%)	89.50	46.10
Bawan Co	23.49	1,409	2,073	13.0x	1.8x	0.6x	0.9x	12.6x	0.9	1%	49.79	22.50
United Wire Factories Co	22.62	992	908	11.0x	2.0x	1.0x	1.5x	12.4x	7.0	3%	40.70	20.80
National Co for Glass Mfg.	26.12	784	809	13.7x	1.4x	8.1x	9.7x	31.0x	1.9	(1%)	44.00	25.50
Saudi Arabian Amiantit Co	8.99	1,038	2,962	10.2x	0.7x	0.4x	1.1x	8.7x	NA	1%	14.90	8.70
Red Sea Housing Services Co	24.51	1,471	1,779	18.9x	1.6x	1.4x	1.7x	8.2x	4.1	0%	47.20	20.70
Abdullah A.M. Al-Khodari Sons	16.10	855	1,928	10.7x	1.0x	0.5x	1.3x	8.6x	0.8	0%	35.30	15.50
Saudi Steel Pipe Co	22.00	1,122	1,420	23.1x	1.4x	1.3x	1.6x	15.0x	4.5x	1%	35.00	19.80
National Gypsum	16.00	507	438	22.2x	1.1x	6.3x	5.9x	14.8x	3.8	(0%)	30.80	15.10
Arabian Pipes Co	13.55	542	928	NA	0.9x	1.4x	2.4x	165.2x	NA	0%	22.80	12.78
Saudi Industrial Development Co	13.84	554	396	NA	1.3x	1.7x	1.0x	9.3x	NA	(2%)	21.20	10.60
Middle East Specialized Cables	9.23	554	1,078	NA	1.2x	0.6x	1.2x	27.1x	NA	(0%)	26.90	8.75
Zamil Industrial Investment Co	32.80	1,968	4,448	7.3x	1.1x	0.4x	0.9x	8.7x	6.1x	1%	68.00	31.30
Saudi Cable Co	7.67	583	1,731	NA	1.4x	0.3x	0.9x	NA	NA	(0%)	11.65	6.90
Sector Median*		14,708	23,984	12.0x	1.3x	1.2x	1.4x	12.4x	3.5	(1%)		

Source: Bloomberg,

*Market Cap and EV are total

Conclusion

In our view, there is no real excitement in 2016 for the sector as investment cycle witnessed in 2010-15 is unlikely to repeat for 2016 and 2017 despite any modest uptrend in oil prices. We believe the slowdown cycle will continue over the medium term and affect the sector unless oil price come back to the 80's which according to IMF should take at least 5 years. With limited spending, companies are set to witness slow growth in topline as only priority sectors continue to post an increase in spending. For now, we are neutral on the sector over the medium term but highlight that valuation bargains persist.

Stock Rating

Strong Buy	Buy	Hold	Sell	Not Rated
Expected Total Return ≥ 25%	Expected Total Return ≥ 15%	Expected Total Return < 15%	Overvalued	Under Review/ Restricted

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