

Saudi Cement Company (SCC)

STRONG BUY
Target Price
SAR96.2

Market Data

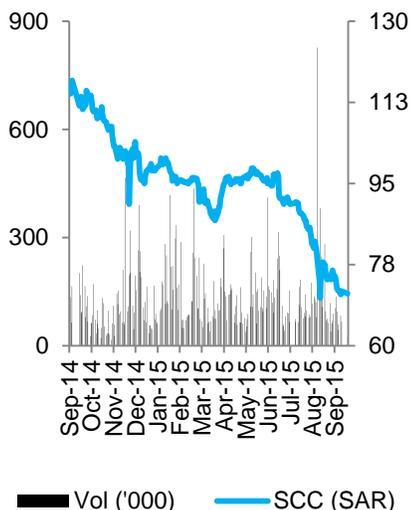
Bloomberg Code:	SACCO AB
Reuters Code:	3030.SE
CMP (29 September 2015):	SAR71.3
O/S (mn)	153.0
Market Cap (SAR mn):	10,901.3
Market Cap (USD mn):	2,906.6
P/E 2015e (x):	10.4
P/Bv 2015e (x):	3.3

Price Performance 1-Yr

High (SAR):	118.0
Low (SAR):	69.3
Average Volume ('000):	129

	1m	3m	12m
Absolute (%)	-8.1	-26.7	-37.6
Relative (%)	-4.6	-19.0	-31.8

Price Volume Performance



Source: Bloomberg

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- **Sluggish top line due to low infrastructure spending and competition**
- **Well positioned to take advantage of a pickup in demand**
- **Unwarranted correction and high dividend yield make SCC attractive**
- **Fair value reduced; upgraded to STRONG BUY**

Saudi Cement Company (SCC) reported weak revenue and profit for 2Q15, mainly due to declines in cement sales volume and prices. A slowdown in construction activity due to low infrastructure spending, owing to a decline in oil prices will likely hinder top-line growth. Moreover, competition from small players could weigh on the top line. However, this negative impact could be partly offset by strong activity in Saudi Arabia's residential sector. There are also talks of lifting the three-year old cement export ban on Saudi cement companies. With a low utilization rate, large capacity, and high clinker inventory, we believe SCC is well placed to capitalize on any increase in the local and export demand. The pressure on margins is also expected to ease due to focus on efficiency and as the current year included one off disbursement of salaries to Saudis and non-Saudi employees. Moreover, SCC completed the refurbishment of Kilns 4 and 5 in the Hofuf factory, but has still not started operations due to already high clinker inventories. Once these kilns start commercial operations they would aid in margin expansion. We have lowered our target price to SAR96.2/share. However, given the unwarranted decline in the stock price, we upgrade it to **STRONG BUY** from HOLD. Furthermore, the attractive valuation and strong dividend yield make it a good buy.

Net profit declines in 2Q15 due to drop in local sales

SCC's net profit declined 12.0%YoY to SAR253.8mn in 2Q15. This was mainly ascribed to a 6.1%YoY drop in the volume of cement sold on account of low local dispatches. However, cement export volumes inched up to 126,000tons in 2Q15 (125,000tons in 2Q14). Moreover, the realized price of cement sold fell to SAR250.6/ton in 2Q15 from SAR253.6/ton in 2Q14. Lower realized prices, along with higher cost of sales (as a % of sales), led to contraction in gross margins to 56.8% in 2Q15 from 60.0% in 2Q14. Furthermore, operating margins also reported a contraction to 51.7% in 2Q15 from 54.9% in 2Q14. Nevertheless, the fall in operating profit was partly offset by high other income. On a QoQ basis, net profit declined 16.3% led by an 8.7%QoQ decline in cement sales volumes and lower realized cement prices.

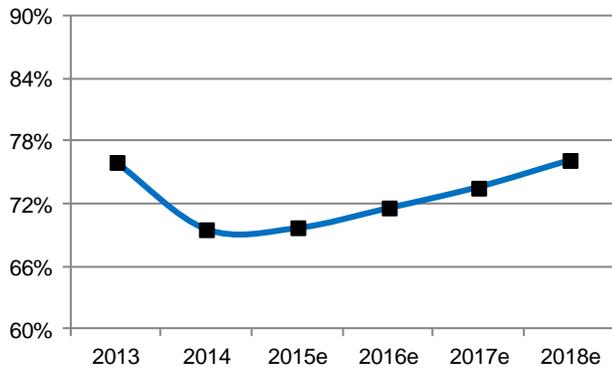
SAR mn	2Q15	2Q14	YoY	1Q15	QoQ
Revenue	499.6	538.4	-7.2%	550.9	-9.3%
Cost of Sales	(215.7)	(215.6)	0.1%	(211.6)	1.9%
Gross Profits	283.9	322.8	-12.0%	339.3	-16.3%
S.G. & A. Expenses	(25.5)	(27.0)	-5.8%	(29.0)	-12.2%
Operating Profit	258.4	295.8	-12.6%	310.2	-16.7%
Financial Charges	(3.2)	(3.9)	-16.3%	(3.0)	9.3%
Other Income	5.1	3.7	37.2%	3.6	43.4%
Zakat	(6.5)	(7.4)	-11.3%	(7.7)	-15.6%
Net Profit	253.8	288.3	-12.0%	303.1	-16.3%

Source: Company Accounts

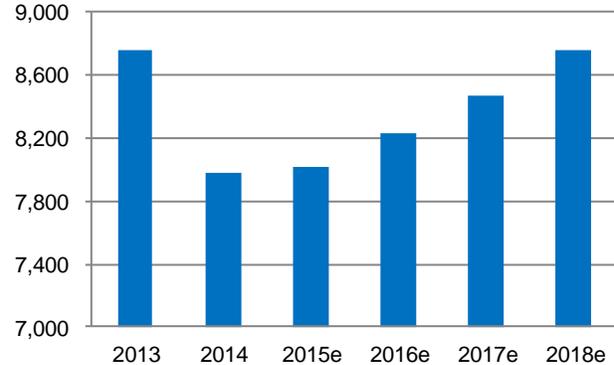
Large capacity, low utilization, and strategic location to aid growth

SCC has one of the largest cement production capacities in the KSA and is also strategically located. The company has access to key demand regions of Riyadh (major projects underway such as the Riyadh metro) and Jubail. Moreover, it is one of the few producers that are able to export cement to Bahrain amid the ban. Going forward, we believe SCC would benefit from its low utilization rate and large capacity. SCC's cement capacity utilization rate was 70% for 2014, lower than 76% in 2013.

Cement capacity utilization (%)

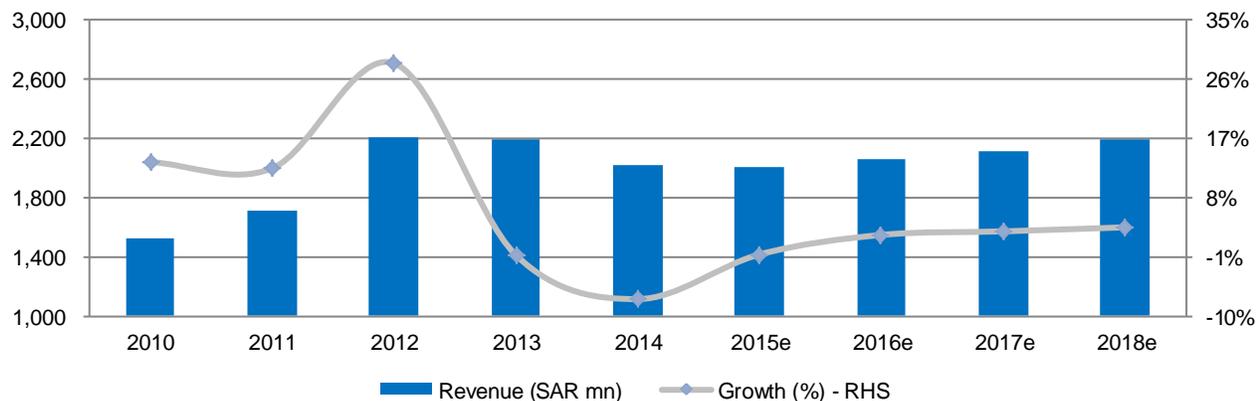


Yearly cement sales ('000 tons)



Source: Company Accounts, Global Research

The demand for cement has been slightly impacted by the decline in crude oil prices, as the regional governments are rationalizing investments. Recently, the Government of Saudi Arabia announced to reduce expenditure due to weak oil prices. However, concerns related to low infrastructure spending are expected to be partly offset by strong demand from the housing sector in Saudi Arabia. Another concern for SCC is the expansion of small cement producers. Although the demand for cement is soft now, SCC is better placed to tap any increase in cement demand in Saudi Arabia. We expect the cement capacity utilization rate to improve to 74% in 2017e and 79% in 2019e, and SCC's cement sales volume to record a CAGR of 2.7% during 2014–19e. Consequently, the top line would expand at a CAGR of 2.4%, as we have assumed the realized prices to decline slightly to SAR250/ton.



Source: Company Accounts, Global Research

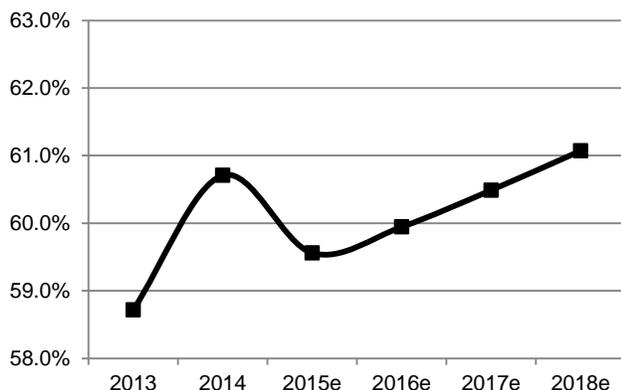
Lifting export ban could trigger upside

In 2012, the Saudi government imposed a ban on cement export to all countries except for Bahrain. However, given the increase in clinker inventories due to a dented demand environment, the cement producers have asked the Saudi government to lift the three-year ban. The supply of clinker and cement in Saudi Arabia is currently more than the demand from the local government and private sector projects. Furthermore, the strong demand for cement in neighboring countries such as Egypt and Qatar presents a good opportunity for cement players in Saudi Arabia to increase sales volume. Currently, the government is mulling over the lifting of this ban. A positive development on this front is expected to benefit SCC the most, given that it has the highest clinker inventory of 3.6mn tons among peers. Moreover, it would be able to ramp up production due to low utilization rates at the plants. As there is still uncertainty over this proposal, we have not included the impact of higher cement exports in the estimates.

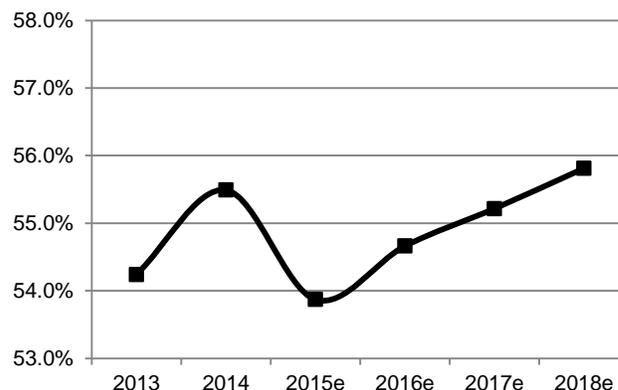
Margin pressure to ease after expected contraction in 2015

SCC's gross margins improved to 60.7% in 2014 from 58.7% in 2013. However, margins are expected to contract slightly in 2015 due to the decline in realized prices and high operating costs, as Saudis and non-Saudis received two and one month salary bonus respectively. We expect SCC's margins to improve in the long term, given its focus on improving efficiency. Moreover, an increase in cement production volumes would lead to economies of scale, as the utilization rates are currently low. However, we have capped the realized prices at SAR250/ton from 2016e. This is expected to partly offset the impact of margin expansion. SCC completed the rehabilitation of Kilns 4 and 5 at the Hofuf factory, but has not started them yet due to an already high clinker inventory (3.6mn tons at the end of August 2015). When the kilns become operational, these would enhance productivity due to the low production cost supported by high efficiency after the rehabilitation.

Gross Margin (%)



Operating Margin (%)



Source: Company Accounts, Global Research

Valuation update: Fair value lowered; upgraded to **STRONG BUY**

We arrived at a fair value using the weighted average of the DCF and relative methodologies that yielded a target price of SAR96.2/share, 35.0% above the current market price. We assumed a risk-free rate (US 10-year Treasury yield) of 2.8% and risk premium of 9.1%, including country- and stock-specific risks. We believe the steep decline in the stock price is slightly unwarranted. Thus, we upgrade the stock to a **STRONG BUY** rating.

Given the recent correction in the stock price amid the decline in the broader market, SCC currently presents a dividend yield of 8.4% for 2015e. Therefore, the current trading levels for SCC make it attractive not only for capital appreciation but also for the realization of returns through dividends.

Financial Statements

	(SAR mn)	2012	2013	2014	2015e	2016e	2017e	2018e
Income Statement	Revenue	2,203	2,187	2,025	2,011	2,058	2,117	2,190
	Cost of sales	(974)	(903)	(796)	(813)	(824)	(836)	(853)
	Gross Profit	1,229	1,284	1,229	1,198	1,234	1,280	1,338
	SG&A	(87)	(98)	(106)	(114)	(109)	(112)	(115)
	Operating Profit	1,142	1,186	1,123	1,084	1,125	1,169	1,222
	Financial charges	(15)	(13)	(15)	(15)	(12)	(8)	(6)
	Other income	15	(2)	3	11	11	12	12
	Profit Before Zakat	1,142	1,171	1,111	1,079	1,124	1,173	1,229
	Zakat	(41)	(47)	(37)	(36)	(37)	(39)	(41)
	Net Profit	1,102	1,124	1,074	1,043	1,087	1,134	1,188
Balance Sheet	Cash and Bank Balance	227	113	298	345	417	563	791
	Receivables and Prepayments	205	214	217	237	254	273	294
	Inventories	323	537	658	702	721	740	765
	Other Current assets	47	122	56	83	90	99	108
	Total Current Assets	802	986	1,229	1,366	1,482	1,675	1,958
	Long-term investments	98	91	87	84	82	79	77
	Work in progress	88	129	64	55	56	56	57
	Net fixed assets	3,346	3,164	3,104	2,980	2,863	2,755	2,655
	Total Fixed Assets	3,532	3,384	3,255	3,119	3,001	2,890	2,789
	Total Assets	4,333	4,371	4,484	4,486	4,482	4,565	4,747
Cash Flow	Accounts payables	33	45	33	43	42	41	40
	Short-term loan	485	525	715	600	436	307	216
	Other current liabilities	249	272	315	330	331	333	336
	Long-term debt	335	235	120	80	64	51	41
	Employee end-of-service benefits	73	85	91	101	111	122	134
	Share capital	1,530	1,530	1,530	1,530	1,530	1,530	1,530
	Retained Earnings	793	843	844	967	1,134	1,347	1,615
	Other reserves	835	835	835	835	835	835	835
	Total Shareholders Equity	3,158	3,208	3,209	3,332	3,499	3,712	3,980
	Total Equity & Liability	4,333	4,371	4,484	4,486	4,482	4,565	4,747
Cash Flow	Cash Flow from Operating Activities	1,432	1,075	1,271	1,199	1,266	1,308	1,358
	Cash Flow from Investing Activities	(59)	(53)	(78)	(63)	(82)	(92)	(103)
	Cash Flow from Financing Activities	(1,378)	(1,135)	(1,008)	(1,090)	(1,112)	(1,070)	(1,027)
	Change in Cash	(5)	(113)	185	46	72	146	227
	Net Cash at End	227	113	298	345	417	563	791
Ratio Analysis	Gross Margin	55.8%	58.7%	60.7%	59.6%	59.9%	60.5%	61.1%
	Operating Margin	51.8%	54.2%	55.5%	53.9%	54.7%	55.2%	55.8%
	Net Margin	50.0%	51.4%	53.1%	51.9%	52.8%	53.6%	54.2%
	Return on Average Assets	24.7%	25.8%	24.3%	23.3%	24.2%	25.1%	25.5%
	Return on Average Equity	34.2%	35.3%	33.5%	31.9%	31.8%	31.4%	30.9%
	EV/ton (USD)	317.8	367.3	346.5	258.7	252.9	246.5	239.2
	Quick ratio (x)	0.6	0.5	0.5	0.7	0.9	1.4	2.0
	Debt / Equity (x)	0.1	0.1	0.2	0.2	0.1	0.1	0.1
	EV/EBITDA (x)	11.9	13.4	13.3	10.2	9.6	9.0	8.3
	EV/Revenues (x)	6.2	7.2	7.4	5.5	5.3	5.0	4.7
	FCF Yield	10.3%	6.6%	8.1%	10.3%	10.8%	11.1%	11.4%
	EPS (SAR)	7.2	7.3	7.0	6.8	7.1	7.4	7.8
	Book Value Per Share (SAR)	20.6	21.0	21.0	21.8	22.9	24.3	26.0
	Market Price (SAR) *	88.4	101.5	95.7	71.3	71.3	71.3	71.3
	Market Capitalization (SAR mn)	13,529.8	15,529.5	14,640.6	10,901.3	10,901.3	10,901.3	10,901.3
Dividend Yield	9.0%	6.9%	6.3%	8.4%	8.4%	8.4%	8.4%	
P/E Ratio (x)	12.3	13.8	13.6	10.4	10.0	9.6	9.2	
P/BV Ratio (x)	4.3	4.8	4.6	3.3	3.1	2.9	2.7	

Source: Company Reports & Global Research

* Market price for 2015 and subsequent years as per closing prices on September 29, 2015

Disclosure

The following is a comprehensive list of disclosures which may or may not apply to all our researches. Only the relevant disclosures which apply to this particular research has been mentioned in the table below under the heading of disclosure.

Disclosure Checklist

Company	Recommendation	Bloomberg Ticker	Reuters Ticker	Price	Disclosure
Saudi Cement (SSC)	STRONG BUY	SACCO AB	3030.SE	SAR71.3	1,10

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SELL	Fair value of the stock is < -10% from the current market price

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