

June 30, 2016

SAUDI BUILDING MATERIALS
2Q2016 Preview

Modest Recovery This Quarter

After a modest ride in the first quarter of this year, we look towards slightly weaker expectations forward for earnings in the second quarter. A seasonal adjustment is due considering an early impact of Ramadan. 2Q2016 was less timid as oil (Brent) prices surprisingly moved up by +81% from their lows of US\$ 27/bbl. However, TASI index relatively recorded a modest rebound of +19% from its lows of 5,459 as compared to oil. A major drive for the TASI came from announcements related to vision 2030 and reforms by the government. For the quarter, TASI index returned +4%, while the sector index (TBMCI) registered a growth of +7%, aided by a recovery in some of the key sector stocks such as Saudi Ceramics and Bawan. Our coverage stocks are trading at median 2016E P/E of 11.7x versus overall sector's 13.0x and TASI's 13.5x.

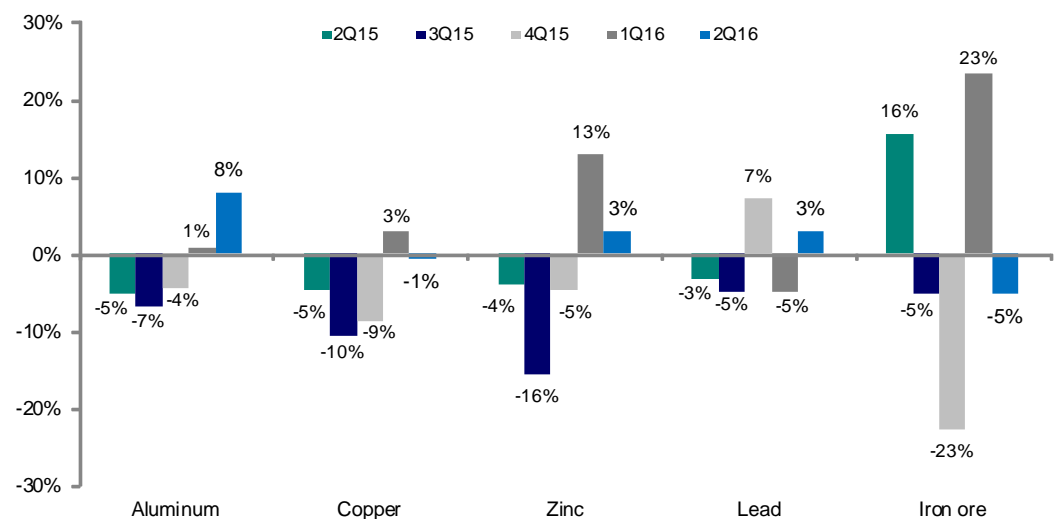
Due for recovery though slightly delayed

The sector is showing signs of a delayed recovery and is driven by slowing project market, which according to MEED is not expected to recover until 2017. Some of the most evident concerns are i) declining project awards data which recorded a fall of -25% Q/Q in 1Q2016 ii) -18% decline in real estate sales transactions during the quarter across KSA and iii) oversupply in private commercial and residential real estate projects. Industry indicators are showing signs of a delayed recovery as outlook remains weak, however feeble signs of growth emerge from government backed housing sector. The impact of white land tax over the short run is slightly negative as land prices are set for a decline while over long term, real estate developments are likely. Overall, impact on sector earnings is limited in the short run but we await clarity in the long run.

Commodities shows some relief

A relief rally in commodities suggests some price driven growth for companies in their top line. Notably, growth in steel and aluminum prices over the quarter is a positive for the sector. We believe commodities are in the midst of recovery cycle as China's consumption trends are showing some signs of growth. The performance of global base metal prices were resilient, especially prices of aluminum and steel, improving over the quarter. Iron ore prices decreased by -5% Q/Q to USD 51/ton after a sharp rally in 2Q2016. Aluminum moderately increased by +8% Q/Q to USD 1,642/ton while copper declined by -1% Q/Q to 4,818/ton.

Exhibit 1: Global Base Metals Performance



Source: Bloomberg

Ramadan impact to affect construction activity

We believe an early impact of Ramadan versus previous years coupled with lower utilization could pressure growth, though this is expected. Margins versus last quarter have relatively declined because of the cut in subsidies as most companies started witnessing the pressure.

Earnings trend to be weaker on seasonality

We forecast 2Q2016 estimates with minimal revisions to our full year projections. We believe a detailed interpretation of the impact of hike in utility tariffs is unclear and expect this to take another 1-2 quarters to clearly depict a forward trend. We expect revenues to register a decline of -18% Y/Y and earnings to decline -64% Y/Y for the companies under our coverage.

Table 1: 2Q2016 Estimates (SAR mln, except per share data)

Company	Revenue			EBITDA			Net Income			EPS	
	2Q2015	2Q2016E	Y/Y Chg	2Q2015	2Q2016E	Y/Y Chg	2Q2015	2Q2016E	Y/Y Chg	2Q2015	2Q2016E
Ceramics	444	330	-26%	122	83	-32%	84	41	-51%	1.68	0.83
Bawan	646	582	-10%	43	49	14%	24	26	10%	0.40	0.44
Aslak	269	170	-37%	32	20	-38%	25	14	-44%	0.57	0.32
Zoujaj	23	28	21%	7	10	49%	17	9	-45%	0.55	0.31
Amiantit	673	570	-15%	105	86	-18%	26	(28)	-208%	0.23	(0.24)

Source: Riyad Capital, Company Reports

- ✓ Saudi Ceramics is expected to witness a -51% Y/Y decline due to ailing ceramics segment as margins continue to erode, coupled with impact of early Ramadan.
- ✓ Bawan is expected to witness a +10 Y/Y growth, as margins improvement in metals segment is likely amid a robust growth in packaging segment.
- ✓ Aslak is expected to register a sluggish 2Q16 as early Ramadan impact could affect growth as witnessed in the previous years.
- ✓ Zoujaj's earnings are expected to fall as associates fail to deliver decent performance. It is expected to register Y/Y EPS decline of -44%.
- ✓ Amiantit is likely to record the remainder of its provisions this quarter due to impact from one of its subsidiaries. As a result it is likely to report loss of SAR 28 million this quarter.

Valuations reach a mid-cycle peak

Out of the coverage, Bawan's and Zoujaj's stock price has declined significantly in 1Q, while the same witnessed a reasonable reversion in 2Q. TASI was up by +4%, while the sector (TBMCI) was up by +7%. Some of the sector stocks did not witness a reversion trend due to standalone fundamental issues and have underperformed TASI and TBMCI. Valuations of coverage stocks have retracted to a P/E of 11.7x its 2016E earnings, while on a TTM basis hovering around same levels.

Table 2: TASI Building Materials Sector Stocks Trailing Multiples

Company Name	Price (SAR)	Mcap SAR Mln	EV SAR Mln	P/E	P/B	P/S	EV/Sales	EV/EBITDA	Div.Yld (%)	YTD	52 Wk-Hi (SAR)	52 Wk-Lo (SAR)
Saudi Arabian Amiantit Co	8.20	947	2,890	19.1x	0.7x	0.3x	1.1x	8.3x	7.9	(8%)	13.45	6.50
Red Sea Housing Services Co	25.79	1,547	1,772	20.0x	1.5x	1.5x	1.6x	8.3x	2.9	6%	39.30	15.90
Abdullah A.M. Al-Khodari Sons Co	11.63	649	1,760	27.3x	0.7x	0.4x	1.1x	10.3x	N/A	(24%)	29.24	8.38
Saudi Steel Pipe Co	18.19	928	1,242	24.0x	1.2x	1.2x	1.5x	14.2x	N/A	(16%)	30.20	14.80
Bawan Co	23.04	1,382	1,994	15.3x	1.8x	0.6x	0.7x	8.8x	4.3	(1%)	40.67	14.00
National Gypsum	13.90	440	367	22.1x	1.0x	5.5x	4.4x	11.8x	4.3	(13%)	25.00	10.60
United Wire Factories Co	23.97	1,052	883	13.9x	2.1x	1.2x	0.7x	6.0x	5.4	9%	35.00	14.50
Arabian Pipes Co	13.33	533	937	N/A	0.9x	1.9x	2.9x	N/A	N/A	(1%)	21.80	7.70
Saudi Ceramic Co	39.15	1,957	2,661	7.9x	1.0x	1.2x	1.6x	6.1x	5.1	(16%)	80.25	32.30
Saudi Industrial Development Co	10.52	421	308	N/A	1.1x	1.3x	0.9x	11.1x	N/A	(25%)	18.30	7.80
Middle East Specialized Cables Co	7.42	445	907	N/A	1.2x	0.5x	1.0x	68.3x	N/A	(20%)	14.00	5.90
Zamil Industrial Investment Co	28.13	1,688	3,867	7.0x	0.9x	0.3x	0.7x	6.8x	7.1	(14%)	61.75	24.25
Saudi Cable Co	6.76	514	1,617	N/A	1.3x	0.3x	0.9x	N/A	N/A	(12%)	9.95	5.60
National Co for Glass Manufacturing/Th	20.79	624	664	16.0x	1.1x	5.7x	6.0x	17.3x	2.4	(21%)	41.10	15.85
Sector Median		11,643	19,447	12.50x	1.00x	1.00x	1.30x	11.30x	5.2			

Source: Bloomberg

Conclusion

We maintain our target prices and ratings for Saudi Ceramics and Zoujaj but adjust for Bawan to Neutral and Sell for Aslak and Amiantit and may revise if we see a valuation opportunity. The sector is likely to witness some decline on volume growth rates as demand slows due to early Ramadan effect, hence earnings could see a seasonal trend. We do not see any large recovery for the rest of 2016 unless the reforms drive growth in a more amicable manner, which we believe is gradual. We maintain our neutral view on the sector.

Table 3: Ratings and Valuations (SAR mln)

Company	TASI Code	Rating New	CMP (SAR)	12-Month Target price	Upside
Ceramics	2040	Buy	39.15	50.00	28%
Bawan	1302	Neutral	23.04	21.00	(9%)
Aslak	1301	Sell	23.97	17.00	(29%)
Zoujaj	2150	Buy	20.79	23.00	11%
Amiantit	2160	Sell	8.20	7.50	(9%)

Source: Riyad Capital

Stock Rating

Buy	Neutral	Sell	Not Rated
Expected Total Return Greater than 15%	Expected Total Return between -15% and +15%	Expected Total Return less than -15%	Under Review/ Restricted

* The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors

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