

January 1, 2017

SAUDI BUILDING MATERIALS

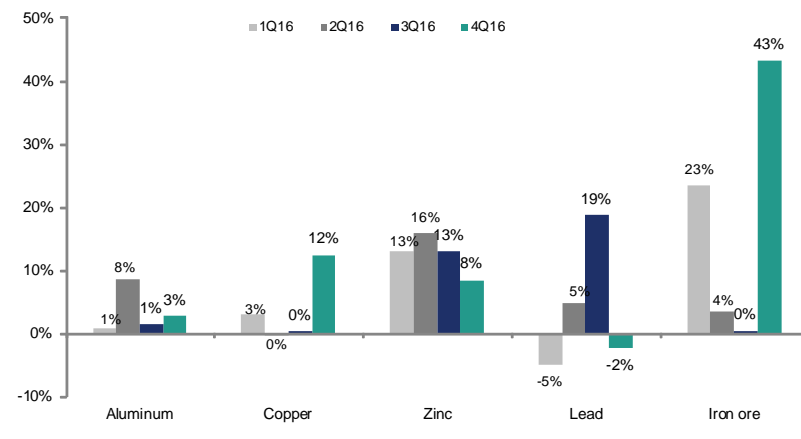
4Q2016 Preview

Renewed Hopes from Budget 2017

4Q2016 ends with a slight revival in sector performance as markets rallied by +29% Q/Q during the quarter, while the sector rose by +31%. Despite such outperformance, we believe the same is unlikely to reflect in sector's earnings performance as structural indicators on business still looks subdued. However, we view 2017 to be better due to a positive state budget, which featured higher spending amid low budget deficit of SAR 198 billion. We view this to be a revival of the sector, as expenditure allocation increased by +6% versus 2016. Additionally, the new non-oil revenue streams will eventually cushion cash flows aiding continued spending.

We believe the 2017 budget is trying to reshape its spending patterns witnessed in the past. The decision on settlement of delayed payments is a strong indicator that the country is focused on spending and notifies its intention to restart its strong non-oil growth engine, which is construction. An allocation of SAR 140 billion is already appropriated for contractor payments in 2016 coupled with some additional spending plans, hence expect some growth momentum to continue in 2017. Though emphasis is laid on prioritizing its capital spending, we believe it looks forward for a restart. The recent reforms on white land tax, with government identifying nearly 635 million square meters of land, is expected to drive some private developments. Additionally the housing minister has put forward plans for 100K homes every year in JV with private sector, another positive.

Exhibit 1: Global Base Metals Performance



Source: Bloomberg

Globally, a rally in commodities was unexpected mainly driven by iron ore and copper, with the global S & P base metals index growing by +18% Q/Q in 4Q2016. Copper prices rose by +12% Q/Q to USD 5,545/ton while aluminum rose by +3% to USD 1,719/ton and Zinc increased by +8% to USD 2,577/ton. A look at local metals markets in 4Q suggest an increase with SABIC pricing its steel rebar at SAR 1,790/ton at start of 4Q, however the iron ore rally driven by China led to eventual rise in local prices to SAR 2,150/ton since start of December. Iron ore rallied by +43% Q/Q to USD 80/dmt (USD 44/dmt in 2015) as China has lowered its production and tried - stimulating its economy thereby driving steel consumption, rebalancing its excess inventories. The supply glut in KSA since the start of the year and recent news on steel exports has brought in some cheer for local producers but at the cost of rerouting its subsidy benefits back to the government. The government has advised firms to direct back its subsidy benefits through an export fee ranging between SAR 58 and SAR 390 per ton of steel incase of exports. Overall, in 4Q subdued business conditions prevailed in KSA due to lower economic activity, which had brought down building materials sector.

Earnings tends to be subdued

We forecast 4Q2016 estimates and adjust numbers as we expect some improvement in few companies, as contractors are likely to revisit their project plans. We expect revenues to register a decline of -18% Y/Y and earnings to decline -53% Y/Y under our coverage.

Table 1: 4Q2016 Estimates (SAR mln, except per share data)

Company	Revenue			EBITDA			Net Income			EPS		
	4Q2015	4Q2016E	Y/Y Chg	4Q2015	4Q2016E	Y/Y Chg	4Q2015	4Q2016E	Y/Y Chg	4Q2015	4Q2016E	Y/Y Chg
Ceramics	412	287	-30%	94	46	-51%	56	10	-82%	1.11	0.20	-82%
Bawan	550	570	4%	45	46	2%	17	24	38%	0.28	0.39	39%
Aslak	218	180	-17%	19	23	21%	12	18	50%	0.28	0.42	50%
Zoujaj	33	9	-73%	10	(10)	-200%	4	(9)	NM	0.12	(0.30)	-350%
Amiantit	705	525	-26%	85	52	-39%	23	10	-56%	0.23	0.21	-8%
Group Total	1,918	1,571	-18%	253	157	-38%	111	53	-53%			

Source: Riyad Capital, Company Reports

- ✓ Saudi Ceramics is expected to witness a decline in top-line as low project spending restricts volumes sales, while margins decline on lower economies of scale.
- ✓ Bawan is likely to witness a higher realization as pick up in electric segment and price recovery in metals to aid some margin growth.
- ✓ Aslak is expected to see positive impact of hike in metal prices and slight increase in demand, while low cost inventory management to aid profitability in 4Q.
- ✓ Zoujaj's earnings are set to decline, as shutdown in Riyadh -1 plant since Sep for a period of 70 days is likely to drive fixed costs higher leading to losses, while slowdown in UAE hurt float glass segment is likely to affect associate income.
- ✓ Amiantit is likely to record lower earnings as realization in KSA projects continues to be weak, while restructuring from overseas entities may influence write-down's.

Valuation and Conclusion

TASI displayed a robust performance in 4Q2016 taking it's 2016 returns in the positive territory by +4%, while sector is at -11%, though in 4Q most sectors and stocks rose significantly erasing its large losses in 1H2016. For the quarter, stock that had lowest gains was Saudi Ceramics with +24% (2016: -29%), while the best performer was Amiantit with +41% in 4Q (2016: -7%), though Aslak had the best year with +17% in 2016 and +38% in 4Q.

Table 2: Ratings and Valuations (SAR mln)

Company	TASI Code	Current Price	Market Cap	Target Price (Old)	Target Price (New)	Rating	Dividend Yield	P / E		P/B	
								2015	2016E	2015	2016E
Ceramics	2040	33.25	1,663	32.00	32.00	Neutral	3.0%	5.9x	41.6x	0.9x	0.9x
Bawan	1302	22.62	1,357	24.00	24.00	Buy	5.5%	15.4x	10.6x	1.6x	1.4x
Aslak	1301	25.73	1,129	23.50	23.50	Neutral	5.8%	15.7x	12.6x	2.6x	2.6x
Zoujaj	2150	19.89	597	21.00	21.00	↓ Neutral	3.8%	13.3x	32.1x	1.5x	1.5x
Amiantit	2160	8.25	953	6.50	6.50	Sell	NA	9.5x	NM	0.6x	0.6x
Group Average								11.9x	24.2x	1.4x	1.4x

Source: Riyad Capital

On a valuation perspective, sector continues to trade at 2017E P/E of 18.2x versus TASI P/E of 15.6x. We believe Amiantit, Saudi Ceramics and Zoujaj in 2017, could see the benefits of budget spending gradually flowing in to business. The concerns on delayed payments are eased out, as these issues seem to be resolved well by government. For now, we maintain our target prices, but may revise after the full earnings cycle in 4Q2016. Most stocks have surpassed our target prices, hence adjust our recommendation accordingly to our rating criteria. We revise Zoujaj to Neutral from Buy as stock prices rallied and valuations looks overridden amid shutdown, while Bawan remain in our Buy list. We maintain Neutral on Ceramics and Aslak, while Amiantit remain as Sell in our list. We expect to witness a decent performance in 2017, but continue our Neutral view on the sector unless we see the reflection in 1H2017.

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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