

Yamama Cement Company (YSCC)

STRONG BUY
Target Price
SAR48.2

Market Data

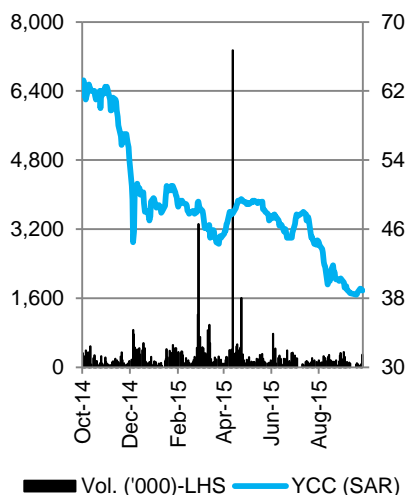
Bloomberg Code:	YACCO AB
Reuters Code:	3020.SE
CMP (07 October 2015):	SAR38.9
O/S (mn)	202.5
Market Cap (SAR mn):	7,877.2
Market Cap (USD mn):	2,101.7
P/E 2016e (x):	11.7
P/Bv 2016e (x):	2.0

Price Performance 1-Yr

High (SAR):	64.5
Low (SAR):	37.0
Average Volume ('000):	259

	1m	3m	12m
Absolute (%)	-2.8	-13.6	-41.3
Relative (%)	1.6	-16.3	-29.9

Price Volume Performance



Source: Bloomberg

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- **Net profit declined 7.7% in 2Q15; 3Q15 profit estimated to be up by 2.2%**
- **Margins to improve aided by efficiencies after plant relocation**
- **Planned expansion and use of vacated land – key triggers**
- **Fair value reduced; upgraded to STRONG BUY; price ↓ 41.3% in 12m**

Yamama Cement Company (YSCC) reported weak performance in 2Q15 (YoY) mainly due to lower revenue. The top line was subdued due to a decline in cement price realizations, despite a 1.1%YoY increase in volume of cement sold. Low infrastructure spending in the backdrop of a decline in crude oil prices, along with intense competition from small players weighed on realized prices. YSCC is planning to set up a 20,000-ton clinker plant in Al-Kharj after the Company received a license from the Ministry of Petroleum to operate a raw materials quarry in the same governorate. This plan if materialized on time could drive volumes. However we believe at current point of time there is enough clinker inventory stock available which will hinder this move. Along with that YSCC is shifting production lines outside the city, away from residential areas due to governmental regulations. These shifted, refurbished lines are expected to enhance operational efficiency for YSCC and improve margins but will also result in a slight increase in distribution expense. Furthermore, we believe YSCC would either lease or sell the vacated land plot of the existing plant. This could be a key trigger for the stock price. With an overall mixed outlook and growing inventory stock in Saudi, we have lowered our target price to SAR48.2/share. Despite the 41.3% decline in stock price in last 12 months, our target price still stands 23.8% above current market price. Thus, we upgrade our recommendation to **STRONG BUY**.

Net profit declined 7.7% in 2Q15; 3Q15 profit estimated to be up by 2.2%

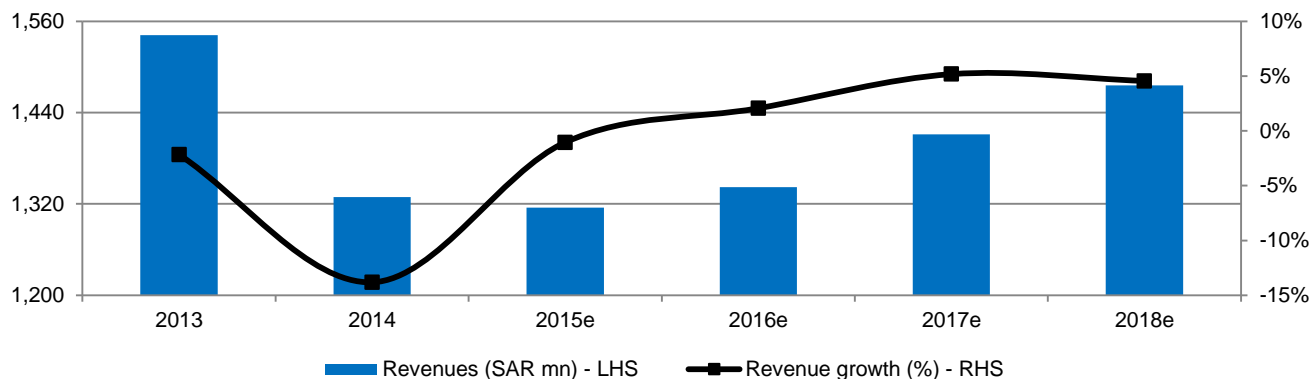
YSCC's net profit declined 7.7%YoY to SAR191.5mn in 2Q15. The fall was mainly ascribed to a decline in the value of sales (revenue), mainly due to lower price realizations to SAR223.8/ton in 2Q15 from SAR243.7/ton in 2Q14. This decline was partly offset by a 1.1%YoY increase in the volumes of cement sold to 1.5mn tons in 2Q15. Furthermore, the impact of the lower revenue was partly offset by a decline in the cost of sales, which expanded gross margins to 55.4% in 2Q15 from 54.3% in 2Q14. Also, operating margins inched up to 50.5% from 50.2% during the same period. Other income for the quarter came in lower (YoY), which eventually decreased net profit by 7.7%YoY. For 3Q15, we expect the company to report a net profit of SAR140mn, growth of 2.2%YoY.

SAR mn	2Q15	2Q14	YoY	1Q15	QoQ
Revenue	339.5	366.0	-7.2%	338.9	0.2%
Cost of Sales	(151.5)	(167.4)	-9.5%	(156.9)	-3.5%
Gross Profits	188.0	198.6	-5.3%	182.1	3.3%
S.G. & A. Expenses	(16.7)	(14.9)	12.0%	(14.0)	19.4%
Operating Profit	171.3	183.7	-6.7%	168.1	1.9%
Financial Charges	(0.2)	(0.6)	-66.7%	(0.3)	-32.1%
Other Income	30.4	35.8	-15.1%	18.1	67.4%
Net Profit before Zak	201.5	218.9	-7.9%	185.9	8.4%
Zakat	(10.0)	(11.5)	-13.0%	(10.5)	-4.8%
Net Profit	191.5	207.4	-7.7%	175.4	9.2%

Source: Company Accounts

Strategic location key to company's future outlook

YSCC has plants in the central region, which is home to increasing construction activity in the commercial and residential sectors. Currently, the demand for cement is slightly impacted, as the regional governments are rationalizing expenditures due to the plunge in crude oil prices. Despite some major players reporting weaker volumes, YSCC has been able to maintain the cement sales volume. YSCC's cement sales volume rose 1.1%YoY to 1.52mn tons in 2Q15. Growth in construction activity in the central region presents a great potential for YSCC. The company is well positioned to tap this potential as it has the second-largest clinker inventory in Saudi Arabia. Consequently, we expect YSCC's top line to register a CAGR of 3.0% to SAR1.5bn in 2019e.

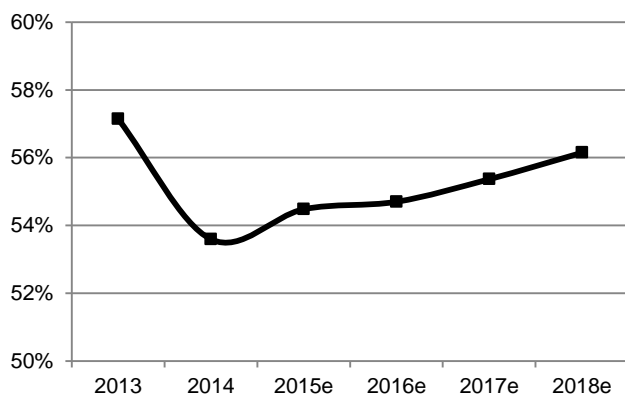


Source: Company Accounts, Global Research

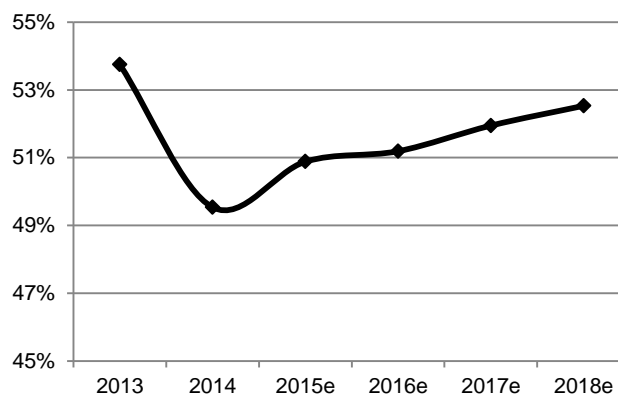
Margins to expand after plant relocation

YSCC is relocating its plant outside Riyadh as part of the government's plan to move industries away from residential areas. Given that the lines to be shifted will be refurbished, production efficiency is set to increase. This is expected to drive margin growth for YSCC. However, the margin expansion is expected to be slightly offset by increased transportation costs for the company as the plants would now be located slightly away from the main demand centers. In the last two quarters, driven by the existing cost control measures, YSCC has been reporting improvement in margins. Gross margin in 1Q15 and 2Q15 was 53.7% (49.4% in 1Q14) and 55.4% (54.3% in 2Q14), respectively. Therefore, driven by both cost control measures and enhanced efficiency of production lines, we expect gross margin to improve to 54.5% in 2015e and 55.4% in 2017e from 53.6% in 2014. Similarly, operating margin is expected to improve to 50.9% in 2015e and 51.9% in 2017e from 49.5% in 2014.

Gross Margin (%)



Operating Margin (%)



Source: Company Accounts, Global Research

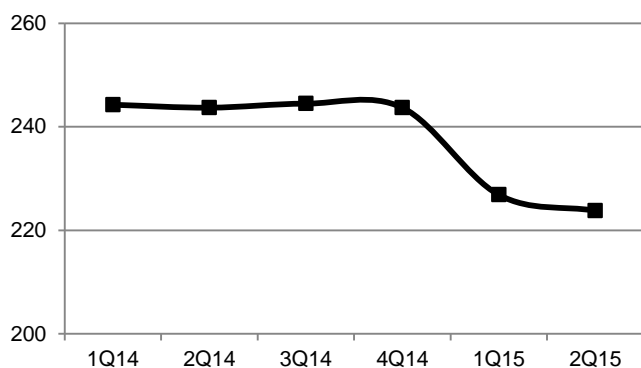
Utilization of existing land after relocation – another key trigger

YSCC is shifting its plants outside Riyadh, vacating the land site of the existing plant. We believe YSCC could lease or sell this land site, which is located in a relatively prime area. In such a scenario, we may witness a one-off gain or continued rental income stream for the stock. This could, therefore, be a key trigger for a rise in the company's stock price.

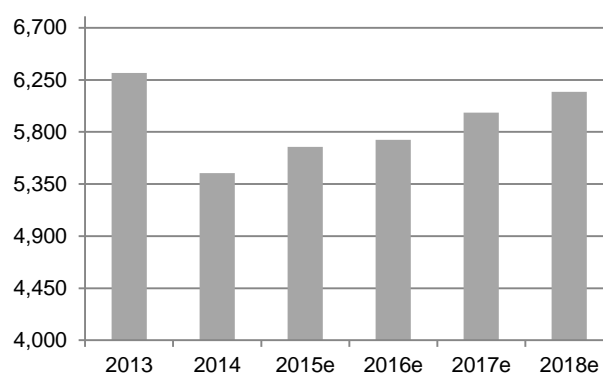
Competition from small players dent price realizations and restrict growth

YSCC is facing competition from small players in the central region, as they are offering discounts to gain market share. Consequently, its realized prices are lower than that of other major players in Saudi Arabia. YSCC recorded cement price realizations of SAR244.1/ton in 2014, down from SAR244.4/ton in 2013 and SAR247.3/ton in 2012. The decline is more visible in the recent two quarters, with 1Q15 and 2Q15 reporting price realizations of SAR223.8/ton and SAR226.9/ton, respectively. Following an expected dip in 2015, we anticipate price realizations to improve as demand picks up.

Price realization (SAR/ton)



Yearly cement sales ('000 tons)



Source: Company Accounts, Global Research

Lifting of export ban and realization of expansion plans to be a key catalyst

The Saudi government imposed a ban on cement export to all countries except Bahrain. However, due to an increase in clinker inventories amid strong supply and a slightly subdued environment, cement producers have asked the Saudi government to lift the ban. There is a strong potential demand for cement in the neighboring countries such as Egypt and Qatar. Currently, the government is mulling over the lifting of this ban. A positive development on this front is expected to benefit YSCC significantly, given a high clinker inventory. Earlier, YSCC used to export cement and it comprised 7% of its total sales volume in 2008. As there is still uncertainty over this proposal, we have not included the impact of higher cement exports in the estimates.

In 2013 and 2014, YSCC's clinker capacity utilization rates were more than 100%. Utilization rates above 100% significantly restrict the headroom available for any further increase in production, limiting growth prospects. Consequently, the company intends to install two lines, after the Company received a license from the Ministry of Petroleum to operate a raw materials quarry in the Al Kharij governorate. This plan if materialized on time could drive volumes. However we believe at current point of time there is enough clinker inventory stock available which will hinder this move.

Valuation update: Fair value reduced; upgraded to **STRONG BUY**; stock price down 41.3% in 12m

We arrived at a fair value using the weighted average of DCF and relative valuation that yielded a target price of SAR48.2/share, 23.8% above the current market price. Thus, we upgrade our recommendation to **STRONG BUY**.

Given the recent correction in stock price amid the decline in the broader market, YSCC currently offers a dividend yield of 7.7% for 2015e. Therefore at current level company looks attractive both from capital appreciation perspective as well as offers a decent dividend yield.

Financial Statements

	(SAR mn)	2012	2013	2014	2015e	2016e	2017e	2018e
Income Statement	Revenue	1,576	1,542	1,329	1,315	1,342	1,412	1,476
	Cost of sales	(662)	(661)	(617)	(599)	(608)	(630)	(647)
	Gross Profit	914	881	712	716	734	781	829
	SG&A	(51)	(52)	(54)	(47)	(47)	(48)	(53)
	Operating profit	863	829	658	669	687	733	775
	Financial charges	(7)	(4)	(3)	(3)	(3)	(3)	(3)
	Other income	25	86	70	25	27	30	32
	Profit Before Taxation	866	896	711	691	711	761	805
	Taxation	(48)	(26)	(40)	(35)	(36)	(38)	(40)
	Net Profit	818	870	671	657	676	723	764
Balance Sheet	Cash and Bank Balance	1,241	1,254	1,248	1,234	1,217	1,232	1,282
	Receivables and Prepayments	322	298	319	312	315	328	338
	Inventories	66	161	233	228	233	243	252
	Other Current assets	21	102	56	61	67	74	82
	Long-term investments	438	648	514	565	622	684	752
	Capital work-in-progress	69	80	71	92	120	156	203
	Deferred charges after amortization	14	17	34	32	30	29	27
	Loans to affiliated companies	-	-	-	-	-	-	-
	Net fixed assets	1,809	1,679	1,580	1,594	1,601	1,600	1,590
	Total Assets	4,005	4,263	4,079	4,120	4,206	4,346	4,527
	Accounts payables	182	159	148	131	139	151	163
	Dues to shareholders	43	49	60	66	73	80	88
	Other current liabilities	88	86	73	74	76	79	82
	Long-term debt	31	10	-	-	-	-	-
	Employee end-of-service benefits	62	65	67	70	74	77	81
	Share capital	2,025	2,025	2,025	2,025	2,025	2,025	2,025
	Retained Earnings	675	848	593	546	515	527	576
	Other reserves	899	1,020	1,113	1,208	1,305	1,406	1,512
	Total Shareholders Equity	3,599	3,893	3,732	3,779	3,845	3,958	4,113
Total Equity & Liability	4,005	4,263	4,079	4,120	4,206	4,346	4,527	
Cash Flow	Cash Flow from Operating Activities	1,178	868	761	811	842	883	933
	Cash Flow from Investing Activities	(432)	(258)	66	(223)	(258)	(268)	(283)
	Cash Flow from Financing Activities	(763)	(622)	(781)	(601)	(601)	(600)	(600)
	Change in Cash	(18)	(12)	47	(14)	(17)	15	50
	Net Cash at End	48	36	83	1,234	1,217	1,232	1,282
Ratio Analysis	Operating profit margin	54.8%	53.7%	49.5%	50.9%	51.2%	51.9%	52.5%
	Net Profit Margin	51.9%	56.4%	50.5%	49.9%	50.3%	51.2%	51.8%
	Return on Average Assets	20.9%	21.1%	16.1%	16.0%	16.2%	16.9%	17.2%
	Return on Average Equity	23.4%	23.2%	17.6%	17.5%	17.7%	18.5%	18.9%
	EV/ton (USD)	332.0	439.0	358.4	281.6	282.3	281.7	279.6
	Quick ratio (x)	5.1	5.7	5.9	5.9	5.6	5.3	5.1
	Debt / Equity (x)	0.01	0.01	0.00	0.00	0.00	0.00	0.00
	Cash return as % of invested capital	21.6%	19.5%	16.2%	16.2%	16.3%	16.9%	17.1%
	EV/EBITDA (x)	9.1	12.5	12.9	10.0	9.7	9.1	8.5
	EV/Revenues (x)	5.0	6.7	6.4	5.1	5.0	4.7	4.5
	FCF Yield	12.4%	7.2%	7.4%	7.5%	7.8%	8.2%	8.7%
	EPS (SAR)	4.0	4.3	3.3	3.2	3.3	3.6	3.8
	Book Value Per Share (SAR)	2.5	3.0	2.6	2.1	2.0	2.0	1.9
	Market Price (SAR) *	44.6	57.3	47.9	38.9	38.9	38.9	38.9
	Market Capitalization (SAR mn)	9,038	11,593	9,706	7,877	7,877	7,877	7,877
	Dividend Yield	6.3%	5.2%	6.3%	7.7%	7.7%	7.7%	7.7%
P/E Ratio (x)	11.1	13.3	14.5	12.0	11.7	10.9	10.3	
P/BV Ratio (x)	2.5	3.0	2.6	2.1	2.0	2.0	1.9	

Source: Company Reports & Global Research

* Market price for 2015 and subsequent years as per closing prices on October 07, 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
Yamama Cement (YSCC)	STRONG BUY	YACCO AB	3020.SE	SAR38.9	1,10

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HOLD	Fair value of the stock is between +10% and -10% from the current market price
SELL	Fair value of the stock is < -10% from the current market price

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