JUNE 2013

KSA CEMENT SECTOR

IMPORTS TO PRESSURE MARGINS

Recent moves by the government to increase cement supply in the Saudi market we believe will lead to margin pressure for stocks under our coverage. Facilitating imports of 10mn and ordering the establishment of 3-4 new companies we believe will increase competition for existing firms. We remain Neutral on all stocks under coverage as the sector had a strong rally YTD and multiples have expanded to a fair level. On a relative basis, we prefer Southern Cement due to its attractive 2013E dividend yield of 7.3% and growth potential once the new line starts operations in 2H14.

- **We remain Neutral on the sector despite multiples expansion:** We maintain our Neutral rating on the Saudi cement stocks under coverage. Our price targets have increased by 4-9% mainly due to the (1) increase in estimates (2) decrease in the equity risk premium and (3) the expansion in multiples by 5.5% which to some extent is justified. We expect cement sales volumes to grow by 8.2% YoY in 2013 to reach 56mn tons and continue to grow at a CAGR of 6.3% until 2015E.
- **Imports should increase revenues, however pressure margins:** We believe the government's order to import cement will ease some of the shortage in the near term leading to an increase in revenues for local cement firms. However, if the import subsidies are insufficient to negate the high cost of imports, margins for local firms could be negatively impacted.
- **Attractive dividend yields despite growth limitations:** Although the outlook of earnings growth is somewhat limited due to capacity constraints, attractive dividend yields remain a key attraction of the sector. Moreover, the sector has limited exposure to global market volatility, thus it can be viewed as a relatively "safer" investment given the domestic economic growth which will maintain the high demand in the near-term.
- **In the short-run, only multiples expansion can support upside:** As revenue/profitability growth for most companies is constrained by the price ceiling and high utilisation rates, we believe only an expansion in valuation multiples will lead to further upside for the Cement sector. The forward P/E for the sector has increased from 10.8x in 2010 to 12.1x in 2012 and is up 6.6% to 12.9 YTD. We believe the justification for further expansion is limited, hence our neutral rating for the sector.

Exhibit 1: Saudi cement companies – Valuation matrix

	Rating	TP (SR)	MCap $mn	Stock perf (%) Jun	Stock perf (%) YTD	P/E (x) `13	EV/ EBITDA `13	P/BV (x) `13	EV/ton ($) `13	DY (%) `13	ROE (%) `13
Southern Cem (SPCC)	N	114.3	3,864	5.1	3.5	13.6	11.2	5.4	593	7.3	39.4
Yamamah Cem (YSCC)	N	51.9	2,754	4.3	7.4	10.5	9.9	2.7	390	5.9	23.3
Saudi Cem (SCC)	N	92.4	4,161	2.5	7.4	12.2	11.5	4.8	495	6.9	37.0
Qassim Cem (QCC)	N	87.2	1,968	2.2	1.9	12.8	11.2	3.6	439	7.3	28.6
Yanbu Cem (YCC)	N	70.5	2,877	0.4	30.9	12.3	10.9	3.0	653	4.8	25.2
Eastern Cem (EPCC)	N	57.0	1,347	(0.4)	2.2	12.5	9.9	2.1	381	6.8	17.4
Arabian Cem* (ACC)	NC		1,472	1.5	38.0	10.7	8.8	1.8	304	5.1	13.7
Al Jouf Cem* (TCC)	NC		588	(5.3)	3.7	20.1	13.6	1.5	418	3.0	7.8
Tabuk Cem* (TCC)	NC		696	(10.8)	19.6	11.3	7.4	2.1	387	6.6	16.6

Source: NCBC Research, Bloomberg, All prices as of June 26, 2013, * On a TTM basis
N: Neutral, UW: Underweight, OW: Overweight, NC: Not Covered

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NCBC Investment Ratings

OVERWEIGHT: Target price represents expected returns in excess of 15% in the next 12 months

NEUTRAL: Target price represents expected returns between -10% and +15% in the next 12 months

UNDERWEIGHT: Target price represents a fall in share price exceeding 10% in the next 12 months

PRICE TARGET: Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon

Other Definitions

NR: Not Rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or in circumstances when NCB Capital is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations

CS: Coverage Suspended. NCBC has suspended coverage of this company

NC: Not covered. NCBC does not cover this company

Important information