Cement Sector

Arabian Cement Co.	BUY
12M Price Target (SAR)	43.00
CMP (SAR)	38.95
Potential upside	10.4%
Market cap (SAR mn)	3,895
P/E (FY23e)	21.34
EV/EBITDA (FY23e)	10.80
Dividend Yield (FY23e)	6.42%
ROE (FY23e)	7.11%

Eastern Province Cement Co.	BUY
12M Price Target (SAR)	51.00
CMP (SAR)	45.20
Potential upside	12.8%
Market cap (SAR mn)	3,887
P/E (FY23e)	18.80
EV/EBITDA (FY23e)	8.38
Dividend Yield (FY23e)	4.98%
ROE (FY23e)	8.71%

City Cement Co.	Neutral
12M Price Target (SAR)	21.00
CMP (SAR)	22.74
Potential upside	-7.7%
Market cap (SAR mn)	3,184
P/E (FY23e)	30.15
EV/EBITDA (FY23e)	14.57
Dividend Yield (FY23e)	3.96%
ROE (FY23e)	5.87%

Saudi Cement Sector – 2023 Half Yearly Update

For 1H23 cement offtake continued to be weak, as cement volumes fell by 5.6% YoY to 23.9mn tons. Though cement sales were partly impacted by both Eid-Al-Fitr and Eid-Al-Adha holidays occurring in the first half of the year, the fall was mainly attributable to weak demand. New residential loans by banks to retail averaged SAR6.7bn per month for YTD'May-23, which is lower than the average monthly new loan of SAR10.0bn for 2022. Despite this, mortgage loans for 1Q23 grew by 19.1% YoY and by 13.1% (annualised) from Dec-22 levels. Going forward, we expect new residential loans for 2023 to average between SAR7-8bn, with mortgage loans continuing to grow, though at a relatively lower rate, vis-à-vis its historical performance. However, the main impetus for cement sector is likely to come from the various Mega and Giga projects, valued at c.USD715bn, which continue to be at initial stages of implementation. As the execution of these projects picks up pace, we could see a revival in the performance of the construction segment, which in turn will have a positive impact on cement sales. Further, Saudi has bid for conducting the World expo in Riyadh, and towards this have set aside a budget of USD7.8bn. With oil prices expected to remain strong (Bloomberg median consensus Brent estimates USD81/bbl for 2023 and USD84/bbl 2024), there will be sufficient resources to fund these investments. Given this, we expect cement volumes to recover from 2H23, albeit slowly, as we expect cement volume to end flat in 2023, compared to 2022 levels and grow by 3-6% YoY for 2024.

In line with our expectations, cement realizations have improved, and averaged c.SAR185 per ton in 1Q23, compared to c.SAR170 per ton for 2022. Though we continue to remain optimistic on the pricing, the same is tempered by the high clinker inventory levels in the industry, which averaged c.8 months of production in June-23. Further, most of the infrastructure projects are focussed in the Central and Western regions. This could result in the flow of cement from the other regions into the two regions, once there is a pick up in the execution of these projects, resulting in an increase in competition, which could cap the growth in cement prices. Given this, we continue to remain cautiously optimistic, as we expect cement realizations to average SAR181 per ton for 2023e and improve to SAR184 per ton for 2024e. Overall, the sector is quoting at c.25x its TTM' 1Q23 EPS and at an average dividend yield of c.3.5%. We feel that at these valuations the upside appears to be limited, though there are still opportunities available on select companies.

Arabian Cement Company (ACC): Cement realization of ACC is forecasted to improve, while cement volumes will recover from the current levels, though it might underperform the industry in the short term. We expect profitability too will improve, aided by improved margins and better control over operating cost. The company is currently quoting at c.18x its 2024e EPS, compared to the median valuation of c.25x (TTM' 1Q23) and has a very attractive dividend yield of c.6%. Given this we initiate coverage on the company with a BUY rating and a target price of SAR43 per share.

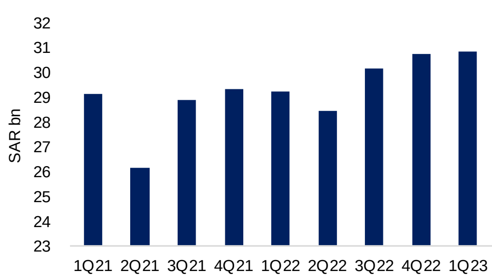
Eastern Province Cement Company (EPCCO): In line with its performance in 1H23, we expect EPCCO's cement volume will continue to perform better than the industry, while cement realization will grow steadily, even as it maintains its premium over the industry average. Buoyed by the growth in volume and realization, we expect the financial performance of the company to be strong. EPCCO is currently quoting at c.17x its 2024e EPS, compared to the industry median of c.25x (TTM' 1Q23). Given this we see upside potential in the stock and initiate coverage on EPCCO with a target price of SAR51 per share and a BUY rating.

City Cement Company (CCO): The volume performance of CCO is likely to lag industry average in 2023, though we expect a recovery from 2024. Cement realization on the other hand will continue to remain strong and post steady growth. We expect the financial performance of the company to come under pressure in 2023, though will recover post this. CCO is quoting at 27x its 2024e EPS, compared to the industry median of 25x (TTM' 1Q23), which we feel discounts all the expected upside to the stock. Given this we initiate coverage on the company with a Neutral rating, and a target price of SAR21 per share.

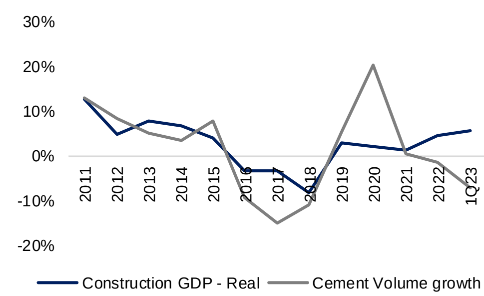
Construction GDP reports growth in 1Q23

Real construction GDP increased by 5.5% YoY to SAR30.9bn for 1Q23 and have been registering a strong performance in the past few quarters. Post 2018, real construction GDP have been showing signs of recovery, though the growth has been limited. However, since 2Q22, the improvement has been prominent, which in turn points to a trend of the construction sector rebounding. Going forward we expect this trend to continue, given the strong infrastructure spending lined up in the country. With oil prices expected to remain strong (Bloomberg median consensus Brent estimates USD81/bbl for 2023 and USD84/bbl 2024), we feel that there will be sufficient resources to fund these investments.

Construction GDP improves



Cement performance diverges from construction



Source: GASTAT; Yamama Cement; US Research

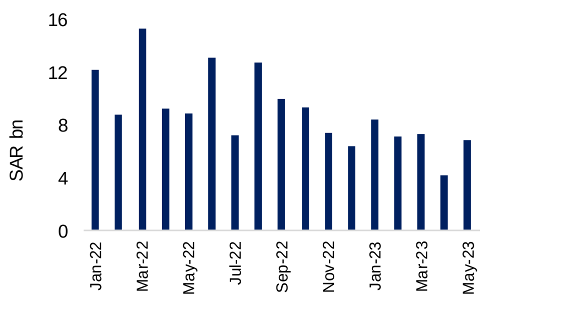
Cement volume performance have shown divergence to real construction GDP in the past few quarters

However, since 2021, there has been some divergence between the movement in real construction GDP and cement volumes. In 2022 and 1Q23 cement performance have broadly underperformed the movement in the real construction GDP. With an acceleration in the execution of the Mega and Giga projects, we expect construction sector growth to rebound and the performance of cement too is likely to reflect this in the next few quarters.

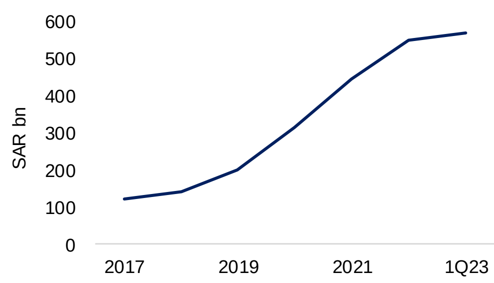
Residential mortgage continues to grow, though at a slower rate

New residential mortgages for Apr-23 fell to SAR4.1bn, compared to the 1Q23 monthly average of SAR7.6bn and is the lowest since Dec-2018. However, it has since recovered to SAR6.8bn in May-23. For YTD ’May-23, new residential mortgage averaged SAR6.7bn per month compared to the average of SAR10bn in 2022. However, this fall has been in line with our expectations, as we had forecasted the new mortgage loan to average between SAR7-8bn per month for 2023.

New residential mortgages lower than historical levels



Retail real estate loans continue to grow



Source: SAMA; US Research

Mortgages continue to grow, though at a slower pace

Real estate retail loans provided by banks increased by 19% YoY and by 13% (annualized) over 2022 to SAR567bn in 1Q23. Though the growth is lower than the CAGR 35% achieved between 2017-22, the overall momentum continues to be positive. Given that we expect new residential mortgages to improve in 2H23, compared to the average levels of 1H23, we expect the overall real estate loan growth to remain robust in 2023. This in turn will continue to support the demand for cement in the Kingdom for the rest of the year.

Mega and Giga projects provides upside potential

The Kingdom has lined up projects of c.USD715bn to diversify the country’s economy, promote tourism and improve the infrastructure of the country. These projects are expected to be executed over the next seven to 10 years. With more than 90% of the value of projects yet to be commissioned, we see strong pent-up demand for the construction sector in the years to come. Added to this, Saudi Arabia has announced its interest to conduct the World expo, scheduled to be held in 2030. Towards this, it has placed its bid with the Bureau International des Expositions (BIE). The government has earmarked USD7.8bn as budget towards this, with the proposed venue located near King Salman International Airport. A final decision on the allotment of the expo to Saudi is yet to be taken. These in turn are likely to provide an impetus to the construction segment in the country, which in turn will have a favorable impact on the offtake of cement demand in the medium term.

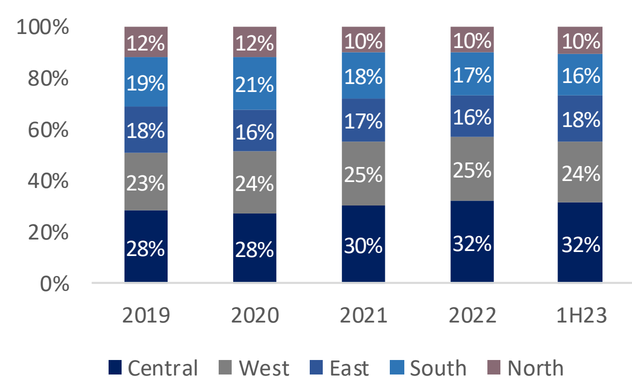
However, a majority of these projects are concentrated in the Central and Western regions and this could create a mismatch in the demand and supply scenario. This in turn could put pressure on cement prices, capping the upside.

Cement sales under pressure in 1H23

Cement volumes falls across all regions, except in East

Cement volume for 1H23 fell by 5.6% YoY to 23.9mn tons, at the back of continued lackluster construction activity. Cement sales for the period was also impacted by both the Eid Al Adha holidays falling in the month of June in the current year, compared to July in 2022. Cement sales fell across the regions, excluding the East, which increased by a robust 10.7% YoY. The region's growth comes at the back of a lower base in 2022, when the monthly sales in the first half averaged 0.65mn tons compared to 0.72mn tons in the current year. Western region was the most impacted, as the cement volume fell by 12.1% YoY, followed by the South, which fell by 8.3% YoY. Cement volumes in the Central and the Northern regions on the other hand fell by 7.2% and 4.7% respectively.

Regional distribution of sales remains similar to 2022



Source: Yamama Cement; US Research

The regional distribution in cement sales was broadly in line with 2022, with the Central and Western regions together accounting for 56% of the industry's revenue, with West's market share coming down slightly by c.100bps from 2022 levels to 24% in 1H23. The market share of the South too fell by c.100bps from 2022 levels to 16% in 1H23. The market share of the Eastern region on the other hand improved by c.200 bps from 2022 levels to 18% in 1H23 and was aided by both Saudi Cement and Arabian Cement outperforming the industry during the period. The market share in the Central and North were stable for 1H23.

Cement volumes to report flat performance YoY in 2023, and grow by 3-6% YoY in 2024

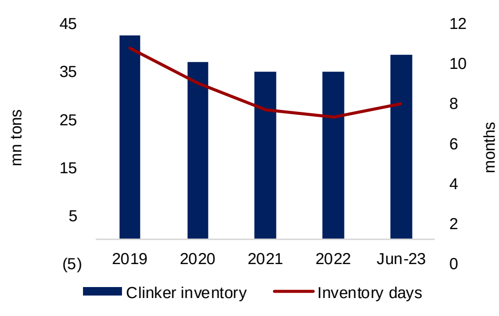
Going forward, we expect cement volume growth to recover in 2H23, as we forecast a pickup in the construction activity to positively aid the cement offtake. However, despite the improvement, we expect the overall cement sales in 2023 to be flat vis-à-vis 2022 levels. We project a better volume growth in 2024, as we forecast sales to increase by 3-6% over 2023.

Cement prices reported strong a improvement in 1Q23, though we remain cautious on the extent of upside

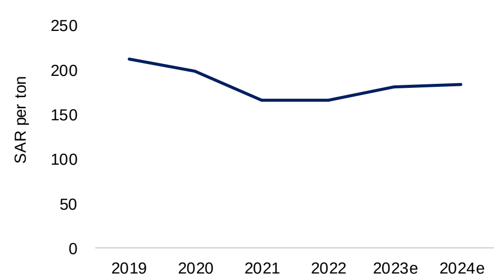
Cement realizations averaged SAR185/ton, higher than our full year estimates of SAR181/ton

As expected cement realization in the Kingdom improved from the levels of c.SAR170 per ton in 2022 to c.SAR185 per ton in 1Q23. Despite weak cement volumes, cement prices improved at the back of better supply side management by the industry players. The current levels of realization are better than our 2023 expectation of SAR181/ton. We continue to remain positive on the pricing scenario, as we expect cement volumes to improve in 2H23, with the momentum continuing in 2024. We also do not expect any major move by the players to capture market share, similar to what happened in 2021 and 2022, which too makes us optimistic.

Clinker inventory continues to remain high



Cement prices to improve from 2022 levels



Source: Yamama Cement; US Research

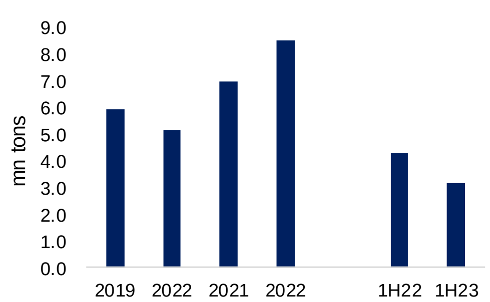
However, clinker inventory levels of the industry continue to be high at c.8 months of production. Also, there is a potential for increased competition, given the geographical concentration of the Mega and Giga projects in the

Central and Western zones. Given these we continue to remain cautious on the extent of upside and maintain our estimates of cement realization at SAR181/ton for 2023 and SAR184/ton for 2024.

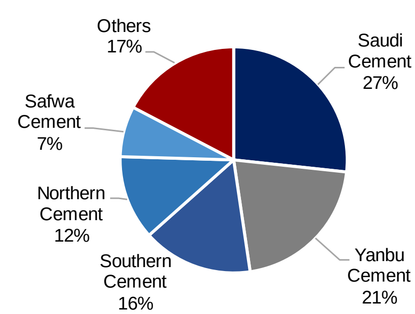
Clinker sales falls, though the fall was expected

Clinker sales fell by 25.8% YoY to 3.2mn tons in 1H23, with the fall being driven by lower volumes from certain major players, Hail Cement (-65.5% YoY), ACC (-74.5% YoY), Yanbu Cement (-45.5% YoY), and Northern Cement (-16.5% YoY). This fall in clinker volumes is in line with our expectation, given that we had forecasted that certain players like Yanbu Cement will be unable to maintain their clinker sales at 2022 levels. Added to this, revenue from clinker have traditionally been volatile and opportunistic in nature.

Clinker volumes falls in 1H23



Top-4 players account for +75% of clinker sales



Source: Yamama Cement; US Research

However, Southern Cement (+170.8% YoY), Safwa Cement (+60.4% YoY), Jouf Cement (32.8% YoY), and Saudi Cement (11.4% YoY) all reported an improvement in clinker sales. Clinker sales were dominated by the top-4 players, who together accounted for more than 75% of sales in 1H23. Going forward, among the companies under our coverage, we expect clinker sales of Saudi Cement and Southern Cement will continue to grow, while Yanbu Cement and ACC are likely to register lower volumes in 2023.

KSA Cement Companies valuation table

Companies	CMP SAR	Mcap SAR mn	P/E	Div. Yield
Saudi Cement	57	8,736	18.9x	5.7%
Yamama Cement	36	7,290	16.6x	2.8%
Southern Province Cement	50	7,042	26.8x	2.5%
Yanbu Cement	40	6,269	27.6x	5.7%
Qassim Cement	70	6,255	39.0x	3.4%
Arabian Cement	39	3,895	20.7x	5.6%
Eastern Province Cement	45	3,887	22.5x	4.4%
Riyadh Cement	35	3,786	19.9x	4.3%
City Cement	23	3,184	25.4x	4.0%
Najran Cement	13	2,292	19.2x	3.7%
Northern Cement	12	2,088	19.0x	4.3%
Tabuk Cement	16	1,433	30.3x	1.6%
AL Jouf Cement	12	1,339	26.3x	0.0%
Hail Cement	13	1,245	29.8x	3.9%
Umm Al-Qura Cement	19	1,019	66.8x	0.0%
Average			**22.9x**	**3.5%**
Median			**25.4x**	**3.9%**

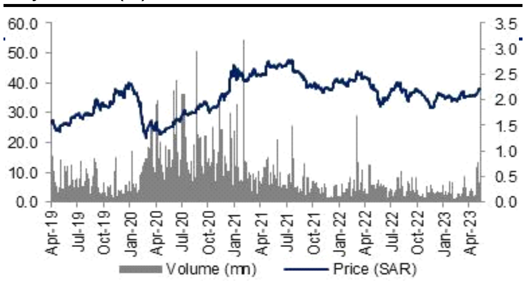
Source: Company Filings; Saudi Exchange; US Research (valuations based on TTM-1Q23)

COMPANIES SECTION

Cement Sector

BUY: 12M TP @ 43

Valuation Summary (TTM)			
Price (SAR)			38.950
PER TTM (x)			20.7
P/Book (x)			1.5
P/Sales (x)			4.1
EV/Sales (x)			3.9
EV/EBITDA (x)			9.7
Dividend Yield (%)			5.6
Free Float (%)			90%
Shares O/S (mn)			100
YTD Return (%)			14%
Beta			1.0
(mn)		**SAR**	**USD**
Market Cap		3,895	1,038
Total Assets		3,298	879
Price performance (%)	**1M**	**3M**	**12M**
Arabian Cement Co/Saudi Ara	-4%	8%	4%
Tadawul All Share Index	4%	5%	0%
Industry Index	4%	5%	0%
Trading liquidity (,000)	**1M**	**3M**	**6M**
Avg daily turnover (SAR ,000)	5,018	6,642	5,854
Avg Daily Volume (,000)	146	177	160
52 week	**High**	**Low**	**CTL***
Price (SAR)	40.25	31.00	23.2
* CTL is % change in CMP to 52wk low			
Major shareholders			
AIN SEIN INV CO			7%
Vanguard Group Inc/T			1.6%
Dimensional Fund Adv			1.3%
Others			90.5%
Other details			
Exchange			Saudi Arabia
Sector			Building Materials
Index weight (%)			0.2%
Key ratios	**2020**	**2021**	**2022**
EPS (SAR)	1.85	1.62	1.81
BVPS (SAR)	28.73	27.50	26.35
DPS (SAR)	2.25	2.75	2.20
Payout ratio (%)	122%	170%	122%



Arabian Cement Company (ACC)

ACC is the 7th largest cement player in the Kingdom, with a market share of 6% of sales volume for 1H23. The company is the second largest player in the Western region with a market share of c.26% for 1H23. In line with the industry trend, the cement realizations of ACC recovered in 2022, and as per our calculations improved by c.3% YoY to SAR175 per ton in 2022. We expect this trend of improving prices to continue in the medium term. Cement volumes however remained under pressure, as it fell by 8.5% YoY to 1.5mn tons, underperforming the industry which fell by 5.6% YoY for 1H23. Though we expect the cement volumes to start recovering in 2H23, the recovery is likely to be slow, as we expect ACC will continue to underperform the industry in 2023. Profitability of ACC have been under pressure in the past few years, with the EBIT margins of ACC falling from c.26% in 2020 to c.20% in 2022. Inflexible pricing scenario and high operating costs have impacted the performance of the company. Going forward, aided by an improved pricing scenario, and better control over its operating costs, we expect the EBIT margins of the company to improve steadily, with the same reaching 2020 levels by 2027e. Aided by this, we expect the net income of ACC to grow by c.8% between 2022-27e. The company is currently quoting at c.18x its 2024e EPS, compared to the median valuation of c.25x (TTM' 1Q23) and has a very attractive dividend yield of c.6%. Given this we initiate coverage on the company with a BUY rating and a target price of SAR43 per share.

Cement realization recovery to continue: Even as the average cement realization for ACC came under pressure in 2021 and 2022, in line with the industry, the recovery in pricing for the company has been faster. As per our calculation the realization of ACC has improved by c.3% y-o-y in 2022, compared to a more flattish performance by the industry. Apart from this, we see that the company's pricing has been at a premium to the industry average, aided by its regional presence. Going forward, we expect that the company's pricing will be in-line with or slightly better than the industry average. Overall, we forecast the average cement realizations of ACC to increase at a CAGR of c.3% between 2022-27e.

Cement volume growth underperforms industry; expect it to improve, albeit slowly: Cement volume of ACC fell by 8.5% y-o-y for 1H23, underperforming the industry (-5.6%). We expect the company will continue to lag industry performance in 2023, as we expect volumes for the year to fall by c.5% YoY, while we expect industry performance will be flat. However, we expect the momentum to recover, though slowly, as we forecast cement volumes of ACC to grow at a CAGR of c.1% between 2022-27e.

Attractive dividend yield, which is expected to improve: For 2022, ACC had distributed a dividend of SAR2.20 per share, lower than the 2021 levels of SAR2.75 per share. Despite this, the company is trading at an attractive dividend yield of c.6%, compared to the industry average of c.3.5%. Given the expected improvement in the financial performance of the company, we expect dividend levels to improve consistently and reach 2021 levels by 2024e. This in turn provides a strong downside protection to the stock.

Valuation: We expect cement realization of ACC to improve for the next 3-5 years, while cement volumes will recover from the current levels, though it might underperform the industry in the short term. We expect profitability too will improve, aided by improved margins and better control over operating cost. Added to this, the attractive dividend yield of ACC provides downside protection to the stock. Overall, we initiate coverage on the company with a target price of SAR43 per share and a BUY rating. We have used an equal weighted average of P/E (20x) and DCF (8.8% cost of equity and 2% terminal growth) to value the company.

Mid-sized player in a highly competitive industry, though strong regionally

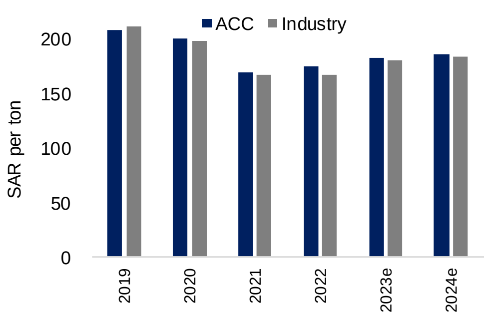
ACC is the 7th largest player in the industry with a market share of 6% in 1H23. ACC operates in the Western region, which is the second largest region in the country accounting for 24% of the cement volume during 1H23. This region is made up of 5 players, with Yanbu Cement (YCC) being the largest, with a regional market share of 31% in 1H23. This is followed by ACC, with a market share of 26%. The other players in the region included, United Cement, with a market share of 18%, Al Safwa Cement, with a market share of 17%, and Umm Alqura Cement, with a market share of 9%.

Cement realization will continue to recover

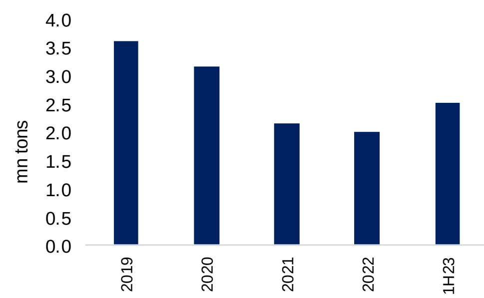
Cement realization in 1Q23 an improvement over 2022 levels

The average realization of ACC in 2021 and 2022 came under pressure, as it fell from the average levels of SAR205 per ton in 2019 and 2020 to SAR169 per ton for 2021. However, it recovered at a faster rate, relative to the industry, to SAR175 per ton for 2022, compared to the industry average of c.SAR170 per ton. This trend has broadly continued in 1Q23, as we project the cement realization to be c.SAR180 per ton, an improvement of c.3% from the average 2022 levels.

Cement prices of ACC slightly better than industry



Clinker inventory rises in 1H23



Source: Company Filings; Yamama Cement; US Research

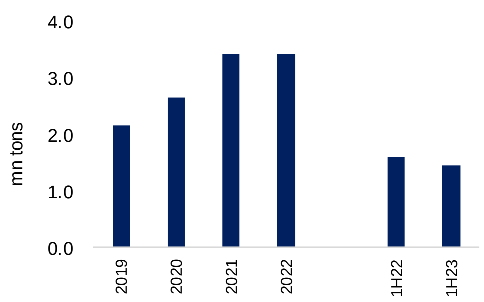
Clinker inventory levels of the company was high at c.8 months of production, though we expect the same to improve in the coming months, as cement sales picks-up. Going froward we expect cement realization will continue to improve, though the same is likely to be lower than the historical levels of 2019 and 2020. Overall, we expect cement realizations to improve at a CAGR of c.2.5% between 2022-27e.

Cement volumes to recover, albeit slowly

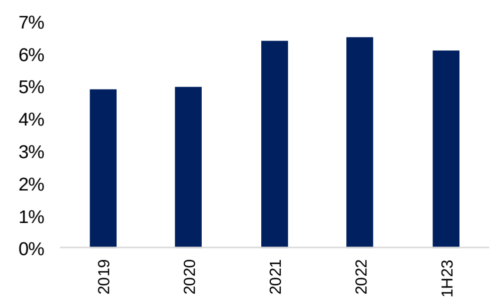
Cement volume falls higher than industry average

Cement volumes of ACC for 1H23 fell 8.5% YoY, underperforming the industry average, which recorded a fall of c.5.6%. This performance comes at the back of a relatively positive 2022, where it performed better than the industry average (+0.2% YoY of ACC vs -1.6% YoY of industry) and was impacted by a weak demand in the region. Clinker sales on the other hand fell by a massive 75% YoY in 1H23, due to increased competition from its regional peers.

Cement volume under pressure in 2023



Market share of ACC falls slightly in 1H23



Source: Yamama Cement; US Research

Cement volume to grow at a CAGR of c.1% between 2022-27e

Going forward, we expect ACC's cement volumes will continue to underperform the industry average in 2023. While we expect performance to improve post 2023, the advance is likely to be slow. Overall, we expect the cement volumes of ACC to grow at a CAGR of c.1.1% for 2022-27e.

Financial performance to remain strong

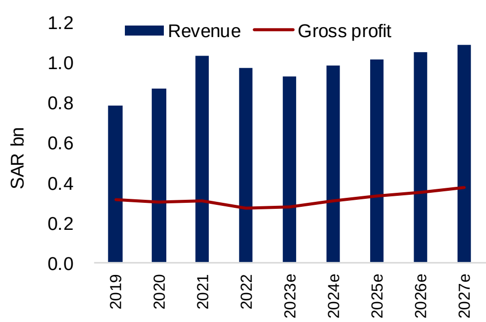
Revenue of ACC fell by 6.0% YoY to SAR971mn in 2022 and was impacted by lower clinker sales, at the back of a 51.0% YoY fall in clinker volumes. Revenue was also impacted by a 10.1% YoY fall in the revenue from its operations in Jordon. ACC owns 86.7% stake in Qtrana Cement Company, which is engaged in production of black Portland cement, white cement and calcium carbonate. Revenue from this operation accounted for c.31% of the company's total revenue, though its contribution to net income is limited.

Revenue was supported to a certain extent by its cement operation in the Kingdom, and was aided by an c.3% improvement in cement realization to

SAR175 per ton (based on our calculations), even as cement volumes were flat. Overall revenue growth of the company underperformed the industry performance, which had reported a 1.6% YoY improvement for 2022.

Going forward, we expect revenue of ACC to increase at a CAGR of 2.3% between 2022-27e, aided by an improvement in cement volumes and average realization. We also expect revenue from Jordon operations to grow at c.2% for the same period, while clinker sales will continue to remain under pressure for our forecast period.

Gross profit growth to outpace revenue growth



Gross margins to steadily increase post 2022

Source: Company Filings; US Research

Profitability to report robust improvement

Gross profit fell by 11.1% YoY to SAR275mn for 2022 and was impacted by lower revenue and higher cost of sales per ton, as gross margins of ACC fell to 28.3% in 2022, compared to 29.9% in the previous year. Gross margins of ACC have fallen significantly from the average gross margins of c.38% during the 2019 and 2020 period and were impacted by inflexible pricing in the past two years and lower clinker sales in 2022.

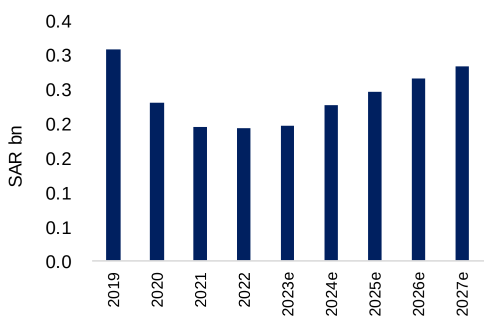
Gross margins to reach 2020 levels by 2027e

The gross margins for 2022 were also lower than the average industry levels of 32.6%. ACC's Jordanian investment was the main reason for this, as it is a low margin operation, compared to ACC's standalone operations. Going forward, we expect gross margins to steadily improve, and reach the levels of 2020 by 2027e. For 2023e, we expect a c.160-bps improvement in gross margins to 29.9%, which is gradually expected to improve to c.34% by 2027e.

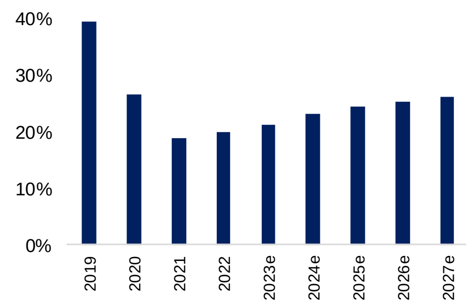
Operating profits fell by 0.9% YoY, with the fall being relatively lower, compared to the fall in gross profit. Better control over SG&A, and a

SAR16mn provisions in 2021 towards impairment on PP&E, restricted the fall in 2022 profitability. Overall operating margins improved by c.100-bps to 19.9%, though the same was lower than the industry average of 24.5% for 2022. Overall, net income increased by 12.1% YoY; lower gross profit was made up by lower operating expenses, and higher income from associates, aiding the overall profitability.

EBIT to consistently improve for the forecast period



EBIT margins to be near 2020 levels by 2027e



Source: Company Filings; US Research

Going forward, improved scale of operation, improving gross margins, and better control over operating costs are likely to have a positive impact on the company's financial performance. Overall, we expect net income to grow at a CAGR of 8.4% between 2022-27e.

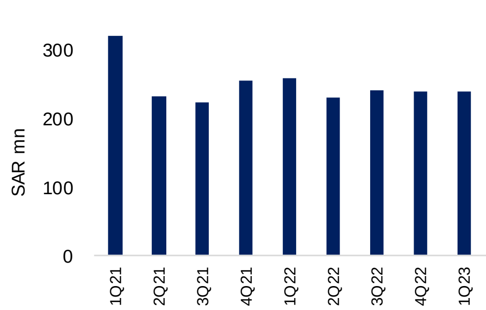
Strong financial position

The financial position of ACC is strong with a limited and manageable debt; debt to total assets stood at a low of 7.2% in 2022. During the year the company also had cash and liquid investments of SAR373mn, which was 1.6x the debt outstanding. Between 2019-22, the company generated an average cash flow from operation of SAR342mn p.a., which was 0.9x the average EBITDA over the period. Though ACC has no major capex lined up, its operations are working capital intensive, with inventory days of c.235 days in 2022. Though we expect the inventory days to fall during the next five years, it will continue to remain high. Despite this we feel that the company's financial position continues to be strong.

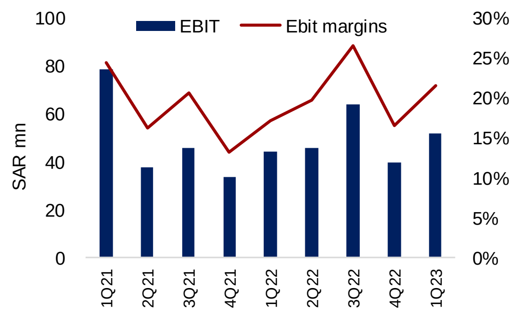
1Q23 performance review

Revenue of ACC fell by 7.4% YoY in 1Q23 to SAR240mn and was impacted by a 4.2% YoY fall in cement volume and an 85.8% YoY fall in clinker volume. The fall was to a certain extent restricted by a 25.3% YoY increase in revenue from Jordan operations.

1Q23 revenue under pressure



EBIT and margins improve YoY



Source: Company Filings; US Research

Gross profit fell by 3.4% YoY in 1Q23 to SAR67mn and was impacted by lower revenue, even as an improvement in the gross margins restricted the fall in profitability to a certain extent. Gross margins of ACC improved by c.100-bps to 27.8% in 1Q23. Operating profit however increased by 16.4% YoY, as operating costs fell by 39% YoY and was aided by lower selling and distribution expenses. Overall, net income increased by 17.4% YoY and was aided by an improved pricing scenario and lower operating expenses.

Consistent dividend payer

For 2022, ACC paid a dividend of SAR2.2 per share, despite this being lower than SAR2.75 per share in 2021, the company quotes at an attractive dividend yield of c.6%, compared to the industry average of c.3.5%. Going forward, we expect dividend payment to improve, in line with the improvement in profitability, to SAR2.5 per share for 2023e and to SAR2.75 per share by 2024e.

Dividends to improve steadily post 2022

Source: Company Filings; US Research

Valuations

ACC's operating performance will be aided by the improvement in pricing scenario, and an improvement in cement volume, albeit slowly. The financial performance of the company will be supported by the pickup in gross margins and better control over operating cost, leading to improved profitability.

Discounted Cash Flow (SAR mn)	2023E	2024E	2025E	2026E	2027E
Net operating profit after tax	164	194	217	236	253
Add Depreciation	145	145	145	145	145
Working capital changes	42	(1)	6	4	4
Less: Capex	(37)	(39)	(41)	(42)	(44)
Debt repayments	(43)	(71)	(68)	(50)	0
Free cash flow to equity	**270**	**228**	**259**	**292**	**358**
PV of free cash flow to equity	**261**	**202**	**211**	**219**	**247**
Sum of PV of free cash flow to equity					**1,140**
Add: Terminal value					2,854
EV					**3,993**
Add: Net cash and investments					440
Equity value					**4,433**
Fair value per share (SAR)					***44***

Cost of Capital	
Risk free rate	4.1%
Adjusted beta	1.0x
Equity risk premium	4.7%
Cost of equity	8.8%
Terminal growth	2.0%

Relative valuation	
2024E EPS (SAR)	2.1
Fair value P/E	20.0x
Value per share (SAR)	***41***

Methodology	Tp/Sh SAR	Wt	Avg./Sh SAR
DCF	44	50%	22
P/E	41	50%	21
Value per share			**43**

We have valued the company using an equal weight of DCF (Equity) and P/E methodologies. We have taken a cost of equity of 8.8% and terminal growth of 2% for the DCF and arrived at a value of SAR44 per share. For P/E, we have used a forward P/E of 20x, a discount of c.20% to the industry median (TTM' 1Q23), and arrived at a value of SAR41 per share. Overall, we arrive at a weighted average Target Price of SAR43 per share, which gives a BUY rating for the company.

About the company

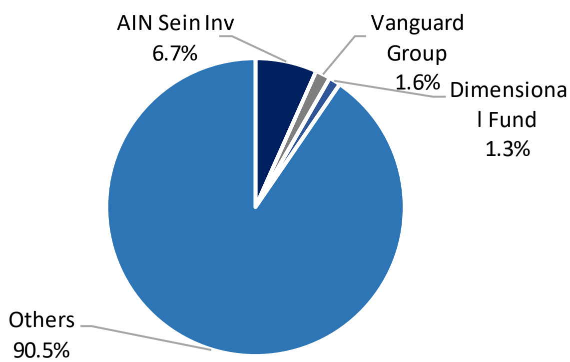
ACC was incorporated on Jan 5, 1955 and was the first cement company in the Kingdom of Saudi Arabia and the Gulf region. In 1957, the company commenced operations with a clinker production capacity of 2,000 tpd in Jeddah. The operations of the company were relocated to Rabigh, North of Jeddah in 1984, with a capacity of 4,000 tpd of clinker production. In 1996, the company doubled its designed capacity by adding a new line (line-5) with a capacity of 4,000 tpd pf clinker. In 2009, the company commissioned a new line (line-6) with a capacity of 7,000 tpd of clinker and shut down its old lines (lines 1 to 4), increasing its overall capacity to 11,000 tpd of clinker. Post this, owing to improvement in operating rates, the production capacity of the plant has reached 12,200 tpd of clinker. The company has a cement grinding capacity of 20,000 tpd.

In 2007, the company established Qatrana Cement Company in the Hashemite Kingdom of Jordan with a capacity of 5,000 tpd of clinker production.

During 1H23, the company was the 7th largest player in the Kingdom, in terms of cement sales with a market share of 6%. During the same period, the entire cement sales were made up of domestic sales. In 2022, 69% of the company's revenue came from its operation in Saudi Arabia, with the balance coming from its operations in Jordan. However, in terms of net income, the operations in Saudi accounted for 98% of the net income in 2022.

Board of Directors		
S.no	**Name**	**Position**
1	HE. Eng. Abdullah Muhammad Nour Rahimi	Chairman
2	Mr. Saud Abdul Aziz Al-Suleiman	Vice Chairman
3	Eng. Al-Waleed Abdul-Razzaq Al-Dryaan	Board Member
4	Eng. Mutaz Kusai Al-Azzawi	Board Member
5	Mr. Turki Abdullah Al-Rajhi	Board Member
6	Mr. Fahad Abdullah Al-Issa	Board Member
7	Mr. Abdullatif Ali AlSaif	Board Member
8	Mr. Yousef Saleh Abalkhail	Board Member
9	Eng. Mohammed Hamed Alklaiby	Board Member

Shareholding of ACC



Source: Company Filings; US Research

Income Statement(SAR mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Revenue	782	872	1,033	971	932	981	1,014	1,051	1,090
Cost of sales	(466)	(569)	(724)	(696)	(654)	(672)	(682)	(698)	(715)
Gross profit	**316**	**303**	**309**	**275**	**279**	**310**	**332**	**353**	**374**
Operating expenses	(7)	(72)	(114)	(81)	(81)	(84)	(86)	(88)	(90)
Operating profit	**309**	**231**	**195**	**193**	**197**	**226**	**247**	**265**	**284**
Other income	(43)	7	23	29	22	23	23	23	24
Finance expenses	(34)	(25)	(19)	(16)	(14)	(8)	(3)	-	-
Earnings before tax	**231**	**213**	**199**	**207**	**206**	**241**	**266**	**288**	**308**
Tax	(18)	(21)	(29)	(23)	(23)	(26)	(29)	(32)	(34)
Net income	**213**	**191**	**170**	**184**	**184**	**214**	**237**	**257**	**274**
Minority interest	(4)	(6)	(8)	(3)	(1)	(2)	(3)	(3)	(3)
Net income post MI	**209**	**185**	**162**	**181**	**182**	**213**	**235**	**254**	**271**

Balance Sheet(SAR mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
PP&E	2,434	2,330	2,199	2,101	1,996	1,892	1,789	1,688	1,589
Investments	137	180	150	109	109	109	109	109	109
Investments in associates	57	48	55	67	72	78	83	88	94
Other non-current assets	53	53	47	44	42	41	39	37	36
Total non-current assets	**2,682**	**2,611**	**2,449**	**2,321**	**2,219**	**2,119**	**2,020**	**1,923**	**1,827**
Inventory	580	548	408	455	411	405	394	386	378
Receivables	230	222	204	221	212	223	230	239	248
Cash & Cash Equivalents	144	234	143	264	299	267	266	273	322
Other current assets	11	22	228	20	20	20	20	20	20
Total current assets	**965**	**1,026**	**984**	**959**	**941**	**915**	**910**	**918**	**968**
Total assets	**3,647**	**3,637**	**3,433**	**3,280**	**3,161**	**3,034**	**2,930**	**2,841**	**2,795**
Share Capital	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Total reserves	1,883	1,873	1,750	1,635	1,568	1,505	1,465	1,419	1,365
Minority interest	75	75	84	87	88	90	93	96	99
Total Equity	**2,958**	**2,948**	**2,833**	**2,722**	**2,656**	**2,595**	**2,557**	**2,514**	**2,464**
Payables	174	211	196	174	163	168	170	174	179
Short term debt	89	11	8	43	71	68	50	-	-
Other current liab.	38	35	33	31	31	31	31	31	31
Total current liabilities	**301**	**256**	**236**	**248**	**265**	**267**	**252**	**206**	**210**
Long-Term Debt	331	323	249	189	118	50	-	-	-
Long-term lease liabilities	5	5	4	4	4	4	4	4	4
Other non-current liab.	53	106	110	117	117	117	117	117	117
Total non-current liabilities	**388**	**433**	**363**	**310**	**239**	**171**	**121**	**121**	**121**
Total Liabilities	**689**	**689**	**600**	**558**	**505**	**438**	**373**	**327**	**331**
Equity and liabilities	**3,647**	**3,637**	**3,433**	**3,280**	**3,161**	**3,034**	**2,930**	**2,841**	**2,795**

Cash Flows(SAR mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Cash from operations	261	406	467	235	365	353	383	400	418
Cash from investments	45	(26)	(231)	171	(37)	(39)	(41)	(42)	(44)
Cash from financing	(249)	(290)	(327)	(286)	(293)	(346)	(343)	(350)	(325)
Net changes in cash	58	91	(91)	120	35	(32)	(1)	7	49
Cash balance	**144**	**234**	**143**	**264**	**299**	**267**	**266**	**273**	**322**

Ratios	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Per Share (SAR)									
EPS	2.1	1.8	1.6	1.8	1.8	2.1	2.3	2.5	2.7
BVPS	28.8	28.7	27.5	26.4	25.7	25.1	24.6	24.2	23.6
DPS	1.8	2.3	2.8	2.2	2.5	2.8	2.8	3.0	3.3
FCF/share	2.0	3.7	4.4	1.9	3.3	3.1	3.4	3.6	3.7
Revenue/share	7.8	8.7	10.3	9.7	9.3	9.8	10.1	10.5	10.9
Valuations									
M.Cap (SAR mn)	3,680	3,685	3,780	3,390	3,895	3,895	3,895	3,895	3,895
EV (SAR mn)	3,841	3,636	3,568	3,274	3,696	3,654	3,585	3,525	3,473
P/E	17.6x	19.9x	23.4x	18.7x	21.3x	18.3x	16.6x	15.3x	14.4x
EV/EBITDA	8.6x	9.8x	10.6x	9.7x	10.8x	9.9x	9.2x	8.6x	8.1x
EV/Sales	4.9x	4.2x	3.5x	3.4x	4.0x	3.7x	3.5x	3.4x	3.2x
P/BV	1.3x	1.3x	1.4x	1.3x	1.5x	1.6x	1.6x	1.6x	1.6x
P/S	4.7x	4.2x	3.7x	3.5x	4.2x	4.0x	3.8x	3.7x	3.6x
Div. yield	4.8%	6.1%	7.3%	6.5%	6.4%	7.1%	7.1%	7.7%	8.3%
FCF yield	5.5%	10.1%	11.6%	5.7%	8.4%	8.1%	8.8%	9.2%	9.6%
Liquidity									
Cash Ratio	0.5x	0.9x	0.6x	1.1x	1.1x	1.0x	1.1x	1.3x	1.5x
Current ratio	3.2x	4.0x	4.2x	3.9x	3.5x	3.4x	3.6x	4.5x	4.6x
Quick ratio	1.3x	1.9x	2.4x	2.0x	2.0x	1.9x	2.0x	2.6x	2.8x
Return ratio									
ROA	5.8%	5.3%	5.0%	5.6%	5.8%	7.1%	8.1%	9.0%	9.8%
ROE	7.2%	6.4%	5.9%	6.9%	7.1%	8.5%	9.5%	10.5%	11.5%
ROCE	9.1%	7.0%	6.3%	6.5%	6.9%	8.3%	9.4%	10.5%	11.5%
Cash cycle									
Inventory turnover	0.8x	1.0x	1.8x	1.5x	1.6x	1.7x	1.7x	1.8x	1.9x
Payables turnover	2.7x	2.7x	3.7x	4.0x	4.0x	4.0x	4.0x	4.0x	4.0x
Receivables turnover	3.4x	3.9x	5.1x	4.4x	4.4x	4.4x	4.4x	4.4x	4.4x
Inventory days	448	346	203	235	226	217	208	199	190
Payable days	134	133	97	90	90	90	90	90	90
Receivables days	106	92	71	82	82	82	82	82	82
Cash Cycle	420	305	177	227	218	209	200	191	182
Profitability ratio									
Gross margins	40.4%	34.7%	29.9%	28.3%	29.9%	31.6%	32.8%	33.6%	34.4%
EBITDA margins	57.0%	42.6%	32.6%	34.8%	36.7%	37.8%	38.6%	39.0%	39.4%
Operating margins	39.5%	26.5%	18.9%	19.9%	21.2%	23.0%	24.3%	25.2%	26.1%
PBT margins	29.5%	24.4%	19.3%	21.3%	22.1%	24.5%	26.3%	27.4%	28.3%
Net margins	26.7%	21.2%	15.6%	18.6%	19.6%	21.7%	23.1%	24.1%	24.9%
Effective tax rate	8.0%	10.0%	14.7%	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%
Leverage									
Total debt (SAR mn)	425	339	262	236	194	123	55	5	5
Net debt (SAR mn)	281	104	118	(28)	(105)	(144)	(211)	(269)	(318)
Debt/Capital	12.6%	10.3%	8.5%	8.0%	6.8%	4.5%	2.1%	0.2%	0.2%
Debt/Total assets	11.7%	9.3%	7.6%	7.2%	6.1%	4.1%	1.9%	0.2%	0.2%
Debt/Equity	0.1x	0.1x	0.1x	0.1x	0.1x	0.0x	0.0x	0.0x	0.0x
Debt/EBITDA	1.0x	0.9x	0.8x	0.7x	0.6x	0.3x	0.1x	0.0x	0.0x
Net debt/EBITDA	0.6x	0.3x	0.4x	-0.1x	-0.3x	-0.4x	-0.5x	-0.7x	-0.7x

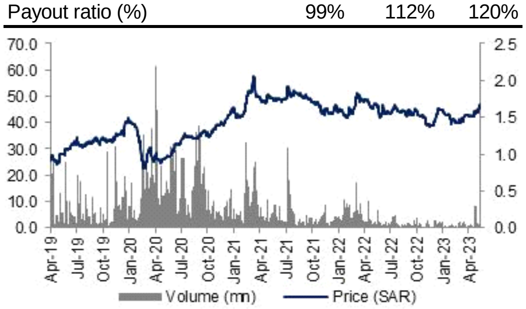
INVESTMENT RESEARCH | Saudi Arabia

Cement Sector

Eastern Province Cement Co. (EPCCO)

BUY: 12M TP @ 51

Valuation Summary (TTM)			
Price (SAR)			45.200
PER TTM (x)			22.5
P/Book (x)			1.7
P/Sales (x)			4.5
EV/Sales (x)			3.8
EV/EBITDA (x)			9.0
Dividend Yield (%)			4.4
Free Float (%)			71%
Shares O/S (mn)			86
YTD Return (%)			13%
Beta			0.9
(mn)		**SAR**	**USD**
Market Cap		3,887	1,036
Total Assets		2,885	769
Price performance (%)	**1M**	**3M**	**12M**
Eastern Province Cement Co	-3%	6%	5%
Tadawul All Share Index	4%	5%	0%
Industry Index	4%	5%	0%
Trading liquidity (,000)	**1M**	**3M**	**6M**
Avg daily turnover (SAR ,000)	1,231	1,554	1,286
Avg Daily Volume (,000)	33	34	29
52 week	**High**	**Low**	**CTL***
Price (SAR)	48.00	38.15	19.0
* CTL is % change in CMP to 52wk low			
Major shareholders			
Al Saud Abdul Aziz B			17%
Public Investment Fu			10.0%
Vanguard Group Inc/T			1.6%
Others			71.2%
Other details			
Exchange			Saudi Arabia
Sector			Building Materials
Index weight (%)			0.2%
Key ratios	**2020**	**2021**	**2022**
EPS (SAR)	2.53	2.24	1.67
BVPS (SAR)	29.46	27.93	27.44
DPS (SAR)	2.50	2.50	2.00
Payout ratio (%)	99%	112%	120%



EPCCO is the 9th largest cement player in Saudi Arabia, with a market share of c.5% of the cement sold in 1H23. It operates in the Eastern region, which has just two players, and accounted for c.28% of the cement volume in the region in 1H23. After reporting a 16.9% YoY drop in cement volume in 2022, the company's cement sales have rebounded in 1H23, increasing by 16.0% YoY, outperforming the industry, which reported a fall of 5.6% YoY for the same period. Going forward we expect this trend to continue, as we forecast EPCCO to post better than industry performance in 2023. EPCCO's cement realization for 2022 averaged at SAR265 per ton, which was at a substantial premium to the industry average of c.170 per ton. We expect this trend to continue, with the company maintaining its premium over the industry. We also forecast the cement realization to remain strong in 2023 and grow steadily for the next 3-5 years. Aided by an improvement in both cement volume and realization, we expect the company's financial performance to report strong growth, with the revenue growing by a CAGR c.7% between 2022-27e. Strong revenue, and increasing scale of operation is likely to aid in margin expansion, as we estimate gross margins to improve from c.32% in 2022 to c.35% by 2027e. Overall, we have forecasted a net income growth of c.14% CAGR between 2022-27e. EPCCO is currently quoting at c.17x its 2024e, compared to the industry median of c.25x (TTM' 1Q23). Given this we see upside potential in the stock and initiate coverage on EPCCO with a target price of SAR51 per share.

Cement volume growth to recover in 2023: Cement volume of EPCCO outperformed the industry in 1H23 and we expect the company to continue to report better than industry performance in 2023. We have forecasted the cement volumes for 2023 to increase by c.16% YoY, compared to a flattish performance by the industry. Overall, we have forecasted the cement volumes of EPCCO to grow at a CAGR of 5.5% between 2022-27e.

Cement realization of EPCCO to improve progressively: The average cement realization for the company came under pressure in 2021 and 2022, in line with the industry. However, the recovery in pricing of EPCCO has been swifter with the average cement realization increasing by 8.1% YoY in 2022 to SAR265 per ton, compared to a flattish performance by the industry for the same period. The realization has further improved to SAR282 per ton for 1Q23, an increase of c.6.5% from 2022 levels. Going forward, we expect the company's pricing will improve consistently. Overall, we forecast the average cement realizations of EPCCO to increase at a CAGR of c.3% between 2022-27e.

Attractive dividend yield, though capex could dampen the payout: For 2022, EPCCO had distributed a dividend of SAR2.0 per share, lower than the 2021 levels of SAR2.5 per share. Despite this, the company is trading at an attractive dividend yield of c.4%, compared to the industry average of c.3.5%. Given the forecasted improvement in the financial performance of the company, we expect dividend levels too to improve consistently and reach 2021 levels by 2024e. However, EPCCO is looking to set up a new line of production with a clinker production capacity of 10,000 tpd to replace its existing obsolete lines. Currently the cost and the timing of execution of this capex is uncertain. Though based on our initial estimates we expect dividend payments to improve, there could be a potential downside to this, once more clarity is available on the investment.

Valuation: We expect both cement volume and average realization to improve steadily and outperform the industry performance in 2023. Aided by this, we expect EPCCO's financial performance to improve. We initiate coverage on the company with a target price of SAR51 per share and a BUY rating. We have used an equal weighted average of P/E (20x) and DCF (8.3% cost of equity and 2% terminal growth) to value the company.

EPPCO is one of the two players operating in the Eastern region

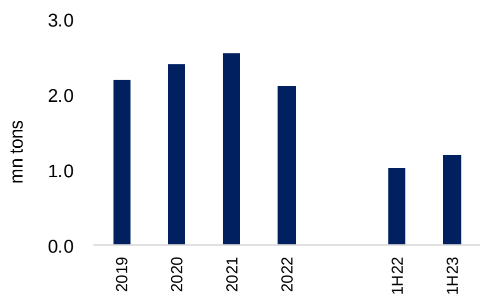
Mid-sized player with a presence in the relatively less competitive Eastern region

EPCCO was the 9th largest player in the industry with a market share of c.5% in 1H23. EPCCO operates in the Eastern region, which is the third largest region in the country accounting for 18% of the cement volume in 1H23. This region is made up of just 2 players, with Saudi Cement the largest, having a regional market share of 72%, followed by EPCCO with a market share of 28% during 1H23. This region is relatively less competitive, given the presence of just two players, which in turn offers the company a major advantage in terms of pricing.

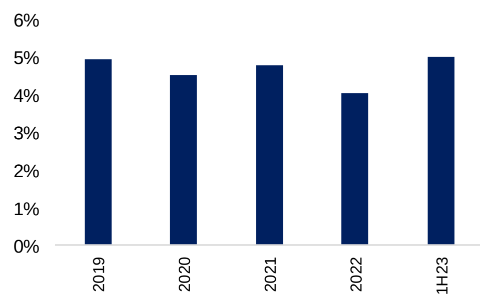
EPCCO volumes outperform industry in 1H23

Cement sales volume of EPCCO increased by 16.0% YoY to 1.2mn tons, outperforming the industry (-5.6% YoY) in 1H23. In 2022, the company's sales volume had fallen by 16.9% YoY to 2.1mn tons (-1.6% YoY industry), its lowest levels since 2018. Pickup in the construction activity in the region, along with relatively low level of competition in the Eastern region had a positive impact on its performance. The growth was also aided by a 6x improvement in cement exports, though it continues to remain a meagre part of total sales (cement exports were 8% of total sales in 1H23). Aided by the strong growth in cement volume, the company's market presence has improved, with its market share increasing from 4% in 2022 to 5% in 1H23, making it the 9th largest player in the Kingdom in 1H23 (11th largest in 2022).

Cement volume recovers in 1H23, after a lower 2022



Market share improves to historical levels in 1H23



Source: Yamama Cement; US Research

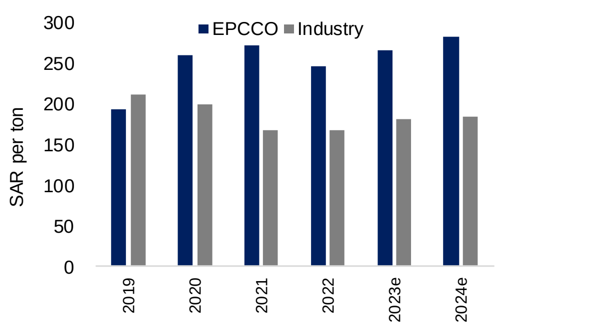
Expect cement volume to grow at a CAGR of 5.5% between 2022-27e

We expect the cement sales volume of the company to outperform the industry in the current year and grow by c.16% YoY, compared to a flattish industry performance for 2023. Overall, we expect cement volumes of EPCCO to grow at a CAGR of 5.5% between 2022-27e.

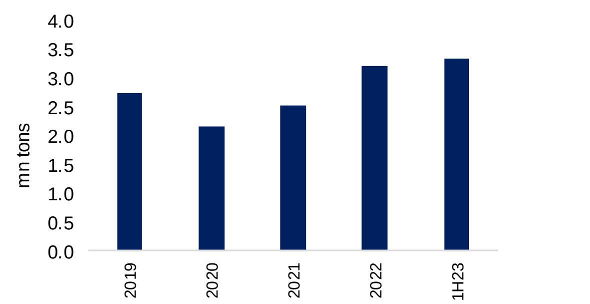
EPCCO's cement realization a premium to the market; expect it to continue

In 2022 EPCCO's cement realization increased by 8.1% YoY to SAR265 per ton and was at a substantial premium to the industry average of c.SAR170 per ton. The company's presence in the Eastern region and its product portfolio were the main reason for this. The average realization continued to improve and increased to SAR282 per ton for 1Q23, an increase of c.6.5% from the levels of 2022.

Realization of EPCCO consistently higher than Industry



Clinker inventory consistently high



Source: Company Filings; Yamama Cement; US Research

Expect cement realization to improve at a CAGR of c.3% between 2022-27e

However, the company had one of the highest inventory levels in the industry, with c.13 months of clinker production. EPCCO has traditionally maintained inventory levels that have been higher than the industry average. We expect the same to decline, albeit slowly over the next 3- 5 years. Going forward, we expect the company to maintain its pricing premium over the industry average, even as we expect the realization will continue to increase. Overall, we expect cement realizations of EPCCO to increase by c.3% between 2022-27e.

EPCCO to establish a new 10,000 tpd line to replace its existing lines

In Mar-23, EPCCO invited bids from specialist companies to setup a new production line of 10,000 tpd in its plant in Khursaniyah to replace some of its existing obsolete lines. The company currently holds a limestone extraction license in the Khursaniyah region and the new line is expected to aid the company utilize this license better. Currently, the details of the capex, including the cost and the time frame, is not clear and hence we have not taken it into account for our estimates. It has to be noted that the company has no major debt, apart from lease liabilities, which offers the company a strong financial flexibility to finance its capex.

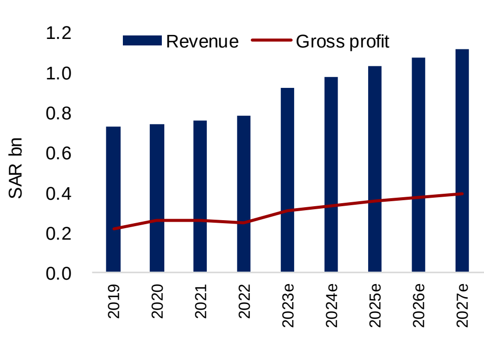
Financial performance to report improvement

Revenue of EPCCO registered a 3.5% YoY growth to SAR784mn in 2022 and was aided by a 68% YoY improvement in precast revenue, even as cement revenue fell by 10.1% YoY. Revenue from precast was aided by new customer acquisitions in the segment, as it accounted for 28% of total revenue in 2022 (17% in 2021). However, net income from this segment accounted for a mere 6% of total net income. Cement sales on the other hand was impacted by a 16.9% YoY fall in cement volume, which was to a certain extent made up by an 8.1% YoY improvement in cement prices.

Expect revenue to grow at a CAGR of c.7% between 2022-27e

Going forward, we expect revenue growth to pickup in 2023 and will be aided by a recovery in the cement volume and an improvement in average realizations. Precast revenue on the other hand is expected to report stable growth over the forecast period. Overall, we expect revenue of EPCCO to grow at a CAGR of c.7% over 2022-27e.

Financial performance to improve post 2022



Gross margins to improve steadily

Source: Company Filings; US Research

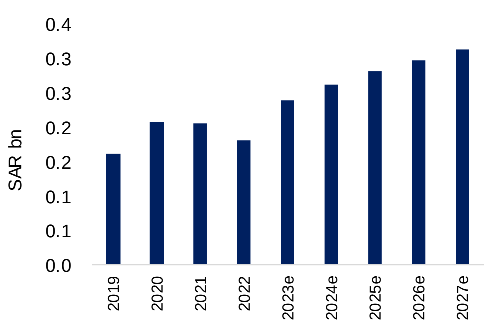
Despite an improvement in revenue in 2022, gross profit fell by 5.1% YoY and was impacted by the increasing proportion of precast revenue to total revenue, which resulted in lower margins. Gross margins fell by c.290-bps YoY to 31.6% in 2022 and was lower than the industry average of 32.6%.

Going forward, we expect this trend to reverse, given the improvement in cement sales. We expect gross margins of EPCCO to improve from the current levels to c.35% by 2027, with a bulk of the improvement happening in 2023.

Operating cost increased by 22.6% YoY, at the back of higher SG&A, as operating profits fell by 12.4% YoY to SAR181mn in 2022. Operating margins for the year fell by c.420bps YoY to 23.1%, lower than the peer average of 24.5%. Net income on the other hand fell by 25.7% YoY, and apart from lower margins and higher SG&A, the profitability was also impacted by lower income from associates.

The income from associates represents the company's investments in Arab Yemen Cement Company, which operates in the Republic of Yemen and is involved in the production and sale of cement. EPCCO holds 31.6% stake in the associate. In 2022, due to a decline in profits EPCCO conducted a study through an independent consultant to assess the value of the investment and took a provision of SAR13.6mn as impairment. This in turn impacted the profitability of EPCCO during the year.

EBIT to register robust recovery



EBIT margins expected to consistently increase

Source: Company Filings; US Research

Increase in revenue, and improvement in margins to aid net income growth

Going forward, we expect the overall profitability to increase, and will be aided by higher sales, improving gross margins and a better control over operating cost. Overall, we expect net income to grow at a CAGR of 13.6% between 2022-27e.

Low debt levels provide financial flexibility to EPCCO

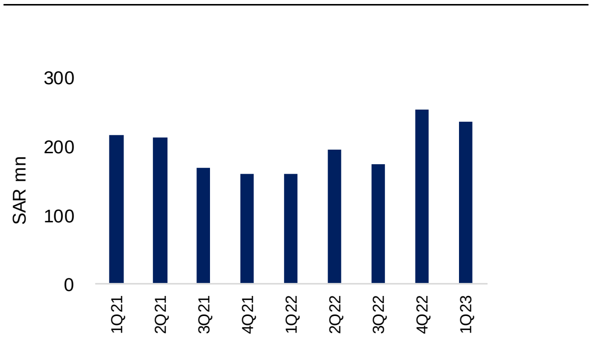
Strong financial position, though the inventory days are very high

The financial position of EPCCO is strong with no major debt, except for SAR7mn in lease liabilities. Between 2019-22, the company generated an average cash flow from operation of SAR262mn p.a., which was 0.9x the average EBITDA over the period. EPCCO's operations are working capital intensive, with inventory days of c.388 days in 2022, one of the highest in the industry. Though we expect the inventory days to fall during the next five years, it will continue to remain higher than industry average. EPCCO is planning to add a new clinker production line, with a capacity of 10,000 tpd. Currently the budget and the timings of the capex are uncertain, though the company has the financial flexibility to finance the same.

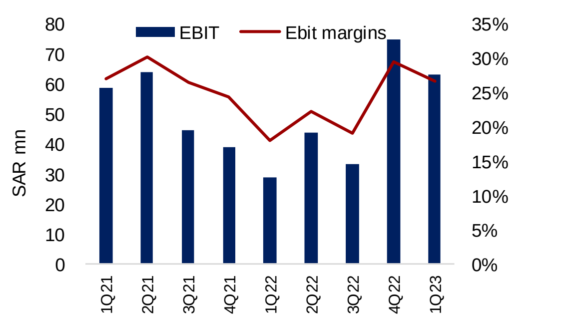
1Q23 registers robust performance

Revenue of EPCCO increased by 47.2% YoY to SAR237mn for 1Q23 and was aided by a 39.4% YoY increase in cement sales, while precast sales increased by 76.2% YoY. Cement sales was positively aided by a 12.4% YoY improvement in cement volume and a 24.0% YoY improvement in the average cement realization.

1Q23 revenue reports strong YoY improvement



EBIT and margins higher YoY in 1Q23



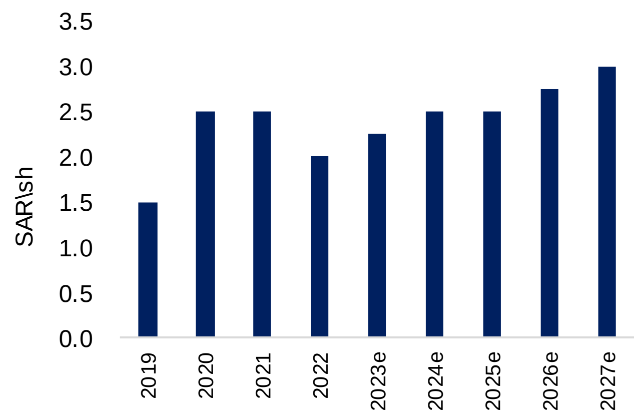
Source: Company Filings; US Research

Gross profits increased by 81.1% YoY to SAR78mn for 1Q23 and was aided by improved pricing scenario and operating leverage, as gross margins improved to 33.2% corresponding to 27.0% in 1Q22. Operating cost increased marginally by 6% YoY to SAR15mn for 1Q23, as net income increased by a robust 111.1% YoY to SAR56mn for 1Q23.

Historically strong track record for dividend payment

For 2022 EPCCO declared a dividend of SAR2.0 per share, despite the same being lower than the 2021 levels of SAR2.5 per share, the company generated a dividend yield of c.4%, higher than the peer average of c.3.5%. Going forward, based on our initial estimates, we expect dividend to reach 2021 levels by 2024e. However, currently we do not have sufficient information on the status of the capex and if the company will execute the same. There could be downside pressure on the dividend that the company can pay, depending on the level of investment required for this project. We have not considered the additional capex for our dividend assumptions.

Dividends to improve steadily post 2022



Source: Company Filings; US Research

Valuations: We expect EPCCO's cement volume performance to outperform the industry average, while it is likely to maintain its robust premium in cement realization over the industry average, even as it improves steadily. These in turn are likely to have a positive impact on the overall revenue and profitability of the company. The company is currently quoting at 17x its 2024e EPS, compared to the industry median of 25x (TTM' 1Q23), which we feel provides sufficient upside.

Discounted Cash Flow (SAR mn)	2023E	2024E	2025E	2026E	2027E
Net operating profit after tax	195	214	232	245	259
Add Depreciation	106	105	105	106	107
Working capital changes	(78)	(19)	(15)	(8)	(26)
Less: Capex	(93)	(98)	(103)	(107)	(112)
Free cash flow to equity	**130**	**202**	**218**	**235**	**227**
PV of free cash flow to equity	**125**	**180**	**180**	**179**	**160**
Sum of PV of free cash flow to equity					**824**
Add: Terminal value					2,521
EV					**3,345**
Add: Net cash and investments					1,063
Less: Debt					(7)
Equity value					**4,401**
Fair value per share (SAR)					***51***

Cost of Capital	
Risk free rate	4.1%
Adjusted beta	0.9x
Equity risk premium	4.7%
Cost of equity	8.3%
Terminal growth	2.0%

Relative valuation	
2024E EPS (SAR)	2.6
Fair value P/E	20.0x
Value per share (SAR)	***51***

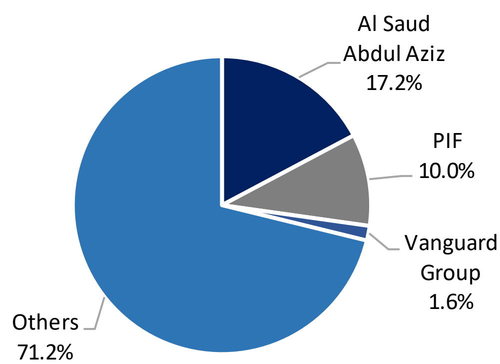
Methodology	Tp/Sh SAR	Wt	Avg./Sh SAR
DCF	51	50%	26
P/E	51	50%	25
Value per share			**51**

We have valued the company using an equal weight of DCF (Equity) and P/E methodologies. We have taken a cost of equity of 8.3% and terminal growth of 2% for the DCF and arrived at a value of SAR51 per share. For P/E, we have used a forward P/E of 20x, a discount of c.20% to the industry median (TTM' 1Q23), and arrived at a value of SAR51 per share. Overall, we arrive at a weighted average Target Price of SAR51 per share, which gives a BUY rating for the company.

About the company

EPCCO was established in 1982 and in 1985 it obtained the mining franchise for exploring limestone in the Al Khorasania region for a period of thirty years to be utilized for its factory located in Al-Tawy. In 2015, the company had renewed its license for a further period of thirty years. In 2012, EPCCO also obtained a license to explore limestone reserves in Al Najabia valley at Al Ahsa province, which is valid till 2035. The plant is located at Al Khorasania on Abu Hadriyah Highway, 145km north of Dammam and is rich with the raw materials required for the manufacture of cement. The company's proximity to Maaden offers it the opportunity to use some of the byproducts as additives for cement production, resulting in lower cost. The Jubail industrial port is 70 kms from the plant, which provides the opportunity for the company to tap export markets.

Shareholding of EPCCO



Board of Directors		
S.no	Name	Position
1	Mr. Mohammed Saad Al-Farraj	Chairman
2	Mr. Ibrahim Salem Al-Ruwais	Vice Chairman
3	Mr. Waleed Mohammed Al-Jaafari	Board Member
4	Dr. Zamil Abdulrahman Al-Mokrin	Board Member
5	Eng. Mohammed Wasalla Al-Harbi	Board Member
6	Mr. Abdulaziz Abdulrahman Al-Khanin	Board Member
7	Ms. Sheikha Abdullah Al-Jubeir	Board Member
8	Mr. Ahmed Ibrahim Al-Shathri	Board Member
9	Mr. Majid Saleh Al-Rajhi	Board Member

Source: Company Filings; US Research

In Mar-23, EPCCO had called for bids from companies to setup a new production line of 10,000 tpd in its plant in Khursaniyah to replace some of its existing obsolete lines. The company currently holds a limestone extraction license in the Khursaniyah region and the new line is expected to aid the company utilize this license better.

As of YTD-June 2023, the company was the 9th largest player in the Kingdom, in terms of cement sales with a market share of 5%. During the same period, 92% of the cement volume were made up of domestic sales. In 2022, 72% of the company's revenue came from cement, while the balance 28% came from precast. However, in terms of net income, the cement operations accounted for 94% of the net income in 2022.

Income Statement(SAR mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Revenue	729	742	758	784	926	981	1,032	1,073	1,117
Cost of sales	(511)	(484)	(497)	(536)	(617)	(647)	(676)	(700)	(725)
Gross profit	**218**	**258**	**261**	**248**	**308**	**333**	**356**	**373**	**392**
Operating expenses	(56)	(51)	(55)	(67)	(70)	(72)	(74)	(75)	(77)
Operating profit	**161**	**207**	**206**	**181**	**239**	**262**	**282**	**298**	**314**
Other income	17	4	3	(7)	12	12	12	12	13
Finance expenses	(1)	(3)	(3)	(5)	(5)	(5)	(6)	(6)	(6)
Income from affiliate	24	38	21	1	-	-	-	-	-
Earnings before tax	**200**	**246**	**227**	**170**	**245**	**268**	**289**	**305**	**321**
Tax	(20)	(29)	(34)	(26)	(38)	(42)	(45)	(47)	(50)
Net income	**181**	**217**	**193**	**143**	**207**	**226**	**244**	**257**	**271**

Balance Sheet(SAR mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
PP&E	869	820	758	762	752	748	749	754	762
Investments	536	577	590	642	642	642	642	642	642
Investments in associates	170	199	213	200	200	200	200	200	200
Other non-current assets	96	100	106	109	106	103	100	97	94
Total non-current assets	**1,671**	**1,695**	**1,668**	**1,714**	**1,701**	**1,694**	**1,692**	**1,694**	**1,698**
Inventory	506	427	460	579	650	666	678	685	710
Receivables	198	193	209	298	352	373	393	408	425
Cash & Cash Equivalents	340	529	402	91	39	38	53	64	46
Other current assets	50	26	46	170	177	180	182	184	187
Total current assets	**1,094**	**1,175**	**1,117**	**1,138**	**1,218**	**1,256**	**1,306**	**1,342**	**1,367**
Total assets	**2,765**	**2,870**	**2,785**	**2,851**	**2,919**	**2,950**	**2,998**	**3,035**	**3,065**
Share Capital	860	860	860	860	860	860	860	860	860
Total reserves	1,552	1,673	1,542	1,500	1,513	1,524	1,553	1,574	1,587
Total Equity	**2,412**	**2,533**	**2,402**	**2,360**	**2,373**	**2,384**	**2,413**	**2,434**	**2,447**
Payables	103	133	162	266	305	320	335	346	359
Other current liab.	147	89	96	96	110	115	120	124	129
Total current liabilities	**250**	**222**	**258**	**361**	**415**	**436**	**455**	**471**	**488**
Long-term lease liabilities	0	0	4	5	5	5	5	5	5
Other non-current liab.	103	115	120	125	125	125	125	125	125
Total non-current liabilities	**103**	**115**	**124**	**130**	**130**	**130**	**130**	**130**	**130**
Total Liabilities	**353**	**337**	**382**	**492**	**546**	**566**	**585**	**601**	**618**
Equity and liabilities	**2,765**	**2,870**	**2,785**	**2,851**	**2,919**	**2,950**	**2,998**	**3,035**	**3,065**

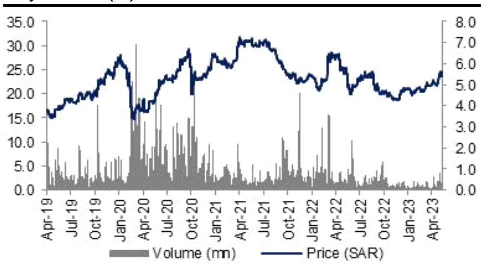
Cash Flows(SAR mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Cash from operations	362	348	209	130	234	312	334	355	352
Cash from investments	(65)	(27)	(2)	(130)	(93)	(98)	(103)	(107)	(112)
Cash from financing	(67)	(132)	(333)	(311)	(194)	(215)	(215)	(237)	(258)
Net changes in cash	231	189	(126)	(311)	(52)	(1)	15	11	(18)
Cash balance	**340**	**529**	**402**	**91**	**39**	**38**	**53**	**64**	**46**

Ratios	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Per Share (SAR)									
EPS	2.1	2.5	2.2	1.7	2.4	2.6	2.8	3.0	3.2
BVPS	28.0	29.5	27.9	27.4	27.6	27.7	28.1	28.3	28.5
DPS	1.5	2.5	2.5	2.0	2.3	2.5	2.5	2.8	3.0
FCF/share	4.0	3.5	2.2	0.6	1.6	2.5	2.7	2.9	2.8
Revenue/share	8.5	8.6	8.8	9.1	10.8	11.4	12.0	12.5	13.0
Valuations									
M.Cap (SAR mn)	3,096	3,539	3,780	3,462	3,887	3,887	3,887	3,887	3,887
EV (SAR mn)	2,051	2,235	2,580	2,405	2,883	2,884	2,869	2,858	2,876
P/E	17.1x	16.3x	19.6x	24.2x	18.8x	17.2x	15.9x	15.1x	14.3x
EV/EBITDA	7.8x	7.4x	8.4x	8.4x	8.4x	7.9x	7.4x	7.1x	6.8x
EV/Sales	2.8x	3.0x	3.4x	3.1x	3.1x	2.9x	2.8x	2.7x	2.6x
P/BV	1.3x	1.4x	1.6x	1.5x	1.6x	1.6x	1.6x	1.6x	1.6x
P/S	4.2x	4.8x	5.0x	4.4x	4.2x	4.0x	3.8x	3.6x	3.5x
Div. yield	4.2%	6.1%	5.7%	5.0%	5.0%	5.5%	5.5%	6.1%	6.6%
FCF yield	11.0%	8.5%	5.1%	1.4%	3.6%	5.5%	5.9%	6.4%	6.2%
Liquidity									
Cash Ratio	1.4x	2.4x	1.6x	0.3x	0.1x	0.1x	0.1x	0.1x	0.1x
Current ratio	4.4x	5.3x	4.3x	3.1x	2.9x	2.9x	2.9x	2.9x	2.8x
Quick ratio	2.4x	3.4x	2.5x	1.5x	1.4x	1.4x	1.4x	1.4x	1.3x
Return ratio									
ROA	6.5%	7.6%	6.9%	5.0%	7.1%	7.7%	8.1%	8.5%	8.9%
ROE	7.5%	8.6%	8.0%	6.1%	8.7%	9.5%	10.1%	10.6%	11.1%
ROCE	6.7%	8.2%	8.6%	7.6%	10.0%	10.9%	11.7%	12.2%	12.8%
Cash cycle									
Inventory turnover	1.0x	1.1x	1.1x	0.9x	0.9x	1.0x	1.0x	1.0x	1.0x
Payables turnover	5.0x	3.6x	3.1x	2.0x	2.0x	2.0x	2.0x	2.0x	2.0x
Receivables turnover	3.7x	3.9x	3.6x	2.6x	2.6x	2.6x	2.6x	2.6x	2.6x
Inventory days	356	318	333	388	379	370	361	352	352
Payable days	72	99	118	178	178	178	178	178	178
Receivables days	98	93	99	137	137	137	137	137	137
Cash Cycle	382	312	315	347	338	329	320	311	311
Profitability ratio									
Gross margins	29.9%	34.8%	34.4%	31.6%	33.3%	34.0%	34.5%	34.8%	35.1%
EBITDA margins	36.2%	40.7%	40.8%	36.4%	37.2%	37.4%	37.5%	37.6%	37.7%
Operating margins	22.2%	27.9%	27.2%	23.1%	25.8%	26.7%	27.3%	27.8%	28.2%
PBT margins	27.5%	33.2%	30.0%	21.6%	26.5%	27.3%	28.0%	28.4%	28.8%
Net margins	24.8%	29.3%	25.5%	18.3%	22.3%	23.1%	23.6%	24.0%	24.3%
Effective tax rate	9.8%	11.8%	15.1%	15.5%	15.5%	15.5%	15.5%	15.5%	15.5%
Leverage									
Total debt (SAR mn)	2	0	6	7	7	7	7	7	7
Net debt (SAR mn)	(338)	(528)	(397)	(84)	(31)	(30)	(46)	(57)	(39)
Debt/Capital	0.1%	0.0%	0.2%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Debt/Total assets	0.1%	0.0%	0.2%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%
Debt/Equity	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
Debt/EBITDA	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
Net debt/EBITDA	-1.3x	-1.7x	-1.3x	-0.3x	-0.1x	-0.1x	-0.1x	-0.1x	-0.1x

Cement Sector

Neutral: 12M TP @ 21

Valuation Summary (TTM)			
Price (SAR)			22.740
PER TTM (x)			25.4
P/Book (x)			1.8
P/Sales (x)			7.4
EV/Sales (x)			6.1
EV/EBITDA (x)			13.6
Dividend Yield (%)			4.0
Free Float (%)			72%
Shares O/S (mn)			140
YTD Return (%)			14%
Beta			1.1
(mn)		**SAR**	**USD**
Market Cap		3,184	849
Total Assets		1,963	523
Price performance (%)	**1M**	**3M**	**12M**
City Cement Co	-11%	4%	0%
Tadawul All Share Index	4%	5%	0%
Industry Index	4%	5%	0%
Trading liquidity (,000)	**1M**	**3M**	**6M**
Avg daily turnover (SAR ,000)	5,795	5,393	4,261
Avg Daily Volume (,000)	235	229	189
52 week	**High**	**Low**	**CTL***
Price (SAR)	26.15	18.58	22.6
* CTL is % change in CMP to 52wk low			
Major shareholders			
Abdullatif Group Hol			25%
ALMOAJIL TRADING & C			2.0%
Vanguard Group Inc/T			1.7%
Others			71.8%
Other details			
Exchange			Saudi Arabia
Sector			Building Materials
Index weight (%)			0.2%
Key ratios	**2020**	**2021**	**2022**
EPS (SAR)	1.57	1.14	0.82
BVPS (SAR)	13.18	13.07	12.99
DPS (SAR)	1.50	1.25	0.90
Payout ratio (%)	95%	109%	110%



City Cement Co. (CCO)

CCO is the 10th largest cement player with a market share of 4% in 1H23. It operates in the very lucrative, but also competitive Central region, where there are 4 players. CCO's cement sales came under pressure in 2022 and fell by 10.4% YoY, and this trend has continued in 1H23, with the volume falling by 20.8% YoY. The company underperformed the industry (-1.6% YoY in 2022 and -5.6% YoY for 1H23) average for both the periods. In 2023, we expect this trend to continue as CCO is likely lag industry performance. However, we view positively the various infrastructure projects lined up for execution, and expect CCO's performance will start improving from 2024. Cement realization of CCO came under pressure, falling to SAR162 per ton in 2022, compared to the average realization SAR196 per ton in 2019 and 2020. It also lagged the industry average of c.170 per ton in 2022. However, cement prices have started to recover, and reached SAR180 per ton in 1Q23. Given the historical track record of price competition in the region and the scope of other regional players entering the Central province, we remain cautious on the extent of upside in the prices. However, we do not expect the level of prices witnessed in the region in 2021 and 2022 to recur in the next three to five years, and forecast for a steady improvement in the cement realization from the 2022 levels. Overall, we expect CCO's financial performance will remain under pressure in 2023, with both revenue and net income coming lower than 2022 levels. However, post 2023, we expect revenue growth to recover, aided by an improvement in both cement volume and price. Overall, we expect revenue to grow at a CAGR of 5.1% for 2022-27e and net income growing at a CAGR of 9.5% between 2022-27e. CCO is quoting at 27x its 2024e EPS, compared to the industry median of 25x (TTM' 1Q23), which we feel discounts all the expected upside to the stock. Given this we initiate coverage on the company with a Neutral rating, and a target price of SAR21 per share.

Cement volume to remain weak in 2023 and recover post that: Cement volume of CCO has underperformed the industry in 2022 and1H23 and we expect a recovery in 2H23, though the full year performance will continue to lag industry levels. We have forecasted the cement volumes for 2023 to fall by c.15% YoY, compared to a flattish performance by the industry. Post this we expect the company's performance will improve, as we project the cement volumes of CCO to grow at a CAGR of c.7% between 2023e-27e.

Cement realization of CCO improves in 2023, expect it to remain strong: Due to unfavourable industry scenario cement realization in 2022 remained weak, falling by 3.1% YoY to SAR162 per ton. However, the scenario has improved in 2023, with the average realization increasing to SAR180 per ton for 1Q23, an improvement of 10.6% from 2022 levels. Going forward, we expect the cement prices to remain strong and grow steadily from 2022 levels, though we remain cautious on the extent of growth. Overall, we have forecasted cement prices to increase at a CAGR of c.3% between 2022-27e.

Consistent dividend payer, with a better than industry yield: For 2022, CCO had distributed a dividend of SAR0.9 per share, lower than 2021 the levels of SAR1.25 per share. Despite this, the company is trading at an attractive dividend yield of c.4%, compared to the industry average of c.3.5%. In line with the expected improvement in the financial performance of the company from 2024e, we expect dividend levels to improve consistently and reach 2021 levels by 2025e.

Valuation: We expect cement volume growth to pick-up post 2023, while cement prices will remain strong and improve consistently for the forecast period. Aided by this, we expect both revenue and net income performance to recover post 2023. However, we feel that the current valuation fully reflects the potential upside to the stock, and we initiate coverage on the company with a target price of SAR21 per share and a Neutral rating. We have used an equal weighted average of P/E (20x) and DCF (9.0% cost of equity and 2% terminal growth) to value the company.

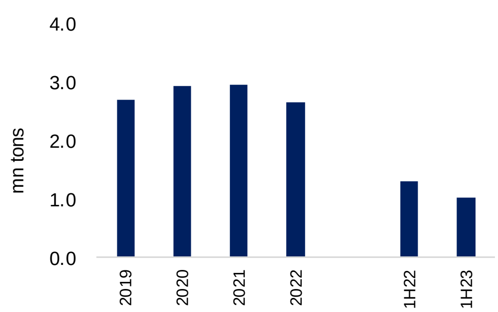
Mid-sized player with a moderate presence in the region

CCO is the fourth largest player in the Central region

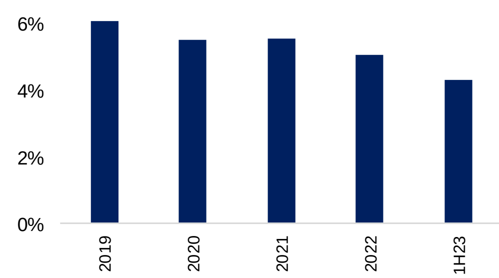
CCO was the 10th largest player in the industry with a market share of 4% in 1H23. CCO operates in the Central region, which is the largest region in the country, accounting for 32% of the cement volume during 1H23. This region is made up of 4 players, with Yamama Cement being the largest, with a regional market share of 41%, followed by Qassim Cement, with a market share of 24% for 1H23. The other players are Riyadh Cement, with a regional market share of 21%, and CCO, with a market share of 14% for the same period. The region offers mixed prospects, as it is a very attractive region in terms of demand, given that a lot of the major infrastructure projects have been planned in this region. However, traditionally the region has also witnessed high level of price competition, resulting in price wars.

Cement volumes under pressure, will continue to underperform industry average in 2023

Cement volume under pressure since 2021



Market share under pressure



Source: Yamama Cement; US Research

CCO's cement offtake continued to be weak, as it witnessed a 20.8% YoY fall in volume for 1H23, underperforming the industry average, which recorded a fall of 5.6%. The weak performance follows a 10.4% YoY fall in volumes in 2022 (-1.6% YoY industry). In 2022, the region witnessed high levels of price competition, which had squeezed the smaller players to restrict their supply to maintain the overall prices. Though the pricing scenario has improved in the current year, it continues to be a drag in terms of volume performance. Despite being a hot bed for infrastructure investment, cement offtake has been weak due to the investments still being in the initial stages of execution and high competition, not only from the regional players, but also from supply of cement from other regions.

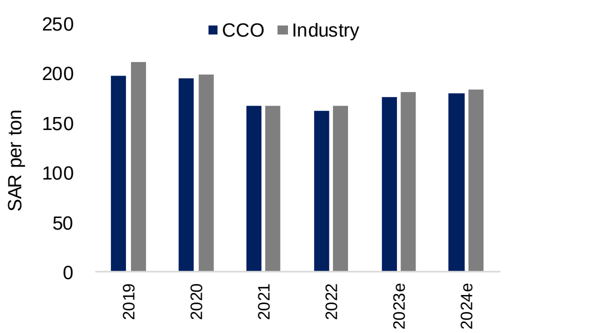
Post 2023, expect cement volume growth to recover and increase at a CAGR of c.7% between 2023e-27e

We expect the offtake of cement to improve from 2H23, aided by an improvement in the execution of the various Mega and Giga projects. However, we expect this recovery to be slow, and the company is likely to continue to underperform the overall industry in 2023. Post this, we expect the cement volumes of CCO to recover and grow at a CAGR of c.7% for 2023e-27e.

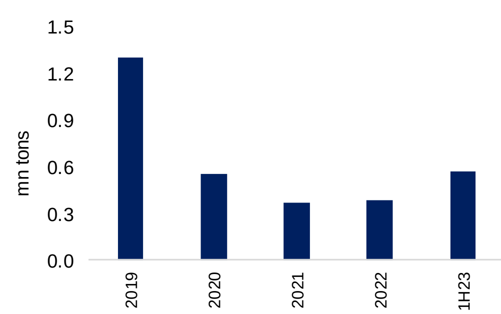
Cement realization continues to remain strong, though we remain cautious on the upside

In line with the regional trend, the average realization of CCO came under pressure in 2021 and 2022, as it fell from the average levels of SAR196 per ton in 2019 and 2020 to SAR168 per ton for 2021 and to SAR162 per ton in 2022. These levels were lower than the industry's average realization of c.SAR170 per ton in 2022. Since then, the prices for CCO have recovered to SAR180 per ton for 1Q23.

CCO average realization trails industry average



Clinker inventory one of the lowest in the industry



Source: Company Filings; Yamama Cement; US Research

Expect cement realization to increase at a CAGR of c.3% between 2022-27e

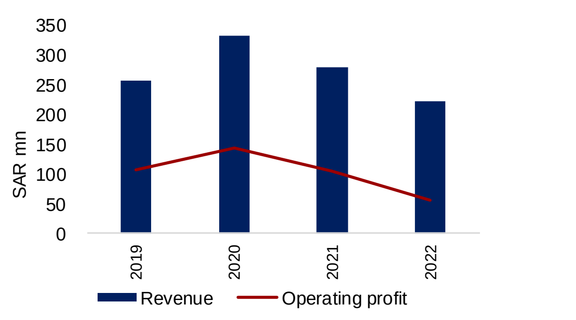
However, we remain cautious on the extent of the upside on prices, given the historical track record of price competition in the region. Added to this, there is a potential for competition to increase due to a surge in the flow of volumes from the other regions, given the high concentration of investments in the Central province. Despite this, we continue to remain optimistic on the pricing situation in the Central province, as we do not expect the scenario in 2021 and 2022 to recur in the medium term. Overall, we forecast cement prices to increase at a CAGR of c.3% between 2022-27e.

Acquisition of Umm Al-Qura Cement will provide CCO with an entry into the Western region

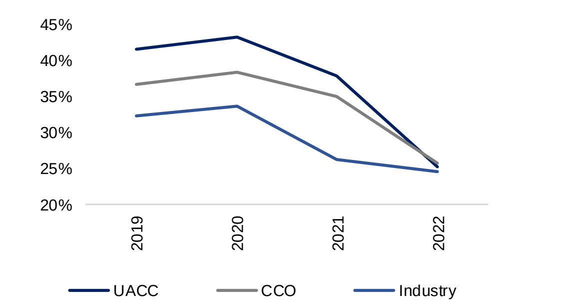
In Nov-22, CCO entered into a non-binding MOU, valid for six months, with Umm Al-Qura Cement (UACC) to fully acquire the latter's share through share swap. Currently the due diligence process is ongoing, post which the valuation of the company and the required share swap will be decided. On Apr-23, the MOU was extended for another six months.

UACC is a small player operating from the Western region, with a market share of 2% overall and 9% regionally during 1H23. For 1H23, UACC's cement volume fell by 35.2% YoY, and this comes at the back of a 12.5% YoY fall in cement volumes in 2022. The company has significantly underperformed the industry (-5.6% YoY for 1H23 and -1.6% YoY for 2022) in both these periods. In 2022, UACC reported a revenue of SAR221mn and a net income of SAR23mn. Traditionally UACC's operating margins have been better than both the industry and CCO average, though in 2022 the same have converged.

UACC revenue and EBIT fall



UACC EBIT margins converge with peers in 2022



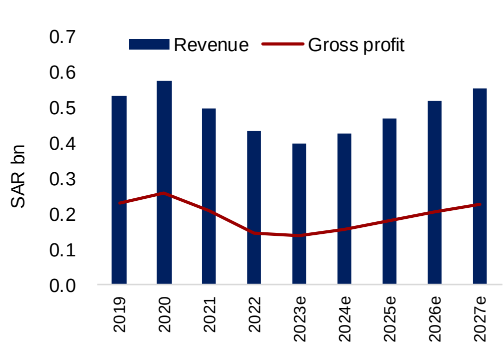
Source: Company Filings; US Research

The acquisition will improve the market share of CCO from the existing 4% to 6% (1H23), making it the 7th largest player in the Kingdom (currently 10th). Profitability measures may not be impacted substantially, given that both the companies are operating at almost the same levels in 2022. However, the acquisition will add a debt of SAR318mn, from UACC's balance sheet, though the debt to equity of the combined entity will be at c.12%, it will still be under control. However, UACC is a small company and is present in a different region; though the acquisition will provide CCO entry into another lucrative region, any advantage of scale could be limited, given that the physical difference in the location of both the plants. Added to this, due to its size UACC has limited bargaining power in a competitive region. As a result of this, operational gains to CCO too could be limited. Overall, the acquisition, if it gets finalized, is likely to have a positive impact on the company's financial performance, through the consolidation of UACC's financials into CCO's financials, though gains from synergies in operations could be limited. We have not taken the acquisition for our forecast and valuation, since the deal is yet to be finalized and many variables, including share swap, are yet to be disclosed.

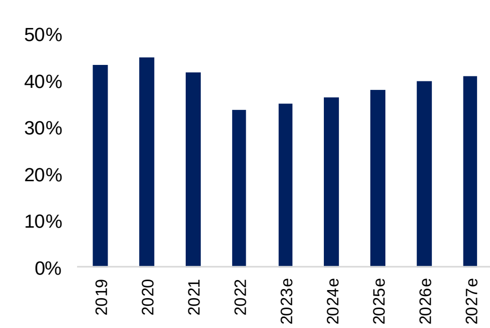
Financial performance under pressure; recovery to be slow

Revenue of CCO in 2022 fell by 13.2% YoY and was impacted by a 10.4% YoY fall in cement volume and a 3.1% YoY fall in average realization. The company underperformed the industry, with both the volume and the pricing moving adversely. Going forward, we expect the revenue in 2023 will continue to come under pressure, as we expect cement volumes to fall by c.15% YoY, though the impact on revenue will be restricted to a certain extent by a c.8% recovery in the average realization. Post 2023 however, we expect revenue to improve, aided by a pickup in volume growth and a steady improvement in pricing. Overall, we forecast revenue of CCO to increase at a CAGR of c.5% between 2022-27e.

Financial performance to recover post 2023



Gross margins to improve steadily



Source: Company Filings; US Research

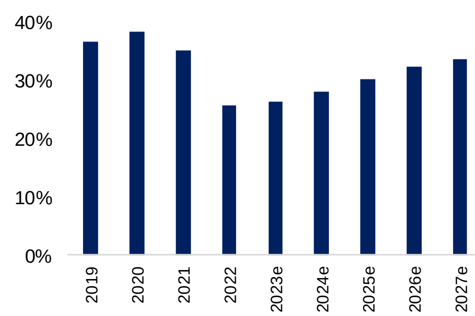
Gross profits in 2022 on the other hand fell by a higher (relative to fall in sales) 30.0% YoY to SAR145mn, as gross margins declined from 41.8%

in 2021 to 33.7% in 2022, though the same was better than the industry average of 32.6%. Lower scale of operation, inflexible pricing scenario and higher cost of sales put pressure on the gross margins of the company. Going forward, we expect gross margins to improve gradually from c.35% in 2023e to c.41% in 2027e. Improved cement volumes and favorable pricing scenario is likely to aid in the improvement of profitability.

Operating cost increased by 3.3% YoY, at the back of higher selling expenses, as operating profits fell by 36.4% YoY to SAR111mn in 2022. Operating margins for the year declined from 35.1% in 2021 to 25.7% in 2022, though it was better than the peer average of 24.5%. Overall, net income decreased by 28.2% YoY, and was impacted by lower revenue and a subdued gross margin.

EBIT to grow consistently post 2023

EBIT margins to recover from 2023



Source: Company Filings; US Research

Going forward, we expect the profitability to remain under pressure in 2023, and recover post that, in line with the improvement in revenue and gross margins. Overall, we expect net income to grow at a CAGR of 9.5% between 2022-27e.

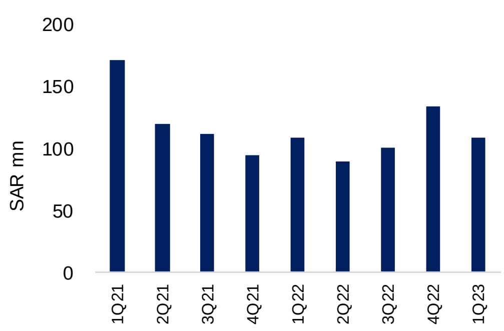
Strong financial position

The financial position of CCO is strong with no major debt, but for some lease liabilities (SAR4mn in 2022). In 2022, the company had cash and liquid investments of c.SAR400mn, which was c.20% of the company's total assets. Between 2019-22, the company generated an average cash flow from operation of SAR286mn, which was 1.1x the average EBITDA. The company's proposed acquisition of UACC will be through a share swap, though post the acquisition, CCO will be absorbing the debt of UACC. Despite this we feel that the company's financial position continues to be strong.

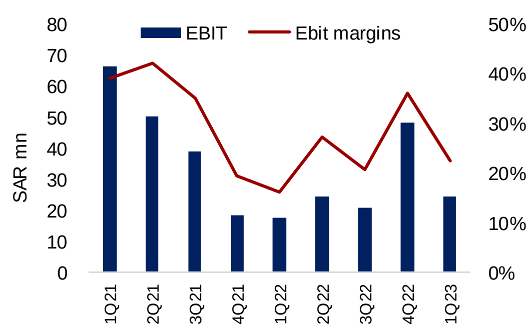
1Q23 witness recovery in financial performance

Revenue of CCO at SAR108mn for 1Q23 was flat at 1Q22 levels, with the 31.0% YoY improvement in the average cement realization, compensated by a 23.6% YoY fall in cement volume.

CCO report flat revenue on a YoY basis



YoY EBIT and margins recover in 1Q23



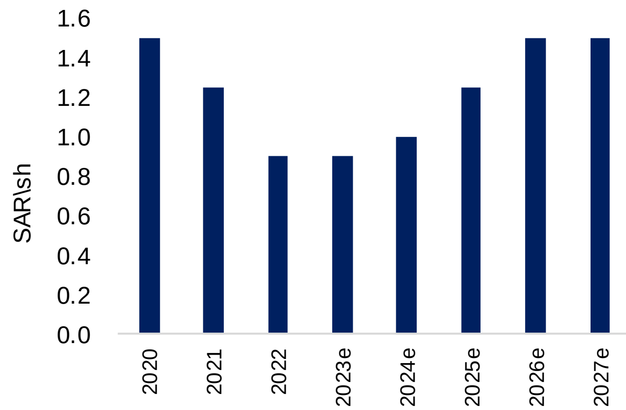
Source: Company Filings; US Research

Gross profits increased by a robust 25.5% YoY to SAR33mn for 1Q23 and was aided by an improved pricing scenario, as gross margins improved to 30.5% corresponding to 24.3% in 1Q22. Operating cost was flat at SAR9mn for 1Q23, as net income increased by a robust 60.9% YoY to SAR28mn for 1Q23. The strong quarterly performance of the company comes at the back of a lower base, as 1Q22 numbers were impacted by substantially lower cement realization.

Consistent dividend payer

For 2022 CCO declared a dividend of SAR0.9 per share, and despite the same being lower than the 2021 levels of SAR1.25 per share, the company generated a dividend yield of c.4%, higher than the peer average of c.3.5%. Going forward, we expect dividend payment to remain flat at SAR0.90 per share for 2023e and improve to SAR1.0 per share for 2024e and reach 2021 dividend levels of SAR1.25 per share by 2025e.

Dividends to remain strong



Source: Company Filings; US Research

Valuations: We expect CCO's volume growth to underperform industry average in 2023, but will recover from 2024. Cement realizations on the other hand is expected to continue to remain strong and grow steadily. Aided by these, we expect the financial performance of CCO to improve post 2023. The company is currently quoting at 27x its 2024e EPS, compared to the industry median of 25x (TTM' 1Q23), which we feel discounts all the expected upside to the stock.

Discounted Cash Flow (SAR mn)	2023E	2024E	2025E	2026E	2027E
Net operating profit after tax	95	108	129	153	170
Add Depreciation	82	82	82	80	80
Working capital changes	17	0	(2)	(9)	(7)
Less: Capex	(10)	(10)	(11)	(13)	(14)
Free cash flow to equity	**184**	**180**	**197**	**211**	**229**
PV of free cash flow to equity	**177**	**159**	**160**	**157**	**156**
Sum of PV of free cash flow to equity					**808**
Add: Terminal value					2,518
EV					**3,326**
Add: Net cash and investments					404
Less: Debt					(4)
Equity value					**3,726**
Fair value per share (SAR)					***27***

Cost of Capital	
Risk free rate	4.1%
Adjusted beta	1.1x
Equity risk premium	4.7%
Cost of equity	9.0%
Terminal growth	2.0%

Relative valuation	
2024E EPS (SAR)	0.8
Fair value P/E	20.0x
Value per share (SAR)	***16***

Methodology	Tp/Sh SAR	Wt	Avg./Sh SAR
DCF	27	50%	13
P/E	16	50%	8
Value per share			**21**

We have valued the company using an equal weight of DCF (Equity) and P/E methodologies. We have taken a cost of equity of 9.0% and terminal growth of 2% for the DCF and arrived at a value of SAR27 per share. For P/E, we have used a forward P/E of 20x, a discount of c.20% to the industry median (TTM' 1Q23), and arrived at a value of SAR16 per share. Overall, we arrive at a weighted average Target Price of SAR21 per share, which gives a Neutral rating for the company.

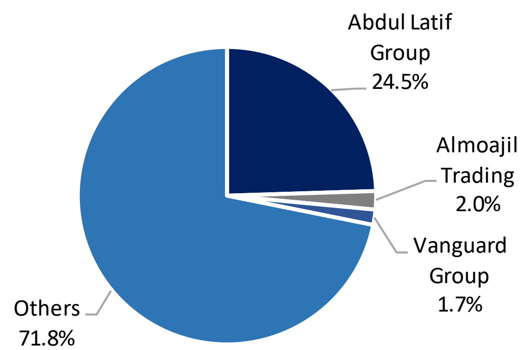
About the company

CCO was established in the year 2005 and procured a quarry license in 2004 for a duration of 30 Hijra years. The company's factory is located 135 km from the city of Riyadh and the plant started its operations in 2007 with a clinker production capacity of 5,000 tpd or c.1.75mtpa. The plant added a second production line in 2015 with an additional capacity of 5,500 tpd, taking the total clinker production to 10,500 tpd. CCO has a cement grinding capacity of 16,000 tpd.

The company has signed a MOU with UACC to acquire its entire share capital through a share swap. If the acquisition goes ahead, it will have a positive impact on the company's market share, while also giving it an entry into the Western region. During 1H23, the company was the 10th largest player in the Kingdom, in terms of cement sales with a market share of 4%. During the same period, the entire cement sales of CCO was from the domestic market.

Board of Directors		
S.no	Name	Position
1	HRH Prince Abdulaziz bin Mishaal bin Abdulaziz Al Saud	Chairman
2	Majid bin Abdurrahman Al-Osailan	CEO
3	Badr bin Omar Alabdullatif	Vice Chairman & MD
4	Saleh bin Sulaiman Al-Rajhi	Board Member
5	Mohammed bin Saad Al-Moajil	Board Member
6	Saleh bin Ibrahim Al-Shabnan	Board Member
7	Mohammed bin Hikmat Al-Zaiem	Board Member

Shareholding of CCO



Source: Company Filings; US Research

Income Statement(SAR mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Revenue	531	573	497	431	398	426	469	517	553
Cost of sales	(300)	(316)	(289)	(286)	(259)	(271)	(291)	(311)	(327)
Gross profit	**231**	**257**	**208**	**145**	**139**	**155**	**178**	**206**	**226**
Operating expenses	(36)	(37)	(34)	(35)	(34)	(36)	(37)	(39)	(40)
Operating profit	**195**	**220**	**174**	**111**	**105**	**119**	**141**	**168**	**186**
Other income	12	11	(1)	15	11	11	11	11	11
Finance expenses	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Earnings before tax	**205**	**230**	**173**	**125**	**115**	**129**	**151**	**177**	**196**
Tax	(15)	(10)	(12)	(10)	(9)	(10)	(12)	(14)	(15)
Net income	**190**	**220**	**160**	**115**	**106**	**119**	**139**	**164**	**181**

Balance Sheet(SAR mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
PP&E	1,518	1,453	1,383	1,313	1,243	1,173	1,104	1,037	970
Other non-current assets	9	6	11	14	12	11	9	9	9
Total non-current assets	**1,527**	**1,460**	**1,393**	**1,327**	**1,255**	**1,184**	**1,114**	**1,046**	**979**
Inventory	213	145	143	154	133	132	135	144	151
Receivables	40	40	28	31	29	31	34	37	40
Cash & Cash Equivalents	68	50	56	50	118	169	201	213	243
Other current assets	500	254	336	380	377	379	382	385	388
Total current assets	**822**	**489**	**563**	**614**	**657**	**711**	**752**	**780**	**823**
Total assets	**2,348**	**1,948**	**1,956**	**1,941**	**1,912**	**1,895**	**1,866**	**1,826**	**1,802**
Share Capital	1,892	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400
Total reserves	365	445	430	419	399	378	342	296	266
Total Equity	**2,257**	**1,845**	**1,830**	**1,819**	**1,799**	**1,778**	**1,742**	**1,696**	**1,666**
Payables	15	17	24	28	25	26	28	30	32
Other current liab.	53	63	73	66	60	63	67	72	75
Total current liabilities	**68**	**80**	**96**	**94**	**85**	**89**	**95**	**102**	**107**
Long-term lease liabilities	3	-	4	2	2	2	2	2	2
Other non-current liab.	20	24	26	26	26	26	26	26	26
Total non-current liabilities	**23**	**24**	**30**	**28**	**28**	**28**	**28**	**28**	**28**
Total Liabilities	**91**	**103**	**126**	**122**	**113**	**117**	**124**	**130**	**135**
Equity and liabilities	**2,348**	**1,948**	**1,956**	**1,941**	**1,912**	**1,895**	**1,866**	**1,826**	**1,802**

Cash Flows(SAR mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Cash from operations	331	382	268	164	204	201	219	234	254
Cash from investments	(492)	235	(84)	(43)	(10)	(10)	(11)	(13)	(14)
Cash from financing	(79)	(635)	(178)	(128)	(126)	(140)	(175)	(210)	(210)
Net changes in cash	(240)	(18)	6	(6)	69	51	33	12	30
Cash balance	**68**	**50**	**56**	**50**	**118**	**169**	**201**	**213**	**243**

Ratios	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Per Share (SAR)									
EPS	1.0	1.6	1.1	0.8	0.8	0.8	1.0	1.2	1.3
BVPS	11.9	13.2	13.1	13.0	12.8	12.7	12.4	12.1	11.9
DPS	-	1.5	1.3	0.9	0.9	1.0	1.3	1.5	1.5
FCF/share	(1.1)	2.6	1.8	1.1	1.4	1.4	1.5	1.6	1.7
Revenue/share	2.8	4.1	3.5	3.1	2.8	3.0	3.4	3.7	4.0
Valuations									
M.Cap (SAR mn)	3,950	3,584	3,156	2,800	3,184	3,184	3,184	3,184	3,184
EV (SAR mn)	3,398	3,291	2,783	2,400	2,715	2,665	2,632	2,620	2,590
P/E	20.8x	16.3x	19.7x	24.3x	30.2x	26.8x	22.8x	19.5x	17.6x
EV/EBITDA	12.3x	10.9x	10.8x	12.5x	14.6x	13.3x	11.8x	10.6x	9.7x
EV/Sales	6.4x	5.7x	5.6x	5.6x	6.8x	6.3x	5.6x	5.1x	4.7x
P/BV	1.8x	1.9x	1.7x	1.5x	1.8x	1.8x	1.8x	1.9x	1.9x
P/S	7.4x	6.3x	6.4x	6.5x	8.0x	7.5x	6.8x	6.2x	5.8x
Div. yield	0.0%	5.9%	5.5%	4.5%	4.0%	4.4%	5.5%	6.6%	6.6%
FCF yield	-5.3%	10.3%	8.1%	5.3%	6.1%	6.0%	6.5%	7.0%	7.5%
Liquidity									
Cash Ratio	1.0x	0.6x	0.6x	0.5x	1.4x	1.9x	2.1x	2.1x	2.3x
Current ratio	12.1x	6.1x	5.8x	6.6x	7.7x	8.0x	7.9x	7.7x	7.7x
Quick ratio	9.0x	4.3x	4.4x	4.9x	6.2x	6.5x	6.5x	6.3x	6.3x
Return ratio									
ROA	8.1%	11.3%	8.2%	5.9%	5.5%	6.3%	7.5%	9.0%	10.0%
ROE	8.4%	12.0%	8.8%	6.3%	5.9%	6.7%	8.0%	9.6%	10.9%
ROCE	8.6%	11.9%	9.5%	6.1%	5.8%	6.7%	8.1%	9.9%	11.2%
Cash cycle									
Inventory turnover	1.4x	2.2x	2.0x	1.9x	1.9x	2.0x	2.2x	2.2x	2.2x
Payables turnover	19.9x	18.9x	12.2x	10.4x	10.4x	10.4x	10.4x	10.4x	10.4x
Receivables turnover	13.4x	14.4x	17.8x	13.8x	13.8x	13.8x	13.8x	13.8x	13.8x
Inventory days	255	165	178	194	185	176	167	167	167
Payable days	18	19	29	35	35	35	35	35	35
Receivables days	27	25	20	26	26	26	26	26	26
Cash Cycle	264	171	169	185	176	167	158	158	158
Profitability ratio									
Gross margins	43.5%	44.9%	41.8%	33.7%	35.0%	36.3%	38.0%	39.9%	40.9%
EBITDA margins	52.0%	52.7%	51.7%	44.6%	46.9%	47.2%	47.6%	47.9%	48.2%
Operating margins	36.7%	38.4%	35.1%	25.7%	26.3%	28.0%	30.2%	32.4%	33.7%
PBT margins	38.7%	40.2%	34.7%	28.9%	28.8%	30.3%	32.3%	34.3%	35.5%
Net margins	35.8%	38.5%	32.3%	26.7%	26.6%	27.9%	29.7%	31.6%	32.7%
Effective tax rate	7.5%	4.2%	7.1%	7.8%	7.8%	7.8%	7.8%	7.8%	7.8%
Leverage									
Total debt (SAR mn)	5	2	5	4	4	4	4	4	4
Net debt (SAR mn)	(63)	(48)	(51)	(46)	(114)	(165)	(198)	(209)	(239)
Debt/Capital	0.2%	0.1%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Debt/Total assets	0.2%	0.1%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Debt/Equity	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
Debt/EBITDA	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
Net debt/EBITDA	-0.2x	-0.2x	-0.2x	-0.2x	-0.6x	-0.8x	-0.9x	-0.8x	-0.9x

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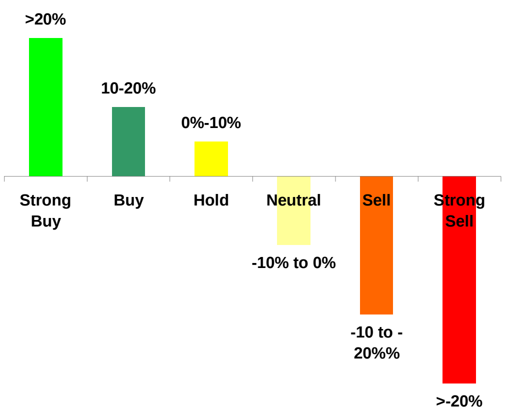
Rating Criteria and Definitions

Rating



Rating Definitions

Strong Buy	This recommendation is used for stocks whose current market price offers a deep discount to our 12-Month target price and has an upside potential in excess of 20%
Buy	This recommendation is used for stocks whose current market price offers a discount to our 12-Month target price and has an upside potential between 10% to 20%
Hold	This recommendation is used for stocks whose current market price offers a discount to our 12-Month target price and has an upside potential between 0% to 10%
Neutral	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential between 0% to -10%
Sell	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential between -10% to -20%
Strong Sell	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential in excess of 20%
Not rated	This recommendation used for stocks which does not form part of Coverage Universe

Disclaimer