Arabian cement Company
Construction and Materials – Industrial
ARCCO AB: Saudi Arabia
08 August 2019

الراجحي المالية
Al Rajhi Capital

Target price	**29.00**	1.75% over current
Current price	**28.50**	**as at 06/08/2019**

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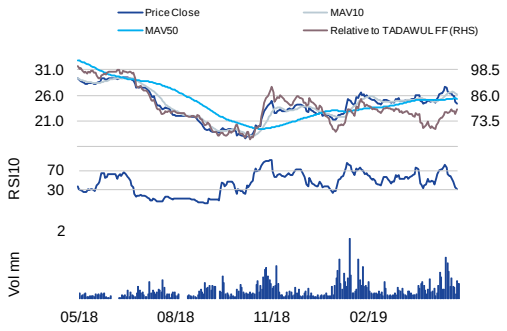
Existing rating

Underweight	Neutral	Overweight

Performance



Source: Bloomberg

Earnings

(SARmn)	2018	2019e	2020e
Revenue	601	705	722
Revenue growth	1%	17%	2%
Gross profit	38	261	267
Gross margin	6%	37%	37%
EBITDA	122	339	345
EBITDA margin	20%	48%	48%
Net profit	-26	156	162
Net margin	-4%	22%	22%
EPS	-0.26	1.56	1.62
DPS	1.00	1.50	1.50
Payout ratio	NA	96%	93%
EV/EBITDA	20.2x	9.5x	8.9x
P/E	-85.5x	18.5x	17.6x
RoE	-0.9%	5.6%	5.8%

Source: Company data, Al Rajhi Capital

Arabian Cement

Q2: Earnings beat on the back of Jordanian operations; Increase TP to SAR29/sh

Arabian Cement reported healthy net profit of SAR37mn in Q2 2019, beating our estimate of SAR27mn and consensus estimate of SAR29mn. The beat in bottom-line is mainly driven by higher than expected gross margin (which was inturn due to higher than expected selling prices], and surprisingly good performance of Jordan operations (+84% y-o-y) as it contributed to ~ 42.5% of top-line. This may be because of higher cement prices in Jordan. Jordanian operations "Qitrana" has contributed to SAR5.15mn (~14%) in Q2 up from net losses of SAR45mn in Q2 2018 to the company's bottom-line. Gross profit jumped significantly to SAR64mn (Q2 18: -SAR36mn) because of a) considerable increase in average selling price SAR214/tonne (65% y-o-y, 3% q-o-q). b) lower production cost per ton c) depreciation leading to margin expansion. So far, in Q2 earnings, we have observed a pattern of sharp increase in realized prices for most of the cement producers including Arabian Cement, reflecting their shift towards higher pricing strategy. Accordingly, we revise our estimates to reflect higher cement prices and soft demand outlook with regard to sales volumes. Further, we expect a higher contribution to net income from the Jordanian operations. The company has a healthy cash position, valuable liquid assets and higher than market average dividend yield (2019E yield: ~5.3%). Based on our revised estimates, we revise our TP to SAR29/sh (earlier SAR27/sh.) implying a "Neutral" rating.

Q2 results: Revenue increased significantly by +53% y-o-y to SAR165mn as decline in sales volumes was offset by increase in average cement price. Cement sales volume dipped to 426K tonnes in Q2 2019 (-20% y-o-y, -29% q-o-q) while average local selling price increased to SAR214 per ton (65% y-o-y, 3% q-o-q). As discussed above, the impact of higher gross profit flowed down to the bottom-line level with company reporting net income of SAR37mn, well ahead of our estimates.

Figure 1 Arabian Cement: Summary of Q1 2019 results

	Q2 2019	Q2 2018	Q1 2019	% chg y-o-y	% chg q-oq	ARC Estimate
Revenue	165	108	189	53%	-13%	159
Gross Profit	64	-36	62	NA	4%	48
Gross Margin	39%	-33%	33%	NA	NA	30%
Operating Profit	50	-52	49	NA	2%	35
Net Profit	37	-51	37	NA	1%	27

Source: Company data, Al Rajhi Capital

Valuation and risks: Post Q2 results, we revise our forward looking estimates upwards, on account of improvement in average cement prices, subdued local sales volumes and improving performance of Jordanian operations. We value the company based on an equal mix of DCF and relative valuation (forward P/E of 17.2x). The company currently trades at a forward P/E of 18.5x vs. Saudi cement peers at 22.6x. On the dividend side, we believe that the company is likely to increase its DPS to SAR1.5/sh. in 2019, owing to healthy cash position, high level of retained earnings and liquid assets (mostly listed stocks/funds). Further, the company trades at an attractive dividend yield of ~5.3%, which is positive for income seeking investors. Accordingly, we raise our target price to SAR29/sh. (SAR27/sh earlier) implying a "Neutral" rating on the stock.

The downside key risks are lower than expected market demand, lower than forecasted selling prices and lower than expected contribution from Jordanian operations. **The key upside risks** are higher than anticipated cement selling prices either in Saudi Arabia or in Jordan and higher than forecasted pick up in Government infrastructure spending.

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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