



Key themes

This is a quick update on the cement sector in Saudi Arabia, focusing on the current market dynamics and the outlook for the sector.

What do we think?

Stock	Rating	Price Target
Yamama	N	SAR 17.0
Southern	UW	SAR 37.0
Saudi	UW	SAR 47.0
Yanbu	N	SAR 27.5
Qassim	N	SAR 41.0
Arabian	OW	SAR 27.0

Saudi Cement sector: High selling prices raise companies' profitability to the top

Although local Cement demand remain under pressure for the third consecutive year, average local selling prices jumped during Q1 2019. The price increase is not due to higher demand as demand in fact decreased to 10.7mn ton (-9% y-o-y, 3%q-o-q) but its related to producers' preference towards end of the price war and focusing on higher prices rather than market share. On the other hand, as local demand remained weak export went up to 2.51mn tones (64% q-o-q). Going forward, we expect demand to drop significantly in the coming two quarters due to seasonality factors (Ramadan, Eid and summer vacation). However, we believe the current sales prices to remain firm as producers are now focused more on pricing rather than volume. Further, the cement demand will continue to decline in 2019, on the back of limited capital spending by the government, coupled with rising construction costs. The government's announced mega projects (including Neom, Qiddiya, Red Sea Tourism and social housing) are likely to create an incremental demand only in the long-term, in our view. In addition, we believe export will increase further as the weak local market continues, which could help the sector to liquidate the current huge inventory level. Overall, we remain on Neutral on the sector, given the current weak market dynamics.

Weak cement demand to continue in 2019

- In 2018, total cement dispatch in the Kingdom continued to decline for the third consecutive year, down by 13% y-o-y to ~40.9mn tons, primarily due to weak construction activities (Figure 1).
- On Regions level, the southern (1Q19: 21%, 1Q18: 15%) and central (1Q19: 29%, 1Q18:24%) regions were able to capture more market shares on the account of other regions. Western region impacted the most, with the market share falling to 23% (-890 bps drop y-o-y) in 2019 Q1, weighed down by lower sales volume of Yanbu Cement (-44% y-o-y drop; -470bps decline in the market share) and Arabian Cement (-42%; -310bps). Eastern region too has contracted slightly (2019 Q1 market share: 17% vs. 16% in Q1 2018) in 2019 Q1.
- The construction sector is expected to remain under pressure in 2019, due to limited capital spending by the government, coupled with rising costs for the construction companies (such as Al Khodari) on higher labour costs and energy prices, and the exodus expats workers. Consequently, we expect the total cement demand to decline by 5% y-o-y to reach ~38mn tons.

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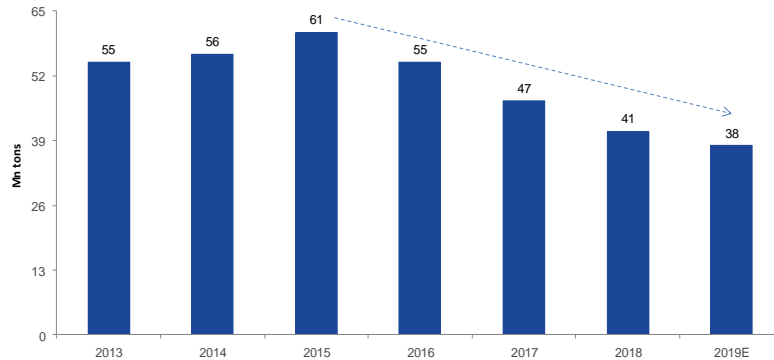
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Figure 1 Cement demand in the Kingdom

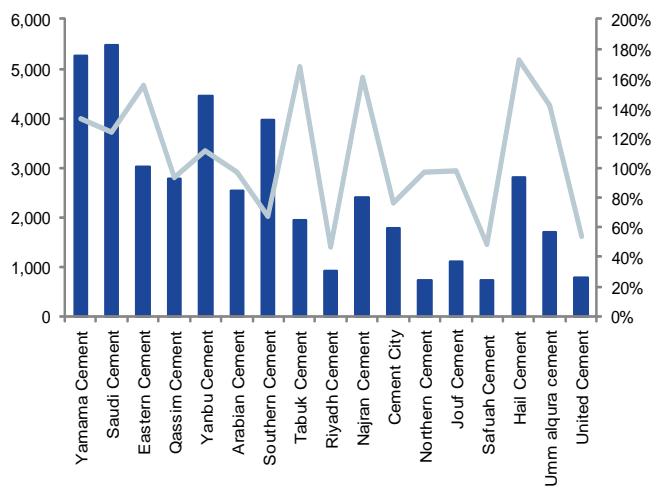


Source: Yamama Cement, Al Rajhi Capital

Exports picking up

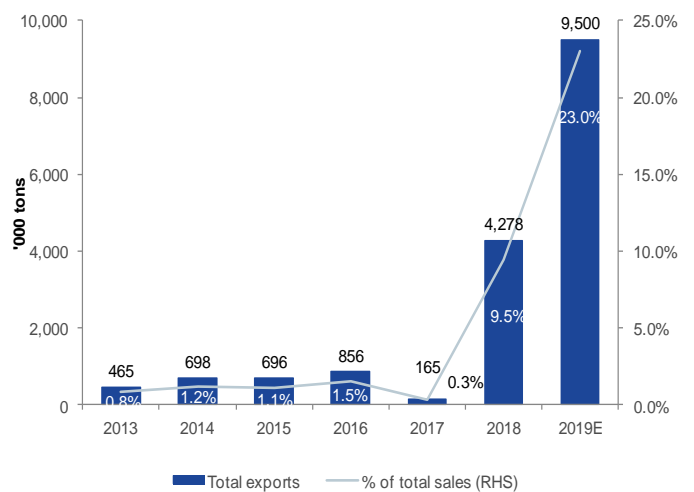
- Lower domestic demand has pushed the producers to start exporting more quantities outside the Kingdom. In Q1 2019, Saudi companies had exported 2.04mn tons of clinker and 459k tons of cement in Q1 (Vs 127k tons of clinker and 38K tons of cement in the same period last year) accounting for 18.8% of the total sales compared to 1.4% for the same period last year.
- Further, the growing exports sales has helped to relief some inventories as the market inventory had declined by ~4% as in April compared with the start of year, accumulating the market inventory to 40.65mn tons (accounting to 103% of the last 12m sales).
- We believe that the new export opportunities had allowed the companies to focus more on prices and to liquidate the huge accumulated inventories level amid weak domestic cement demand. However, the average realized export prices could be lower, largely due to oversupply market condition in the most of neighbouring countries and due to shipping and transportation associated fees. Accordingly, we expect total exports to reach ~9.5mn tons (cement + clinker) in 2019.

Figure 2 Inventory as a of 12month sales



Source: Yamama Cement, Al Rajhi Capital

Figure 3 Exports continue to increase in 2019



Source: Yamama Cement, Al Rajhi Capital

- The top exporters, who are likely to witness a jump in their exports, are shown below.
 - **Southern Province Cement Co.:** The company signed deals to export 1.5mn tons of clinker to Bangladesh (starting from Jan 2019 to June 2020) and 20k tons of cement to Yemen. If we assume average price of SAR75 per ton for clinker and SAR80 per ton for cement, then export revenue from these deals would be ~SAR114.1mn (SAR112.5mn for clinker and SAR1.6mn for cement). This will reduce the total clinker inventory level of 3.3mn tons as of March 2019, as well increase the EPS to SAR2.2 for 2019.
 - **Yanbu Cement:** If the company is able to maintain the current level of export, then it can export ~3.5mn tons of clinker and 0.5mn tons of cement in 2019, implying an export revenue of ~SAR310mn in 2019. Further, this will also bring down the total clinker inventory level of 3.9mn tons as of March 2019 while increasing the EPS to SAR1.36 for 2019.
 - **Saudi Cement:** Based on the current export run-rate, we expect the company to export ~1.2mn tons of clinker and 0.9mn tons of cement, enabling the company to generate ~SAR405mn of revenue (higher average export price as most of the export is towards Bahrain).
- We can also witness the incremental export activities for the other companies like Jouf (50k tons of cement to Palestine), Tabuk (150k tons of clinker to Yemen + MOU of additional 600k tons of clinker to Yemen), Qassim Cement contract to Export 120k of cement to Kuwait during 2019 and Northern Cement (plans to export the white cement following the inauguration of its White Cement Production Line project, which would be the largest production line in the world with a production capacity of 1,500 tons per day).

Local prices: In Q1 2019, we observed that the producers reported a substantial rise in average realized cement prices (ranges from 25-40% q-o-q), reflecting the continuous price balance strategy and end of price war among companies. It seems producers have tested the market in Q4 2018 with average price level near SAR150 per ton and now they raised it up to reach ~SAR200. In addition, in Q4 not all of the companies followed the same strategy as we believe only centre, western and northern companies were among them, however, we believe southern and eastern province companies also followed the same strategy as their prices went up around 35% and 25% q-o-q respectively.

Below, we present the cement prices outlook under different market scenarios.

- **Scenario 1:** If the cement demand remains broadly at the current level or increases in only one particular region (for an example, the Western region, due to mega projects such as Neom), then the current rise in cement prices seems to be sustainable, in our view. However, in case of any sharp and sustainable rise in demand across the regions, producers are expected to liquidate their huge inventory back-log by lowering their sales prices.
- **Scenario 2:** In case of a significant decrease in demand across all the regions, the cement producers are likely to keep the prices at the optimum level with limited downside potential. On the other hand, if the cement demand decreases sharply only in one region, then producers of that particular region may shift to other regions to maintain/regain their market shares and liquidate some of its inventory position. This will also pressurize the other producers to keep the sales prices.



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