Saudi Cement Sector, *cementing the future…*

21 May 2023

Company	Rating
Saudi Cement Co. (SACCO)	Accumulate
City Cement Co. (CITYC)	Buy
Qassim Cement Co. (QACCO)	Hold
Yamama Cement (YACCO)	Accumulate

- **The KSA construction sector is poised for robust growth supported by improving government fiscal position amid recovery in oil prices.**
- **Strong mega projects pipeline under "Vision 2030" provides strong demand visibility for the construction materials such as cement in the KSA.**
- **Favorable demographics and rapid urbanization to propel housing demand, benefitting the cement sector.**
- **Domestic cement producers well positioned to leverage construction activity recovery with ample capacity and inventory levels**

We initiate our coverage on the Saudi Arabia Cement Sector with four companies – Saudi Cement Co. (SACCO), City Cement Co. (CITYC), Qassim Cement Co. (QACCO), and Yamama Cement Co. (YACCO). Our overall view on the sector is positive, driven by sustainable economic growth, improving sector dynamics underpinned by mega projects, and favorable housing demand supported by demographic trends. We have used a combination of different valuation methodologies (DCF, DDM and peer-group P/E and EV/EBITDA multiples) to arrive at our target price.

- **KSA GDP growth to moderate after a strong FY22.** The KSA economy experienced a significant boost in GDP during FY22, driven by a pick-up in demand as the economy reopened post pandemic related lockdowns and an increase in crude oil prices. This boost led to a fiscal surplus, allowing the government to increase its spending on construction activities. Additionally, rapid urbanization in the country has increased the demand for housing as young populations shift to cities. This surge in demand for housing and increased spending on construction activities is expected to benefit cement, a major raw material used in construction. With a focus on construction and infrastructure development, the Saudi Arabian economy is poised for growth in the coming years.
- **Construction of Megaprojects under "Vision 2030" to boost demand for cement in Saudi Arabia.** Saudi Arabia has plans to diversify its economy away from oil and focus on other non-oil sectors. Under its Vision 2030 plan, the country aims to build megaprojects to attract tourism, improve healthcare, and enhance other sectors of the economy. These projects include major initiatives like the Neom City Project, worth USD 500 billion, ROSHN worth USD 90 billion, King Salman International Park worth USD 23 billion, among others, and are expected to increase the demand for cement in the future. Cement companies near these projects will likely experience better demand and price dynamics.
- **Strong growth prospects for KSA cement producers driven by construction activities:** Domestic cement producers in Saudi Arabia are well-positioned to benefit from the pick-up in construction activities. This growth in demand is expected to create ample opportunities for cement manufacturers to increase their production capacity and improve their utilizations, catering to the incremental cement demand in the region. As a result, higher sales volume, steady realizations, and healthy financial performance are expected going forward.

Name	Last Px (SAR)	Target Price (SAR)	Upside / (Downside) (%)	P/E'23e, (x)	P/B'23e, (x)	EV/EBITDA' 23e, (x)	ROE'23e, (%)	Cash Div Yield, %
Saudi Cement	56.9	**63.0**	10.7%	20.8	4.0	13.7	18.8%	6.2%
City Cement	22.1	**26.5**	20.0%	19.3	1.7	12.1	8.9%	6.3%
Qassim Cement	67.8	**64.3**	-5.1%	25.1	3.7	18.0	14.7%	4.4%
Yamama Cement	33.1	**38.0**	14.7%	17.4	1.4	12.8	8.2%	3.0%
Average				**20.7**	**2.7**	**14.2**	**12.7%**	**5.0%**

Source: Bloomberg, U Capital Research; Last price as on 18 May 2023

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Valuation

We have used DCF, DDM, P/E-based valuation, and EV/EBITDA multiple and assigned 50% weightage to DCF, 15% each to P/E-based valuation, and EV/EBITDA multiple and 20% to DDM to derive the target price for each cement company. For DCF and DDM, we have used a 5-year explicit forecast period (2023-27) and afterward have assumed a 2% terminal growth rate. We have then calculated the present value of future cash flows/dividends (Enterprise Value/Fair Value) using the weighted average cost of capital (WACC). After arriving at the enterprise value, we have made the required adjustments such as net debt, minorities, investments, pension obligations to derive equity value for the company.

For the relative valuation, we have considered the average 1Y TTM of relevant peers due to the unavailability of forward data. The adjusted P/E and EV/EBITDA multiples are then multiplied by the forecasted FY23 EPS and EBITDA, respectively.

Valuation

	SACCO	CITYC	QACCO	YACCO
(Currency)	*SAR*	*SAR*	*SAR*	*SAR*
DCF (50% Weight)				
PV of Free Cash Flow (mn)				
Sum of PV of FCFs (Year 1 to 5)	2,501	914	1,287	1,783
Terminal	11,758	4,082	5,829	11,738
Total PV of Excess Returns	8,153	2,640	3,893	7,445
Equity value (mn)	10,341	3,935	6,084	8,136
Target Price	***67.6***	***28.1***	***67.6***	***40.2***
DDM (20% Weight)				
PV of Dividends (mn)				
Sum of PV of Dividends (Year 1 to 5)	2,351	1,015	1,473	1,468
Terminal	10,721	3,993	7,107	9,304
Total PV of Excess Returns	7,433	2,582	4,747	5,901
Fair value (mn)	9,785	3,597	6,220	7,370
Target Price	***64.0***	***25.7***	***69.1***	***36.4***
Assumptions				
Risk Free Rate (%)	4.3%	4.3%	4.3%	4.3%
Adj. Beta	0.61	0.8	0.69	0.9
Risk Premium (%)	7.0%	7.0%	7.0%	7.0%
Cost of Equity (COE) (%)	8.6%	9.9%	9.1%	10.6%
WACC (%)	8.2%	9.9%	9.1%	10.3%
Outstanding Shares (mn)	153	140	90	202
P/E Based Relative Valuation (15% weight)				
Target multiple for 2023e	20	20	20	20
EPS 2023e	2.74	1.14	2.7	1.9
Target Price	***54.8***	***22.9***	***54.0***	***38.1***
EV/EBITDA Based Relative Valuation (15% weight)				
Target multiple for 2023e	13	13	13	13
EBITDA 2023e	665.67	250.87	327.24	592.79
Target Price	***54.5***	***26.0***	***57.3***	***32.7***
Weighted Average Target Price	**63.0**	**26.5**	**64.3**	**38**
Current Market Price	*56.9*	*22.1*	*67.8*	*33.1*
Upside/(Downside), %	10.7%	20.0%	-5.1%	14.7%
Recommendation	**Accumulate**	**Buy**	**Hold**	**Accumulate**

Source: Company Filings, Bloomberg, U Capital Research

Risks to Valuation

Key downside risks to our valuations include:

- Fall in demand might impact realization prices which can restrict revenue growth during the forecasted period.
- Slow pick-up of construction activities led by weak economic growth may lead to lack of cement demand.

Key upside risks to our valuations include:

- Commissioning more megaprojects can increase the demand for cement which can boost volume as well as realization for the companies.
- More M&As in the sector can help the companies to gain market share and increase production volume.

Sensitivity Analysis

Our TP for **Saudi Cement** changes about +/-1-2% to +/- 0.25% changes to terminal growth or in WACC assumptions. Our TP also changes less than +/-1% to +/- 0.5x changes in the target P/E multiple.

Saudi Cement

WACC \ Terminal growth	1.5%	1.8%	2.0%	2.3%	2.5%
7.7%	63.03	64.59	66.29	68.13	70.15
8.0%	61.53	62.99	64.57	66.28	68.15
8.2%	60.15	61.51	**62.99**	64.57	66.30
8.5%	58.85	60.13	61.51	63.00	64.61
8.7%	57.64	58.84	60.14	61.53	63.04

P/E multiple \ 2023e EPS (SAR)	1.74	2.24	2.74	3.24	3.74
19.0x	59.73	61.15	62.58	64.00	65.43
19.5x	59.86	61.32	62.78	64.25	65.71
20.0x	59.99	61.49	**62.99**	64.49	65.99
20.5x	60.12	61.66	63.19	64.73	66.27
21.0x	60.25	61.82	63.40	64.97	66.55

Our TP for **City Cement** changes about +/-2-3% to +/- 0.25% changes to terminal growth or in WACC assumptions. Our TP also changes less than +/-1% to +/- 0.5x changes in the target EV/EBITDA multiple.

City Cement

WACC \ Terminal growth	1.5%	1.8%	2.0%	2.3%	2.5%
9.4%	26.80	27.28	27.78	28.32	28.90
9.6%	26.23	26.67	27.13	27.63	28.17
9.9%	25.69	26.09	**26.53**	26.99	27.49
10.1%	25.17	25.56	25.96	26.39	26.85
10.4%	24.69	25.05	25.43	25.83	26.26

EV/EBITDA multiple \ 2023e EBITDA (SAR mn)	151	201	251	301	351
13.0x	26.26	26.26	26.26	26.26	26.26
13.5x	26.40	26.40	26.40	26.40	26.40
14.0x	26.53	26.53	**26.53**	26.53	26.53
14.5x	26.66	26.66	26.66	26.66	26.66
15.0x	26.80	26.80	26.80	26.80	26.80

Our TP for **Qassim Cement** changes about +/-1-2% to +/- 0.25% changes to terminal growth or in WACC assumptions. Our TP also changes less than +/-1% to +/- 0.5x changes in the target EV/EBITDA multiple.

Qassim Cement

WACC \ Terminal growth	1.5%	1.8%	2.0%	2.3%	2.5%
8.6%	64.99	66.27	67.64	69.12	70.72
8.9%	63.48	64.66	65.92	67.29	68.75
9.1%	62.07	63.16	**64.33**	65.58	66.94
9.4%	60.74	61.76	62.84	64.00	65.25
9.6%	59.50	60.45	61.46	62.53	63.68

EV/EBITDA multiple \ 2023e EBITDA (SAR mn)	227	277	327	377	427
12.0x	63.78	63.78	63.78	63.78	63.78
12.5x	64.06	64.06	64.06	64.06	64.06
13.0x	64.33	64.33	**64.33**	64.33	64.33
13.5x	64.60	64.60	64.60	64.60	64.60
14.0x	64.87	64.87	64.87	64.87	64.87

Our TP for **Yamama Cement** changes about +/-1-2% to +/- 0.25% changes to terminal growth or in WACC assumptions. Our TP also changes less than +/-1% to +/- 0.5x changes in the target EV/EBITDA multiple.

Yamama Cement

WACC \ Terminal growth	1.5%	1.8%	2.0%	2.3%	2.5%
9.8%	38.46	39.29	40.17	41.10	42.10
10.1%	37.45	38.22	39.04	39.91	40.84
10.3%	36.50	37.22	**37.98**	38.79	39.66
10.6%	35.60	36.27	36.99	37.75	38.55
10.8%	34.75	35.38	36.05	36.76	37.51

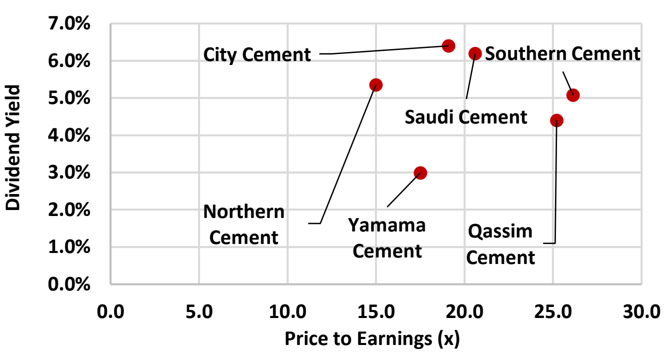
EV/EBITDA multiple \ 2023e EBITDA (SAR mn)	493	543	593	643	693
12.0x	37.54	37.54	37.54	37.54	37.54
12.5x	37.76	37.76	37.76	37.76	37.76
13.0x	37.98	37.98	**37.98**	37.98	37.98
13.5x	38.20	38.20	38.20	38.20	38.20
14.0x	38.42	38.42	38.42	38.42	38.42

Peer Group Valuation

Name	Mkt Cap (SAR mn)	Last Px (SAR)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	EV/EBITDA' 23e, (x)	P/E'23e, (x)	ROE'23e, (%)	Div Yield' 23e, (%)	FCF Yield'22 (%)
Cement										
SOUTHERN PROVINCE CEMENT CO	7,210	51.5	-2%	3%	1%	NA	25.7	8.2%	5.2%	2.4%
NAJRAN CEMENT CO	2,390	14.1	-4%	12%	17%	NA	NA	NA	5.2%	1.8%
YANBU CEMENT CO	5,694	36.2	3%	2%	1%	NA	23.1	NA	NA	7.8%
NORTHERN REGION CEMENT CO	2,192	12.2	1%	10%	13%	NA	15.0	NA	5.3%	1.8%
SAUDI CEMENT	8,706	56.9	1%	8%	12%	13.7	20.8	18.8%	6.2%	6.5%
CITY CEMENT CO	3,094	22.1	2%	9%	1%	12.1	19.3	8.9%	6.3%	5.0%
QASSIM CEMENT/THE	6,102	67.8	-1%	2%	12%	18.0	25.1	14.7%	5.2%	0.2%
YAMAMA CEMENT CO	6,703	33.1	-2%	11%	23%	12.8	17.4	8.2%	3.0%	NA
Average						**13.1**	**21.4**	**13.1%**	**5.0%**	**3.6%**
Median						**13.2**	**22.3**	**12.4%**	**5.2%**	**2.4%**

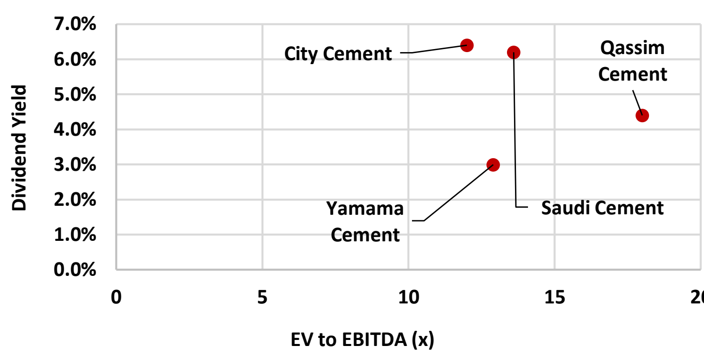
Source: Bloomberg, U Capital Research, values as of 18 May 2023

Fig. 1: Cement - Price to Earnings & Dividend Yield



Source: Bloomberg, U Capital Research, as of 18 May 2023

Fig. 2: Cement - EV to EBITDA & Dividend Yield



Source: Bloomberg, U Capital Research, as of 18 May 2023

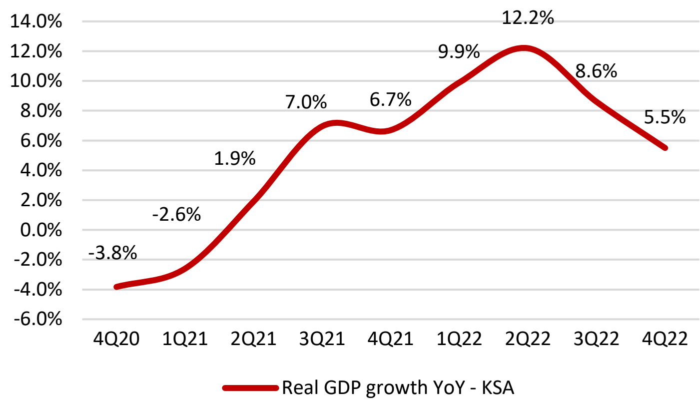
Macro-economic & Sector Overview

GDP growth expected to moderate after strong growth in FY22

The Saudi Arabian economy experienced a significant boost in GDP during FY22 driven by a pickup in oil prices and demand as the economy reopened. In FY22, Saudi Arabia's GDP grew by 8.7%, the highest YoY growth in 11 years as the economic recovery was aided by a sharp rebound in energy prices, particularly crude oil and natural gas, which are major revenue sources for the country.

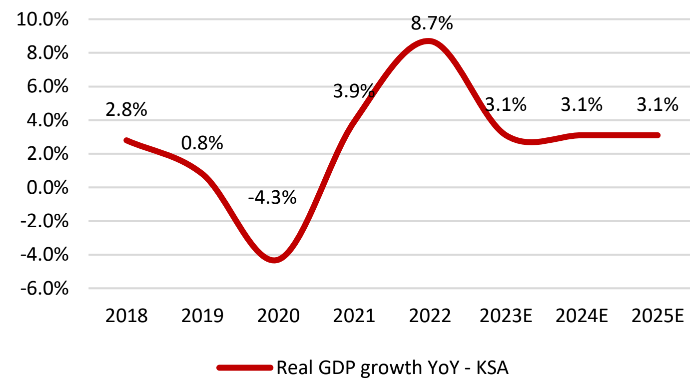
Looking ahead, the IMF expects that Saudi Arabia's GDP growth will slow down to a moderate pace of 3% during the years 2023-2025, mainly due to lower oil production as agreed with OPEC+. However, the non-oil sector of the economy is expected to grow at a relatively faster pace.

Fig. 3: Saudi GDP showed strong growth post-pandemic



Source: **General Authority for Statistics, Saudi Arabia, *U Capital Research***

Fig. 4: Saudi economy growth to normalize from 2022 levels



Source: IMF, U Capital Research

Improving fiscal balance to boost government spending

Most GCC countries, including Saudi Arabia, have faced significant budgetary pressures due to the sharp decline in energy prices between 2015 and 2020. This led to the implementation of austerity measures, which had a further impact on investment spending and consumption across the region. However, since 2020, energy prices, especially crude oil and natural gas, have shown a sharp recovery due to various factors such as the OPEC+ production cut agreement, gradual demand recovery post-Covid era, geopolitical issues, and logistics challenges. Higher energy prices have increased government revenues, significantly easing fiscal pressures, as evidenced by the actual performance of 2022 and the expected higher government revenues for 2023. In 2022, Saudi Arabia recorded revenue of SAR 1.26 trillion, resulting in a fiscal surplus of SAR 103.85 billion. Oil revenue, which contributed 68% of total revenue, grew by 52% YoY. The 2023 budget for Saudi Arabia is conservative, reflecting a cautious approach to any major development in the domestic or global economy. The expenditure is expected to increase due to the implementation of capital projects delayed by Covid-19 and the Vision 2030 programs and Giga projects. Despite increased expenditure, it is expected that Saudi Arabia will achieve a fiscal surplus of 0.4% of GDP in 2023.

Furthermore, it is expected that the general government gross debt as a percentage of GDP in Saudi Arabia will decline, mainly driven by higher fiscal revenue. This will create further room to increase spending across various sectors, especially infrastructure, as it is expected to have a major role in the success of Saudi Vision 2030. Increased spending on infrastructure will have a positive impact on cement demand in the country.

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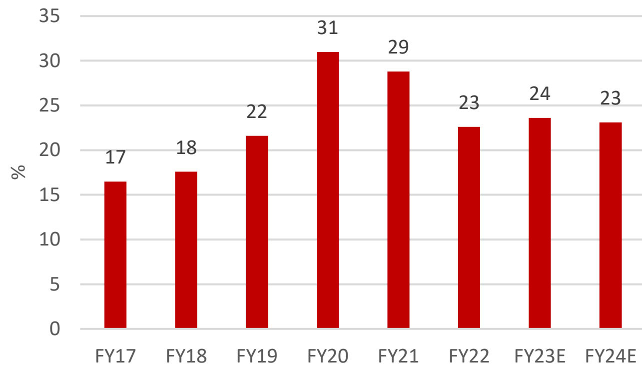
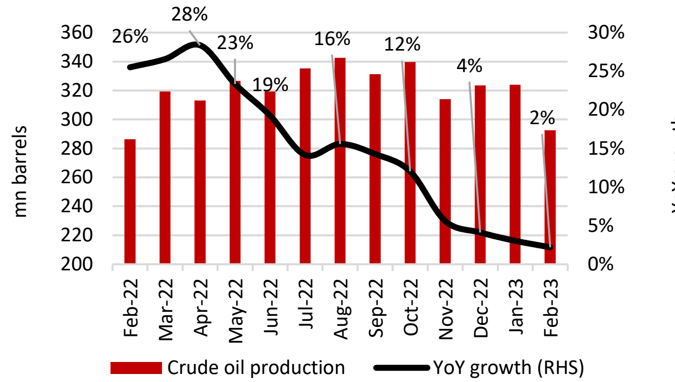
Fig. 5: Saudi Arabia Gross Debt % of GDP



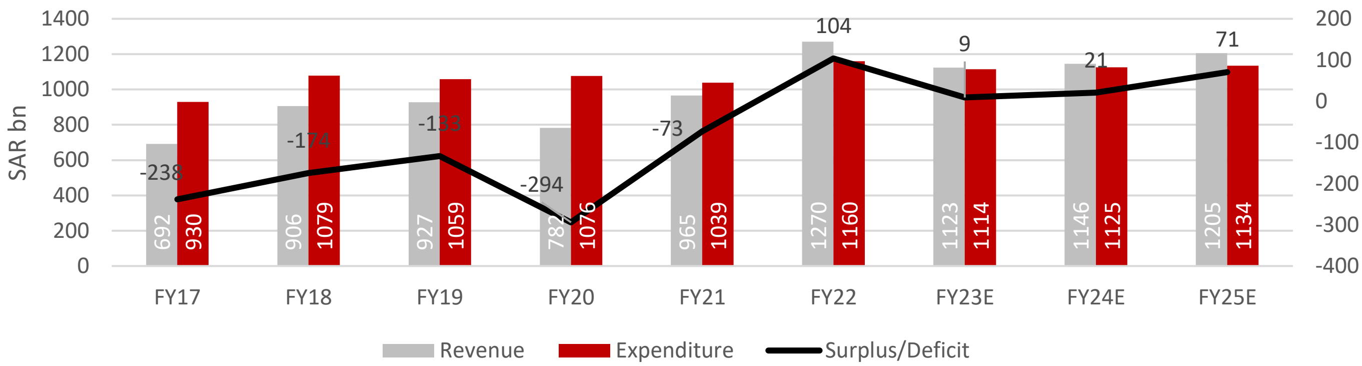
Source: IMF, U Capital Research

Fig. 6: Production of crude oil has been falling in Saudi Arabia



Source: Energy Information Administration, U Capital Research

Fig. 7: Improving Saudi Arabia Fiscal Budget (SAR bn)



Source: **General Authority for Statistics, Saudi Arabia*, U Capital Research***

Construction sector set for strong growth led by planned mega projects

Like other GCC countries, Saudi Arabia has also been focusing on diversifying its economy to reduce its reliance on energy prices and increase contributions from non-oil sectors. To achieve this, Saudi Arabia has laid out long-term strategic plans under "Vision 2030". The country has been investing heavily in infrastructure development, particularly in sectors such as transportation, energy, and healthcare. As a result, the construction sector is expected to receive significant government support in the coming years, leading to likely higher demand for construction materials such as cement.

Below are some of the big-ticket projects which would help the governments to achieve their long-term goals:

Major projects in Saudi Arabia

According to Mordor Intelligence report, in 2023, the Saudi Arabian construction industry was valued at USD 140.2 billion, with a projected 5% growth from 2023 to 2028. The Saudi government has allocated approximately 14% (SAR 157 billion) of the total expenditure (SAR 1.14 trillion) towards capital expenditure, representing a YoY increase of 4.7%. The ongoing construction of megaprojects such as NEOM and Qiddiya is expected to drive growth in construction activities in Saudi Arabia, leading to increased demand for cement.

In the table below, we show mega projects along with strong construction spending is likely to boost demand the building and construction materials including Cement which should benefit local cement companies in the KSA.

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Projects	Description	Project Value (USD bn)
Neom City Project	Neom City Project is a planned cross-border city in northwestern Saudi Arabia, Tabuk Province located in the northern part of Red sea. Covering an estimated area of 26,500 km extending 460 km on the coast of the Red Sea, the project will have smart city technologies and be an attractive tourist destination. The first phase of the Neom City Project is expected to complete by 2025.	500
Qiddiyah City Development Project	Qiddiyah City Development Project is a megaproject that focuses on entertainment and is currently under development in Al Qidiya, which is 45 km from Riyadh. The project occupies a total of 334 sq. km with a planned build-up area of 223 km. Qiddiyah City project has been divided into five development areas, such as a Resort Core, a City Centre, an Eco Core, a Motion Core, and a Golf and Residential Neighborhood.	8
Riyadh Metro Project	Riyadh Metro Project is a transit system, including six metro lines that span a total length of 176 km. It will be served by 85 stations that will include several interchange stations.	22.5
King Salman International Park	Saudi Arabia launched an ambitious project in 2023. Construction will begin this year on four schemes — King Salman Park, Sports Boulevard, Green Riyadh and Riyadh Art. The four projects - King Salman Park, Sports Boulevard, Green Riyadh and Riyadh Art – will complement the Saudi Vision 2030's "Quality of Life" Program and are aligned with the UN Sustainable Development Goals	23
Rua Al Madinah	Rua Al Madinah Project which will be constructed in the area east of the Prophet's Mosque and the project will raise the capacity to facilitate hosting 30 million Umrah pilgrims by 2030. After rehabilitating 1.5msqm, the project is set to add over 47,000 hotel rooms by 2030. It will also boost the hotel inventory of the area on the east side of the Prophet's Mosque, including the luxury segment.	10
Diriyah Gate	The project is located just 20 minutes northwest of Riyadh's city center, Diriyah will be transformed into one of the world's foremost lifestyle destinations for culture and heritage, hospitality, retail, and education, and will become one of the world's great gatherings places	20
ROSHN	Saudi Arabia has an ambitious target of building 1mn affordable residential units across the kingdom over the next five years through Roshn, a leading Saudi real estate developer powered by PIF.	90
Alula project	The AlUla Project is a long-term plan to preserve a living museum of cultural heritage. Saudi Arabia plans to transform Alula desert landscape into a tourist destination for travelers eager to see preserved tombs, monuments, and sandstone structures. The project will include sub-projects such as The Sharaan Resort and Nature Reserve, a luxury holiday destination scheduled to open in 2024. The project is expected to attract 2Mn annual visitors, contribute SAR 120bn to the GDP and create 38k jobs by 2035.	15

Source: Media articles, U capital Research

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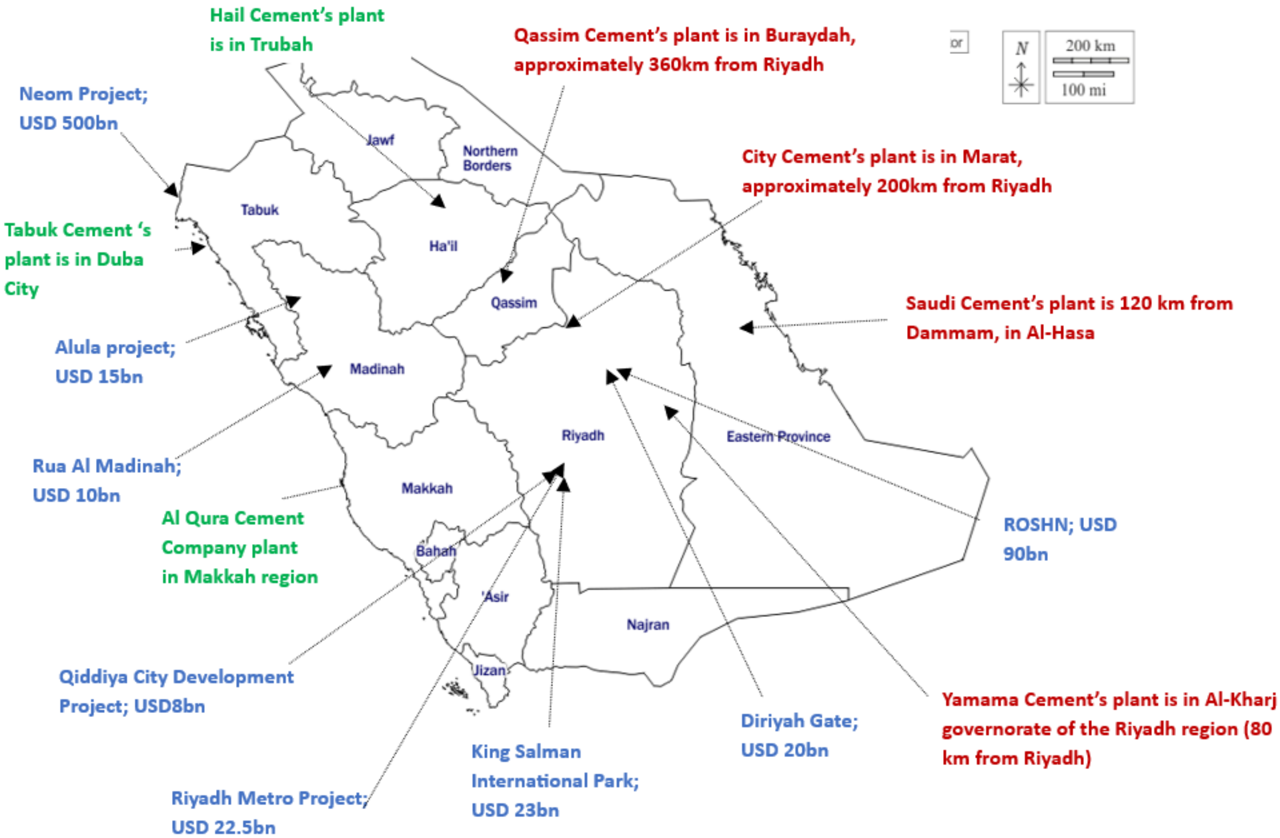
Mega- Projects in KSA and its proximity to Cement producers



Source: Media Articles, Company website, U Capital Research

Rising population and rapid urbanization to increase housing demand

Saudi Arabia benefits from a favorable demographic profile, with a large and growing population, more than half of whom are under 30. The population is projected to continue growing at an annual rate of 2.5%, according to the IMF, reaching 36.92mn in 2025 from 34.79mn in 2022. A young and expanding population typically drives urbanization and reduces household size, which leads to increased demand for housing. Historically, homeownership rates in Saudi Arabia have been low, but "Vision 2030" aims to increase this to 70% by 2030. The strong demand for housing is reflected in the rapidly growing mortgage market, which surged from SAR 14.9bn in 2016 to SAR 152.5bn in 2021 before normalizing at SAR 120.3bn in 2022.

Furthermore, the unemployment rate in Saudi Arabia has fallen to 8% in 4Q22 from 11.7% in 1Q21, giving locals greater purchasing power and potentially boosting demand for housing. We anticipate that although the growth rate may be lower than that seen in 2020-21, housing demand will remain strong in the future, driven by population growth, decreasing unemployment, and urbanization. This will ultimately increase the demand for cement, which is a crucial raw material for housing construction.

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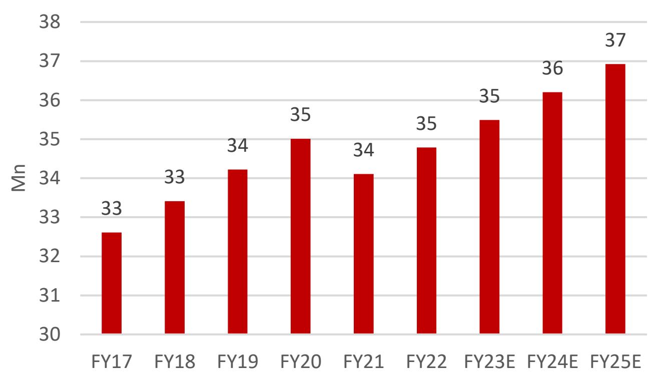
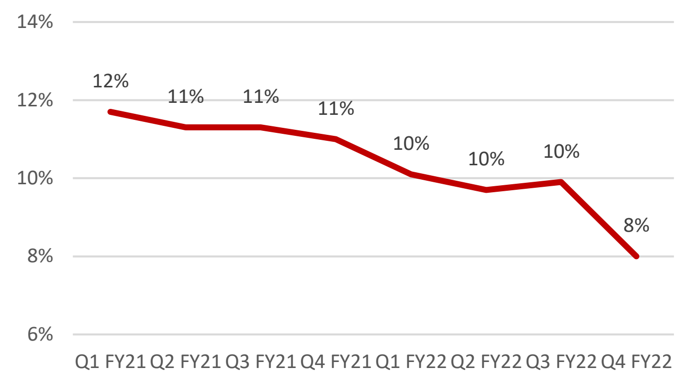
Fig. 8: Saudi Arabia population is expected to grow at a good pace



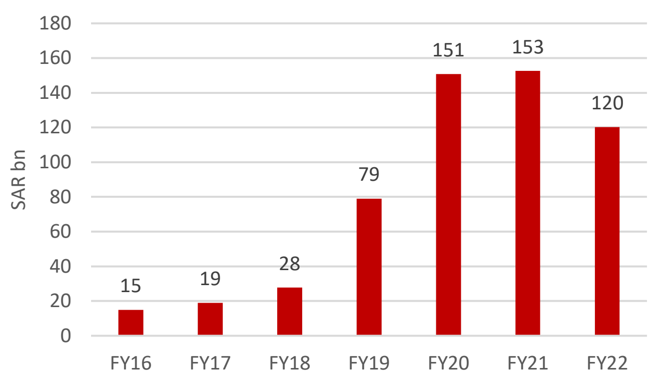
Source: International Monetary Fund, U Capital Research

Fig. 9: Saudi Arabia Unemployment Rate (%)



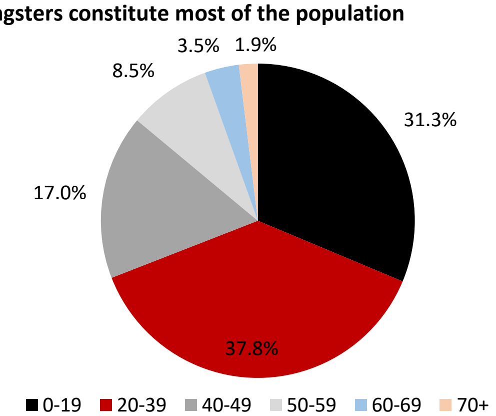
Source: General Authority for Statistics, Saudi Arabia, U Capital Research

Fig. 10: Strong Growth in Residential New Mortgages Finance



Source: Argaam, U Capital Research

Fig. 11: Youngsters constitute most of the population



Source: General Authority for Statistics, Saudi Arabia, U Capital Research

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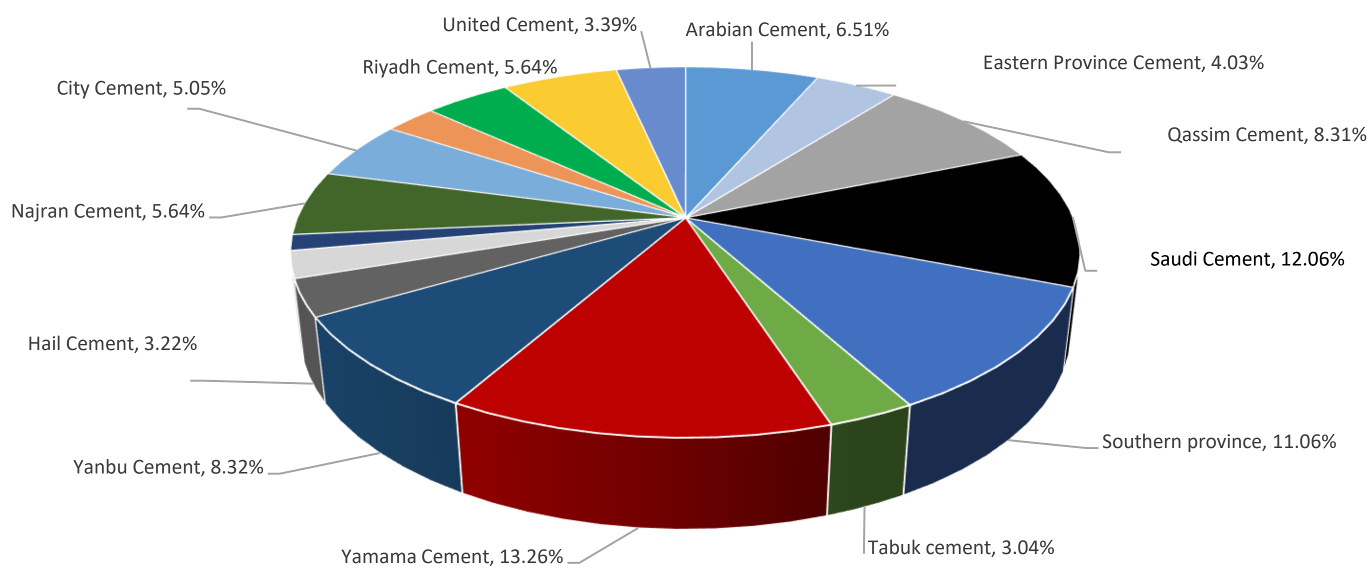
Saudi Arabia's cement industry – an overview

Highly fragmented market

The Saudi Arabian cement industry is a highly fragmented market, with a large number of small and medium-sized players operating alongside a few larger companies. The industry is characterized by intense competition, with companies vying for market share through price wars and aggressive marketing tactics. Despite being one of the largest cement producers in the world, the Saudi cement industry faces several challenges, including rising energy costs, a shortage of skilled labor, and an unpredictable regulatory environment.

To stay competitive in this challenging market, cement companies in Saudi Arabia are increasingly focusing on innovation and sustainability. Many are investing in new technologies to improve production efficiency to reduce power consumption as well as lower their environmental impact, while others are developing new products and services to meet the evolving needs of customers.

Fig. 12: Market share by sales volume in 2022



Source: Argaam, U Capital Research

Overcapacity led to Low plant utilizations, but likely better demand presents positive outlook

During 2011-2022, the production capacity of the Saudi cement industry had grown at a compound annual growth rate (CAGR) of approximately 4%, whereas cement production only increased at a sluggish CAGR of around 1%. This resulted in most cement plants operating at low utilization levels. The sluggish demand can be attributed to the government's financial pressure amid low oil prices, which has caused a delay in the progress of many large-scale construction projects. Furthermore, the outbreak of the pandemic impacted construction activities, resulting in lower production and sales volumes.

Going forward, we expect local cement producers' utilization rate and sales volume to increase, driven by increased government spending on construction activities and increased homeownership among local population.

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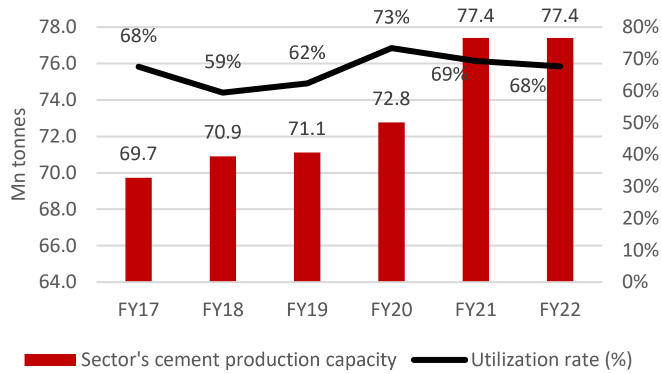
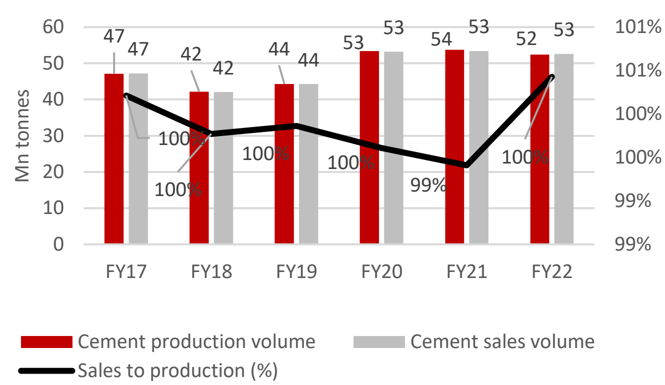
Fig. 13: Plant utilization trending between 60-75%



Source: Argaam, U Capital Research

Fig. 14: Sector's Sales to production ratio remaining near to 100%

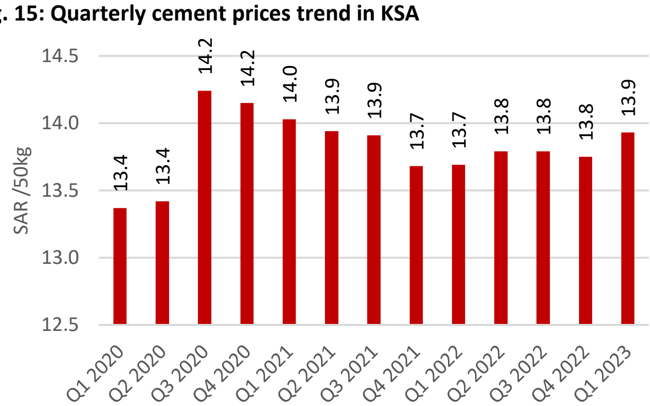


Source: Argaam, U Capital Research

Average realization price likely to increase in future

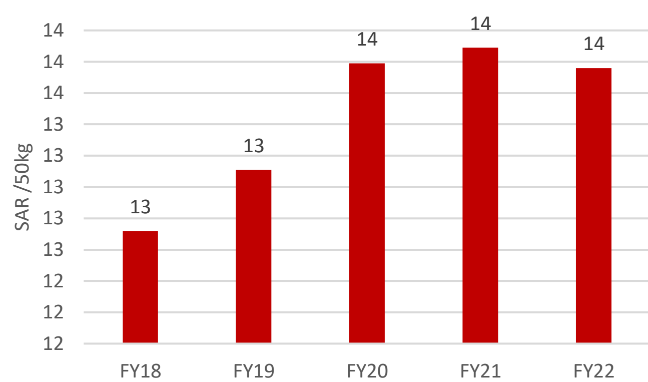
The Saudi Arabian cement sector has experienced a marginal increase in the average realization price of cement, with prices rising from SAR 13.69 per 50 kg bag in 1Q22 to SAR 13.93 per 50 kg bag in 1Q23. However, the current price remains below the peak of SAR 14.24 per 50 kg bag achieved in 3Q20. The decline in the price can be attributed to a surplus of inventory held by cement producers due to higher supply than demand. However, as the demand for cement is expected to increase in the future, we anticipate a decline in inventory levels. This, in turn, should result in an increase in the average realization price of cement over the medium term.

Fig. 15: Quarterly cement prices trend in KSA



Source: General Authority for Statistics, Saudi Arabia, U Capital Research

Fig. 16: Annual cement prices trend in KSA



Source: General Authority for Statistics, Saudi Arabia, U Capital Research

Inventory levels to go down led by a recovery in demand

During FY19, total clinker inventories in Saudi Arabia reached an all-time high of 42.5 million tons. The rise in inventory levels was due to reduced demand caused by the Saudi government's fiscal deficit resulting from low oil prices, which led to lower spending on construction activities. However, in FY21 and FY22, the economy improved with the rise in oil prices and increased government spending on construction activities, causing inventory levels to ease (FY22: 35.1 million tons). With the construction of megaprojects expected to drive demand for cement, we anticipate further decreases in inventory levels. This could lead to better realizations in the coming years for the local cement industry.

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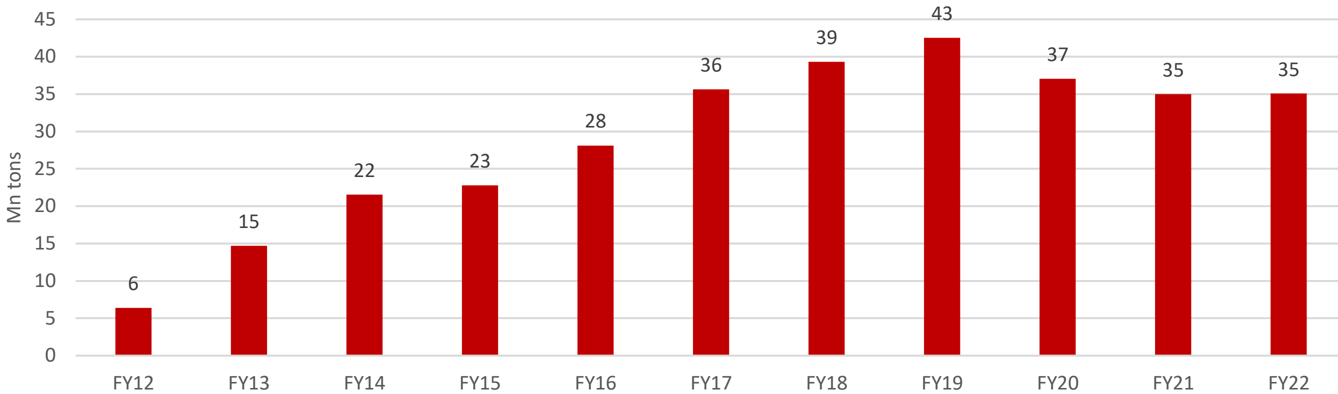
Fig. 17: Trend of Clinker inventory levels in Saudi Arabia

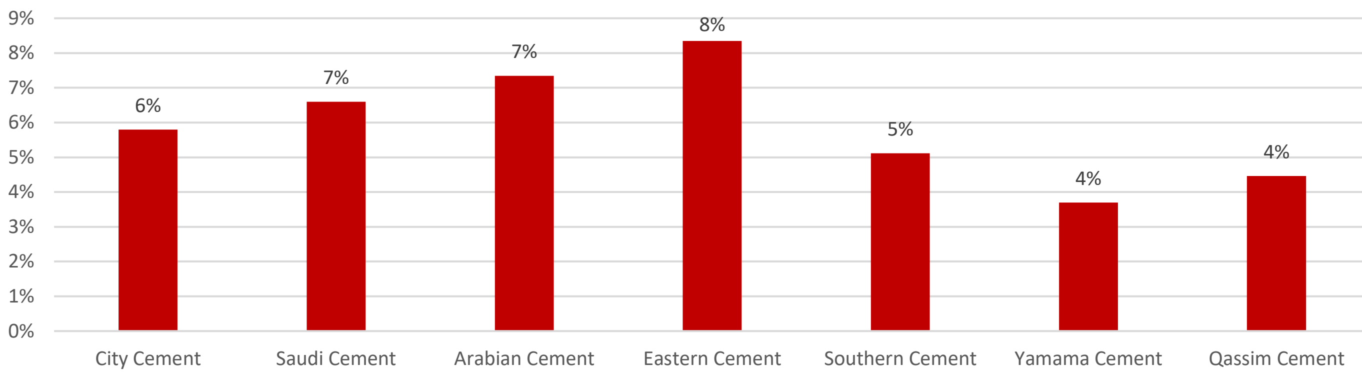


Source: Argaam, U Capital Research

Saudi cement sector: An attractive dividend play

The cement companies in Saudi Arabia have historically paid steady dividends. We anticipate that these companies are strongly positioned to maintain dividend payments in the future driven by expected decent cash flow from operations, low leverage levels and limited capital expenditure requirements given the surplus capacity availability. Accordingly, we expect sector average dividend yield to be ~6% (based on companies shown in below chart) for 2023.

Fig. 18: High Dividend Yield Expected in 2023E



Source: Company report, U Capital Research

Consolidation in the sector to lower competition pressure

The Saudi cement sector has been highly fragmented, but there have been discussions about consolidation in the industry in recent times. This is evidenced by the memorandum of understanding (MoU) signed between Umm Al-Qura Cement and City Cement in April 2023, wherein City Cement will acquire all 55 million issued shares of Umm Al-Qura Cement. Similarly, in September 2022, Qassim Cement and Hail Cement signed an MoU, with Qassim acquiring all the issued shares of Hail Cement. Such consolidation can aid companies in gaining market share and easing pricing pressure due to reduced competition.

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Saudi Cement (SACCO AB)

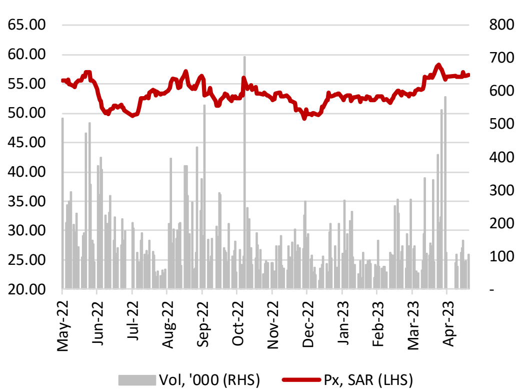
Target Price: SAR 63.0/share
Upside: 10.7%

Recommendation	**Accumulate**
Bloomberg Ticker	SACCO AB
Current Market Price (SAR)	56.90
52wk High / Low (SAR)	58.600/48.800
12m Average Vol. (000)	147.5
Mkt. Cap. (USD/SAR Mn)	22,635/8,706
Shares Outstanding (mn)	153.0
Free Float (%)	92%
3m Avg Daily Turnover (SAR'000)	8,118.8
6m Avg Daily Turnover (SAR'000)	6,777.1
P/E'23e (x)	20.8
EV/EBITDA'23e (x)	13.7
Dividend Yield '23e (%)	6.2%

Price Performance:	
1 month (%)	1.2
3 month (%)	8.4
12 month (%)	3.5

Source: Bloomberg, valued as of 18 May 2023

Price-Volume Performance



Source: Bloomberg

- **Given the underutilized capacity, company is well placed to benefit from likely recovery in the domestic construction sector**
- **Likely better average realizations along with expected higher sales volume to drive revenues as well as margins in the coming years.**
- **Solid balance sheet characterized by low leverage along with improving cash conversion cycle, to strengthen further amid higher cash flows and low capex**
- **Solid dividend yield an attractive investment proposition for income seeking investors**

We re-initiate coverage on Saudi Cement (SACCO AB) and assign Accumulate rating with a target price of SAR 63 per share, offering an upside of 10.7% on the current stock price of SAR 56.90. We hold an optimistic view on the Saudi cement sector as we expect the faster execution of mega construction projects to drive sales volume and improve price realizations in the KSA over the coming years. As a leading cement producer with a 12% market share in sales volume and 18% in sales value as of FY22, Saudi Cement is well positioned to cater to the expected huge domestic cement demand in the coming years, with available underutilized capacity that could be utilized to meet the increased demand. The stock is currently trading at a P/E of 20.8x and EV/EBITDA of 13.7x based on our FY23 estimates.

Investment Thesis

Valuation and risks: Our target price is based on blended valuation methodologies – (i) Discounted Cash Flow (DCF), (ii) Relative Valuation (using P/E and EV/EBITDA multiple) and (iii) DDM.

Key downside risks to our valuation include i) a fall in demand might impact cement realizations ii) concentration risk as the company mainly operates in Saudi Arabia, iii) slow pick-up of construction activities led by weak economic growth which might impact demand for cement. Key upside risks to our valuation include i) commissioning of megaprojects near the company's production plant, ii) M&As can help increase production volume and market share, and iii) Higher utilization led by growth in cement demand.

Organic growth story: i) Expected rise in construction activities led by mega projects will increase demand for cement, Saudi Cement being a leading player stands to benefit, ii) Utilization rate of Saudi Cement is likely to improve as the company will produce more to cater to growing demand. iii) Higher volumes coupled with improvement in average cement realization to drive revenues as well as margins, resulting in higher net income in the coming years, iv) Consistent dividend paying history with attractive dividend yield

Financial and valuation summary:

	FY18	FY19	FY20	FY21	FY22	FY23e
Revenues (SAR mn)	1,119.6	1,441.6	1,569.6	1,409.6	1,419.8	1,482.0
Net income (SAR mn)	400.5	451.4	456.0	331.9	398.8	419.0
Gross margin	48.1%	45.1%	42.5%	37.6%	40.1%	41.0%
Net profit margin	35.8%	31.3%	29.0%	23.5%	28.1%	28.3%
RoE	14.1%	16.4%	16.9%	13.1%	16.9%	18.8%
FCF (SAR/share)	2.62	3.99	3.92	3.56	3.70	2.79
DPS (SAR/share)	3.25	3.25	3.50	3.50	3.25	3.50
P/E (x)	18.5x	23.8x	20.6x	25.3x	19.9x	20.8x
P/B (x)	2.7x	3.9x	3.5x	3.4x	3.5x	4.0x

Source: Company Reports, U Capital Research

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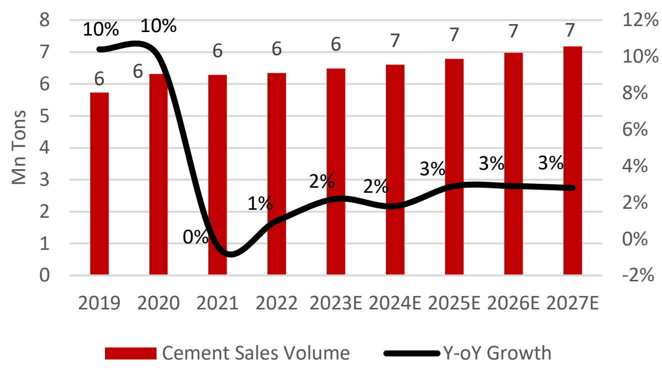
Strategically located plants to help utilization

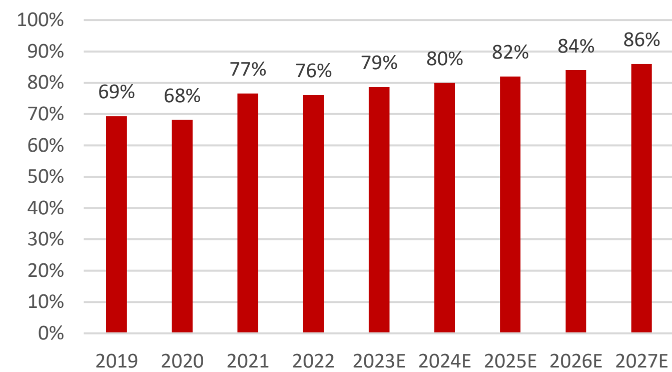
Saudi Cement, a prominent cement producer in Saudi Arabia, has established a significant foothold in the market, boasting a 12% market share in terms of sales volume and 18% market share in terms of sales value as of FY22. The company's plant is situated in the Eastern Province, specifically in the city of Al-Hasa, which is approximately 120 km away from Dammam. The Saudi government inaugurated 24 water and other development projects worth USD 560mn in 2021, which are set to be implemented in areas like Dammam, Al-Ahsa, Qatif, and other neighboring regions. Given the proximity of Saudi Cement's plant to these mega projects and its current underutilized capacity (76% plant utilization level in 2022), the company is well-positioned to benefit from the expected rise in demand for cement in the region. As a result, we anticipate that Saudi Cement's utilization rate will increase to 86% by 2027, resulting in sales volume growth at a CAGR of 3% over FY22-27e.

Fig. 19: Cement sales volume to increase



Source: Company Reports, U Capital Research

Fig. 20: Utilization to Improve consistently



Source: Company Reports, U Capital Research

Price realizations expected to recover in the future

Saudi Cement's cement realization has been under pressure from FY17 to FY22, experiencing highs of SAR 233/ton in FY17 and lows of SAR 201.83/ton in FY22. The average realization has been adversely affected by lower demand, increased inventory, and market competition. However, going forward, we expect that cement prices have reached their bottom and will improve due to the anticipated recovery in demand amid likely faster execution of construction projects in the coming years supported by improving government finances. That said, we anticipate that the company's cement price realizations to grow at a CAGR of 3% from FY23E to FY27E

Fig. 21: Company's realization to improve moderately

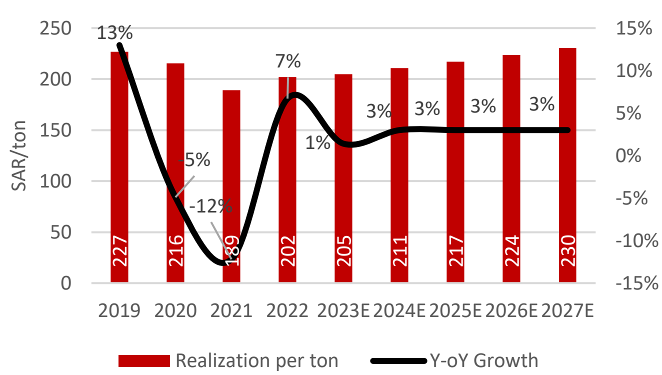
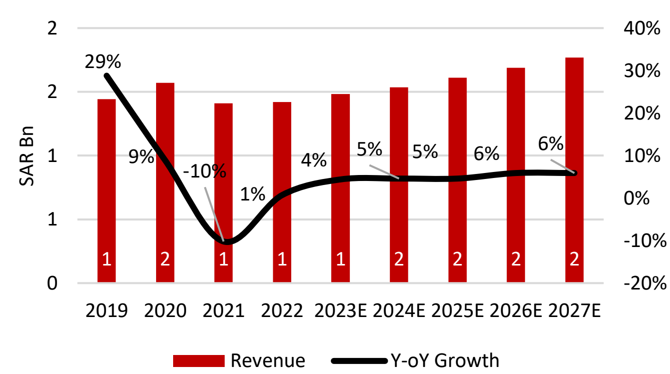


Fig. 22: Revenue to pick-up on the back of growing demand



Source: Company Reports, U Capital Research

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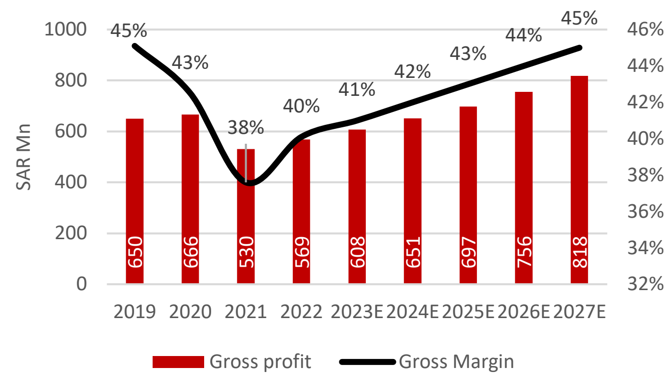
Accordingly, with the anticipated increase in sales volume and cement prices, Saudi Cement is expected to experience higher revenues going forward. We anticipate a total revenue CAGR of 5%, with revenue increasing from SAR 1.41bn in FY22 to SAR 1.81bn in FY27E.

Higher sales volume and average realization expected to drive margin expansion

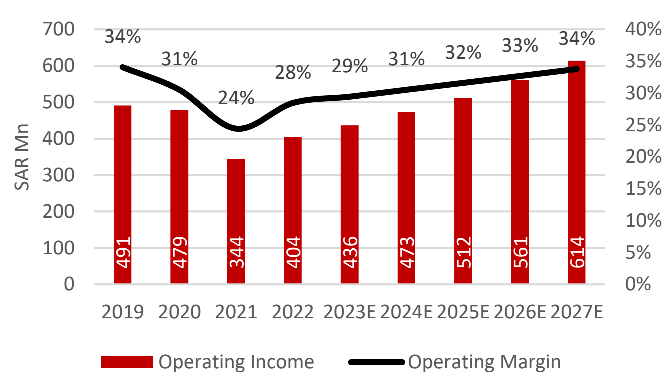
Historically, Saudi Cement has faced margin pressures due to lower average realization and cement volume. This resulted in a contraction of gross margins from a high of 48% in FY17 to 40.1% in FY22. Going forward, we expect margins to improve gradually from current levels as expected higher utilization is likely to lower fixed costs per ton, leading to improved efficiency and cost savings. In addition, projected better realizations to further aid the margins. Accordingly, we have forecasted gross margins to improve to 45% in FY27E from 40.1% in FY22, while operating margins are expected to improve to 33.8% by FY27E from 28.4% in FY22.

Fig. 23: Gross margin expected to recover gradually



Source: Company Reports, U Capital Research

Fig. 24: Operating margin to improve post-FY22

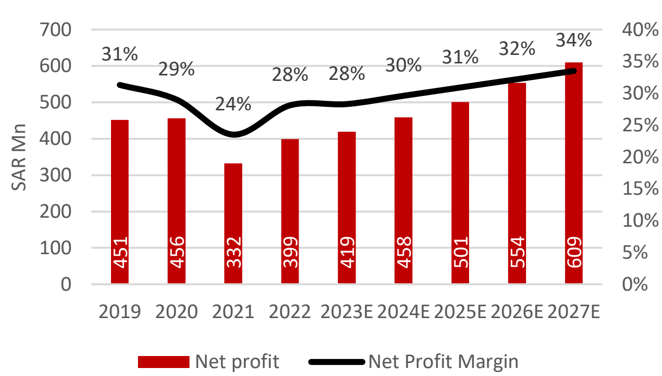


Source: Company Reports, U Capital Research

Net income recovery expected driven by revenue and margin improvement

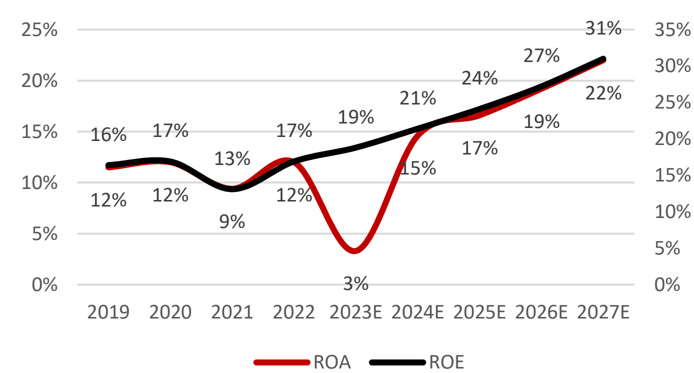
Despite higher revenues, Saudi Cement's net income declined at a CAGR of 3% during FY17-22, with net margins dropping from 38.3% in FY17 to 28.1% in FY22. This was largely due to lower cement price realizations (-3% CAGR), coupled with relatively higher increases in cost of sales (+7% CAGR) and selling and distribution costs (+26% CAGR). Going forward, we anticipate a turnaround in the company's net income, driven by projected improvements in gross and operating margins. Accordingly, we expect net income to grow at a CAGR of 8.8% from FY22 to FY23E while corresponding margins to improve to 34% by FY27. Similarly, ROA is also expected to expand to 22% in FY27E from 12% in FY22, while ROE will expand to 31% in FY27E from 16.9% in FY22.

Fig. 25: Net profit to improve led by higher revenue



Source: Company Reports, U Capital Research

Fig. 26: Return ratios to improve from FY24e onwards



Source: Company Reports, U Capital Research

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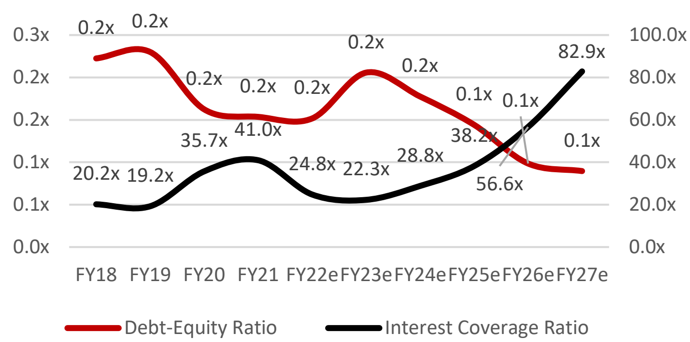
Maintaining a strong balance sheet

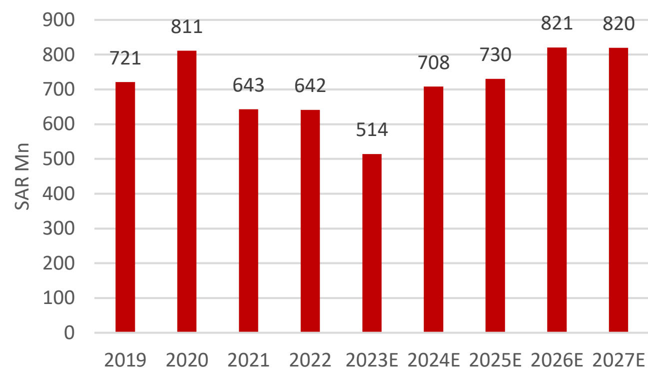
The company has consistently maintained a healthy debt-to-equity (D/E) ratio, which has remained below 0.25x. Looking ahead, we anticipate this ratio to further decrease to 0.1x by FY27E, primarily due to lower strong cash flow from operations, limited capital expenditure requirements and subsequently reduced debt levels. In terms of working capital management, the company has successfully reduced its high inventory levels, resulting in an improved cash conversion cycle of 288 days in FY22 as compared to 458 days in FY17. Going forward, we expect CCC to improve further, albeit marginally, driven by expected better business conditions which should further strengthen the company's financial position in the medium term.

Fig. 27: Debt/Equity ratio trend



Source: Company Reports, U Capital Research

Fig. 28: Decent sustainable cash flows

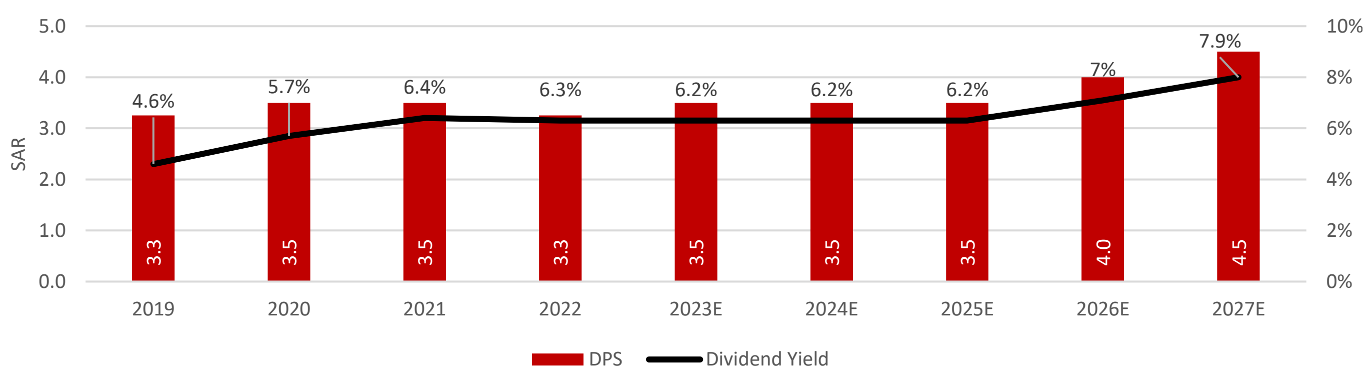


Source: Company Reports, U Capital Research

Consistent dividend payer

Saudi Cement has maintained a consistent track record of paying dividends, with an average payout ratio of approximately 134% during FY17-22. This resulted in an attractive dividend yield of 5-6% for shareholders. Looking ahead, we anticipate the company to continue prioritizing dividend payments, supported by a healthy level of free cash flows and low capital expenditure requirements. For FY23E, we expect the company to pay a dividend of SAR 3.50 per share, with a payout ratio of approximately 128%. At current prices, this translates to a dividend yield of 6.3%, which should appeal to income-seeking investors.

Fig. 29: Dividend expected to increase going forward



Source: Company Reports, U Capital Research

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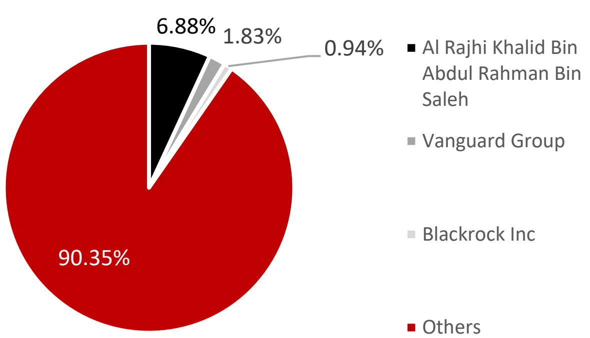
Assigning an Accumulate rating

We are assigning an Accumulate rating to the stock, with a target price of SAR 63, indicating an upside potential of 10.7%. We anticipate an increase in cement demand due to expected higher construction activities amid government's increased focus on faster execution of mega projects in a bid to diversify its economy away from oil. Saudi Cement, being a leading player, is likely to benefit greatly from this trend. We expect the growing demand to result in increased cement volume and better pricing, leading to higher total revenue and improved margins for the company. Overall, we remain optimistic about the company's prospects and recommend accumulating the stock as we feel that the company has huge room to grow.

About Saudi Cement

Saudi Cement was established in the year 1955. The company manufactures clinker and cement. The company is a leader in the Saudi cement industry and have a strategic location in the Eastern Province of Saudi Arabia where high-quality raw materials are available. In 2008, the company expanded its production capacity by installing two new production lines, which could produce 24,000 tons of clinker per day. This was a significant expansion at that time and increased their annual clinker production capacity to an average of 8 million tons per year, thereby increasing the company's economies of scale and production efficiency.

Fig. 30: SACCO's Shareholding Structure



Source: Bloomberg, 18 May 2023

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Key financials

In SAR mn, except stated otherwise	FY20	FY21	FY22	FY23e	FY24e	FY25e
Income Statement						
Sales	1570	1410	1420	1,482	1,550	1,621
Cost of sales	(903)	(879)	(851)	(874)	(899)	(924)
Gross profit	**666**	**530**	**569**	**608**	**651**	**697**
Depreciation and amortization	214	216	220	229	233	235
General and administrative expenses	(70)	(68)	(76)	(79)	(82)	(86)
Operating profit	**479**	**344**	**404**	**436**	**473**	**512**
Other Income	12	14	14	14	15	15
Finance costs	-13	-8	-16	(20)	(16)	(13)
Income before tax	**476**	**354**	**411**	**441**	**483**	**527**
Income tax	(24)	(24)	(12)	(22)	(24)	(26)
Net income for equity shareholders	**456**	**332**	**399**	**419**	**458**	**501**
Balance Sheet						
Inventories	632	517	552	592	566	557
Trade and other receivables	0	0	0	-	-	-
Cash and bank balances	125	81	91	85	98	128
Property and equipment	2434	2283	2138	1,986	1,831	1,677
Right-of-use assets	28	20	19	18	17	14
Total assets	**3,678**	**3,392**	**3,278**	**3,234**	**3,063**	**2,961**
Loans and borrowings	401	351	325	425	350	275
Trade and other payables	65	59	134	81	74	76
Lease liabilities	31	24	23	23	23	23
Total liabilities	**1,001**	**959**	**985**	**1,058**	**963**	**896**
Share capital	1530	1530	1530	1,530	1,530	1,530
Retained earnings	663	444	304	187	110	76
Equity Attributable to Shareholders	**2,652**	**2,433**	**2,293**	**2,176**	**2,099**	**2,065**
Cash Flow Statement						
Net cash generated from operating activities	811	643	642	514	708	730
Net cash generated from investing activities	-75	-92	-75	(85)	(85)	(89)
Net cash (used in) provided by financing activities	(739)	(594)	(557)	(436)	(611)	(611)
Cash and cash equivalents at the end of the period	**125**	**81**	**91**	**85**	**98**	**128**
Key Ratios						
Gross margin (%)	42.5%	37.6%	40.1%	41.0%	42.0%	43.0%
EBITDA margin (%)	44.2%	39.8%	43.9%	44.9%	45.5%	46.1%
Operating margin (%)	30.5%	24.4%	28.4%	29.4%	30.5%	31.6%
Net margin (%)	29.0%	23.5%	28.1%	28.3%	29.6%	30.9%
ROA	12.0%	9.4%	12.0%	3.3%	14.6%	16.6%
ROE	16.9%	13.1%	16.9%	18.8%	21.4%	24.1%
Current Ratio (x)	1.3	1.2	1.2	1.2	1.3	1.5
Capex/Sales	13.0%	4.6%	5.7%	5.8%	5.5%	5.5%
Debt-Equity Ratio (x)	0.16	0.15	0.15	0.21	0.18	0.14
EPS	2.98	2.17	2.61	2.74	3.00	3.27
BVPS	17.33	15.90	14.99	14.23	13.72	13.50
DPS	3.5	3.5	3.25	3.50	3.50	3.50
Dividend Payout Ratio	117.4%	161.3%	124.7%	127.8%	116.8%	106.9%
Dividend Yield (%)	5.7%	6.4%	6.3%	6.2%	6.2%	6.2%
P/E (x)	20.6	25.3	19.9	20.8	19.0	17.4
P/BV (x)	3.5	3.4	3.5	4.0	4.1	4.2
EV/EBITDA (x)	14.1	15.6	13.2	13.7	12.8	11.9
Price as at period end*	61.500	54.800	51.900	56.900	56.900	56.900

Source: Company Reports, U Capital Research

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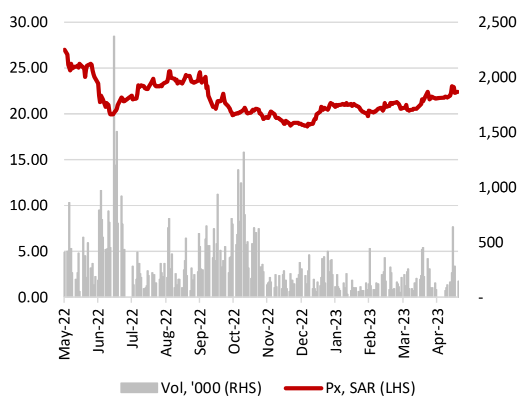
City Cement

Target Price: SAR 26.5/share
Upside: 20.0%

Recommendation	**Buy**
Bloomberg Ticker	CITYC AB
Current Market Price (SAR)	22.10
52wk High / Low (SAR)	26.000/18.580
12m Average Vol. (000)	282.5
Mkt. Cap. (USD/SAR Mn)	8,044/3,094
Shares Outstanding (mn)	140.0
Free Float (%)	74%
3m Avg Daily Turnover (SAR'000)	3,588.1
6m Avg Daily Turnover (SAR'000)	3,335.0
P/E'23e (x)	19.3
EV/EBITDA'23e (x)	12.1
Dividend Yield '23e (%)	6.3%
Price Performance:	
1 month (%)	1.7
3 month (%)	9.2
12 month (%)	(11.5)

Source: Bloomberg, valued as of 18 May 2023

Price-Volume Performance



Source: Bloomberg

- **Strategically located cement plant to help the company benefit from rising demand led by megaprojects**
- **Revenue to grow at a higher rate driven by increased sales volume and better sales price realizations**
- **Profitability expected to rise supported by higher top-line and likely improving margins**
- **Acquisition of Umm Al-Qura Cement can help in gaining market share**

We re-initiate coverage on City Cement Company and assign a Buy rating to the stock with a target price of SAR 26.5/share, offering an upside of 20%. Currently, the stock trades at P/E of 19.3x, based on our FY23 estimates. We are optimistic about the growth prospects of the company as construction activities in KSA are expected to pick up, driven by investments in mega projects. The strategic location of the company's plants near these projects is expected to boost sales volume and utilization in the coming years. We anticipate strong revenue growth (10% CAGR) during FY23-27E, driven by higher sales volumes and moderate increases in realizations. Additionally, we expect double-digit growth in profitability supported by higher revenues and improved margins. The company's solid financial health aided by net cash position and minimal capex requirements, reinforces our positive outlook on the stock. Therefore, we assign a Buy rating on the stock.

Investment Thesis

Valuation and risks: Our target price is based on blended valuation methodologies – (i) Discounted Cash Flow (DCF), (ii) Relative Valuation (using P/E and EV/EBITDA multiple) and (iii)DDM. Key downside risks to our valuation include i) A Fall in realization prices due to lack of demand ii) slow pick-up of construction activities impacted by economic slowdown, can impact cement demand, iii) rise in production costs. Key upside risks to our valuation include i) Higher utilization led by growing demand due to proximity to megaprojects, ii) better-than-estimated realization prices of cement due to spike in demand, and iii) Better than expected synergy from the acquisitions.

Acquisition can help in gaining market share: i) company well positioned to benefit from the expected rise in construction activities given its plants proximity to megaprojects, resulting in higher sales volumes ii) acquisition can help the company gain market share. iii) margins to improve led by higher revenue and costs normalization from higher levels, iv) solid balance sheet with net cash position and steady cash conversion cycle, v) continue to pay higher dividends in the future.

Financial and valuation summary:

	FY19	FY20	FY21	FY22	FY23E	FY24E
Revenues (SAR mn)	531.4	572.7	496.7	431.4	525.3	579.9
Net income (SAR mn)	190.1	220.5	160.3	115.0	160.2	189.8
Gross margin	43.5%	44.9%	41.8%	33.7%	39.0%	41.0%
Net profit margin	35.8%	38.5%	32.3%	26.7%	30.5%	32.7%
RoE	NA	12.0%	8.8%	6.3%	8.9%	10.8%
FCF (SAR/share)	1.62	1.90	1.83	1.05	1.36	1.90
DPS (SAR/share)	0.40	0.74	1.25	0.90	1.40	1.70
P/E	24.1x	22.0x	19.7x	24.3x	19.3x	16.3x
EV/EBITDA	16.3x	15.9x	12.1x	14.3x	12.1x	10.6x

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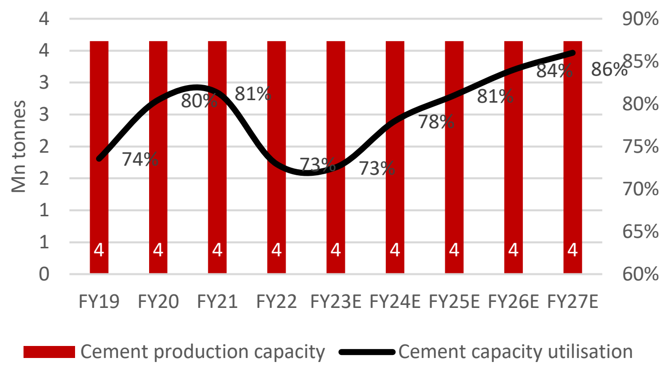
Leveraging mega projects proximity to drive utilization and sales volume

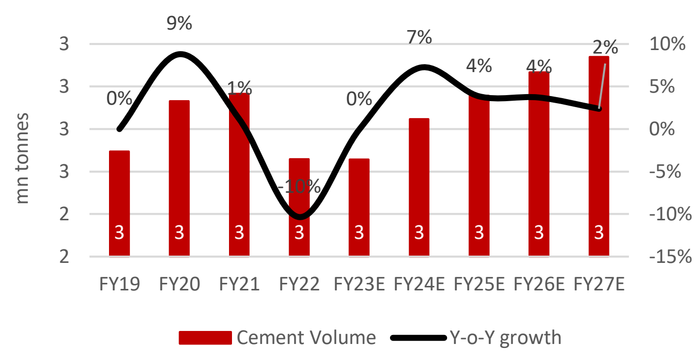
City Cement is a prominent cement producer in Saudi Arabia, with a total cement production capacity of 3.6 MTPA as of FY22. While the company derives 100% of its revenue from Saudi Arabia, cement capacity utilization decreased to 73% in FY22 compared to 81% in FY21 as the company lost some market share to competition amid muted demand conditions. However, we expect the demand for cement to grow in the future led by increased spending on construction activities by the government. City Cement is likely to benefit from this growing demand as its plant is strategically located in Marat, approximately 200km from Riyadh. There are many megaprojects near Riyadh under construction, and with the spare capacity, the company can cater to the rising demand. For instance, the Qiddiya entertainment megaproject, which spans more than 334 sq km on the outskirts of Riyadh, is worth USD8bn, with the first phase slated to open in 2023. Another major project located near Riyadh is Ad Diriyah, known as the pearl of Saudi Arabia, and is set to become a major tourist destination. This project is worth USD17bn and will include luxury resorts, major international hotel brands, and over 100 dining and entertainment options. With spare capacity and strategically positioned plants near megaprojects, City Cement is likely to benefit from growing demand which will help increase its utilization rate. Hence, we forecast the utilization rate to increase to 86% in FY27 from 73% in FY22, with cement volume growing to 3.13 MTPA in FY27 from 2.65 MTPA in FY22.

Fig. 31: Utilization rate is expected to increase



Source: Company Reports, U Capital Research

Fig. 32: Mega projects to drive cement volumes in coming years



Source: Company Reports, U Capital Research

Cement sales price to improve with growing demand

City Cement has been facing challenges in maintaining its average cement realization over the past few years, with a -6% CAGR over FY19-FY22. Factors such as lower demand, higher inventory, and increased competition contributed to this decline. Additionally, the construction sector faced labor shortages due to COVID-19, leading to lower cement volumes and further impacting the average realization. However, the company is expected to see improvement in its average realization going forward, with the recovery of demand. That said, we have projected the company's average price realization to grow at a CAGR of 7%, reaching SAR 223/ton in FY23 from SAR 162/ton in FY22.

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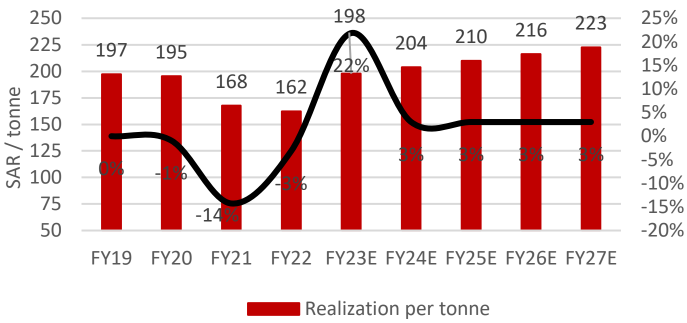
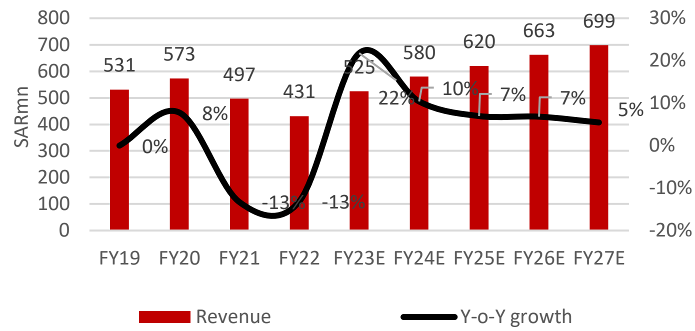
Fig. 33: Average realization is expected to grow from FY23



Source: Company Reports, U Capital Research

Fig. 34: Strong revenue growth led by higher volume and realization



Source: Company Reports, U Capital Research

Correspondingly, with strong growth expectations in both volume and average realization, the company's revenue is expected to have a CAGR of 10% over FY22-FY27E.

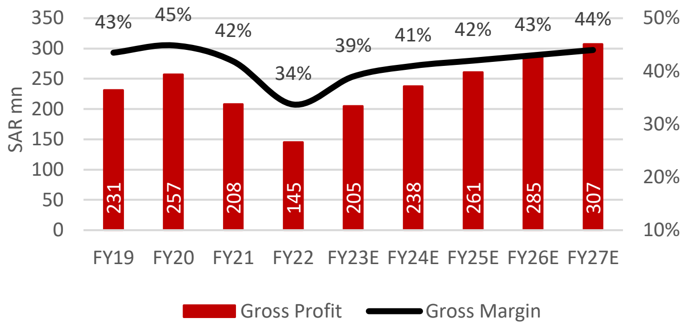
Acquiring local companies to gain market share

City Cement announced on April 26, 2023, that it has extended a non-binding memorandum of understanding (MOU) with Umm Al-Qura Cement Company (UACC), a Saudi-based company, for another six months to acquire all 55 million issued shares in UACC. UACC produced 1.76 million tonnes of clinker and 1.33 million tonnes of cement, with 66% of its revenue coming from the Western region due to its plant being located in Taif city of Makkah region. This plant holds a strategic advantage given its proximity to the USD 15 billion AlUla heritage site development project, which is just over 100 km away. As of FY22, City Cement had a market share of 6% in terms of sales value and 5% in terms of sales volume in Saudi Arabia. With the acquisition of Umm Al-Qura, we expect the company to gain market share, particularly in the Western region, which is expected to experience increased demand for cement due to several big-ticket construction projects in the nearby area.

Margins to improve going forward, however, but not to reach historical highs

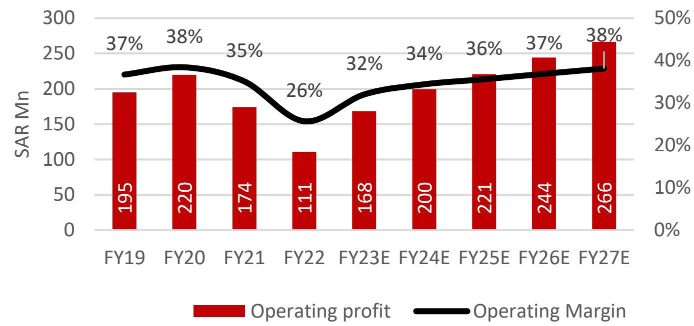
City cement’s gross margins contracted from 43.5% in FY19 to 33.7% in FY22 mainly due to soaring energy prices and lower revenue, caused by a decline in price realizations (-7% CAGR during FY19-22). In Saudi Arabia, energy cost, which represent 30-40% of total production cost, was on the rise in the recent past. We believe margins have bottomed out as expected higher revenues led by better price utilizations along with recovery in sales volume to improve gross profit per tonne, resulting in higher gross margins in the coming years. We expect indirect costs as % of total revenues to decline also from FY22 levels reflecting operating leverage benefit amid higher revenues. Accordingly, we have projected gross margins to increase from 33.7% in FY22 to 44.0% in FY27E while operating margins to improve from 25.7% in FY22 to 38% in FY27E. Given the negligible financial costs, the expected improvement at the operating level would flow to the net income level, resulting in an increase in net margins to 36% by FY27E from 26.7% in FY22.

Fig. 35: Gross margins expected to expand from FY23E



Source: Company Reports, U Capital Research

Fig. 36: Operating profit margin expected to improve

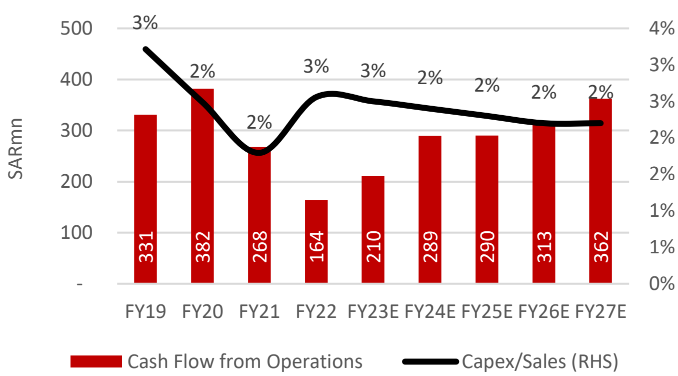


Source: Company Reports, U Capital Research

Healthy financial profile with net cash position

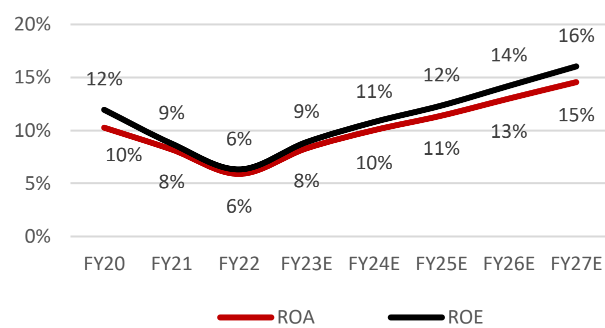
The company maintains a strong balance sheet with no debt in its books supported by decent cash flows and low capex requirements (~3% of revenues in FY22). With no growth capex plans in the pipeline due to spare capacity, the company is projected to maintain its reinvestment rate of 2.5% of its revenues in fixed assets as maintenance capex. Moreover, a steady cash conversion cycle, along with anticipated improved profitability, is expected to boost the company's cash flows to higher levels in the coming years. Average annual cash flow from operations is forecasted to be over SAR 250mn during FY23-27E. As a result, we anticipate the company's financial position to strengthen even further in the coming years, with ROA expected to rise from 5.9% in FY22 to 15% in FY27E and ROE from 6.3% in FY22 to 16% in FY27E.

Fig. 37: Strong cash flow from operations



Source: Company Reports, U Capital Research

Fig. 38: ROA and ROE expected to grow from FY23E



Source: Company Reports, U Capital Research

Strong dividend growth to continue

City Cement has a strong track record of paying dividends, with a DPS CAGR of 22.5% from FY19 to FY22, reaching SAR 0.90/share. This has been supported by the company's low capex requirements and healthy cash flows. With no major reinvestment plans in the pipeline, and expectations of higher cash flow from operations driven by improving profitability, we anticipate a continued trend of high dividends. As such, we expect the dividend to increase at a CAGR of 19.6%, reaching SAR 2.20/share by FY27E, up from SAR 0.90/share in FY22. Based on FY23 estimates, the company's solid dividend yield of 6% should attract shareholders seeking regular cash flows.

Fig. 39: Dividend will continue to grow in coming years

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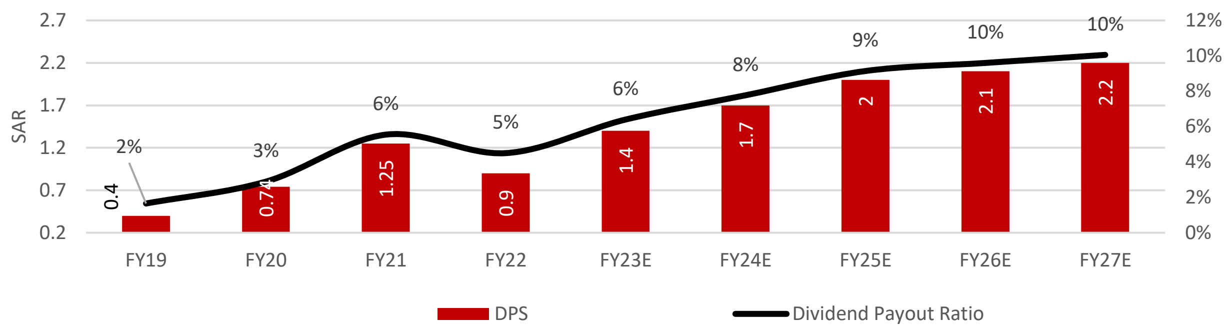


Source: Company Reports, U Capital Research

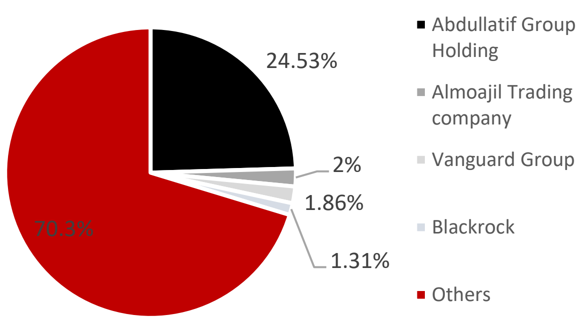
Assign Buy rating

We believe that City Cement is poised for good growth in the coming years, benefiting from increase in construction activities in the country. The strategic location of the company's plants near these projects is expected to boost sales volume and utilization, leading to strong revenue growth (10% CAGR) from FY23-27E, driven by higher sales volumes and moderate increases in realizations. Moreover, we anticipate double-digit growth in profitability, supported by higher revenues and improved margins. Furthermore, the company's solid financial health, aided by its net cash position and minimal capex requirements, along with the expected improvement in its financial performance, reinforce our positive outlook on the stock. Therefore, we value the stock by assigning a Buy rating, with a target price of SAR 26.5, representing an upside potential of 20% from the current market price.

About City Cement

City Cement Company, is a Saudi Joined Stock Company and was established in Riyadh. The company manufactures ordinary Portland cement and Sulphate resistance cement. It derives all of its revenue from Saudi Arabia and had a market share of 6% in terms of sales value and 5% in terms of sales volume in Saudi Arabia.

Fig. 40: Shareholding Structure



Source: Bloomberg, 18 May 2023

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Key financials

In SAR mn, except stated otherwise	FY20	FY21	FY22	FY23e	FY24e	FY25e
Income Statement						
Sales	573	497	431	525	580	620
Cost of sales	(316)	(289)	(286)	(320)	(342)	(360)
Gross profit	**257**	**208**	**145**	**205**	**238**	**261**
Depreciation and amortization	82	83	82	83	83	84
General and administrative expenses	(28)	(25)	(25)	(26)	(27)	(29)
Operating profit	**220**	**174**	**111**	**168**	**200**	**221**
Other Income	6	-4	6	6	7	7
Finance costs	-1	-1	-1	(1)	(1)	(1)
Profit before Zakat	**230**	**173**	**125**	**173**	**205**	**227**
Income tax	(10)	(12)	(10)	(13)	(15)	(17)
Net income for equity shareholders	**220**	**160**	**115**	**160**	**190**	**210**
Balance Sheet						
Inventories	145	143	154	184	178	187
Trade and other receivables	12	17	29	32	29	29
Cash and bank balances	0	70	171	171	171	171
Property and equipment	1454	1383	1313	1,245	1,177	1,109
Right-of-use assets	3	3	3	3	3	3
Total assets	**1,948**	**1,956**	**1,941**	**1,915**	**1,874**	**1,812**
Loans and borrowings	51	62	55	60	66	71
Trade and other payables	2	2	2	2	2	2
Lease liabilities	16	20	19	19	19	20
Total liabilities	**103**	**126**	**122**	**131**	**138**	**147**
Share capital	1400	1400	1400	1,400	1,400	1,400
Retained earnings	272	241	218	183	135	64
Equity Attributable to Shareholders	**1,845**	**1,830**	**1,819**	**1,783**	**1,735**	**1,665**
Cash Flow Statement						
Net cash generated from operating activities	382	268	164	210	289	290
Net cash generated from investing activities	235	-84	-43	(13)	(15)	(16)
Net cash (used in) provided by financing activities	(635)	(178)	(128)	(196)	(238)	(280)
Cash and cash equivalents at the end of the period	**50**	**56**	**50**	**51**	**87**	**81**
Key Ratios						
Gross margin (%)	44.9%	41.8%	33.7%	39.0%	41.0%	42.0%
EBITDA margin (%)	52.7%	51.7%	44.6%	47.8%	48.8%	49.1%
Operating margin (%)	38.4%	35.1%	25.7%	32.0%	34.4%	35.6%
Net margin (%)	38.5%	32.3%	26.7%	30.5%	32.7%	33.8%
ROA	10.3%	8.2%	5.9%	8.3%	10.0%	11.4%
ROE	12.0%	8.8%	6.3%	8.9%	10.8%	12.3%
Current Ratio (x)	6.1	5.8	6.6	6.5	6.5	6.2
Capex/Sales	2.5%	1.8%	2.6%	2.5%	2.4%	2.3%
Debt-Equity Ratio (x)	0.00	0.00	0.00	0.00	0.00	0.00
EPS	1.165	1.145	0.822	1.144	1.356	1.499
BVPS	9.752	13.072	12.993	12.738	12.394	11.893
DPS	0.740	1.250	0.900	1.400	1.700	2.000
Dividend Payout Ratio	63.5%	109.2%	109.6%	122.3%	125.4%	133.4%
Dividend Yield (%)	2.9%	5.5%	4.5%	6.3%	7.7%	9.0%
P/E (x)	22.0	19.7	24.3	19.3	16.3	14.7
P/BV (x)	2.6	1.7	1.5	1.7	1.8	1.9
EV/EBITDA (x)	15.9	12.1	14.3	12.1	10.6	9.9

Source: Company Reports, U Capital Research

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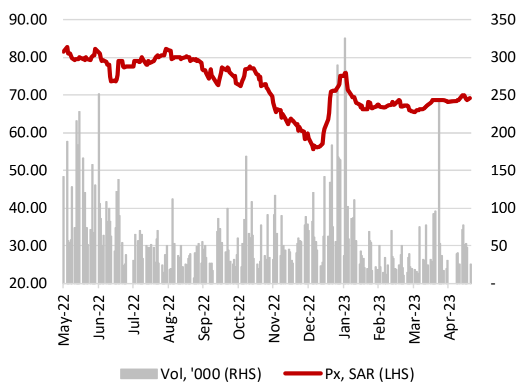
Qassim Cement

Target Price: SAR 64.3/share
Downside: 5.1%

Recommendation	**Hold**
Bloomberg Ticker	QACCO AB
Current Market Price (SAR)	67.80
52wk High / Low (SAR)	85.500/55.600
12m Average Vol. (000)	59.0
Mkt. Cap. (USD/SAR Mn)	15,865/6,102
Shares Outstanding (mn)	90.0
Free Float (%)	99%
3m Avg Daily Turnover (SAR'000)	2,585.6
6m Avg Daily Turnover (SAR'000)	3,831.7
P/E'23e (x)	25.1
EV/EBITDA'23e (x)	18.0
Dividend Yield '23e (%)	4.4%
Price Performance:	
1 month (%)	(0.6)
3 month (%)	1.6
12 month (%)	(15.1)

Source: Bloomberg, valued as of 18 May 2023

Price-Volume Performance



Source: Bloomberg

- **~100% capacity utilization limits volume growth**
- **Expected higher cement sales prices on improving demand conditions to support the company revenue growth in the coming years**
- **Profitability to rise driven by higher revenues and likely better margins**
- **Solid financial position backed by strong cash flows; dividend yield expected to remain healthy going forward**

We initiate coverage on Qassim Cement (QACCO) and assign a Hold rating to the stock with a target price of SAR 64.3/share, offering a downside of 5.1%. The company is presently operating at full capacity, which implies stable volumes despite the expected strong pick up in construction activities in the Kingdom. The company is building a new mill at its current factory in Buraydah with a production capacity of 10,000 tonnes per day. However, it remains unclear whether this new mill will add incremental capacity or simply replace existing older mills. Therefore, any potential revenue growth is expected to be driven by better realizations amid improving demand conditions. On the profitability side, we anticipate the company's earnings to grow strongly on better margins in the coming years. The stock offers a solid dividend yield, which is likely to continue. However, the stock is currently trading at a P/E of 25.1x and EV/EBITDA of 18x, based on our FY23 estimates, which we consider to be on the higher side. Therefore, we see a downside in the stock from current levels.

Investment Thesis

Valuation and risks: Our target price is based on blended valuation methodologies – (i) Discounted Cash Flow (DCF), (ii) Relative Valuation (using P/E and EV/EBITDA multiple) and (iii) DDM. Key downside risks to our valuation include i) Fall in realization prices due to lack of demand and ii) slow pick-up of construction activities, led by an economic slowdown. Key upside risks to our valuation include i) Better than expected synergy from M&As, ii) Any capacity expansion in the future can also help the company in tapping expected growth in demand for cement in the region, thereby giving growth to cement volume.

Strong Fundamentals: We hold positive view on the company primarily on account of i) operating at 100% utilization rate ii) Expected higher revenues driven by higher realization amid strong demand outlook iii) Margins to recover from current levels given our expectations of better price realizations led by improving demand, iv) Acquisition of Hail cement can help the company to increase its market share, v) The combination of strong cash flows and a healthy balance sheet has allowed the company to consistently pay dividends to its shareholders.

Financial and valuation summary:

	FY19	FY20	FY21	FY22	FY23E	FY24E
Revenues (SAR mn)	791.8	898.4	722.8	678.5	806.6	840.7
Net income (SAR mn)	360.7	419.8	291.9	130.5	243.2	258.9
Gross margin	53.9%	52.7%	39.6%	27.8%	36.3%	37.0%
Net profit margin	45.6%	46.7%	40.4%	19.2%	30.1%	30.8%
RoE	0.0%	23.2%	16.9%	7.8%	14.7%	16.1%
FCF (SAR/share)	4.72	5.27	4.81	1.09	3.27	3.64
DPS (SAR/share)	0.24	0.44	3.50	2.20	3.00	3.50
P/E (x)	16.5x	17.4x	23.4x	42.1x	25.1x	23.6x
EV/EBITDA (x)	13.0x	14.6x	20.4x	25.5x	18.0x	17.0x

Source: Company Reports, U Capital Research

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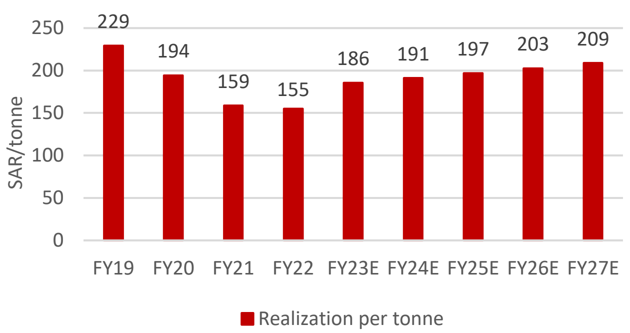
Full capacity utilization constrains volume growth

With a cement plant production capacity of 4.4mtpa, the company has been operating at near-full utilization over the past three years, with production utilization ranging from 98% to 106%. We expect the company to continue operating at maximum utilization levels of 100%, resulting in flat volumes for FY23-27E. The company is currently building a new mill at its current factory in Buraydah with a production capacity of 10,000 tonnes per day, with construction already underway. The total cost of the project is estimated to be SAR 152mn, with over SAR 90mn already spent as of FY22. However, it is unclear whether this new mill will add incremental capacity or simply replace existing older mills. Therefore, we have not factored in any capacity additions from this project in our estimates until we receive more updates from the company.

Higher realization amid stable volumes to drive top-line

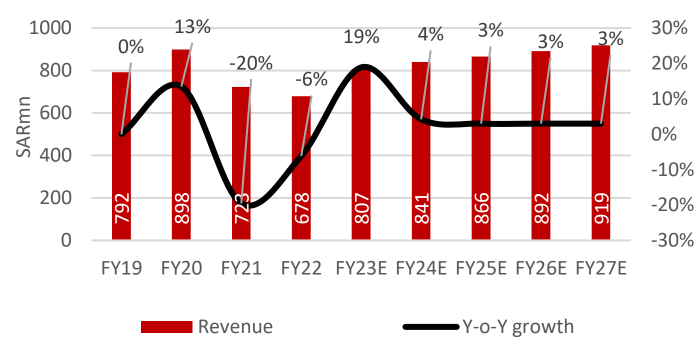
Saudi Arabia's push towards non-oil sectors has resulted in significant investments in infrastructure, with several mega projects commissioned over the last few years. While the pandemic led to delays and postponements, the post-pandemic era is expected to see a pick-up in construction activity, driving demand for cement in the coming years. Despite operating at almost full capacity, the company's average realization suffered (which fell to SAR 155.1/ton in FY22 from SAR 229.2/ton in FY19) due to lower demand, higher inventory, and increased competition. However, with strong demand expected in the future, driven by increased construction activity, the average realization is expected to grow at a CAGR of 6% to reach SAR 209/ton in FY27E, up from SAR 155.1/ton in FY22. Overall, higher realization amid stable volumes is expected to drive the company's revenues in the short to medium term.

Fig. 41: Average realization to improve…



Source: Company Reports, U Capital Research

Fig. 42: Growth in revenue led by improved realization



Source: Company Reports, U Capital Research

That said, given the stable cement volume as the company is operating at ~100% utilization coupled with decent growth in average realization will lead to revenue CAGR of 6% from FY22 to FY27E.

Profitability to grow on higher revenues and better margins

In recent years, the company has experienced a significant decline in gross margins, dropping from 54% in FY19 to 28% in FY22, largely due to a decrease in average cement sales prices. Meanwhile, direct costs remained relatively stable, with the cost of sales per tonne rising from SAR 106/tonne in FY19 to SAR 112/tonne in FY22. Going forward, we expect margins to recover from current levels factoring into our expectations of better price realizations amid improving demand conditions. Consequently, we estimate that gross margins will improve from 28% in FY22 to 43% by FY27, while operating margins are projected to rise from 21% in FY22 to 38% by FY27. Although net margins are unlikely to reach pre-pandemic levels of 45%-47%, we expect them to reach 36% by FY27, up from 19% in FY22. Overall, the company's net income is forecast to grow at a CAGR of 21% during FY22-27E, driven by stronger revenues and margins.

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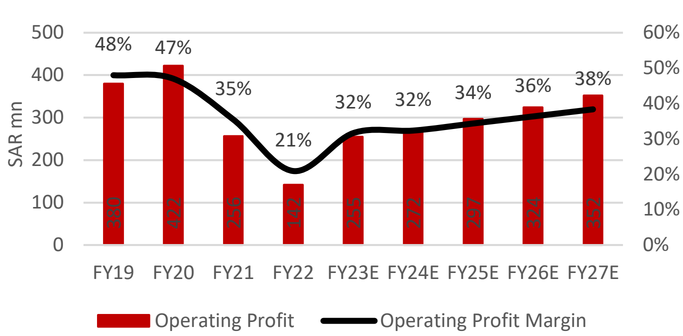
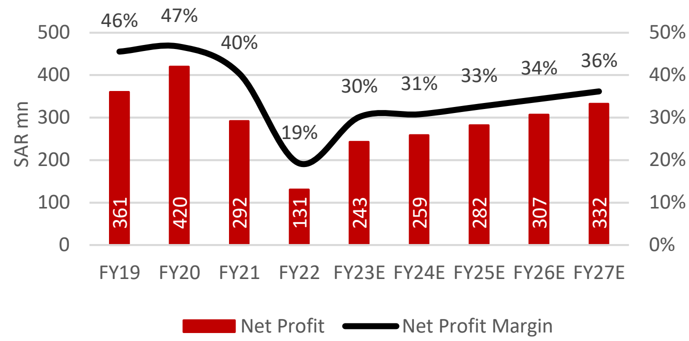
Fig. 43: Better pricing to drive improvement in margins



Source: Company Reports, U Capital Research

Fig. 44: Net income to grow strongly on higher revenues and margins



Source: Company Reports, U Capital Research

Potential acquisition of Hail Cement to increase market share and cement production capacity

Qassim Cement, a leading cement producer in Saudi Arabia with a sales volume market share of 8% and a sales value market share of 9%, is set to acquire Hail Cement, a cement manufacturer located approximately 360km away from Riyadh. Qassim Cement has a production capacity of 4.4mt and was operating at nearly full capacity utilization rate of 98.6% in FY22. The acquisition discussions were initiated through a MOU signed by the two companies in September 2022. Hail Cement produced 1.69mt of cement in 2022 and generated around 62% of its revenue from the central region of Saudi Arabia. This is a significant advantage since the central region has many large-scale megaprojects under construction, such as Qiddiya, Ad Diriyah, and the Riyadh metro, among others. The acquisition of Hail Cement by Qassim Cement is expected to boost cement demand and increase production capacity, providing the company with a strategic edge over its competitors. Through the acquisition of Hail Cement, Qassim Cement is expected to further increase its market share and cement production capacity, enabling it to better cater to the growing demand for cement in the region. This strategic move is likely to have a positive impact on the company's revenue and profitability, strengthening its position as a leading cement producer in Saudi Arabia. However, there has been no update on the deal since Sep 2022. Thus, we haven't factored this acquisition in our model yet. Once we receive more details on this deal, we will make changes to our model accordingly.

Rewarding the shareholders with high dividends backed by strong FCFs

The company has consistently generated strong free cash flows in the past, supported by healthy profitability and low capital expenditure requirements, and this trend is expected to continue in the coming years with no major expansion plans. Additionally, the company maintains a solid credit profile with a net cash position and an improving cash conversion cycle. The combination of strong cash flows and a healthy balance sheet has allowed the company to consistently pay dividends to its shareholders. In FY22, the company paid a dividend per share (DPS) of SAR 2.20, resulting in a payout ratio of 152%. Going forward, we expect the DPS to increase significantly at a CAGR of 18% to reach SAR 5.00 per share by FY27, driven by the anticipated improvement in profitability from higher revenues and better margins, and with no major reinvestment requirements. With an attractive dividend yield of approximately 5% based on FY23E DPS, the stock offers a good investment opportunity for income-seeking investors.

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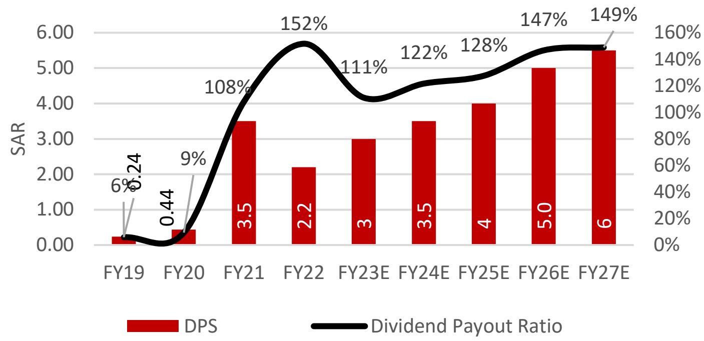
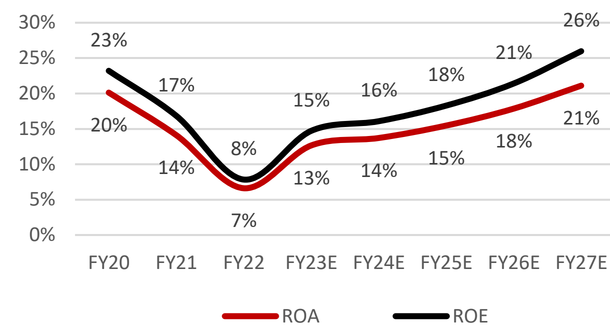
Fig. 45: Dividend likely to continue to grow



Source: Company Reports, U Capital Research

Fig. 46: ROA and ROE expected to improve going forward



Source: Company Reports, U Capital Research

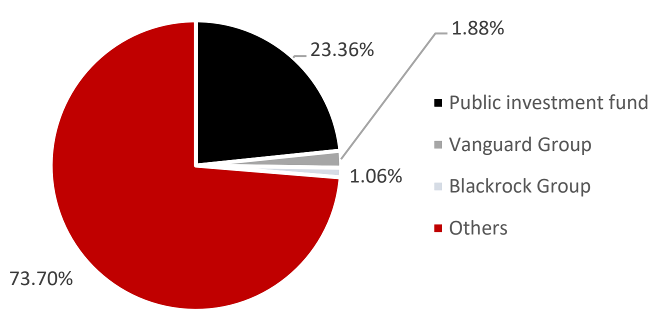
Assign a Hold rating

QACCO is currently operating at full capacity, indicating stable volumes, despite an anticipated increase in construction activities in the Kingdom. A new mill is being constructed at the company's Buraydah factory, with a production capacity of 10,000 tonnes per day. However, it remains unclear if this new mill will add to existing capacity or replace older mills. Any potential revenue growth is therefore expected to come from improved realizations amid better demand conditions. On the profitability side, the company's earnings are expected to grow strongly due to better margins in the coming years. Additionally, the stock offers a solid dividend yield, which is expected to continue. However, the stock is currently trading at a P/E of 25.1x and EV/EBITDA of 18x, based on FY23 estimates, which is on the higher side. As a result, we expect downside in the stock at current levels and assign a Hold rating.

About Qassim Cement

Qassim Cement was founded in 1976 in Qassim Region 330 Km north-west of Riyadh. The company produces more than 4mn metric tons of cement. The company's key products include Ordinary Portland Cement (OPC), Portland Pozzolana Cement (PPC), Sulphate Resistant Cement (SRC), and Finishing Cement. Qassim cement has its production plant in Buraydah, Saudi Arabia.

Fig. 47: Shareholding Structure



Source: Bloomberg, 18 May 2023

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Key financials

In SAR mn, except stated otherwise	FY20	FY21	FY22	FY23e	FY24e	FY25e
Income Statement						
Sales	898	723	678	807	841	866
Cost of sales	(425)	(437)	(490)	(514)	(530)	(528)
Gross profit	**473**	**286**	**188**	**293**	**311**	**338**
Depreciation and amortization	74	73	72	72	73	73
General and administrative expenses	(33)	(19)	(35)	(24)	(25)	(26)
Operating profit	**4**	**20**	**-21**	**0**	**0**	**0**
Other Income	4	20	-21	-	-	-
Finance costs	-30	-30	-25	-27	-29	-31
Net income for equity shareholders	**420**	**292**	**131**	**243**	**259**	**282**
Balance Sheet						
Inventories	42	35	52	58	58	59
Trade and other receivables	86	15	23	46	46	47
Cash and bank balances	67	107	52	229	232	211
Property and equipment	668	606	548	492	436	380
Projects in Progress	10	26	94	94	94	94
Total assets	**2,115**	**2,020**	**1,926**	**1,915**	**1,862**	**1,787**
Loans and borrowings	68	64	58	58	58	58
Trade and other payables	36	41	42	44	46	49
Total liabilities	**306**	**288**	**262**	**277**	**280**	**283**
Share capital	900	900	900	900	900	900
Retained earnings	643	566	499	472	416	338
Equity Attributable to Shareholders	**1,809**	**1,732**	**1,665**	**1,638**	**1,582**	**1,504**
Cash Flow Statement						
Net cash generated from operating activities	505	422	93	313	335	356
Net cash generated from investing activities	-112	-9	57	134	(17)	(17)
Net cash (used in) provided by financing activities	(388)	(373)	(206)	(270)	(315)	(360)
Cash and cash equivalents at the end of the period	**67**	**107**	**52**	**229**	**232**	**211**
Key Ratios						
Gross margin (%)	52.7%	39.6%	27.8%	36.3%	37.0%	39.0%
EBITDA margin (%)	55.3%	45.6%	31.5%	40.6%	41.0%	42.8%
Operating margin (%)	47.0%	35.5%	20.9%	31.6%	32.4%	34.4%
Net margin (%)	46.7%	40.4%	19.2%	30.1%	30.8%	32.6%
ROA	20.1%	14.1%	6.6%	12.7%	13.7%	15.5%
ROE	23.2%	16.9%	7.8%	14.7%	16.1%	18.3%
Current Ratio (x)	5.0	5.2	5.5	5.4	5.4	5.4
Capex/Sales	0.6%	1.1%	1.7%	2.0%	2.0%	2.0%
Debt-Equity Ratio (x)	0.00	0.00	0.00	0.00	0.00	0.00
EPS	4.66	3.24	1.45	2.70	2.88	3.14
BVPS	20.10	19.25	18.50	18.20	17.58	16.71
DPS	0.44	3.50	2.20	3.00	3.50	4.00
Dividend Payout Ratio	9.3%	107.9%	151.7%	111.0%	121.7%	127.6%
Dividend Yield (%)	0.5%	4.6%	3.6%	4.4%	5.2%	5.9%
P/E (x)	17.4	23.4	42.1	25.1	23.6	21.6
P/BV (x)	4.0	3.9	3.3	3.7	3.9	4.1
EV/EBITDA (x)	14.6	20.4	25.5	18.0	17.0	15.9
Price as at period end*	81.00	75.70	61.10	67.80	67.80	67.80

Source: Company Reports, U Capital Research

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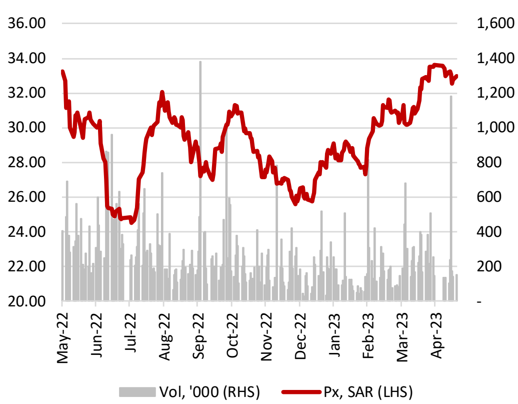
Yamama Cement

Target Price: SAR 38/share
Upside: 14.7%

Recommendation	Accumulate
Bloomberg Ticker	YACCO AB
Current Market Price (SAR)	33.10
52wk High / Low (SAR)	33.900/24.480
12m Average Vol. (000)	256.4
Mkt. Cap. (USD/SAR Mn)	17,427/6,703
Shares Outstanding (mn)	202.5
Free Float (%)	89%
3m Avg Daily Turnover (SAR'000)	7,422.0
6m Avg Daily Turnover (SAR'000)	6,126.0
P/E'23e (x)	17.4
EV/EBITDA'23e (x)	12.8
Dividend Yield '23e (%)	3.0%
Price Performance:	
1 month (%)	(1.6)
3 month (%)	11.1
12 month (%)	10.3

Source: Bloomberg, valued as of 18 May 2023

Price-Volume Performance



Source: Bloomberg

- **Company well placed to benefit from likely recovery in the domestic construction sector**
- **Expected additional production capacity and better utilization amid steadily improving realizations to support top-line growth and earnings**
- **High input costs to weigh on margins in near term, however, likely to improve on better efficiencies in the medium term**
- **Debt to remain at comfortable level providing further room for future growth projects**

We re-initiate coverage on Yamama Cement (YACCO) and assign an Accumulate rating with a target price of SAR 38 per share, offering a upside of 14.7% on the current stock price of SAR 33.10. Currently, the stock trades at a P/E of 17.4x and EV/EBITDA of 12.8x, based on our FY23 estimates. We expect strong pick up in domestic construction sector activities, however, the company's volume to remain flat at least for the next 2-3 years as the company's current capacity is being fully utilized. However, post 2025, we see the company to be a key beneficiary from the construction boom in the Kingdom due to expected 50% rise in the company's product capacity from 2026. Despite stable volumes, we expect the company's revenues to grow led by better prices while profitability to rise supported by improvement in margins. The company holds strong balance sheet supported by good cash flows which should continue in the coming years.

Investment Thesis

Valuation and risks: Our target price is based on blended valuation methodologies – (i) Discounted Cash Flow (DCF), (ii) Relative Valuation (using P/E and EV/EBITDA multiple) and (iii) DDM. Key downside risks to our valuation include i) Fall in realization prices due to lower demand ii) concentration risks-as the company mainly operates in Saudi Arabia, iii) slow pick-up of construction activities, leading to lack of cement demand. Key upside risks to our valuation include i) better-than-estimated realization prices of cement due to increased demand led by strong economic growth, ii) M&As of plants strategically located near megaprojects can boost volume.

Organic growth story: i) YACCO to increase its growth pace by increasing capacity from 6.7mt in FY22 to 10.08mt in FY26e, ii) Company has been working at maximum capacity utilization, iii) Revenue estimated to grow ~16% during FY22-27e, led by increase in volumes sold, iv) Realization prices to support the growth story going ahead due to recovery in demand, v) debt burden forecasted is not a concern for the company vii) expected to continue paying dividend

Financial and valuation summary:

	FY20	FY21	FY22	FY23E	FY24E	FY25E
Revenues (SAR mn)	956.0	735.8	1,022.7	1,235.0	1,288.0	1,326.6
Net income (SAR mn)	405.5	153.7	355.8	363.2	409.7	436.8
Gross margin	46.0%	30.0%	41.4%	41.0%	43.0%	44.0%
Net profit margin	42.4%	20.9%	34.8%	29.4%	31.8%	32.9%
RoE	NA	4.0%	8.1%	8.2%	8.9%	9.1%
DPS (SAR/share)	0.50	-	1.00	1.00	1.00	1.50
P/E (x)	14.3x	30.6x	14.5x	17.4x	15.4x	14.5x
EV/EBITDA (x)	19.6x	38.4x	17.2x	12.8x	12.0x	11.4x

Source: Company Reports, U Capital Research

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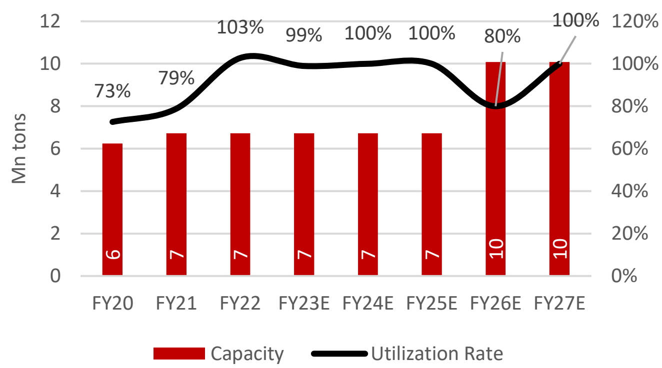
The company implements changes to boost efficiency and drive growth

The company has recently undergone significant changes to improve its operations and drive growth. In 2019, it announced the intention to sell off the old production lines 1 to 5, with a production capacity of 1.8MTPA, as these production lines were completely consumed by book. In January 2022, the company decided to sell the sixth production line, which had a capacity of 2.8MTPA, while shifting the seventh production line, with a capacity of 3.2MTPA, to its new plant later. The new factory, which began operations in Q4 2022 with two clinker lines and a combined capacity of 6.4MTPA, is expected to bring efficiencies through the use of the latest equipment and technology.

The company's plants are currently operating at near full capacity, with many mega projects ongoing in the Riyadh area, where the plants are located. As a result, the company is expected to continue operating at full capacity in the coming years.

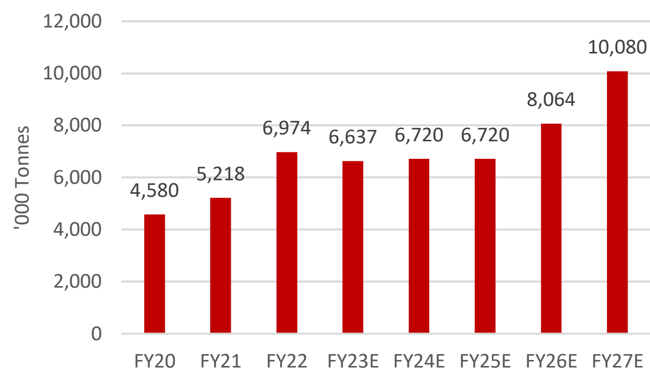
In November 2022, the company announced its plan to shift the seventh production line from its old factory to the new one, with an expected cost of SAR 830mn. This project is expected to start in Q1 2023 and complete in 2025. After completion, the new factory's clinker capacity will increase to 9.6MTPA, while cement capacity will reach 10.1MTPA. With no spare capacity currently, this shift of the seventh line is expected to drive volume growth for the company post-2025. Overall, we expect the company' sales volume to grow at a CAGR of 8% during FY22-27E with most growth companies in the later years due to capacity addition.

Fig. 48: Capacity to increase post 2025E



Source: Company Reports, U Capital Research

Fig. 49: Cement Volume likely to grow on increased capacity



Source: Company Reports, U Capital Research

Average realization expected to recover in the coming years on better demand outlook

From 2020 to 2022, Yamama Cement experienced a significant decline in average realization, from SAR 209/ton to SAR 147/ton, primarily due to lower demand, competitive pressures and elevated inventory levels across the industry. However, with an anticipated uptick in demand for cement in the coming years, we expect to see a recovery in average realization at a CAGR of 7% to reach SAR 209/ton by FY27E. This growth in realization is expected to be a key driver of a 16% CAGR in the company's revenue over FY22-FY27E, alongside a robust increase in sales volume and a favorable demand outlook.

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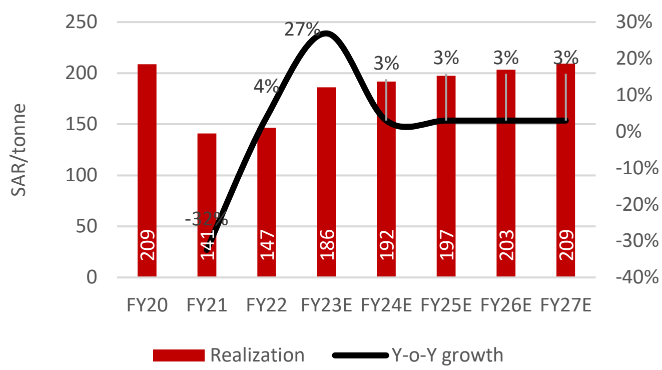
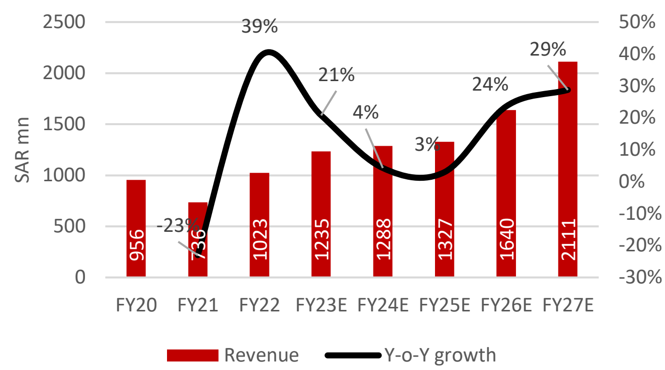
Fig. 50: Realization to improve from FY23E



Source: Company Reports, U Capital Research

Fig. 51: Revenue growth led by high volume and realization

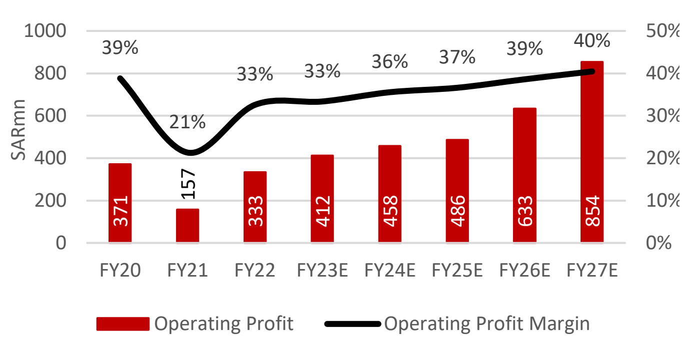


Source: Company Reports, U Capital Research

Margins improvement to drive profitability in years to come

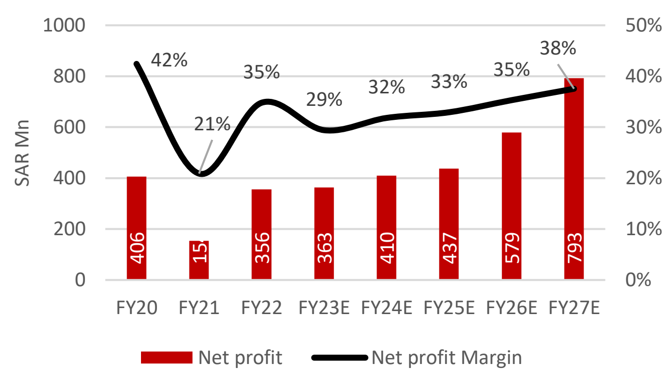
Despite 7% rise in revenues, the company's gross profit declined by 4% in FY22 from FY20 levels with gross margins declining to 41% in FY22 from 46% in FY20. This was largely impacted by sharp decline in cement sales price which caused gross profit per ton to drop to SAR 61/ton in FY22 from SAR 96/tonne in FY19. Going forward, we expect gross margins to improve to 45% by 2027 led by better sales price realization projections as well as supported by efficiencies from new plant. Operating profit is expected to grow at a CAGR of 16% during FY22-27E with margins improving from 33% in FY22 to 38% in FY27 reflecting operating leverage benefit amid higher revenues. Net profit is expected to have a CAGR of 13% over FY22-FY27E despite higher financial costs impact.

Fig. 52: Operating profit expected to grow at a good pace



Source: Company Reports, U Capital Research

Fig. 53: Net profit expected to grow at a good pace



Source: Company Reports, U Capital Research

Strong Balance sheet

Currently, the company holds debt worth SAR 1bn in its books with debt-to-equity ratio of 0.25x. Most of the debt was raised to fund the new cement factory which started operations in Q4 22. Despite additional capex of SAR 830mn to shift 7th production line from old factory to new factory by 2025, the company's debt is expected to decline to SAR 0.7bn by FY27 driven by strong cash flow operations and supported by improving cash conversion cycle. The company paid DPS 1.00 per share in FY22 which we expect to increase to SAR 3.75 by FY27 supported by strong cash flows and no major capex requirements from FY26 onwards. ROE is likely to improve to 16% in FY27E from 8.1% in FY22, while ROA is expected to improve to 12% in FY27E from 6.2% in FY22.

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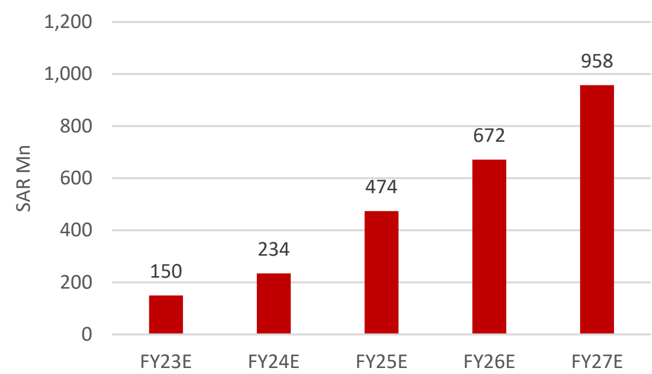
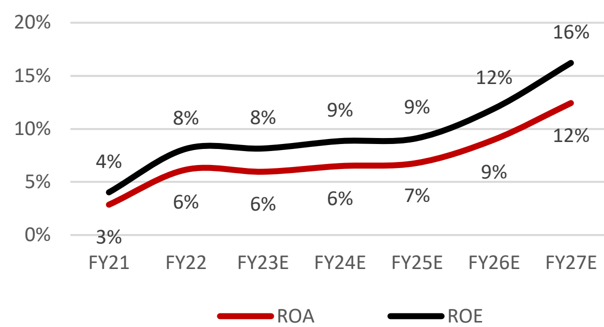
Fig. 54: Expectations of Strong growth in Free Cash Flow



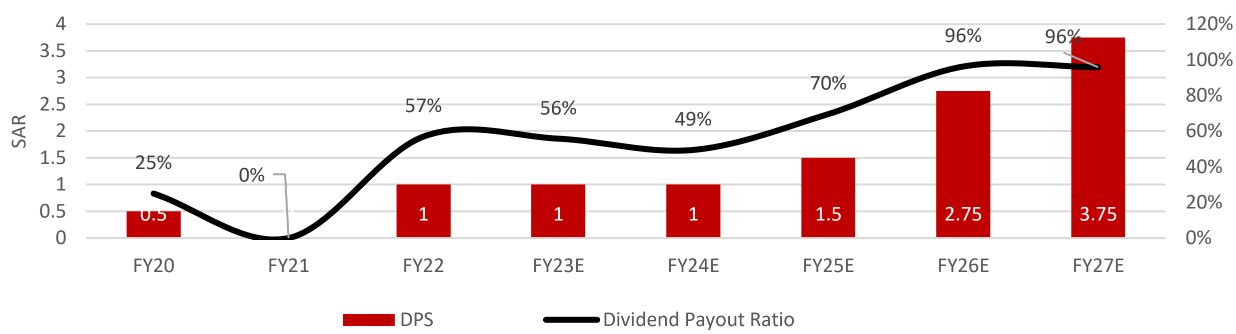
Source: Company Reports, U Capital Research

Fig. 55: Improving ROA and ROE over the period



Source: Company Reports, U Capital Research

Fig. 56: High Dividend yield



Source: Company Reports, U Capital Research

Assigning a Accumulate rating

While we anticipate a strong increase in domestic construction sector activities, we expect the company's volume to remain stagnant for the next 2-3 years due to full utilization of its current capacity. However, we believe that the company will benefit significantly from the construction boom in the Kingdom post-2025, with a projected 50% increase in its product capacity from 2026. In short to medium term, despite stable volumes, we expect the company's revenues to rise due to better prices, while profitability will improve as margins increase. Additionally, the company maintains a strong balance sheet with good cash flows that are expected to continue in the coming years. Therefore, we recommend an Accumulate rating at the current level.

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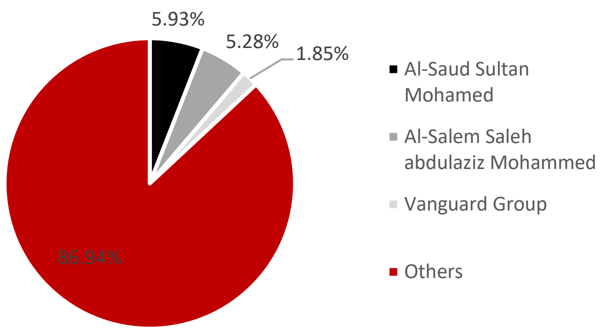
About YACCO

Yamama Cement was established in1956 to manufacture and trade in cement in Riyadh, Saudi Arabia. Yamama which is a shareholding company, is regarded as the oldest cement company in the central region and the third in Saudi Arabia.

Fig. 57: YACCO's Shareholding Structure



Source: Bloomberg, 18 May 2023

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Key financials

In SAR mn, except stated otherwise	FY20	FY21	FY22	FY23e	FY24e	FY25e
Income Statement						
Sales	956	736	1023	1,235	1,288	1,327
Cost of sales	(516)	(515)	(599)	(729)	(734)	(743)
Gross profit	**440**	**220**	**423**	**506**	**554**	**584**
Depreciation and amortization	7	8	36	181	174	175
General and administrative expenses	(8)	(13)	(26)	(28)	(28)	(29)
Operating profit	**0**	**0**	**-7**	**-39**	**-35**	**-34**
Other Income	0	0	-7	(39)	(35)	(34)
Finance costs	0	0	-7	(39)	(35)	(34)
Net income for equity shareholders	**419**	**172**	**378**	**386**	**435**	**464**
Balance Sheet						
Inventories	211	74	76	75	92	171
Trade and other receivables	387	0	0	-	-	-
Cash and bank balances	540	283	267	305	302	305
Property and equipment	295	338	4941	5,086	5,234	5,253
Assets subject to finance lease	0	0	5	5	5	5
Total assets	**6,120**	**5,923**	**6,351**	**6,588**	**6,802**	**6,865**
Loans and borrowings	62	186	314	305	312	315
Trade and other payables	157	253	364	366	372	377
Total liabilities	**2,376**	**1,643**	**1,700**	**1,776**	**1,783**	**1,712**
Share capital	2025	2025	2025	2,025	2,025	2,025
Retained earnings	-9	193	207	207	207	207
Equity Attributable to Shareholders	**3,743**	**4,280**	**4,651**	**4,812**	**5,019**	**5,152**
Cash Flow Statement						
Net cash generated from operating activities	709	470	518	452	541	604
Net cash generated from investing activities	-269	-336	-441	(326)	(322)	(146)
Net cash (used in) provided by financing activities	(441)	(131)	(76)	(128)	(203)	(379)
Cash and cash equivalents at the end of the period	**72**	**74**	**76**	**75**	**92**	**171**
Key Ratios						
Gross margin (%)	46.0%	30.0%	41.4%	41.0%	43.0%	44.0%
EBITDA margin (%)	39.6%	22.4%	36.1%	48.0%	49.1%	49.8%
Operating margin (%)	38.8%	21.3%	32.6%	33.4%	35.6%	36.6%
Net margin (%)	42.4%	20.9%	34.8%	29.4%	31.8%	32.9%
ROA	NA	2.9%	6.2%	6.0%	6.5%	6.8%
ROE	NA	4.0%	8.1%	8.2%	8.9%	9.1%
Current Ratio (x)	2.3	4.2	5.8	5.7	5.9	6.2
Capex/Sales	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Debt-Equity Ratio (x)	0.02	0.04	0.07	0.06	0.06	0.06
EPS	2.07	0.85	1.87	1.90	2.15	2.29
BVPS	18.49	21.14	22.97	23.76	24.79	25.44
DPS	0.50	0.00	1.00	1.00	1.00	1.50
Dividend Payout Ratio	25.0%	0.0%	56.9%	55.7%	49.4%	69.5%
Dividend Yield (%)	1.7%	0.0%	3.7%	3.0%	3.0%	4.5%
P/E (x)	14.3	30.6	14.5	17.4	15.4	14.5
P/BV (x)	1.6	1.2	1.2	1.4	1.3	1.3
EV/EBITDA (x)	19.6	38.4	17.2	12.8	12.0	11.4
Price as at period end*	29.55	26.00	27.00	33.15	33.15	33.15

Source: Company Reports, U Capital Research

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Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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