Saudi Ceramic

Construction and Materials – Industrial

SCERCO AB: Saudi Arabia

31 July 2022

Al Rajhi Capital

US$0.777bn	77%	US$3.537mn
Market cap	Free float	Avg. daily volume

Target price	41.00	12.3% over current
Current price	36.50	as at 28/7/2022

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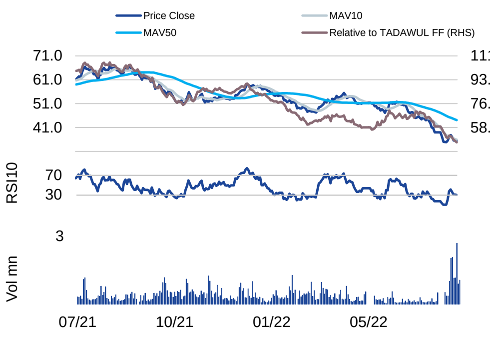
Existing rating

Underweight	Neutral	Overweight

Performance



Source: Bloomberg

Earnings

SAR(Mn)	2021A	2022E	2023E
Revenue	1,535	1,454	1,516
Revenue growth	1%	-5%	4%
Gross Profit	528	444	492
Gross Margin	34%	31%	32%
Operating Income	254	172	213
Operating margin	17%	12%	14%
Net income	234	163	199
Net margins	15%	11%	13%
EPS	2.92	2.03	2.49
DPS	1.50	1.50	1.50
Payout	51%	74%	60%
P/E	12.5x	17.9x	14.7x
EV/EBITDA	9.2x	11.8x	10.2x

Source: Company data, Al Rajhi Capital

Saudi Ceramic

Pressure on revenue continues

Saudi Ceramic Q2 2022 revenue came in at SAR339mn (-5% y-o-y) and is likely to have been impacted by lower demand and due to the temporary suspension of some factories, as a result of to the suspension of gas supplies by Aramco on account of maintenance work. The revenue was lower than our estimate of SAR363mn. Gross profit fell by 23% y-o-y, while operating income fell by 47.8% y-o-y, at the back of a 734bps gross margin erosion (31.2% in Q2 2022 and 30.8% in Q1 2022). We expect lower revenue, increased competition and higher cost of production, due to the increase in certain input costs, to have impacted profitability. Overall, net income fell by 40.0% y-o-y, impacted by lower revenue and a resultant fall in gross margins. In line with the revenue being lower than expectations, the net income too was lower than our estimate of SAR40mn. Lower than expected revenue, moderated by higher-than-expected non-operating income, was the main reason for this. Building and construction segment in KSA has come under pressure during the year, though we expect the sector's performance to improve, aided by stable mortgage offtake, pickup in the execution of giga projects and favourable movement of construction material prices, which have started to fall. However, the recovery is likely to take time, and short-term pressures are likely to persist. We also take into account the strong market position of Saudi Ceramic regionally. Overall, post-Q2 2022 earnings we reduce our target price from SAR50/sh to SAR41/sh, but increase our rating to "Overweight" from "Neutral".

Figure 1 Earnings Summary

SAR(mn)	Q2 2022	Q1 2022	Q2 2021	% chg y-o-y	% chg q-o-q	ARC est
Revenue	339	396	356	-5%	-14%	363
Gross Profit	106	122	137	-23%	-13%	113
Gross Margin	31%	31%	38%	NM	NM	31%
Operating Income	36	53	69	-48%	-33%	43
Net income	38	51	63	-40%	-26%	40
Net Margin	11%	13%	18%	NM	NM	11%

Source: Company data, Al Rajhi Capital

Valuation: We use a 50% DCF and 50% relative valuation, using a P/E of 18.0x, to value Saudi Ceramic. Our DCF based target price (based on 9.8% WACC and terminal growth of 2%) is SAR42/sh and the relative valuation-based target price, based on 18.0x P/E, is SAR41/sh, resulting in a weighted average target price of SAR41/sh, which implies a upside of 12.3%.

Downside Risks: There are a few risks to our valuation and assumptions, as below:

1) Pressure on the performance due to increasing competition from GCC and other local players.
2) Lower government spending, due to a fall in oil prices, could put pressure on the offtake of the company's product, resulting in pressure on financials.
3) Higher than expected increase in raw-material prices, and an inability of the company to pass on the same, could impact the profitability of the company.

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

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

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

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