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Pricing Pressure to Ease in the Near Future, Giga Projects to Drive Long-Term Demand

KSA Cement Sector I Sector Report

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Short-term challenges on demand persistent, but the long-term drivers kicking off; selling prices to recover amid expected end of price war.

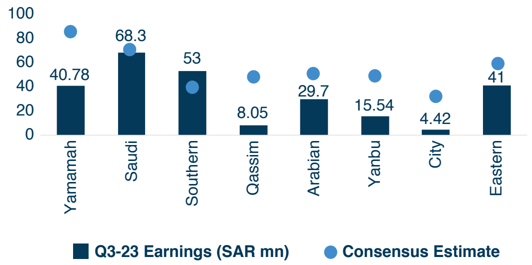
The Cement Sector in Saudi Arabia has been undergoing the effects of the changes in demand dynamics, as housing construction activities have been declining due to slowed mortgages market amid interest rate hikes. However, the demand pressure was mitigated by the execution of the Giga and Vision 2030 related projects. Since most of most of the values of those projects are not rewarded yet, we expect them to be the main driver for cement demand in the coming years, along with the government Capex. Accordingly, we expect volumetric sales to drop by 8.0% in FY23, and to recover by 3.0% in FY24; driven by higher acceleration in Giga project. On the other hand, the cement prices have been pressured by the fierce competition in the Central region where most of those current construction activities are conducted, supported by the high level of inventories, all this was reflected on the companies' earnings during Q2/Q3-FY23. Going forward, we expect the pressure on prices to ease, as more projects are awarded in regions other than the Central region. Thus, providing higher volumetric demand and lowering the current geographic concentration of the construction activities in the Central region. Consequently, the underlining potential in the Saudi cement sector is estimated to be witnessed over the /mid/long run. Given the recent dip in the stock prices and expected recovery for 2024 performance, we believe that the current valuation has been attractive for some of the stocks in our coverage, Yamama Cement, Riyadh Cement, Eastern Cement, Arabian Cement are our top picks in the sector.

Q3-23 earnings missed our estimates amid stronger than expected pressure on prices, earnings forecast to grow 21.1% Y/Y in FY24 backed by recovery in selling prices and volumes: Our cement universe posted earnings of SAR 260.8mn in Q3-23, a decline of 47.4%Y/Y and 25.4% Q/Q, missing our estimated SAR 349.5mn and the consensus's SAR 413.3 mn. The Y/Y and Q/Q decline came steeper than our estimate; mainly due to weaker than expected average selling prices (ASP) for the sector which stood at SAR 158.5 per tonne in Q3-23 (previous quarter: SAR 180). Moreover, local sales declined 4.8% Y/Y during Q3-23. This impacted the margins as well, GP margin for the companies under AJC's coverage stood at 25% in Q3-23, compared to 35% a year earlier, and the lowest margin since Q3-18. However, according to current market sentiment, ASP started to show improvement during Q4-23, which we expect to average around SAR 173.0 per tonne by the end of the quarter, and to recover gradually through FY24. Accordingly, we expect companies under AJC's coverage to record a growth of 21.1% Y/Y in earnings in FY24, after experiencing a 9.7% decline in FY23, to reach combined earnings of SAR 2.22bn.

Topline expected to rise 6.1% Y/Y in FY24 supported by 3.0% Y/Y volume growth; clinker inventories to ease from 3-year high: KSA cement sector witnessed a 7.4% decline in local cement dispatches to near 43.0mn tonnes in 11M-23 due to weak demand from housing constructions activities (average new mortgages per month down 39% Y/Y in 10M-23). This led to a 13.0% Y/Y increase in clinker inventories, reaching 39.75mn tonnes as of Nov-23, after recording the highest level in 3 years during Oct-23. However, the decline in cement demand due to low housing construction activities has been partially offset by the momentum in Giga projects constructions and larger government Capex (government Capex estimated at SAR 203bn in FY23, up 41.8% Y/Y; budgeted SAR 189bn for FY24), which will be realized in the next phase. We expect that the Giga projects constructions and government Capex will drive the demand for cement. Saudi Arabia, represented 44% (USD 44bn) of the total USD 101bn worth of projects awarded in H1-23 in the MENA region, and represents about 35% of the estimated USD 3tn total value of the project pipeline in the MENA region. Moreover, we expect the demand from the private sector to improve in FY24, given the anticipated interest rate cut, which will ease the pressure on the private sector funding costs. The hosting of EXPO 2030 and expectedly 2034 FIFA world cup in KSA and their related constructions activities from both public and private sectors will boost the demand for cement in the upcoming years. Additionally, PIF announced recently that it aims to spend around SAR 4tn in the real estate development market in the next 10 years Driven by expected improvement in demand, volumetric sales are estimated at around 48.1mn tonne (+3.0% Y/Y) and 50.5mn tonne (+5.0% Y/Y) in FY24 and FY25; respectively. Accordingly, the top line is forecast to grow 6.1% and 4.7% in FY24 and FY25; respectively. Higher demand will result in an easing of inventory levels. We estimate clinker inventory to reduce to 39.0mn tonnes in FY24 and 36.5mn tonnes in FY25 from an estimated 40.7mn tonnes in FY23. Additionally, a greater concentration of local sales (due to rising demand) compared to exports is expected to aid the margins of the cement companies. Thus, we are positive on the sector over the medium/long runs.

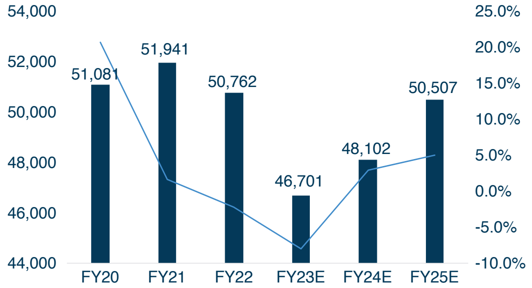
Competition in the Central Region spread to the Western Region, pricing pressure to ease gradually starting Q4-23: Although we have projected the price war in the Central Region previously (starting from Q2-23), and the possibility of it spreading to other regions, the intensity was much higher than we expected. The ASP in the Central Region reached SAR 122.8 per tonne in Q3-23 vs. SAR 148 a year earlier. Competition impacted the Western Region as well, where ASP declined to SAR 147.5 per tonne (Q3-22: SAR 163), despite the 20.7% Y/Y decline in discounted export sales from Arabian Cement and Yanbu Cement. Meanwhile, the Eastern Region still enjoys the leading position in the sector with an ASP of SAR 228 per tonne, thanks to the price premium to oil & gas project sales while avoiding the price competition. The sector's ASP stood at SAR 158.5 per tonne in Q3-23, down 12% Y/Y and 11% Q/Q, respectively. ASPs started to show recovery according to current market sentiment, and we expect them to average around SAR 173 per tonne by the end of Q4-23, driven by eased competition. We stay conservative on the pace of ASP recovery as the local demand stays below 50 MT a year; which we do not expect it to be realized before FY25.

Fig 1: Q3-23 Earnings vs. Consensus Estimates



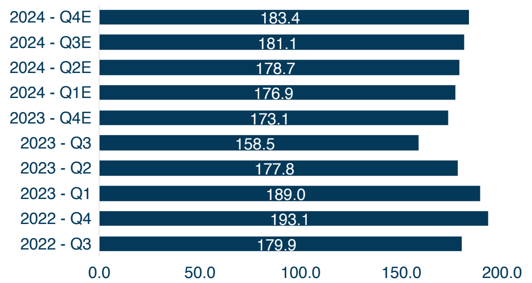
Source: Argaam, Aljazira Capital Research

Fig 2: Cement sales in KSA ('000)



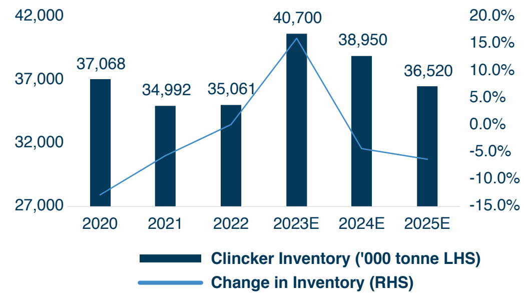
Source: Yamama Cement, Aljazira Capital Research

Fig 3: Average selling prices (SAR/tonne)



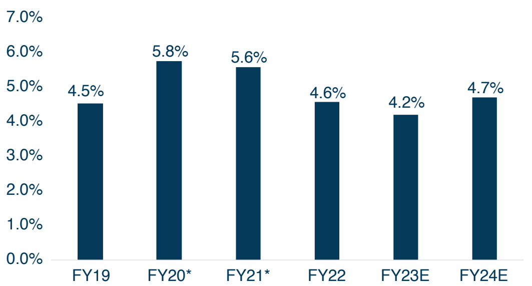
Source: Yamama Cement, Aljazira Capital Research

Fig 4: Clinker inventory trend and forecast



Source: Yamama Cement, Aljazira Capital Research

Fig 5: Dividend yield under AJC's coverage

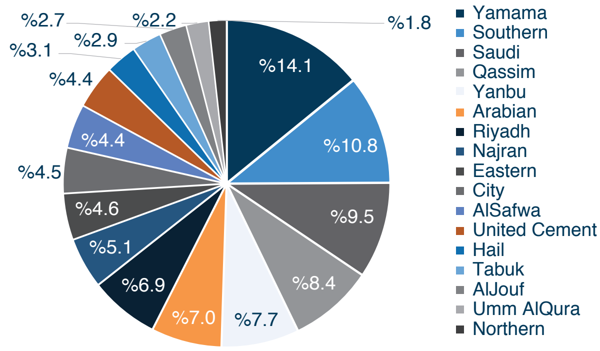


Source: Aljazira Capital Research. *Excluding Yamama Cement.

Yamama Cement still leads in the market in terms of market share: As of Nov-23, Yamama Cement held 14.1% TTM market share of local sales; benefiting from its new plant location, additional capacity, and price discounts. Followed by Southern Cement (10.9%) and Saudi Cement (9.6%). Most of main players in the sector kept their positions during FY23. Meanwhile, Northern Cement and Umm AlQura Cement bottoms the market with market shares of 1.8% and 2.2%, respectively. We expect companies like Saudi, Southern and Arabian Cement to gain more market shares gradually on the back of eased competition. Given its leading position in the market, we expect Yamama Cement to be the primary beneficiary on any improvement of demand. Regarding exports sales, Yanbu Cement and Arabian Cement noticeably decreased their combined exports by 43.4% Y/Y in 11M-23, and Saudi Cement took the lead with a market share of 40.0% of the total export. We expect Saudi Cement's exports to gradually decrease in FY24 and FY25; with the revived and more profitable local demand, which will be reflected on improved margins.

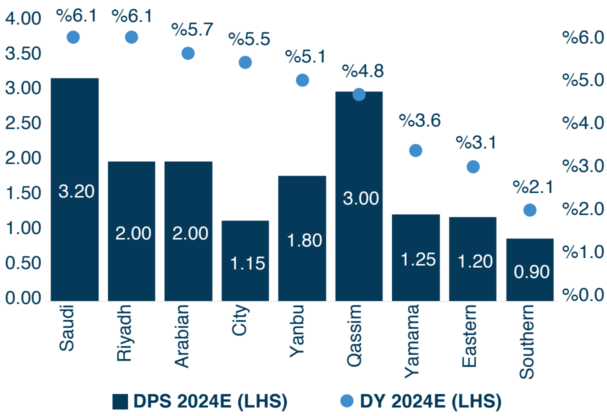
Current market valuations offer dividends yields opportunities: Given their strong cash flows and current market prices, we expect the sector's dividend yield to exceed most of the other sectors in the market. We anticipate a 4.20% average dividend yield to be posted by the companies under AJC's coverage in FY23 (down from 4.60% in FY22), as earnings are contracting in FY23. For FY23, we expect Yanbu Cement to be the lead the sector with a DY of 6.4%, followed by Saudi Cement and Riyadh Cement with a DY of 5.8% and 4.6%, respectively. However; the estimated earnings recovery in FY24 would increase the payouts of the companies in the sector, lifting the sector's yield to 4.70%. We expect Saudi Cement and Riyadh Cement both to lead the sector in FY24 with a DY of 6.1%, each. Followed by Arabian Cement with DY of 5.7%.

Fig 6. TTM market shares (Nov-23)



Source: Yamama Cement, Aljazira Capital Research

Fig 7. Estimated DY and DPS for FY24



Source: Aljazira Capital Research

Valuation and investment thesis: We believe that the current market valuations offer four attractive investments opportunities in our cement universe, accordingly we update our recommendation to "**Overweight**" for Yamama Cement, Arabian Cement, Riyadh Cement and Eastern Cement. **Yamama Cement:** The easing of competition will unlock Yamama's ASP, despite the expected decline in its volumetric sales. The stock is currently trading on a forward P/E of 17.7x based on FY24 estimates. We upwardly update our TP to **SAR 40.10** per share. **Arabian Cement:** Expected improvement in ASP and lower inventory costs are the drivers for Arabian's potential. The stock is currently trading on a forward P/E of 18.0x based on FY24 estimates. We lift our TP to **SAR 42.0** per share for the stock. **Riyadh Cement:** We expect the company to benefit from the eased competition in the Central region. The stock is currently moved to be traded in the main market "TASI", which gives the valuation a premium compared to previous valuations. The stock is currently trading on a forward P/E of 16.8x based on FY24 estimates. We upwardly update our TP to **SAR 39.0** per share. **Eastern Cement:** We expect the company to benefit from the stable demand and prices in the eastern region, and the improving Precast segment both in volumetric sales and margins. The stock is currently trading on a forward P/E of 15.6x based on FY24 estimates, we downwardly update our TP to **SAR 44.0** per share with an "**Overweight**" recommendation. Meanwhile, we stay "**Neutral**" on **Saudi Cement, Southern Cement, Qassim Cement**, **Yanbu Cement and City Cement**. Main downside risks include: 1) less than expected improvement in average selling prices. 2) Some delay from Giga/Mega projects along with the oil price volatility. 3) the continuity in price war.

Table of valuations

Company Name	Recommendation	TP	Upside/ (Downside)	Net Income 2023	Net Income 2024	P/E FY23E	P/E FY24E	DPS FY23E	DPS FY24E	DY (%)
Saudi Cement	Neutral	56.0	7.5%	381.6	408.7	20.9	19.5	3.0	3.2	6.1%
Yamama Cement	Overweight	40.1	16.4%	329.7	394.7	21.1	17.7	1.0	1.25	3.6%
City Cement	Neutral	22.0	5.1%	86.2	142.5	33.8	20.5	0.8	1.15	5.5%
Arabian Cement	Overweight	42.0	19.7%	158.7	195.3	22.1	18.0	1.50	2.00	5.7%
Yanbu Cement	Neutral	38.0	7.5%	131.7	175.9	42.1	35.7	2.25	1.6	5.1%
Eastern Cement	Overweight	44.0	15.5%	205.5	210.0	15.9	15.6	1.2	1.2	3.1%
Southern Cement	Neutral	42.5	-1.2%	176.3	230.3	34.10	26.2	0.70	0.90	2.1%
Qassim Cement	Neutral	64.6	2.4%	149.4	226.6	38.0	25.0	2.60	3.0	4.8%
Riyadh Cement	Overweight	39.0	18.4%	214.0	235.0	18.5	16.8	1.5	2.0	6.1%

Source: the company's profiles, Bloomberg, AlJazira Capital Research. *prices as of 19th of Dec 2023

Financial Performance

Yamama Cement

Amount in SARmn, unless otherwise specified	2022	2023E	2024E	2025E
Revenue	**1,022.7**	**980.1**	**1,099.2**	**1,177.7**
Growth %	39.0%	-4.2%	12.1%	7.1%
Gross Profit	**423.2**	**381.3**	**513.5**	**562.5**
Gross Margin %	**41.4%**	**38.9%**	**46.7%**	**47.8%**
Net Profit	**355.8**	**329.7**	**394.7**	**488.5**
Net Margin %	**34.8%**	**33.6%**	**35.9%**	**38.1%**
EPS	1.76	1.63	1.95	2.21
DPS	1.00	1.00	1.25	1.75
ROA	5.6%	5.2%	6.3%	7.2%
ROE	7.6%	6.9%	8.0%	8.9%
PE (x)	17.8	21.2	17.7	15.6
PB (x)	1.36	1.46	1.42	1.39

Source: the company's profiles, Bloomberg, AlJazira Capital Research

Saudi Cement

Amount in SARmn, unless otherwise specified	2022	2023E	2024E	2025E
Revenue	**1,419.8**	**1,496.3**	**1,546.9**	**1,607.8**
Growth %	0.7%	5.4%	3.4%	3.9%
Gross Profit	**568.9**	**600.6**	**639.8**	**683.3**
Gross Margin %	**40.1%**	**40.1%**	**41.4%**	**42.5%**
Net Profit	**398.8**	**381.6**	**408.7**	**461.7**
Net Margin %	**28.1%**	**25.5%**	**26.4%**	**28.7%**
EPS	2.61	2.49	2.67	3.02
DPS	3.25	3.00	3.20	3.70
ROA	12.2%	12.1%	13.4%	15.7%
ROE	17.4%	17.2%	19.1%	22.6%
PE (x)	19.6	20.9	19.5	17.3
PB (x)	3.40	3.58	3.72	3.91

Source: the company's profiles, Bloomberg, AlJazira Capital Research

Southern Cement

Amount in SARmn, unless otherwise specified	2022	2023E	2024E	2025E
Revenue	**1,022.7**	**1,068.6**	**1,086.4**	**1,078.4**
Growth %	-8.7%	-12.6%	1.67%	-0.74%
Gross Profit	**357.3**	**262.1**	**312.4**	**348.0**
Gross Margin %	**29.2%**	**24.5%**	**28.8%**	**32.3%**
Net Profit	**300.7**	**176.3**	**230.3**	**264.3**
Net Margin %	**24.6%**	**16.5%**	**21.2%**	**24.5%**
EPS	2.15	1.26	1.64	1.89
DPS	1.25	0.70	0.90	1.00
ROA	7.8%	4.3%	5.6%	6.2%
ROE	9.4%	5.4%	6.8%	7.5%
PE (x)	23.7	34.1	26.1	22.8
PB (x)	2.23	1.83	1.78	1.72

Source: the company's profiles, Bloomberg, AlJazira Capital Research

Qassim Cement

Amount in SARmn, unless otherwise specified	2022	2023E	2024E	2025E
Revenue	**678.5**	**613.6**	**723.2**	**785.5**
Growth %	-6.1%	-9.6%	17.9%	8.6%
Gross Profit	**188.5**	**167.5**	**158.8**	**197.8**
Gross Margin %	**27.8%**	**27.3%**	**35.8%**	**37.9%**
Net Profit	**130.5**	**149.4**	**226.6**	**261.3**
Net Margin %	**19.2%**	**24.4%**	**31.3%**	**33.3%**
EPS	1.45	1.66	2.52	2.90
DPS	2.20	2.60	3.02	3.80
ROA	6.8%	8.0%	12.4%	15.1%
ROE	7.8%	9.4%	14.7%	17.9%
PE (x)	42.1	38.0	25.1	21.7
PB (x)	3.30	3.59	3.69	3.89

Source: the company's profiles, Bloomberg, AlJazira Capital Research

Arabian Cement

Amount in SARmn, unless otherwise specified	2022	2023E	2024E	2025E
Revenue	**971.0**	**919.6**	**948.2**	**1,014.9**
Growth %	-6.0%	-5.3%	3.1%	7.0%
Gross Profit	**274.6**	**248.3**	**287.0**	**319.1**
Gross Margin %	**28.3%**	**27.0%**	**30.3%**	**31.4%**
Net Profit	**181.0**	**158.7**	**195.3**	**225.6**
Net Margin %	**18.6%**	**17.3%**	**20.6%**	**22.2%**
EPS	1.81	1.59	1.95	2.26
DPS	2.20	1.50	2.0	2.30
ROA	5.5%	4.9%	6.1%	7.1%
ROE	6.6%	5.8%	7.2%	8.3%
PE (x)	19.5	22.1	18.0	15.6
PB (x)	1.30	1.28	1.28	1.29

Source: the company's profiles, Bloomberg, AlJazira Capital Research

Yanbu Cement

Amount in SARmn, unless otherwise specified	2022	2023E	2024E	2025E
Revenue	**981.2**	**797.5**	**832.6**	**842.2**
Growth %	5.0%	-18.7%	4.4%	1.1%
Gross Profit	**284.7**	**217.7**	**258.2**	**289.1**
Gross Margin %	**29.0%**	**27.3%**	**31.0%**	**34.3%**
Net Profit	**215.4**	**131.7**	**175.9**	**235.4**
Net Margin %	**22.0%**	**16.5%**	**21.1%**	**28.0%**
EPS	1.37	0.84	1.12	1.49
DPS	1.50	2.25	1.80	2.40
ROA	6.4%	4.0%	5.8%	8.3%
ROE	7.8%	5.2%	7.2%	10.3%
PE (x)	30.6	42.3	31.6	27.6
PB (x)	2.38	2.19	2.29	2.85

Source: the company's profiles, Bloomberg, AlJazira Capital Research

City Cement

Amount in SARmn, unless otherwise specified	2022	2023E	2024E	2025E
Revenue	**431.4**	**367.5**	**487.4**	**541.2**
Growth %	-13.2%	-14.8%	32.6%	11.0%
Gross Profit	**145.4**	**117.6**	**183.2**	**220.5**
Gross Margin %	**33.7%**	**32.0%**	**37.6%**	**40.7%**
Net Profit	**115.0**	**86.2**	**142.5**	**174.7**
Net Margin %	**26.7%**	**23.4%**	**29.2%**	**32.3%**
EPS	0.82	0.62	1.02	1.25
DPS	0.90	0.80	1.15	1.50
ROA	5.9%	4.5%	7.3%	9.0%
ROE	6.3%	4.7%	7.8%	9.6%
PE (x)	24.3	34.0	20.6	16.8
PB (x)	1.54	1.61	1.61	1.62

Source: the company's profiles, Bloomberg, AlJazira Capital Research

Eastern Cement

Amount in SARmn, unless otherwise specified	2022	2023E	2024E	2025E
Revenue	**784.2**	**931.5**	**947.1**	**967.7**
Growth %	3.5%	18.8%	1.7%	2.2%
Gross Profit	**247.7**	**299.7**	**310.0**	**328.0**
Gross Margin %	**31.6%**	**32.2%**	**32.7%**	**33.0%**
Net Profit	**143.3**	**205.5**	**210.0**	**217.5**
Net Margin %	**18.3%**	**22.1%**	**22.2%**	**22.5%**
EPS	1.67	2.39	2.44	2.53
DPS	2.0	1.20	1.20	1.30
ROA	5.0%	7.1%	7.0%	7.0%
ROE	6.1%	8.3%	8.2%	8.1%
PE (x)	24.2	15.9	15.6	15.1
PB (x)	1.47	1.33	1.28	1.22

Source: the company's profiles, Bloomberg, AlJazira Capital Research

Riyadh Cement

Amount in SARmn, unless otherwise specified	2022	2023E	2024E	2025E
Revenue	**598.0**	**659.8**	**643.0**	**687.3**
Growth %	-13.2%	-14.8%	32.6%	11.0%
Gross Profit	**231.5**	**264.7**	**289.0**	**325.5**
Gross Margin %	**38.7%**	**40.1%**	**45.0%**	**47.4%**
Net Profit	**189.8**	**214.0**	**235.0**	**272.0**
Net Margin %	**31.7%**	**32.4%**	**36.5%**	**39.6%**
EPS	1.58	1.78	1.96	2.27
DPS	1.50	1.55	2.0	2.30
ROA	10.0%	11.2%	12.3%	14.3%
ROE	11.3%	12.5%	13.8%	15.9%
PE (x)	21.1	18.5	16.8	14.5
PB (x)	2.39	2.32	2.31	2.31

Source: the company's profiles, Bloomberg, AlJazira Capital Research

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RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer