Bawan Company
Engineering – Industrial
BAWAN AB: Saudi Arabia
25 February 2021

الراجحي المالية
Al Rajhi Capital

US$0.454bn	100%	US$4.304mn
Market cap	Free float	Avg. daily volume

Target price	37.00	30.5% over current
Current price	28.35	as at 24/2/2021

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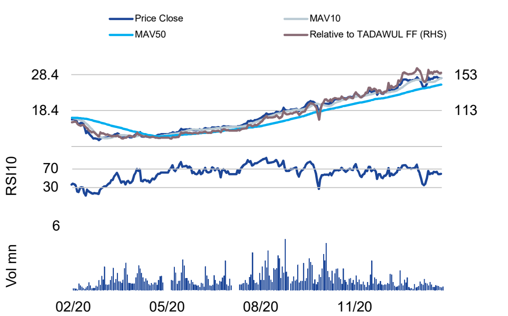
Existing rating

Underweight	Neutral	Overweight

Performance



Earnings

(SARmn)	FY18	FY19	FY20E	FY21E
Revenue	1,953	2,235	2,374	2,681
Revenue growth	-8.2%	14.4%	6.2%	12.9%
Gross profit	156	246	302	366
Gross margin	8%	11%	13%	14%
EBIT	0	46	103	158
EBIT margin	0%	2%	4%	6%
Net profit	-218	27	81	130
Net margin	-11%	1%	3%	5%
EPS	-3.6	0.4	1.4	2.2
DPS	0.0	0.0	0.5	0.5
Payout	0%	0%	40%	25%
P/E	NA	63.9x	20.9x	13.1x
RoE	-36%	4%	12%	17%

Source: Company data, Al Rajhi Capital

Valuation

	FY18	FY19	FY20E	FY21E
P/E	NA	64x	21x	13x
EV/EBITDA	44x	23x	15x	11x
P/B	3x	3x	3x	2x

Source: Company data, Al Rajhi Capital

Bawan Company

Initiating coverage with a TP of SAR37/sh

We initiate coverage on Bawan with a target price of SAR37/sh based on 50:50 weights given to P/E (18x 2021e EPS) based relative valuation (SAR36/sh.) and DCF valuation (SAR38/sh.). The company has a diversified revenue base with operations in five businesses, with steel (44% of revenue) and concrete (c.8%) being correlated strongly to the construction industry. Construction activities have been picking up, with retail real estate loans by banks growing by 58% y-o-y as on 30-Sep-20, while new mortgage loans for 2020 growing by 83% y-o-y. Given these, we expect construction activity in the medium term to remain strong and grow between 8-10%. The second largest segment for the company, wood (c.23%), predominantly caters to the requirement of petrochemical companies, and revenue growth from this segment is likely to trace growth in the user industry. 65-70% of revenue of plastic (c.11%) segment is to food packaging, with the balance coming from building materials. We expect growth from food packaging industry to remain steady, while we expect offtake from the building material to remain strong, at the back of construction activity. The electricity product (c.14%) segment performance has been under pressure since 2018 and was impacted by lower construction activity and lower offtake from the export market. However, we expect this segment to recover in the medium term, at the back of revival in both the domestic and the export markets. In 2021 we expect earnings to be 2.2/sh or a P/E of c.13x, which is at a substantial discount to historical levels. The stock also has a dividend yield of 2% and upside of 30.5% based on our TP.

Growth in construction to aid steel revenue: Construction GDP growth has been lacklustre since 2015, registering an average growth rate of 0.1% between 2015-19. However, in what can be seen as recovery, it grew by 8% y-o-y in 2019. Retail real estate loans by banks as of 30-Sep-2020, grew by 58% y-o-y, while new mortgage loans for 2020 grew by 83% y-o-y. We expect, construction activity to continue to remain strong in the medium term, providing strong visibility for the steel and concrete segments. Given this we expect, revenue from the steel and concrete segments of Bawan to grow by c.15% in the medium term.

Diversified revenue base: Bawan's business is well-diversified through its exposure to five segments. While steel provides growth opportunities through its exposure to construction, wood and plastic provide stable growth opportunities, by catering to the requirements of packaging. The concrete segment too will benefit from improved construction activity, while we expect electricity product division revenue growth to improve. Overall, we expect the revenue of Bawan to grow at around 11% in the medium term.

A higher scale of operations to aid in improvement in margins: Aided by growth in revenue and higher scale of operation, operating (EBIT) margins of Bawan is expected to improve to 4.3% in 2020, from 2.1% in 2019. We expect this trend to continue, as we expect EBIT margins to reach c.8% by 2022.

Valuation and risks: Our target price of SAR37/sh. provides an upside of 30.5% and hence an ***Overweight*** rating. Downside risks to our valuation are oil price weakness, lower mortgage demand, adverse movement of commodity prices and an increase in the working capital requirement, resulting in an increase in leverage.

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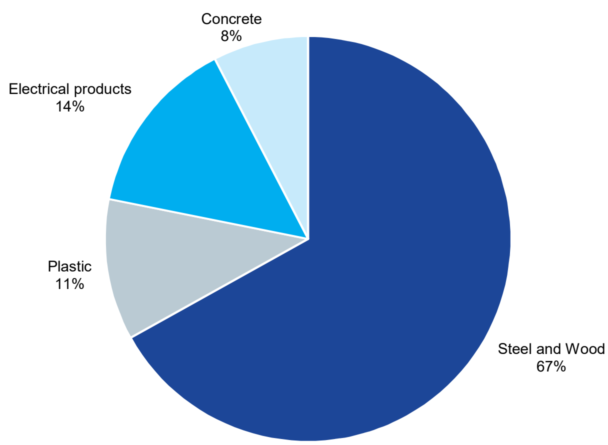
Company Overview: Bawan is a leading manufacturing company, with a diversified presence in metal, wood, concrete, plastic, and electrical products, with exposure to construction, infrastructure, consumer goods, and packaging. Founded in 1980, the company was formed by the amalgamation of Abdulkader Al Muhaidib & Sons General Trading Company L.L.C and Abdullatif & Mohammad Al Fozan Co., two major players in trading & manufacturing of building materials and industrial investment in Saudi Arabia. The company operates in five segments, steel, wood, plastics, electrical products, and concrete. For 9M20, we estimate, steel to have accounted for c.44% and wood 23% of revenue. The third-largest segment is electricity products, which accounted for c.14% of revenue, followed by plastic (c.11%) and concrete (c.8%). Bawan carries its operations through manufacturing facilities spread across the country and the region viz, Riyadh, Jeddah, Dammam, Jubail, Yanbu, Kuwait and Ras Alkhaimah.

Figure 1. Diversified revenue base (9M20)

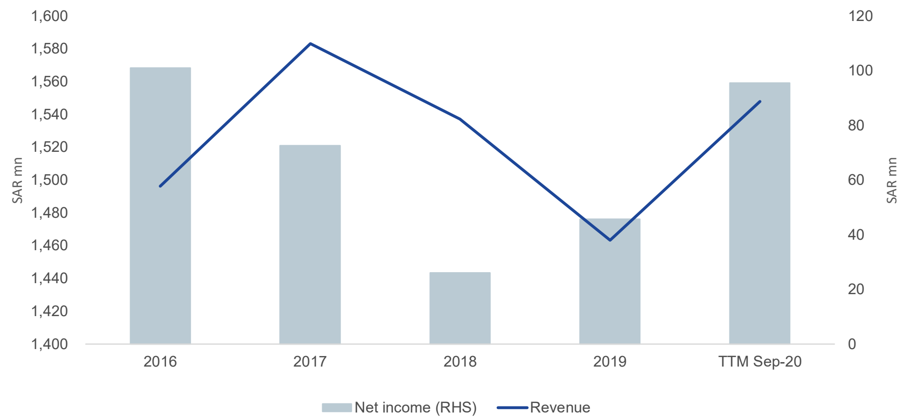


Source: Company data, Al Rajhi Capital

An uptick in the construction activity to drive steel revenue: Steel is the largest segment for the company and as per our estimates, it has accounted for c.44% of total revenue for 9M20. In this business, Bawan operates predominantly with a B2B focus and is one of the largest manufacturers of metal construction products in the Kingdom. In this segment, the company manufactures drawbar, wire mesh, and Epoxy, with an annual capacity to manufacture 250k tons of drawbar, 30k tons of wire mesh, and 60k tons of Epoxy. The company's manufacturing plants for this segment are spread around Riyadh, Jeddah, and Dammam. This segment manufactures a wide variety of products through specialized divisions, the metal works division and the steel doors manufacturing division.

The company is currently operating at an average capacity utilization of 68%. Since 2015, the performance of this segment has come under pressure and as per our estimates, revenue from this segment has fallen by an average of c.2% between 2015 and 2019. Soft demand from the real estate and construction segments, the main consumers of the segment's products, was the main reason for the same. However, with the rebound in construction activity, especially real estate, we expect the growth rates in this segment to recover. Added to this, we also expect a shift in the industry dynamics, especially post the impact of Covid, with manufacturing shifting more towards the organised sector. This in turn will aid Bawan to improve its current market share. Overall, we expect revenue from this segment to grow at c.16% for the next three years (2020-2023).

Figure 2. Revenue and net income from steel and wood



Source: Company data, Al Rajhi Capital

Growth in wood segment to remain stable: Wood is the second largest segment for Bawan and as per our estimates, for 9M20 accounted for 23% of total revenue. It caters to the requirement of the packaging and construction industries. In this segment, the company operates through thirteen manufacturing plants spread across Riyadh, Dammam, Jeddah, Jubail, Yanbu, Kuwait and Ras Alkhaimah. Bawan also owns Al-Raya Co. that operates plants in Kuwait and Ras al-Khaimah (UAE). In this segment, the company manufactures, wooden panels covered with melamine, wooden decorative panels, and wood packaging materials (including wooden pallets, packaging boxes, and cable drums). Bawan has the capacity to manufacture 350k cubic meters of packaging products, 110k pieces of laminated sheets, and 14k door joineries.

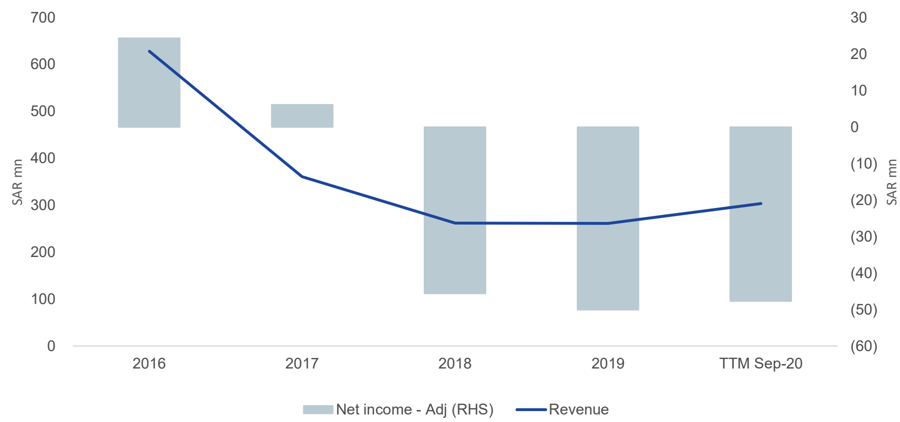
Around 75% of the revenue from this segment is from packaging, 10-15% of the revenue is towards furniture, and c.10% is towards doors. The packaging operations are B2B and predominantly caters to the requirement of the petrochemical industry and revenue growth is expected to trace growth in the user industry. Demand for doors (B2B) and furniture (B2C) are expected to be driven by construction activity. Overall, we expect revenue growth to remain stable from this segment, and we expect an average growth rate of c.4-5% in the medium term.

The profitability of the steel and wood segment is improving with higher revenue: Net income margins of wood and steel have come under pressure since 2016, with the same falling from 7% in 2016 to 3% in 2019. However, the net income margins for 9M20 improved to 2016 levels of 7% and were aided by a recovery in revenue growth, resulting in better-operating efficiency. We expect this trend to continue in the medium term, aided mainly by a recovery in the growth rate of steel and the resulting improvement in operating leverage.

The electrical product segment performance is expected to improve: Electrical products is the third-largest segment for Bawan, accounting for c.14% of the company's 9M20 revenue. In this segment, the company designs, manufactures and builds transformers, low voltage switch gears, low voltage panels, unit substations and package substations. Bawan has a joint venture with Wilson Transformers, a leading manufacturer of transformers in Australia, which provides technical cooperation. The segment's operations are carried out from Riyadh. 30% of the revenue from electricity products is directly to State Electricity Companies, 15% of the revenue is towards exports and the balance to private sector. Revenue from this segment has been volatile and has fallen by c.14% between 2015 and 2019. Revenue of this segment was impacted by lower exports, due to political instability in the MENA region, and lower domestic sales, due to lower construction activities and restructuring in SECs.

However, there has been a recovery in demand in 2020, with an improvement in construction activities in the country. Added to this, we also expect export demand to improve in the medium term. Given this we expect revenue to grow by c. 20% in the current year and post-2020 to stabilise and grow at c.5% in the medium term.

Figure 3. Electricity product revenue and profitability under pressure since 2018



Source: Company data, Al Rajhi Capital

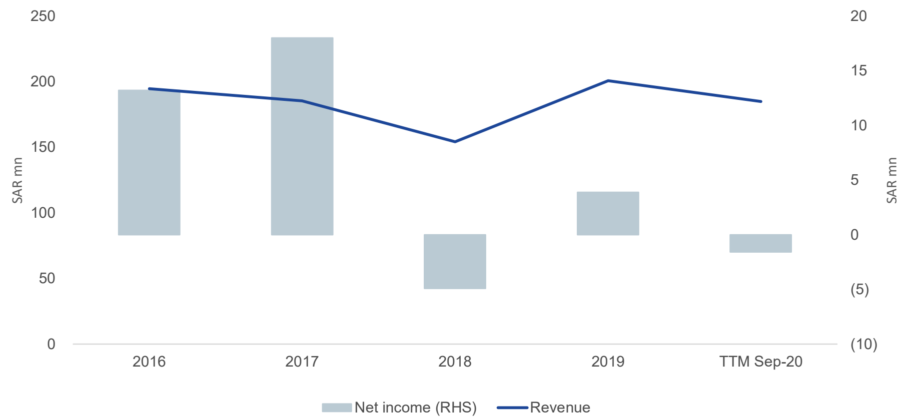
Since 2018, this segment's profitability has been under pressure, with net income margins averaging -18% in 2018 (adjusted for one-offs) and 2019, and was at -10% in 9M20. Going forward, we expect the profitability of this segment to improve from these levels, at the back of improvement in revenue and higher scale of operations.

Plastic to provide stable growth: Plastic segment is a relatively new segment for Bawan and it was added through the acquisition of Arnon Plastic, a wholly-owned subsidiary of Al Fozan Holding Group, for SAR191 million. Plastics account for c.11% of 9M20 revenue and is the fourth largest segment of Bawan. In this division, the company sells treated plastic and 65-70% of these are towards food packaging and the balance 30-35% is used in the construction sector.

In 2020, the revenue of plastics was impacted by a fire, which broke out in one of the company's Dammam factory. The company has insured the factory for both damages due to fire and loss of business. Bawan is expected to receive insurance compensation for this by 1H2021 and the factory affected by fire is expected to commence production by 2Q21. We expect this segment to register stable growth and post 2020, we expect revenue from this segment to grow at an average rate of c.10% in the medium term. In 2019 and 9M20, the net income margin of the plastic segment was between 7-8% and we expect this level of profitability to continue in the medium term.

Concrete segment growth to be strong, aided by strong offtake from construction: This division accounts for c.8% of revenue and is the smallest segment of Bawan. In this segment, the company manufactures a variety of pre-cast and pre-stressed products and ready-mix concrete products for building construction. Between 2015 and 2019, the revenue of this segment has fallen by an average of 1%. However, in 2019 the division's revenue saw recovery, growing by 30%. In 2020, however, we expect revenue to fall by more than 10% y-o-y due to the impact of Covid. We expect the segment's performance to improve from 2021, as we expect revenues to grow by 6-8% in the medium term.

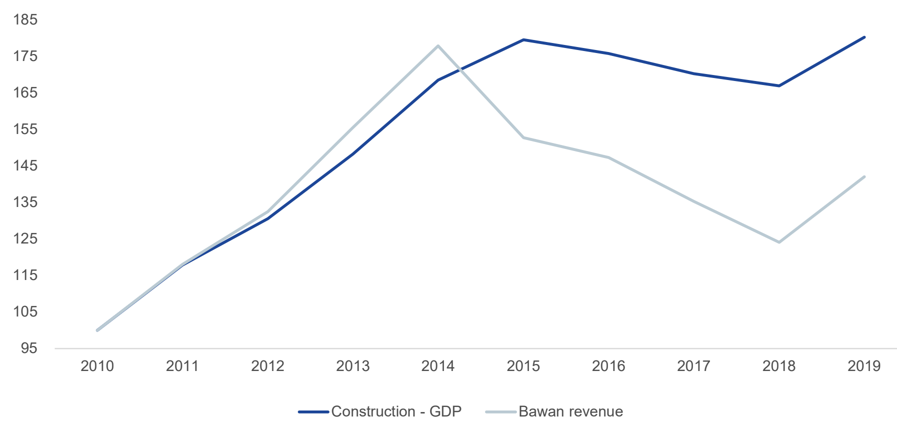
Figure 4. Revenue and net income of concrete



Source: Company data, Al Rajhi Capital

Industry drivers – Construction spending to drive revenue: Total revenue of Bawan since 2015 has come under pressure and has fallen from 2015 levels of SAR2.4 bn to SAR2.2 bn in 2019, an average fall of c.2% p.a. Despite its diversified revenue base, revenue growth of Bawan continues to be mainly driven by construction activity in the Kingdom.

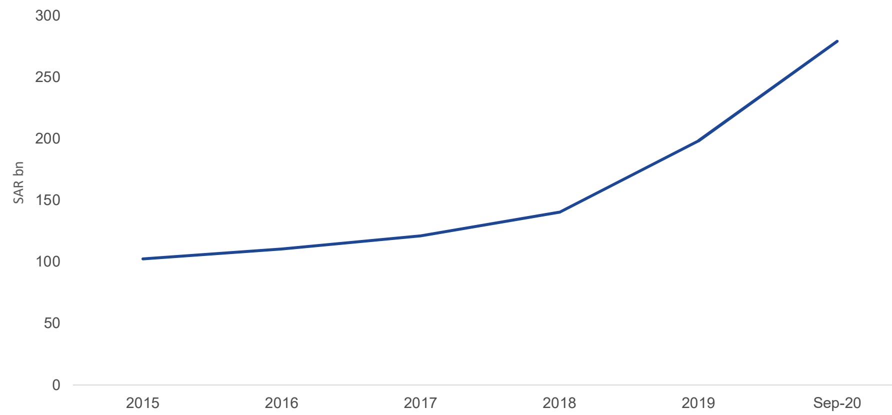
Figure 5. Bawan revenue trace construction GDP



Source: Company data, Al Rajhi Capital

Given this, lower construction activity, due to lower oil prices, has been the main reason for the fall in revenue. Construction GDP, between 2015 to 2019, grew by an average of 0.1% p.a. However, green shoots have started to appear, with construction GDP registering an 8% y-o-y growth in 2019 and a corresponding 1% fall in Bawan's revenue (excluding plastic). The recovery trend in construction activity has largely continued in 2020, with the 9M20 construction GDP growing by c.2% y-o-y, despite the impact of Covid. Correspondingly, the 9M20 revenue of Bawan has registered a growth of c.4% y-o-y. Construction activity in the Kingdom has been aided by higher housing demand, aided by government initiatives, and an increase in mortgage loans. We expect this trend to continue in the short to medium term.

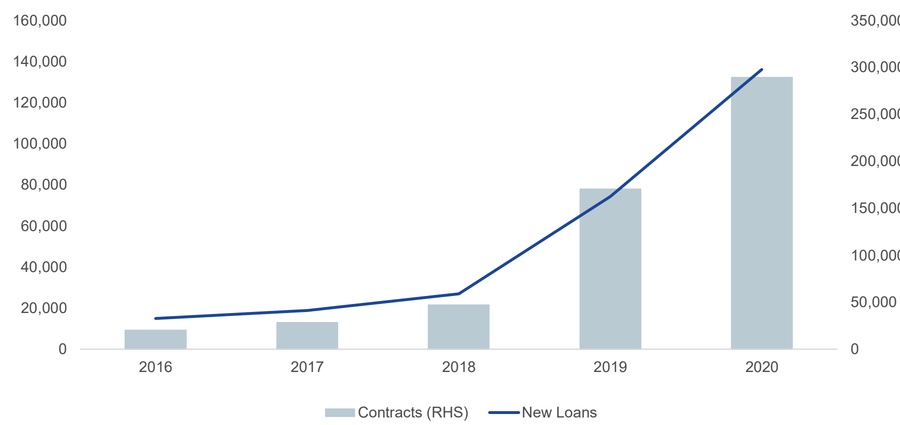
Figure 6. Real estate loan grows exponentially



Source: Company data, Al Rajhi Capital

Between 2015-19, real estate loans provided to retail clients by banks have grown at an average rate of 18% p.a., while as of 30-Sep-20, the loan growth was 58% y-o-y. We expect the growth momentum in mortgages to continue, as cumulative new mortgage loans for 2020 grew by 83% y-o-y. Given that the average time taken to complete a residential housing project is around three to four years, we expect consistent demand from this segment in the medium term.

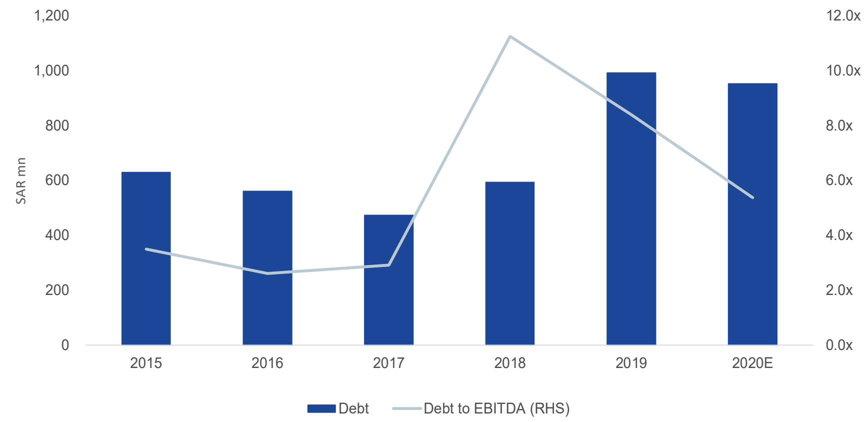
Figure 7. Growth in new real estate loans and number of contracts



Source: Company data, Al Rajhi Capital

Leverage levels high due to high working capital requirements: As on 30-Sep-2020, the debt-to-equity ratio of Bawan was at 127%, while debt to EBITDA (LTM 'Sep-20) was at 6.5x. The leverage of the company has increased in 2019 due to the acquisition of Arnon Plastic and the resultant absorption of the debt of the acquired company. Of the total debt outstanding in 2019 68% is in the form of short-term working capital financing debt. The operations of Bawan have historically been working capital intensive, with average receivables and inventory (around four months of production) turnover of c.30% each. As a result of this, we do not expect a substantial fall in the company's dependence on short-term bank debt. However, with no major capex requirement, we expect long term loans to gradually fall over the medium term. Given this, we expect leverage levels to improve in the medium term.

Figure 8. Leverage increases in 2019



Source: Company data, Al Rajhi Capital

Valuation Chart:

Figure 9. DCF Summary

(SAR mn)	31-Dec-21	31-Dec-22	31-Dec-23	31-Dec-24	31-Dec-25
EBITDA	231	299	340	385	445
Tax	(21)	(31)	(37)	(44)	(53)
Net changes in working capital	(76)	(83)	(44)	(73)	(74)
Net capex	(54)	(60)	(65)	(69)	(74)
Net changes in cash	**80**	**124**	**193**	**199**	**245**
Discount	0.9329	0.8594	0.7917	0.7293	0.6719
Discounted net changes in cash	75	107	153	145	164
Discounted terminal value	2,558				
Net value	**3,202**				
Cash	25				
Net investments	49				
Debt	(952)				
Minority interest	(63)				
Total value	**2,261**				
Shares O/s	60				
Value per share	***38***				

Source: Company data, Al Rajhi Capital

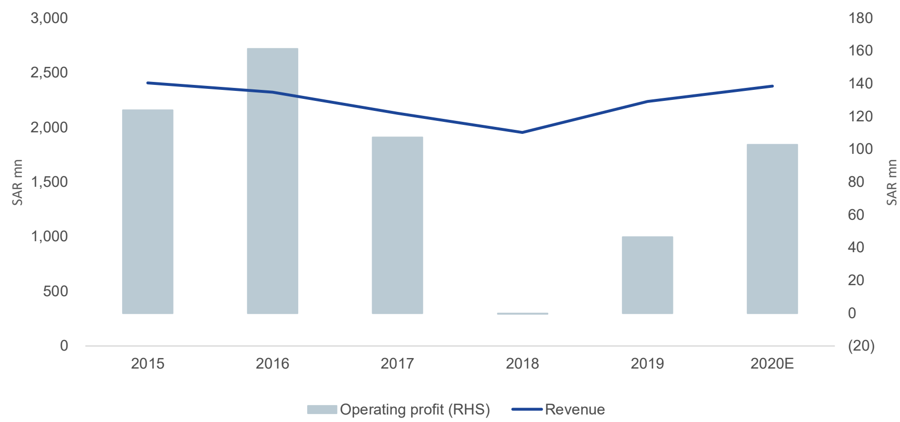
Figure 10. Scenario analysis – Valuations

		Terminal growth				
		0.0%	1.3%	2.0%	3.3%	4.0%
WACC	**6.6%**	39	45	50	63	77
	7.6%	35	39	42	50	58
	8.6%	32	35	**37**	42	47
	9.6%	29	31	33	37	40
	10.6%	27	29	30	33	35

Source: Company data, Al Rajhi Capital

Key Financials: Total revenue of Bawan on average fell by 2% between 2015-19 and was impacted by a fall in revenue across the segment, especially steel and wood. Excluding revenue from plastic, which was acquired by the company in 2019, the fall in revenue would have been higher at 5%. We expect this trend to show a reversal in 2020, as we expect revenue to grow by 6% y-o-y, aided by improvement in revenue of steel & wood and electricity product segments. We expect this trend to continue in the medium term, as we expect the company to register an average revenue growth of 11% between 2020-23. We expect revenue growth to be driven by strong growth from the steel segment, aided by improved offtake from construction and real estate. By 2021, we expect plastic segment performance to recover, post the fire in one of its manufacturing unit, while the recovery in the electricity product segment is also expected to continue.

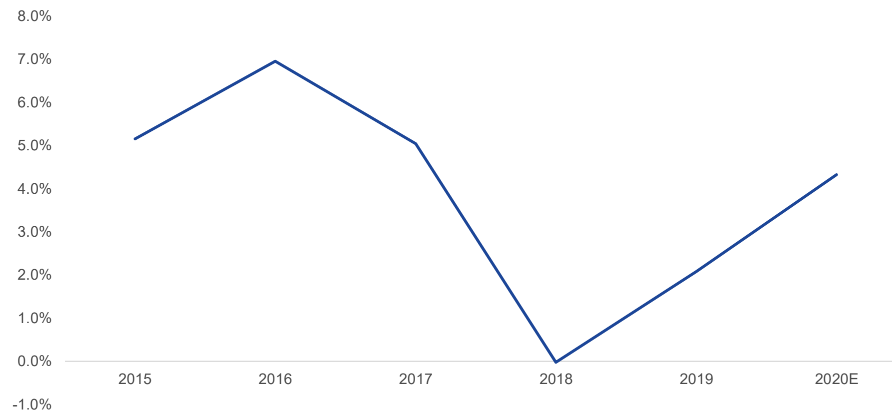
Figure 11. Trends in revenue and operating profits



Source: Company data, Al Rajhi Capital

Operating profits (EBIT) fell by an average of more than 20% between 2015-19 and this was despite the addition of a new segment (plastic). Lower revenue and the resultant fall in operating leverage was the main reason for this. However, we expect the profitability of Bawan to improve, as we expect operating profits to more than double in 2020, vis-à-vis 2019. We expect this trend to continue, as we expect operating profit growth of c.38% in the medium term. Bawan is currently operating with a capacity utilization of 68% in the steel segment, which offers potential upside in improving operating efficiency. Given this, we see substantial potential for the company to improve its operating margins in the medium term, given the favourable demand scenario.

Figure 12. **Trends in operating margins**



Source: Company data, Al Rajhi Capital

Figure 13. **Income Statement**

(SARmn)	FY18	FY19	FY20E	FY21E	FY22E
Revenue	**1,953**	**2,235**	**2,374**	**2,681**	**3,009**
Revenue growth (%)	-8.2%	14.4%	6.2%	12.9%	12.2%
Cost of Sales	(1,798)	(1,989)	(2,072)	(2,315)	(2,563)
Gross Income	**156**	**246**	**302**	**366**	**446**
Gross margin (%)	8.0%	11.0%	12.7%	13.7%	14.8%
SGA Expenses	(156)	(200)	(199)	(208)	(218)
EBIT	**(0)**	**46**	**103**	**158**	**228**
EBIT growth (%)	NA	NA	121.0%	53.8%	44.1%
EBIT margin (%)	0.0%	2.1%	4.3%	5.9%	7.6%
Finance expenses	(27)	(42)	(32)	(31)	(30)
Other income / expenses	8	16	16	16	16
Net income before non-recurring items	**(19)**	**20**	**87**	**143**	**214**
Non-recurring items	(189)	9	0	0	0
Net income before zakat	**(208)**	**29**	**87**	**143**	**214**
Zakat	(16)	(7)	(13)	(21)	(31)
Net income after zakat	**(224)**	**22**	**74**	**122**	**183**
Minority interest	6	5	7	7	7
Net income post minority interest	**(218)**	**27**	**81**	**130**	**190**
Net Margin (%)	-11.2%	1.2%	3.4%	4.8%	6.3%
EPS (SAR)	**-3.6**	**0.4**	**1.4**	**2.2**	**3.2**

Source: Company data, Al Rajhi Capital

Figure 14. Balance Sheet

(SARmn)	FY18	FY19	FY20E	FY21E	FY22E
Current Assets	1,248	1,383	1,429	1,551	1,702
Non-Current Assets	463	870	843	824	812
Total Assets	**1,711**	**2,253**	**2,272**	**2,375**	**2,514**
Current Liabilities	910	1,185	1,163	1,216	1,270
Non-Current Liabilities	105	371	371	330	290
Total Liabilities	**1,015**	**1,556**	**1,534**	**1,546**	**1,560**
Shareholders' Equity	**696**	**697**	**738**	**828**	**954**
Total Liabilities & Shareholder Equity	**1,711**	**2,253**	**2,272**	**2,375**	**2,514**

Source: Company data, Al Rajhi Capital

Figure 15. Cash Flow

(SARmn)	FY18	FY19	FY20E	FY21E	FY22E
Cash flow from operations	(30)	293	100	119	171
CAPEX	(45)	(322)	(47)	(54)	(60)
Free cash flow	(75)	(29)	52	66	111
Cash flow from financing activities	65	32	(73)	(73)	(98)
Changes in forex	(0)	(0)	0	0	0
Change in cash	(10)	3	(21)	(7)	14

Source: Company data, Al Rajhi Capital

Valuation: We value Bawan using 50:50 weight of DCF and P/E based relative valuation. Our DCF based target price based on 2.0% terminal growth and 8.6% cost of capital comes to SAR38/sh and P/E based relative valuation based on 18x multiple gives us a target price of SAR36/sh, thus, the target price stands at SAR37/sh which implies an upside of 30.5% from the current market price of SAR28.35 which implies "*Overweight*". The company is trading at 13x 2021e eps.

Key Risks:

1) Lower oil prices, resulting in a fall in government spending and lower construction activity will put pressure on the company's financials

2) Adverse movement in raw material prices and the inability of the company to pass on the same to customers could have an adverse impact on the financials of the company

3) The inability of the company to control working capital could impact cash flows and increase leverage

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