Bawan Company

Engineering - Industrial
BAWAN AB: Saudi Arabia
16 Aug 2023

US$0.57bn	76.07%	US$5.29mn
Market Cap	Free Float	Avg. Daily Volume

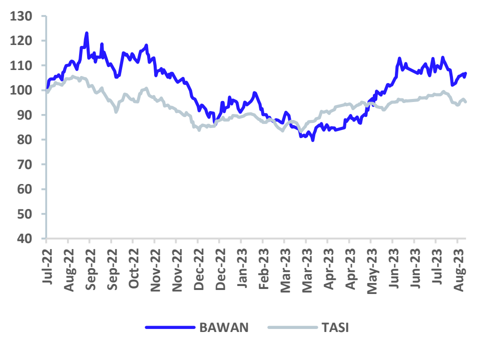
Target price	34.00	4.2% below current
Current price	35.50	as at 15/08/2023

Existing rating

Underweight | **Neutral** | Overweight

Research Department
Mazen AlSudairi, CFA
Tel +966 11 836 5468, alsudairim@alrajhi-capital.com

Performance (Rebased to 100)



Earnings

(SARmn)	2022A	2023E	2024E
Revenue	3,632	3,104	2,882
Revenue growth	13%	-15%	-7%
Gross profit	447	377	397
Gross margin	12%	12%	14%
EBITDA	303	261	271
EBITDA margin	8%	8%	9%
Net profit	163	141	146
Net margin	4%	5%	5%
EPS	2.7	2.4	2.4
DPS	1.5	1.3	1.5
Payout ratio	55%	55%	60%
EV/EBITDA	9.1x	9.9x	9.2x
P/E	13.1x	15.1x	14.6x
RoE	18.9%	15.2%	14.8%

Source: Company data, Al Rajhi Capital.

Bawan Co.

Downgrade to Neutral, Target price reduced to SAR34/sh

Bawan reported Q2 2023 revenue at SAR768mn registering a 4% decline y-o-y. We note that revenues in the Steel and Wood segment further declined by 12% q-o-q in Q2 2023. However, the Electrical segment continued to report robust revenues at SAR166mn witnessing a growth of 18.8% y-o-y despite lower deliverables in Q2 2023 compared to Q1 2023. The prevailing headwinds in global steel prices owing to lower demand from China's construction sector weighed down revenues in the Metal segment. Accordingly, the contribution of Metal and Wood segment to the bottom line dropped sharply from 70% in Q2 2022 to 25% in Q2 2023 (24% in Q1 2023). Contribution of the Electrical segment and Plastic segment to the net income inched up y-o-y and remained almost flat in line with Q1 2023 levels. We believe that steel prices may bottom out in H2 2023 and hence exhibit a more stable trend going forward wherein margins for the steel segment may start to recover from Q3 2023 onwards. Hence, the metal segment looks well poised for H2 2023 in terms of delivering improved margins. In our view, the backlog for electrical products segment will be a key driver for revenues in the future. Going forward, we reiterate our outlook on margins to be healthy at the back of push from Electrical products segment and the expected pick-up in margins in the Steel vertical despite weak revenues. However, the margins for 2023 shall narrow down owing to subdued revenues in the Metal and Wood segment. On the other hand, we believe the company's move to liquidate its entire stake in the Concrete segment shall enable it to concentrate on more profitable segments like Steel, Wood, Electrical and Plastic verticals, and hence reduce over-diversification. We note that the concrete segment constituted a mere 9% to the revenue mix as of 1Q 2023 and the 3-year average contribution to revenue was around 7%. However, its contribution to profit was persistently negligible. Overall, post-Q2 2023 earnings we revise our estimates downwards and reduce our target price to SAR34/sh, from the earlier target price of SAR37/sh. implying a downgrade in rating from Overweight to "Neutral".

Q2 2023 Results: Bawan reported Q2 2023 revenues at SAR768mn significantly lower than our estimates of SAR886mn. Gross profits clocked in at SAR84mn (-21% y-o-y). In line with this, the Gross margins too came in lower at 10.9% as a result of pricing pressure in the steel and wood segment. Overall net profits continued to be under pressure due to higher financing burden and lower profitability in the Metal and Wood segment.

Figure 1 **Earnings Summary Q2 2023 (*)**

(SARmn)	Q2 2023	Q1 2023	Q2 2022	% chg q-o-q	% chg y-o-y	ARC Estimates
Revenue	768	892	798	-14%	-4%	886
Gross Profit	84	96	107	-12%	-21%	115
Gross Margin	*11%*	*11%*	*13%*	*NA*	*NA*	*13%*
Operating Profit	36	48	57	-24%	-37%	NM
Operating Margin	*5%*	*5%*	*7%*	*NA*	*NA*	*NM*
Net Profit	25	35	44	-28%	-44%	43
Net Margin	*3%*	*4%*	*6%*	*NA*	*NA*	*5%*

Source: Company data, Al Rajhi Capital; Revenues excluding discontinued operations (concrete segment)

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Valuations: We value the company based on an equal mix of DCF and relative valuation. The DCF-based target price at a 1% terminal growth and 11.2% WACC comes to SAR34/sh. P/E based relative valuation at a 13x multiple for 2024e EPS implies a target price of SAR34/sh. Thus, we revise our target price for the company to SAR34/sh, implying a downside of 4.2%, and reduce our rating to ‘Neutral’.

Risks: The key downside risks to our valuation assumptions are further downside in steel prices, slump in mortgage demand, adverse movement of commodity prices, and an increase in the working capital requirement, thereby resulting in an increase in leverage.

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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.

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Contact us

Mazen AlSudairi, CFA
Head of Research
Tel : +966 11 836 5468
Email: alsudairim@alrajhi-capital.com

Al Rajhi Capital
Research Department
Head Office, King Fahad Road
P.O. Box 5561, Riyadh 11432
Kingdom of Saudi Arabia
Email: research@alrajhi-capital.com
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