



Key themes

This is a quick update on the cement sector in Saudi Arabia, focusing on the current market dynamics and the outlook for the sector.

What do we think?

Stock	Rating	Price Target
Yamama	N	SAR 14.0
Southern	UR	NA
Saudi	UW	SAR 38.0
Yanbu	UW	SAR 23.0
Qassim	UW	SAR 33.5
Arabian	UW	SAR 20.5

Valuation

	Pe (x)			EV/EBITDA (x)		
	2017A	2018E	2019E	2017A	2018E	2019E
Arabian Cement	13.1	-54.1	-133.9	8.8	23.5	18.9
Yamam Cement	33.9	-55.5	722	13.3	36.2	17
Saudi Cement	16	27.5	29.1	11.3	17.1	17.6
Qassim Cement	16.1	30.2	26.1	10.5	15.2	14.9
Yanbu Cement	16.6	62.9	31.8	10.2	16.9	13.5
Southern Province Cement	18.6	32.3	23.3	12.7	16.8	13.7

Source: Al Rajhi Capital

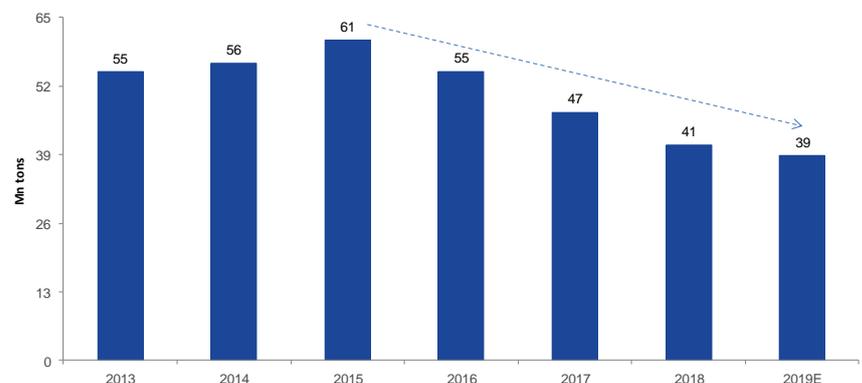
Saudi Cement sector: Cement demand likely to decline in 2019

The Saudi Cement Sector continued to remain under pressure for the third consecutive year, with the local sales volume declining 13% y-o-y in 2018. Average sales prices remained weak in 2018, although we witnessed a sharp jump in cement prices sequentially in Q4 2018 for a number of companies, which can be attributable to producers' preference towards higher pricing and the postpone of the price war. Going forward, we expect the current sales prices to remain firm as producers are now focused more on pricing rather than volume. Further, the cement demand will continue to decline in 2019, on the back of limited capital spending by the government, coupled with rising construction costs. The government's announced mega projects (including Neom, Qiddiya, Red Sea Tourism and social housing) are likely to create an incremental demand only in the long-term, in our view. In addition, weak cement demand will also push the producers to start exporting more to other markets outside Saudi Arabia, which could help the sector to liquidate the current huge inventory level. Overall, we remain on Underweight on the sector, given the current weak market dynamics.

Weak cement demand to continue in 2019

- In 2018, total cement dispatch in the Kingdom continued to decline for the third consecutive year, down by 13% y-o-y to ~40.9mn tons, primarily due to weak construction activities (Figure 1).
- Central region impacted the most, with the market share falling to 27% (-300bps drop) in 2018, weighed down by lower sales volume of City Cement (-31% drop; -150bps decline in the market share), Riyadh Cement (-28%; -100bps) and Qassim Cement (-22%; -80bps). Western region too remained under pressure (2018 market share: 27% vs. 29% in 2017) in 2018.
- The construction sector is expected to remain under pressure in 2019, due to higher costs on construction companies (such as Al Khodari) including higher labour costs and energy prices, and the exodus expats workers. Consequently, we expect the total cement demand to decline by 5% y-o-y to reach ~39mn tons.

Figure 1 Cement demand in the Kingdom



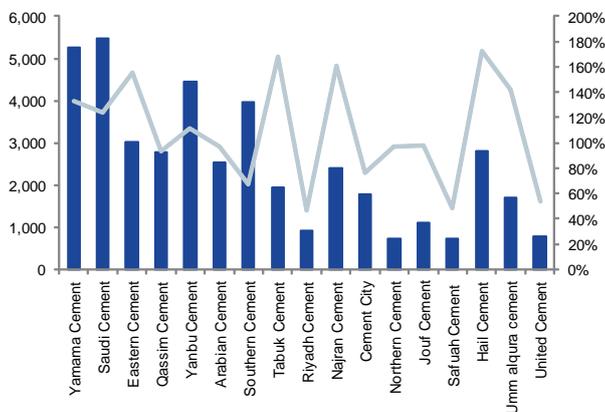
Source: Yamama Cement, Al Rajhi Capital



Exports picking up

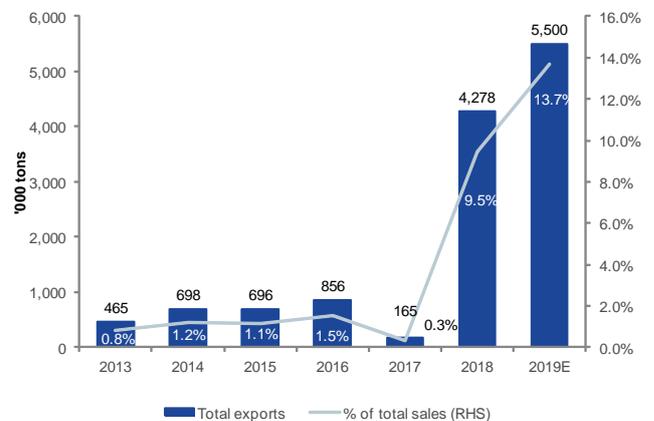
- Lower domestic demand has pushed the producers to start exporting more quantities outside the Kingdom. In 2018, total exports (clinker + cement) jumped from just 165k tons in 2017 to 4.3mn tons (1.1mn tons of cement + 3.2mn tons of clinker), accounting 9.5% of 2018 total sales volume (Figure 3)..
- Further, the sector has 42.3mn tons of inventory as of January 2019, which represents 105% of its last 12 month sales (Figure 2).
- We believe that the companies have to look for more export opportunities to liquidate the huge inventory level amid weak domestic cement demand. However, the average realized export prices could be lower, largely due to oversupply market condition in the most of neighbouring countries. Accordingly, we expect total exports to reach ~5.5mn tons (cement + clinker) in 2019.

Figure 2 Inventory as a of 12month sales



Source: Yamama Cement, Al Rajhi Capital

Figure 3 Exports continue to increase in 2019



Source: Yamama Cement, Al Rajhi Capital

- The top exporters, who are likely to witness a jump in their exports, are shown below.
 - **Southern Province Cement Co.:** The company signed deals to export 1.5mn tons of clinker to Bangladesh (starting from Jan 2019 to June 2020) and 20k tons of cement to Yemen. If we assume average price of SAR75 per ton for clinker and SAR80 per ton for cement, then export revenue from these deals would be ~SAR114.1mn (SAR112.5mn for clinker and SAR1.6mn for cement). This will reduce the total clinker inventory level to 2.5mn tons (Jan 2019: 4.0mn tons) as well increase the EPS to SAR1.7 for 2019.
 - **Yanbu Cement:** If the company is able to maintain the current level of export, then it can export ~1.6mn tons of clinker and 0.25mn tons of cement in 2019, implying an export revenue of ~SAR140mn (SAR120mn for clinker + SAR20mn for cement) in 2019. Further, this will also bring down the total clinker inventory level to 2.9mn tons (Jan 2019: 4.5mn tons of clinker) while increasing the EPS to SAR1.1 for 2019.
 - **Saudi Cement:** Based on the current export run-rate, we expect the company to export ~0.6mn tons of clinker and 0.65mn tons of cement, enabling the company to generate ~SAR220mn of revenue (higher average export price as most of the export is towards Bahrain).
- We can also witness the incremental export activities for the other companies like Jouf (50k tons of cement to Palestine), Tabuk (150k tons of clinker to Yemen + MOU of additional 600k tons of clinker to Yemen) and Northern Cement (plans to export the white cement following the inauguration of its White Cement Production Line project, which would be the largest production line in the world with a production capacity of 1,500 tons per day).

Local prices: In Q4 2018, we observed that the producers (who have announced their Q4 results so far) reported a substantial rise in average realized cement prices (ranges from 43-60% q-o-q), reflecting the postpone of price war among companies, particularly in the Central region. Producers are now focusing more on pricing rather than sale volume, which was the case, seen over the past few quarters.

Below, we present the cement prices outlook under different market scenarios.

- **Scenario 1:** If the cement demand remains broadly at the current level or increases partially in only one particular region (for an example, the Western region, due to mega projects such as Neom), then the current rise in cement prices seems to be sustainable, in our view. However, in case of any sharp and sustainable rise in demand across the regions or a sharp demand in one region, producers are expected to liquidating their huge inventory back-log by lowering their sales prices and jump into the other high demand region.
- **Scenario 2:** In case of a significant decrease in demand across all the regions, the cement producers are likely to keep the prices at the optimum level with limited downside potential. On the other hand, if the cement demand decreases sharply only in one region, then producers of that particular region may shift to other regions to maintain/regain their market shares and liquidate some of its inventory position. This will also pressurize the other producers to keep the sales prices.



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