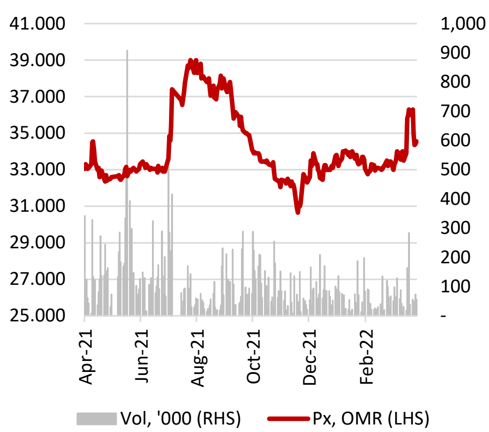
Riyadh Cement

Target Price (TP): SAR 41.6 per share
Upside: 20.3%

Recommendation	**Buy**
Bloomberg Ticker	SAWCEM AB
Current Market Price	34.55
52wk High / Low (SAR)	39.30/30.60
12m Average Vol. (000)	102.7
Mkt. Cap. (USD/SAR mn)	1,119/4,146
Shares Outstanding	120.0
Free Float (%)	100%
3m Avg Daily Turnover	2,080.0
6m Avg Daily Turnover	2,552.7
P/E'22e (x)	19.3
P/B'22e (x)	2.5
Cash Dividend Yield	4.5%
Price Performance:	
1 month (%)	3.3
3 month (%)	2.4
12 month (%)	4.2

Source: Bloomberg

Price-Volume Performance



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- **Economic recovery to benefit the construction sector and hence cement producers**
- **Location of the company offers access to Riyadh's mega projects under Vision 2030**
- **Favorable demographics and high urban population augur well for the cement sector**
- **Rising vaccination coverage has reduced the possibility of further lockdowns that can negatively affect construction activity**

We initiate coverage on Riyadh Cement with a target price (TP) of SAR 41.6 per share, implying an upside of **20.3%** and a P/E'22e and P/B'22e of 23x and 3.0x, respectively. Overall, our view on the Saudi Cement sector is generally positive, considering an improving macroeconomic environment and sector dynamics, favorable demographics, and a continued robustness of construction activity. We have arrived at a weighted average TP based on two valuation methodologies: 1. Discounted Cash Flow (DCF) (80% weight), 2. Peer-group P/E & EV/EBITDA multiple-based valuation (10% weight + 10% weight each).

- **Increase in home ownership under Vision 2030 has supported the sector and will continue to do so.** The Saudi Cement sector has witnessed notable recovery since early 2019 on the back of improved export and local demand supported by heavy housing construction activities under the increased home ownership plan. Saudi banks' mortgage lending has seen stellar growth over the last two years, which has supported construction activity in the country, that has, in turn, supported cement producers.
- **Uptick in economic growth to boost spending on mega construction projects.** The Saudi economy has shown a remarkable recovery from the pandemic lows, driven by demand pick-up post reopening of economic activities, and further supported by higher hydrocarbon prices. Going forward, Saudi Arabia's economy is expected to continue improving, which will boost employment opportunities and support demand for construction activity, be it offices or dwellings, thus boosting cement sector outlook. *Over 2020 and 2021, domestic cement sales rose 21% and 2% respectively. Furthernore, cement clinker inventory levels have steadily declined at a CAGR of 9.1% over the last three years to reach 34.9 mn tons.*
- **Riyadh Cement's location offers it a competitive advantage.** Under the Government's plan to make Riyadh one of world's 10 largest city economies (currently at 40) and to more than double its population (7.5mn today to around 15-20mn in 2030), Riyadh Cement has an advantage over its competitors due to its location at the heart of this planned boost to construction activity in the country's capital city.
- **Intermittent COVID waves remain a risk.** The continued emergence of new COVID variants may pose risks to the projected economic recovery. However, the possibility of a nationwide lockdown is minimal.

Key Indicators

Year	FY19	FY20	FY21	FY22e	FY23e	FY24e
Sales (SAR mn)	594	590	671	712	748	782
Gross profit (SAR mn)	230	254	264	269	278	291
Operating profit (SAR mn)	205	228	231	233	240	251
Net income (SAR mn)	190	220	212	215	221	231
Assets (SAR mn)	1,934	1,905	1,892	1,886	1,929	1,982
EPS (SAR)	1.6	1.8	1.8	1.8	1.8	1.8
BVPS (SAR)	14.5	14.1	14.5	13.9	14.2	14.2
P/E (x)	-	17.0	18.7	19.3	18.7	18.7
P/BVPS (x)	-	2.2	2.3	2.5	2.4	2.4
Dividend Yield (%)	-	4.0%	4.5%	4.3%	4.3%	4.3%

Source: Company Financials, U Capital Research

Riyadh Cement

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Valuation

We have arrived at our weighted-average Target Price (TP) on the stock using Discounted Cash Flow (DCF) (80% weight), P/E multiple and EV/EBITDA multiple-based valuation (10% weight each). For DCF, we have used a 5-year explicit forecast period (2022-26) and afterward have assumed a 3% terminal growth rate. We have then calculated the present value of future cash flows (Enterprise Value) using the weighted average cost of capital (WACC). After arriving at the enterprise value, we have made the required adjustments such as net debt, minorities, investments, employee end-of-service benefits to derive equity value for the company.

For the relative valuation, we have considered **median** 1Y forward multiples of relevant peers sourced from Bloomberg.

DCF Method		FY22e	FY23e	FY24e	FY25e	FY26e
Time Remaining (Years)		0.73	1.73	2.73	3.73	4.73
Operating profit Before Interest and Tax		**233,031**	**240,196**	**251,053**	**266,116**	**285,947**
growth(%)			*3.1%*	*4.5%*	*6.0%*	*7.5%*
Tax rate		*7.8%*	*7.8%*	*7.8%*	*7.8%*	*7.8%*
Post-tax operating profit (NOPAT)		**214,766**	**221,370**	**231,376**	**245,258**	**263,534**
Add: Depreciation & amortization		89,816	92,960	96,678	97,645	98,621
Less: Change in working capital		17,218	7,696	8,239	8,857	9,562
Less: Capex		26,895	(46,125)	(54,560)	(14,185)	(14,327)
Free Cash Flow to Firm		**348,696**	**275,900**	**281,733**	**337,574**	**357,390**
Discount factor		*0.94*	*0.86*	*0.78*	*0.72*	*0.65*
PV of Free Cash Flows		326,600	236,188	220,490	241,466	233,650
Sum of present values of FCFs	**1,258,394**					
Free cash flow (t+1)	368,112					
Terminal value	**5,741,247**					
Present value of terminal value	**3,753,444**					
EV	**5,011,838**					
Less:						
Debt	(3,495)					
Minority Interest	-					
Employee Retirement Benefits	(25,406)					
Add:						
Cash and Bank Balances	35,512					
Equity Investment	0					
Equity value	**5,018,449**					
DCF-based Fair value per share (SAR)	**42.0**					

Assumptions	
Risk free rate (Rf)	3.0%
Adjusted Beta	0.66
Market Risk Premium (Rm-Rf)	9.7%
Cost of Equity (Ke)	**9.41%**
Terminal or perpetual growth rate (g)	3.00%
Pre-tax Cost of Debt	6.87%

Relative Valuation	
EPS 2022e (SAR)	1.79
EBITDA FY2022e (SAR)	322,847
Target P/E multiple for 2022E (x)	23.6x
Target EV/EBITDA Multiple for 2022E (x)	13.8x
Fair value per share (SAR) - P/E Multiple	**42.1**
Fair value per share (SAR) - EV/EBITDA Multipl	**37.6**

	Fair Value per share (SAR)	Weightage	Weighted value per share (SAR)	Upside / (downside)
DCF	42.0	80.0%	33.6	21.6%
P/E multiple-based	42.1	10.0%	4.2	21.9%
EV/EBITDA multiple-based	37.6	10.0%	3.8	8.9%
Weighted Average TP (SAR)			**41.6**	
Current Price (SAR)			34.6	
Upside (%)			**20.3%**	

Source: Company Filings, Bloomberg, U Capital Research

Source: Company Filings, Bloomberg, U Capital Research

Risks to Valuation

Key downside risks to our valuations include:

- Any movement bans/lockdowns due to new coronavirus mutations could negatively affect global growth forecasts and hence the oil and gas prices, which in turn would negatively affect the economic growth prospects of Saudi Arabia.
- Slower-than-expected construction activity in the country.

Key upside risks to our valuations include:

- Better-than-expected improvement in operating efficiencies.
- Faster than estimated cement sales.

Sensitivity Analysis

Our TP for **Riyadh Cement** is not sensitive to +/- 0.25% changes to terminal growth or in WACC assumptions (changes about +/- 0.2%). Our EV/EBITDA-based TP is not sensitive to +/-1.0x changes in the peer-group average multiple, while our PE-based TP is also not sensitive to +/- 1.0x changes in the peer group median multiple. affecting our TP by +/-2% with every change.

Riyadh Cemet (SAWCEM)					
	Terminal growth				
WACC	2.5%	2.8%	3.0%	3.3%	3.5%
8.9%	41.6	43.2	44.0	45.6	47.2
9.2%	40.8	41.6	43.2	44.0	45.6
9.4%	39.2	40.8	41.6	42.4	44.0
9.7%	38.4	39.2	40.0	40.8	42.4
9.9%	37.6	38.4	39.2	40.0	40.8

Riyadh Cemet (SAWCEM)					
	P/E'22e Multiple				
EV/EBITDA'22e Multipl	21.6	22.6	23.6	24.6	25.6
11.8	40.7	40.9	41.0	41.2	41.4
12.8	40.9	41.1	41.3	41.5	41.7
13.8	41.2	41.4	41.6	41.8	41.9
14.8	41.5	41.7	41.8	42.0	42.2
15.8	41.8	41.9	42.1	42.3	42.5

Peer Group Valuation

Ticker	Name	Mkt Cap (SAR mn)	Last Px (SAR)	Chg Pct 1D (%)	Chg Pct 1M (%)	P/E (x)	ROE (%)	Dividend Yld (%)	EV to EBITDA' 22e (x)	PE'22e (x)	Gross Margin (%)	Net Profit Margin (%)	Net Debt, SAR mn	Local Sales (% of Total)
SACCO AB Equity	SAUDI CEMENT	9,333	61.00	0	8	28	13	5.7	13.1	23.2	37.6	23.5	292	85%
SOCCO AB Equity	SOUTHERN PROVINCE CEMENT CO	9,730	69.50	1	4	22	14	5.4	14.7	19.1	39.3	33.6	-175	100%
QACCO AB Equity	QASSIM CEMENT/THE	7,371	81.90	-2	5	25	16	4.3	20.8	28.9	40.0	40.9	-888	100%
YNCCO AB Equity	YANBU CEMENT CO	6,481	41.15	0	7	41	4	5.5	14.0	23.9	23.9	17.1	222	99%
YACCO AB Equity	YAMAMA CEMENT CO	6,683	33.00	0	17	42	4	-	-	-	30.9	21.8	1,075	100%
ARCCO AB Equity	ARABIAN CEMENT	4,295	42.95	0	5	26	6	5.8	-	-	29.9	15.6	-92	97%
SAWCEM AB Equity	RIYADH CEMENT CO	4,146	34.55	0	3	19	13	4.5	13.1	19.3	39.4	31.5	32	100%
NAJRAN AB Equity	NAJRAN CEMENT CO	3,301	19.42	2	5	20	10	7.7	-	-	39.6	28.5	203	93%
NORTHCEM AB Equity	NORTHERN REGION CEMENT CO	2,545	14.14	1	6	24	5	3.5	17.1	25.1	30.1	16.5	774	100%
EACCO AB Equity	EASTERN PROVINCE CEMENT CO	4,343	50.50	0	14	22	8	5.5	11.3	17.7	35.5	26.5	-397	98%
CITYC AB Equity	CITY CEMENT CO	3,822	27.30	3	22	24	9	4.6	10.3	15.7	41.8	32.3	-299	100%
TACCO ab equity	TABUK CEMENT CO	1,627	18.08	-1	0	91	1	2.5	13.5	41.4	24.7	7.8	-3	99%
HCC AB Equity	HAIL CEMENT	1,408	14.38	0	7	33	3	7.0	-	-	26.2	16.7	-96	99%
JOUF AB Equity	AL JOUF CEMENT	1,397	9.77	1	-11	-	-4	-	-	-	31.6	-29.1	657	99%
UACC AB Equity	UMM AL-QURA CEMENT CO	1,444	26.25	2	5	19	11	3.4	-	-	41.5	28.0	332	100%
	Median	**4,059**	**30.15**	**0**	**6**	**25**	**7**	**5.4**	**13.8**	**23.6**	**33.5**	**22.7**	**100**	**99%**
	Average	**4,556**	**36.38**	**1**	**7**	**32**	**7**	**5.1**	**14.4**	**24.4**	**33.8**	**20.0**	**115**	**98%**

Source: Bloomberg, U Capital Research, Argaam, na = not available

Fig. 1: Cement Sector - Price to Earnings & Dividend Yield

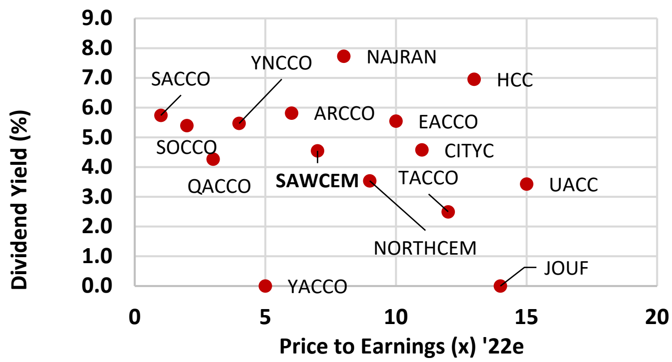
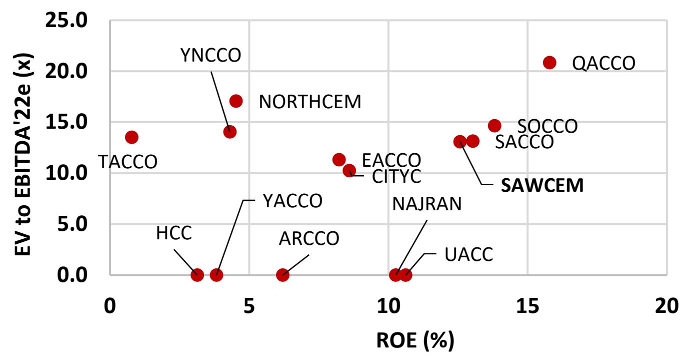


Fig. 2: Cement Sector – ROE & EV to EBITDA



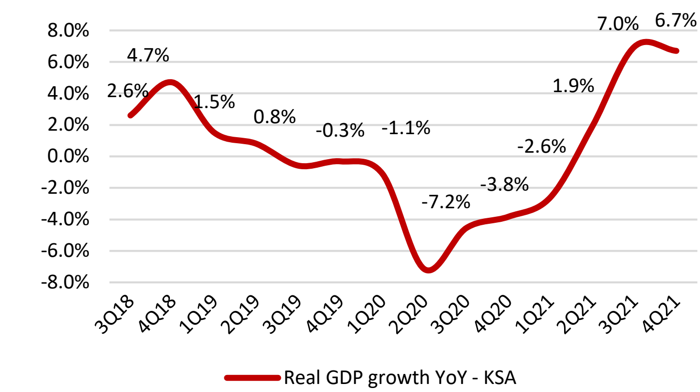
Source: Bloomberg, U Capital Research

Macro-economic Overview & Outlook

Economic growth moves into a positive trajectory

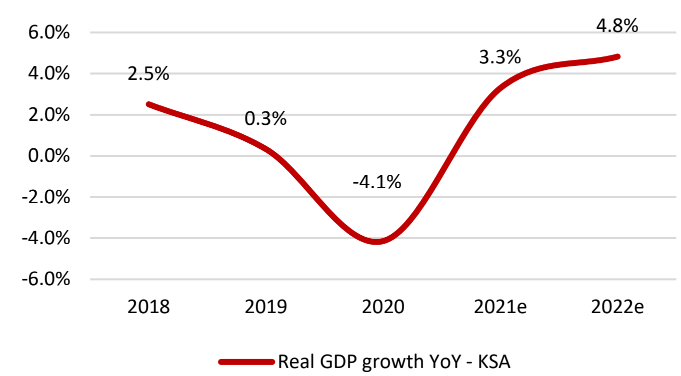
Saudi Arabia's economic growth gained momentum as the real gross domestic product (GDP) rose 6.8% YoY in 4Q 2021 after expanding by 7.0% YoY in 3Q 2021, which was its fastest pace of expansion since 1Q 2012. The GDP growth was driven by a rise in crude oil production, elevated levels of crude oil prices, as well as gradually subsiding pandemic situation. The oil sector's GDP rose 10.8% YoY whereas non-oil activities increased 5.0% YoY in 4Q 2021.

Fig. 3: GDP growth of KSA accelerates



Source: GASTST, U Capital Research

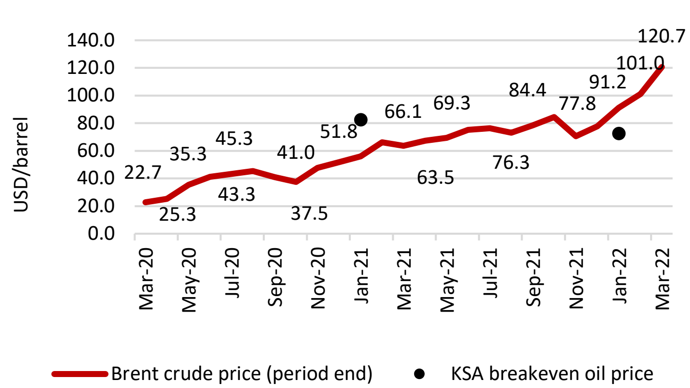
Fig. 4: Real GDP forecasted to improve further in 2022



Source: GASTST, IMF, U Capital Research

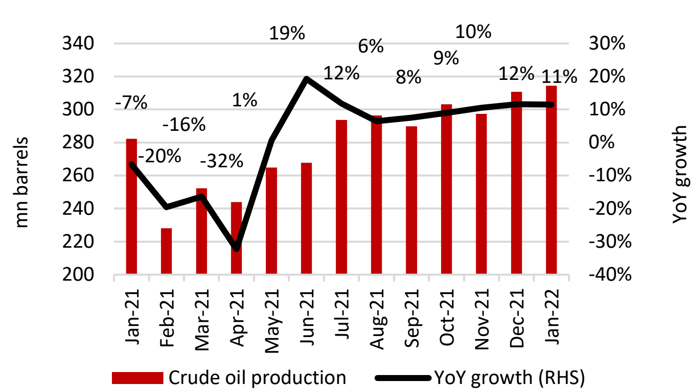
Overall, in 2021, the Kingdom's real GDP grew 3.2%, recording the fastest expansion since 2015 and beating the International Monetary Fund's (IMF) estimate of 2.8%. The economy witnessed strong domestic non-government demand as private final consumption expenditure increased 9.7% YoY while gross fixed capital formation jumped 10.1% YoY. For 2022, the IMF forecasts a higher GDP growth rate at 4.8% for Saudi Arabia. This seems quite likely as the government continues to take initiatives to stimulate the economy amid a rising vaccination coverage. For instance, to ensure long-term growth and as part of its economic diversification plan, Saudi Arabia's Crown Prince Mohammed bin Salman launched a program named 'Shareek' in March 2021. Shareek aims to bring SAR 5tn worth of private investment into the economy by 2030 and is part of a larger SAR 12tn investment program. The initiative revealed that by the end of this decade, private consumption spending would reach SAR 5tn, in addition to government spending of SAR 10tn. In addition, the Crown Prince also announced a new strategy in March 2022 under which the National Development Fund (NDF) is required to invest SAR 570bn in the Kingdom to stimulate its real GDP growth. Further, to expedite the economic diversification process, the NDF has been directed to target tripling non-oil GDP to SAR 605billion by 2030. These initiatives should catalyze domestic demand while creating a more resilient Saudi economy over the medium-to-long term.

Fig. 5: Multi-year high levels of crude oil prices a blessing in disguise



Source: Bloomberg, IMF, U Capital Research

Fig. 6: Kingdom's crude oil production rises on OPEC+ deal



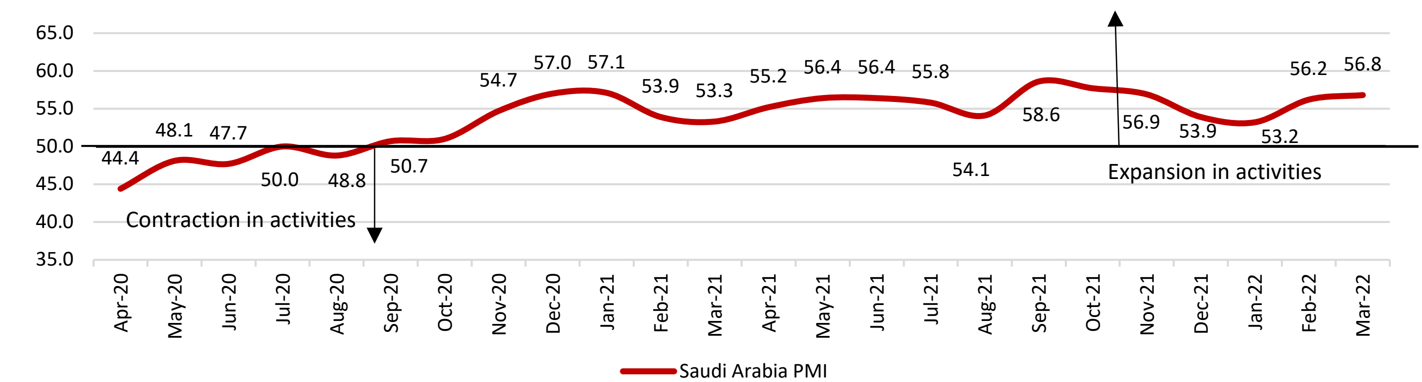
Source: JODI, U Capital Research

The continued solid increase in the average world crude oil prices, post-global economic recovery, and more recently Russia-Ukraine war, and sustained growth in Saudi Arabia's crude oil production on the back of July 2021 OPEC+ deal to completely phase-out oil production cuts by September 2022 should also aid in driving GDP growth up by relieving pressure on government finances. The IMF estimates Saudi Arabia's breakeven crude oil price to fall to USD72.4/barrel in 2022 as compared to USD82.4/barrel in 2021 amid the Kingdom's higher average crude oil production YoY, higher level of crude oil prices, spending cuts taken by the government, and like a reduction/removal of subsidies, etc. Accordingly, the government estimates to record a budget surplus for the first time in around 10 years in 2022 at ~2.5% of GDP.

Non-oil private sector remains in expansionary mode

Non-oil private sector's Purchasing Managers' Index (PMI) for Saudi Arabia remained in an expansionary mode, registering a reading of over 50 for the 19th consecutive month in Mar'22. The latest PMI number snapped a falling trend that started from September 2021 as the spike in new COVID-infections of Omicron variant at the start of 2022 proved to be less harmful than feared previously. Business confidence and customer demand improved during the period, while inflationary pressures eased somewhat for a second month. Overall, the PMI data suggest that the private sector remains optimistic about the near future and gradually getting used to living with the pandemic.

Fig. 7: PMI snaps the softening trend



Source: Trading Economics, FX Empire, Arab News, Gulf Times, U Capital Research

Big ticket projects in the Kingdom to drive cement demand in coming years

Various mega and some Giga projects are under progress in the Kingdom that are expected to drive the demand for building material and construction sector in the coming period. These projects are needed now more than ever to drive foreign investments and increase spending in the economy, as the Kingdom is expecting USD 7trn in investment and government spending to materialize by the end of the decade. Foreign investors can also take comfort from the fact that these projects are political standard bearers; they must be seen to be successful, and they will continue to be funded from PIF, SCB reserves, tapping debt markets, etc. Notably, they will be much easier to do currently when oil prices are elevated above USD 100/bbl.

Name	Project Cost (USD)	Location	Description
Neom	500bn	North-Western edge of Saudi Arabia	Mega city of the future which will be a hub for innovative and sustainable ecosystem for living and working. The project will cover an area of 26,500 sq.km and the project is expected to finish in 2030. The projected is expected to attract up to 5m visitors annually and it will host a population of more than 1 million. The expected GDP contribution is to top USD100bn by 2030.
Amaala	2.7bn	North-Western Red Sea coast	Ultra-Luxury tourism project will feature an equestrian club and four yacht marinas. The project is a resort and wellness destination that is 3,300sq.km, and it will have its own airport. The project will have 2500 luxury hotel rooms and 700 residential villas. The project has recently been merged with the red sea project.
Red Sea Project	5.86bn / year	North-Western Red Sea coast	Luxury tourism venture along 200km of pristine coastline is a project that include 50 hotels, new international airport, and a town for 35,000 residents. The project will create 70,000 jobs and contribute USD5.9bn per year to the economy. The project will have 9 islands backed by vast desert landscape and mountains and it will run on renewable energy, 100% carbon neutral, with a zero waste to landfill policy.
Qiddiya	8bn	South-west **Riyadh (Central)**	Biggest entertainment city in the world, three times the size of Walt Disney world resort, Florida that covers 334sq.km area. The project will include 20,000 seat cliff top stadium, F1 racetrack and

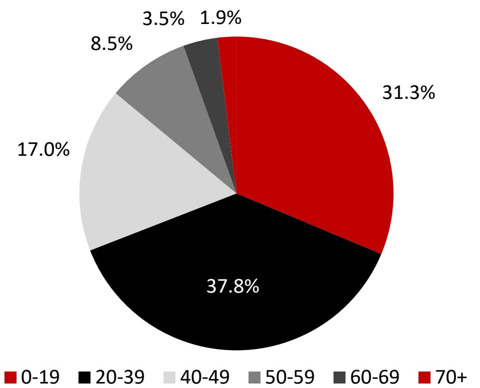
			six flags theme park. The project is estimated to bring 14.5 m visitors per year and will contribute USD4.5bn to GDP.
Aseer	13bn	South-western Aseer	Tourist attractions on Aseer's Mountain peaks will turn the province into a year-round destination, exploiting the tourism potential of its geographical and natural diversity, culture, and heritage. In addition, it will provide new job opportunities, boost life quality, and upgrade essential services and infrastructure in the region. PIF plans a USD3 billion investment to build 2,700 hotel rooms, 1,300 residential units, and 30 commercial and entertainment attractions in Aseer by 2030.
Diriyah	50bn	Western outskirts of **Riyadh (Central)**	The giga project will feature some of the world's most luxurious restaurants and hotels, with all structures built in traditional Najdi architectural style. The first phase of the project's masterplan will focus on a landscaped park, Wadi Hanifah, and Bujairi Terrace, featuring 18 new restaurants, several of which will be Michelin-starred, while others will offer local Saudi delicacies.
Saudi Land-Bridge	7bn	From Jeddah to **Riyadh (Central)**	The Saudi Landbridge Project is a part of the Saudi Railways Organization's railway expansion programme. The project is one of the biggest in the region and involves construction of 950km of new line between Riyadh and Jeddah and another 115km track between Dammam and Jubail.
GCC Railway	250bn	All around the GCC	This project is a proposed railway system to connect all six-gulf cooperation council member states in Eastern Arabia. It was scheduled to be completed by 2023.
Downtown Jeddah	20bn	Jeddah	The operational works of the project will pave the way for the local private sector to participate in the development and operation of promising economic sectors, like tourism, sports, cultural and entertainment, with international standards. The project will include four major international landmarks, namely, an opera house, a museum, a sports stadium, and ocean basins and coral farms. The project will also include a world-class marina and beach resorts, in addition to a wide range of luxury local and international hotels, restaurants and cafes, and various options for shopping.
King Salman Energy Park	First Phase 1.6bn	Eastern province of Saudi Arabia	King Salman Energy Park spans an area of 50 km2 and is being developed to be the leading gateway for the region's energy sector, providing a complete spectrum of solutions to support business growth in the Kingdom. The site also includes a dedicated 3 km2 logistics zone and dry port. The project offers an international standard infrastructure for global investors in oil and gas, refining, petrochemicals, energy and water production and water treatment.
Green Riyadh	32mn	Capital city of Saudi Arabia, **Riyadh (Central)**	Green Riyadh is one of Riyadh's four mega projects. The project will be a milestone that contributes to fulfilling a key goal of Vision 2030 to promote Riyadh's position among the world's top 100 most liveable cities. 7.5 million trees will be planted across Riyadh city in 3,330 neighbourhood gardens, 43 parks, 9,000 mosques, 6,000 schools, 64 universities, 390 healthcare facilities and 1,670 public facilities. Trees will also line 16,400 kilometres of streets and roads, 2,000 car parking sites, 1,100 kilometres of green belts including utilities lines (pylons, oil pipelines, etc.), 175,000 plots of empty land and 272 kilometres of valleys.
Riyadh Metro	23bn	**Central**	Phase 1 – 2021
Jeddah Metro	60bn	West	2025
King Fahad Medical City Exp.	14bn	**Central (Riyadh)**	2021-2022

Source: Various Print/Electronic Media

Young and growing population to support demand for housing and buildings

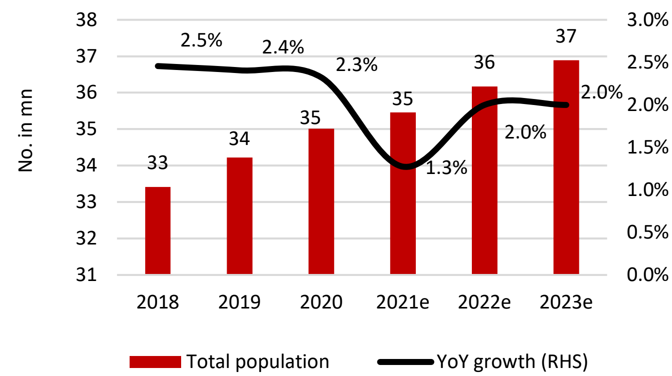
The GCC countries boast of a young population, in contrast with many developed nations that are facing the problem of an aging and declining population. In the 20–39 years age group, Saudi Arabia has 37.8% of its total population, as per the mid-2020 population estimate. The Kingdom's population has grown at ~2% rate on an average during 2017–20.

Fig. 8: Saudi has a young population



*Source: GASTST, U Capital Research. *as per the mid-2020 census*

Fig. 9: Saudi population to continue expanding at ~2% average rate



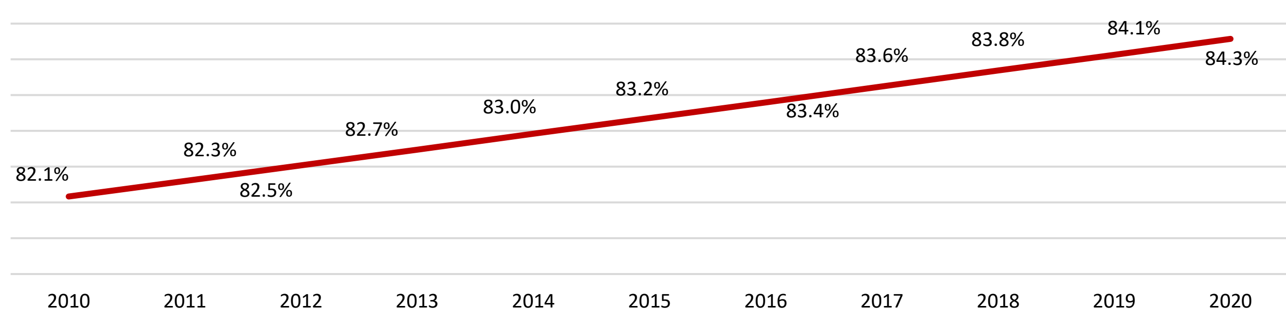
Source: IMF, U Capital Research

However, the expatriate population in the Gulf, which accounts for a significant of the total population, shrank post COVID-19 pandemic as the employment opportunities reduced and governments across the region intensified drive to give preferences to locals in the government and private jobs. According to Saudi-based CCHI, over 555k expatriates left Saudi Arabia's labor market till November 2021. Nevertheless, with an improvement in the job market, the Saudi government allowing free visa renewals for expatriates from 17 countries and automatically extending the validity of residency permits, the decline in the population of non-Saudis is anticipated to stop. Over the medium term, the IMF forecasts the population of Saudi Arabia to grow at an average rate of ~2%. A young and growing population should support the demand for the housing and buildings, especially due to the preference of young Saudis to well in nuclear, independent household units. Demand for housing and buildings means that cement demand will continue to remain elevated.

Rapid urbanization to buoy the demand for buildings and dwellings

Saudi Arabia's Ministry of Municipal & Rural Affairs (MMRA) had projected in 2013 that 88% of the total population to live in urban areas by 2025 as compared to ~80% in 2000. As per the latest data from the World Bank, the urbanization rate in Saudi Arabia had reached ~84% in 2020. A growing and high urban population augur well for the construction market, thereby supporting the positive outlook for cement producers.

Fig. 10: Saudi Arabia's urban population continues to rise



Source: World Bank, U Capital Research

Mortgage loans and number of contracts have risen at a CAGR of about 60% over 2016-2021

The Housing Vision Realization Program under Saudi Vision 2030 sets a target to increase home ownership for citizens to 70% by 2030. The Program's first phase (2018-2020) targeted V2030 ambitions by overhauling the governance, delivery, and financial mechanisms of the residential housing market. The Program has moved the dial on Kingdom's housing market with the key indicator of home ownership rapidly increasing from 47% in 2016 to 60% in 2020 by broadening access to finance, improving sector regulation, introducing modern technologies and practices, and scaling housing unit delivery in-line with market needs. This ownership transformation has normalized the Kingdom's ownership rate with G20 and regional peers.

In the next stage, the Housing Program will resume its efforts to increase the percentage of Saudi families owning houses to 70% by 2030. This will be accomplished by targeting the most underprivileged segments of society. In addition, the program will boost the attractiveness of the sector for investment by the private sector to support the stability and sustainability of the sector under different economic conditions.

This Government drive to achieve its targets will ensure that demand for cement remains elevated, thereby supporting cement producers.

Fig 11: Saudi Arabia's mortgage market has witnessed staller growth

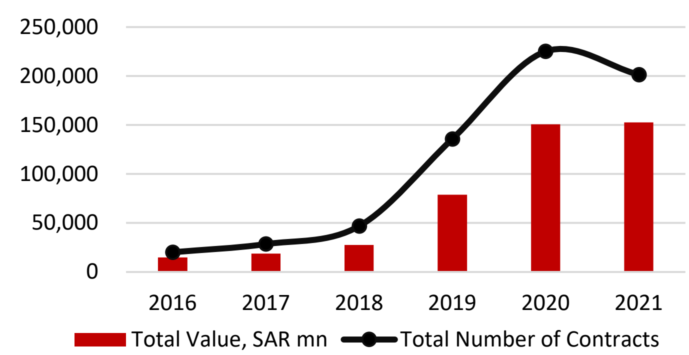
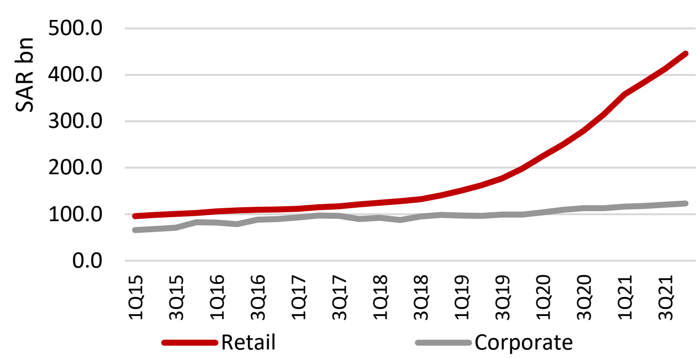


Fig 12: Saudi Arabia's bank loans to the real estate sector



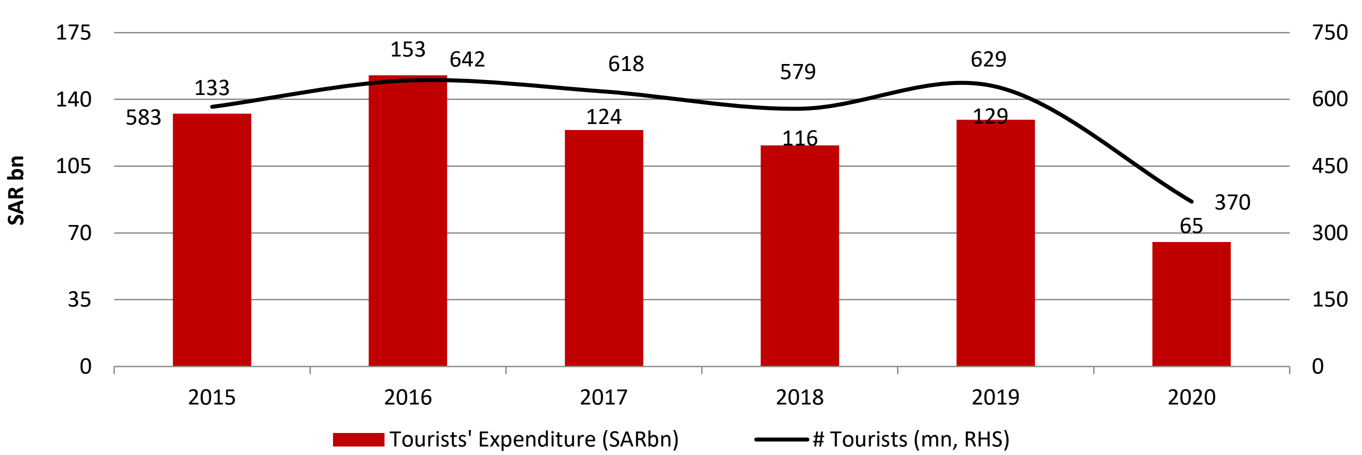
Source: Saudi Central Bank (SAMA) February 2022 bulletin

Development targets for the Tourism sector support buoyant construction activity outlook

The development of the tourism industry is one of the key pillars in Saudi Arabia economic diversification efforts as it wants to lower dependency on oil and gas revenues. Tourism is one of the important sectors in Saudi Arabia's Vision 2030 plans and the government has been introducing several measures to raise the attractiveness of the country as a tourist destination.

For instance, the Saudi tourism ministry had set up a Tourism Development Fund in June 2020 that invested SAR 2bn in tourism projects valued at nearly SAR 6bn by September 2021. According to the Saudi Tourism Authority, the sector is expected to contribute 5.3% to GDP by 2022 and employ 800,000 people as compared to 700,000 in 2021. At the same time, the government also looks forward to attracting 60mn tourists by 2022 end vs. ~54mn tourists in 2021. By 2030, tourism's contribution to GDP is expected to jump to 10% employing one million persons.

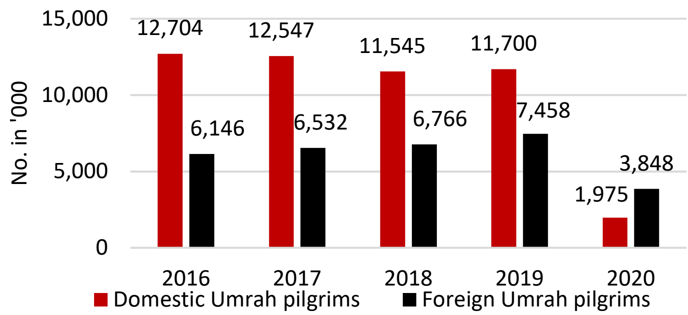
Fig. 13: COVID-19 pandemic heavily impacted the Saudi tourism sector



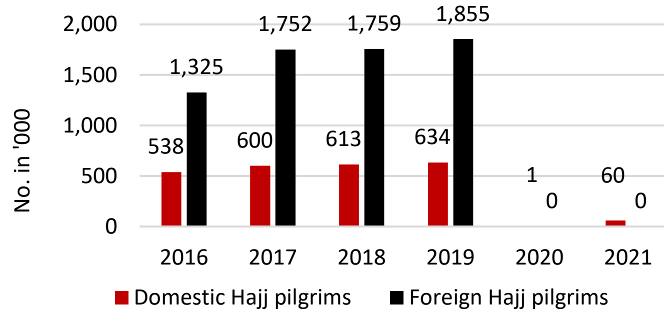
Source: Saudi Ministry of Tourism, U Capital Research

Apart from general tourism, the government is also taking steps to revive religious tourisms that have been hit hard since last year in the backdrop of the COVID-19 pandemic. Saudi Arabia gets a sizeable number of visitors every year from Umrah and Hajj pilgrimage. But their numbers fell exponentially last year as the Kingdom banned outside visitors from performing Umrah and Hajj.

Fig. 14: Both, Umrah and Hajj pilgrims reduced manifold



Source: GASTST, U Capital Research



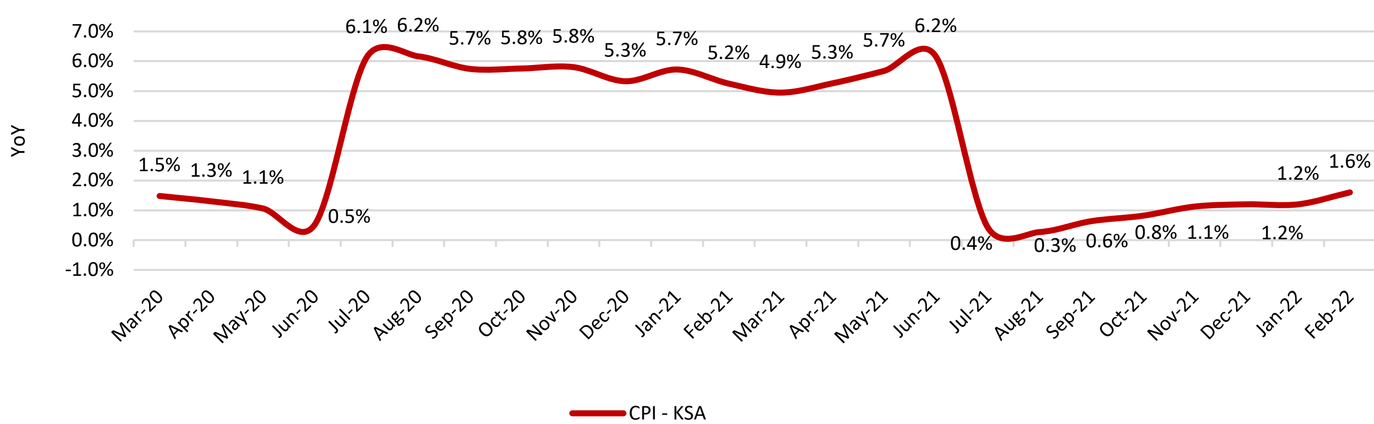
Source: GASTST, U Capital Research

However, as the government allowed Umrah since October 2020 after putting in place required safety protocols, 10mn pilgrims performed Umrah till September 2021, according to the Saudi Ministry of Hajj and Umrah. Recently, it has lowered starting age limit to perform Umrah from 12 years to 5 years, scrapped the upper age limit of 50 years, and lifted all COVID-related restrictions on foreigners. The ministry is also targeting to increase the capacity of pilgrims to 3.5mn from the current 100,000 pilgrims a day. The government has also announced that Hajj will be resumed from this year and is expected to publish a revised quota of pilgrims for the concerned countries. These religious tourists represent the significant target market for the players in the commercial retail i.e., developers, operators, and managers of shopping complexes or malls. Therefore, we expect commercial retail construction activity to remain buoyant in Saudi Arabia, hence supporting cement producers.

Caveat: Consumer inflation edges up in Saudi; could potentially affect cement producers negatively on margin erosion

Inflation in Saudi Arabia has been witnessing a slight uptrend possibly led by runaway commodity and fuel prices partly resulting from supply disruptions from the ongoing conflict between Russia and Ukraine.

Fig. 15: Inflation trend in Saudi (YoY)



Source: GASTST, U Capital Research

Yet, it still is considerably lower than the high rates registered last year due to a VAT hike (5% to 15%). Now, with the VAT likely remaining at the current level and the effect of an increase in base fading, the Kingdom is likely to experience nominal inflationary pressures in the range of 1–2% going forward, according to the forecasts from economists. The current inflation expectations for KSA are still reasonable and stable, and low inflation is always desirable from the cement producers' input costs' point of view as they may not have the ability to pass on the rising costs due to competitive pressures in the industry.

KSA's currently delayed Inherent Defects Insurance (IDI) Policy for Projects could potentially cause short term headwinds for cement producers

The Ministry of Municipality and Rural Affairs (MoMRA) eased the strict requirements for building permits by delaying the issuance of Inherent Defects Insurance (IDI) policies until the start of the construction. Construction activity had been adversely affected when the update of the Saudi Building Code (SBC) was implemented in Jul'21, and the situation as further compounded when MoMRA requested to transition all new submissions to its portal (Balady).

Offering a respite, MoMRA has delayed the requirement for IDI policies, which are to be aligned with the construction period instead of the building permit. IDI program is significant as the sole reinforcer of the updated SBC (a Vision 2030 target for MoMRA), and the requirement to create the ranking scheme for all contractors/developers on its portal. MoMRA revisited its decisions after the ramifications whipsawed across multiple sectors (i.e., construction, cement, housing, etc.). It reduced the prerequisites for building permits to i) a survey report, ii) a deed of ownership, and iii) the presence of a certified contractor/developer. Furthermore, MoMRA delayed the application for an active IDI policy till after the issuance of the building permits, and to be aligned with the construction period instead. We believe that once IDI rules are enforced, we might potentially see short term headwinds for the cement producers, as contractors/construction firms adjust to the new requirements.

Sector Overview

Cement sales in Saudi Arabia grew at a notable rate in 2020 but were flat YoY in 2021…

Cement sales in Saudi Arabia grew at a notable rate in 2020 (+20%), but were flat YoY seen in 2021. Cement sales were adversely affected in the second half of 2021 due to the amended and implemented Saudi Building Code (SBC) which slowed down the market, but we believe that this downturn is a transitory period. The effective implementation of the amended code would guarantee the quality of buildings and construction work, and once the sector overcomes teething issues, the new regulations will have a positive impact on the construction sector. The SBC is a set of legal, administrative, and technical regulations and requirements that specify the minimum construction standard for buildings in the Kingdom to ensure public safety and health. The codes apply to all construction works in the public and private sectors, whether new buildings — including their design, execution, operation, maintenance, and any changes — or existing ones that undergo renovation or expansion work.

Fig 16: KSA -Total Cement Sales (thousand tons)

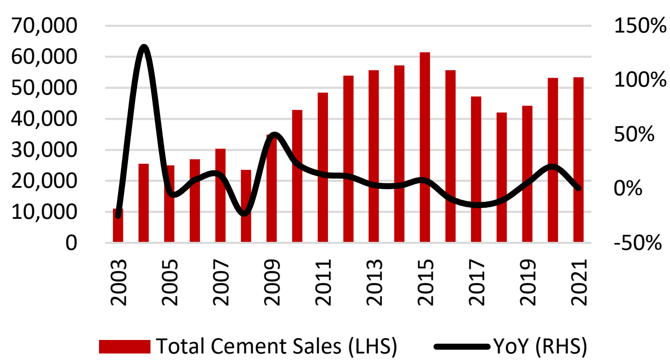
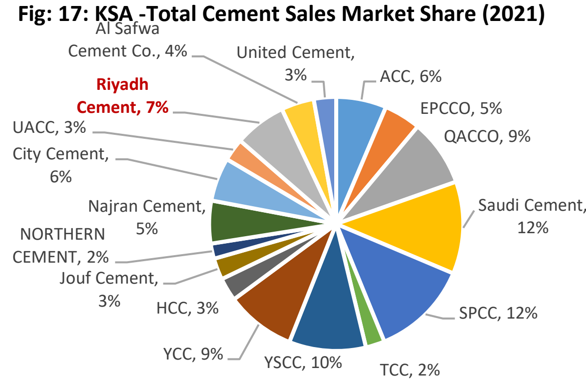


Fig: 17: KSA -Total Cement Sales Market Share (2021)



Source: Argaam, U Capital Research

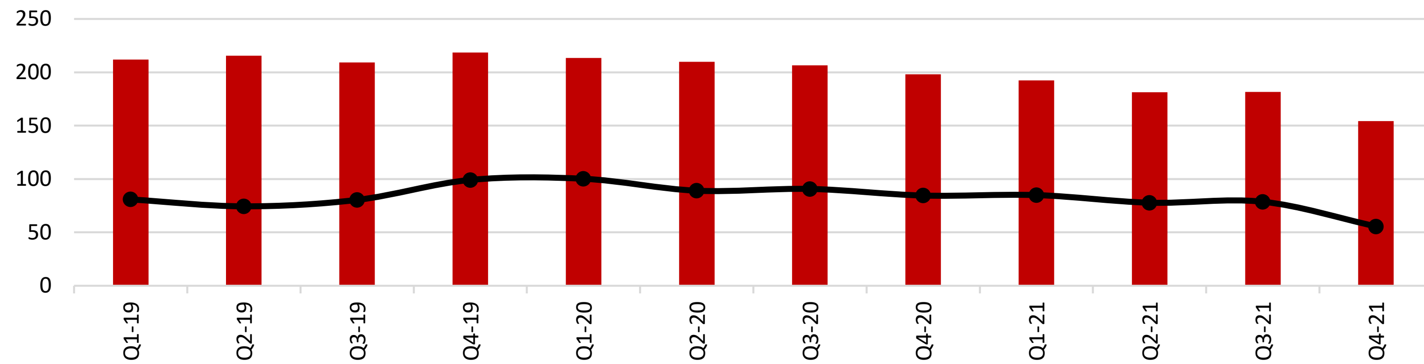
During 2021, **Riyadh Cement recorded a maximum gain of 1.9% in market share to 6.8%**, followed by Arabian Cement with a market share of 6.4% (+1.2%). Yanbu (+0.7%) and Yamama (+1.0%) also gained market share during the year. Southern Cement lost market share by 2.6% to 12.8%, driven by a 16.0% decline in sales. However, the company maintained its leading position, above Saudi Cement, at a 10.3% market share.

We believe that given the expected expansion in volumes driven by the anticipated improvement in the construction activity, as well as the expected improvement in average selling prices (ASPs), we believe that sales will pick up for Saudi cement producers.

Average selling prices (ASPs) expected to improve as demand picks up…

During the previous few quarters, average selling prices (ASPs) for Saudi Arabia's cement sector have been adversely affected. This pressure on prices commenced in 2H20, as companies absorbed the impact of the increase in VAT from 5% to 15%. In FY21, the combined effect of discounts offered to maintain market share amid lower demand and Yamama Cement's efforts to clear inventory at the old plant resulted in a significant decline in ASPs. As Yamama shifts production to the new plant, it is expected to withdraw the heavy discounts offered to clear inventory at the old plant and this is expected to ease the pressure on prices. Moreover, expected recovery in demand by the end of 1H22 is likely to support ASPs.

Fig 18: Average Selling Prices vs. Net Realizations



Source: Argaam, U Capital Research

Inventory to ease with expected recovery in demand

Total cement inventories in Saudi Arabia jumped 1% QoQ in 4Q21 after rising 5% in 3Q21 as sales slowed down. However, inventory levels had eased over the prior few quarters through to 2Q21, as the economy had recovered from the pandemic. We believe that as elevated oil prices kickstart a few projects, cement sales are expected to recover from 1H22 and the inventory levels are expected to ease. Clinker inventories declined 12.8% in FY20 and 5.6% in FY21. In FY21, City Cement (-33.1%), Arabian Cement (-31.7%), and Qassim Cement's (-26.3%) inventories declined the most; meanwhile, Southern Cement (+21.3%) witnessed a substantial build-up in inventories. For Riyadh Cement, the inventories were flat in 2021.

Our forecast is based on revival in cement sales in 2H22, lower production to sales in the sector, and better prospects over the long-term demand.

Fig 19: Sector - Inventory (Thousand Tons)

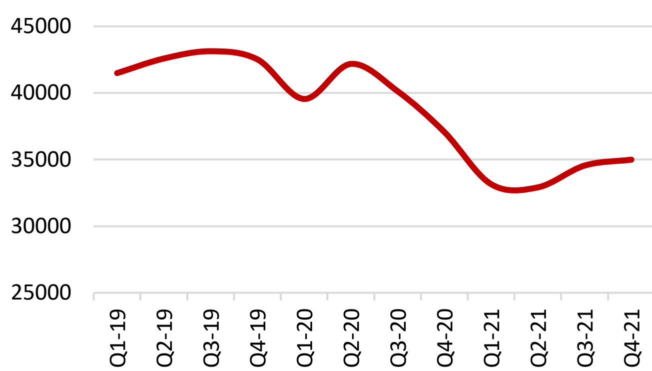
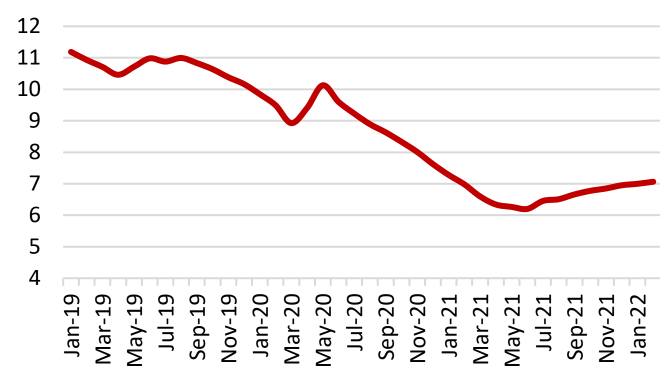


Fig 20: Sector - Inventory (Months of Sales)



Source: Argaam, U Capital Research

Key downside risks to KSA cement sector valuation

Downside risks to investment in the Cement sector of Saudi Arabia are:

1. Slow-down in execution of mega and giga projects that directly affects earnings of the sector.
2. Global inflationary pressures could weigh on the domestic economy and could potentially negatively affect consumer spending and housing demand.

3. The emergence of new variants of COVID-19 continue to be a threat even now, as it could affect the economy negatively through delays projects etc.
4. Global supply chain issues can negatively affect the construction sector, potentially affecting cement demand.

Key upside risks include:

1. Faster-than-expected economic recovery and cement demand.
2. More-than-expected recovery in selling prices of cement.
3. Elevated oil price may enable Government as well as the private sector to increase capital expenditure, which may benefit cement sector.

SWOT Analysis for KSA Cement Sector

Strengths

1. Cement is one of the elementary material components in the construction industry, and KSA has a flourishing construction sector.
2. KSA's climate requires usage of cement in construction of homes rather than wood.
3. Government infrastructure development drive supports cement industry.
4. The Government's Housing Program supports the cement industry.
5. KSA Cement Sector has a very high level of integration both forwards and backwards.

Weaknesses

1. Heavy reliance on local construction industry and relatively low level of exports. (Lack of geographical diversification).
2. Reliance on Government and private sector infrastructure and residential building programs.
3. Cement players could potentially face oversupply through excessive investments in capacity expansions, and negatively affect selling prices.

Opportunities

1. Geographic diversification of revenues, especially cross-border. As of February 2022, cement exports comprised of only 2.8% of the overall cement sales.
2. dispatches compared with 3.1% in February 2021 and 1.3% in January 2021.
3. Investment in technologically advanced plants to improve efficiencies.
4. Government and private sector construction projects.

Threats

1. Geopolitical tensions could negatively affect construction industry in the country
2. Economic slowdown adversely affecting the construction activity and hence the cement industry.
3. Changes in government regulations regarding the supply of subsidized fuel, which has so far made it cheaper for companies to transport cement over longer distances.

Company Analysis & Outlook

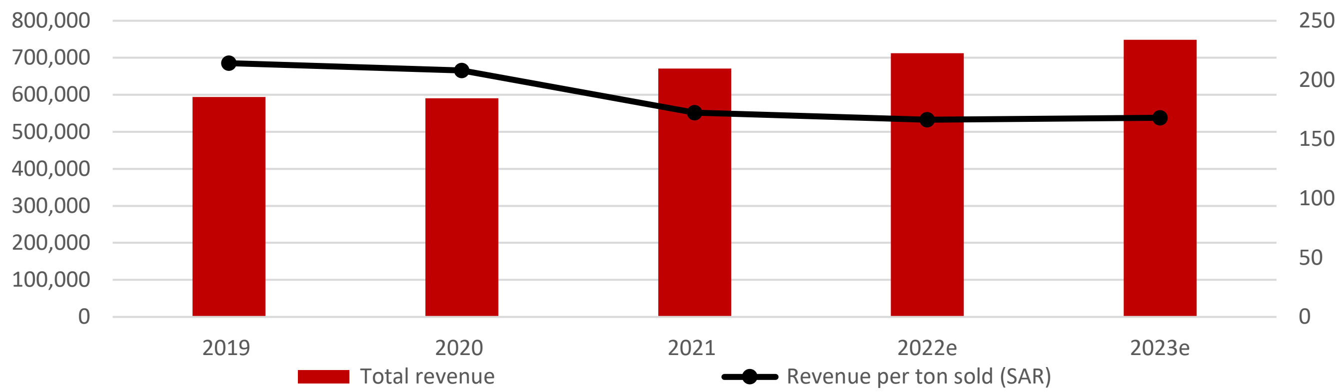
Riyadh Cement's location gives it a competitive advantage…

Riyadh Cement's location in the Central region that is expected to see a boon in construction activity will support its cement sales volumes. As outlined above, we believe that the current pressure on selling prices is fleeting in nature and will ease from 1H22. The company is expected to witness a net profit growth of CAGR 5%, with a net profit of SAR 211mn for FY21. The growth in net profit will be driven by both: higher volumes and higher selling prices.

…led by ambitious expansion plans in Riyadh

The government is planning to transform the capital city of Riyadh into one of the major economic hubs globally. To achieve this, the Kingdom aims to invest USD 220bn and a similar amount is expected to come from the private sector, the finer details of which are likely to be revealed this year. The government has also initiated steps early last year inducing multinational companies to move their regional headquarters into Riyadh. The Royal Commission for Riyadh City projects that these steps would lead to the doubling of population in the Saudi Arabia's capital to 15-20 million, in addition to attracting over 40 million visitors by 2030. This is expected to support the Central Region cement producers, Riyadh Cement being one of them.

Fig. 20: Riyadh Cement's sales are expected to improve on higher selling prices as well as higher volumes

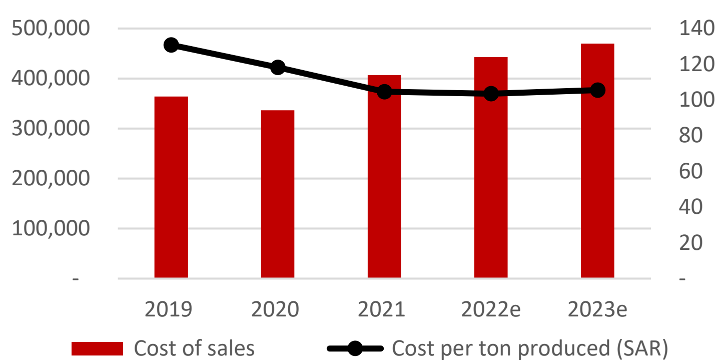


Source: Company Reports, U Capital Research

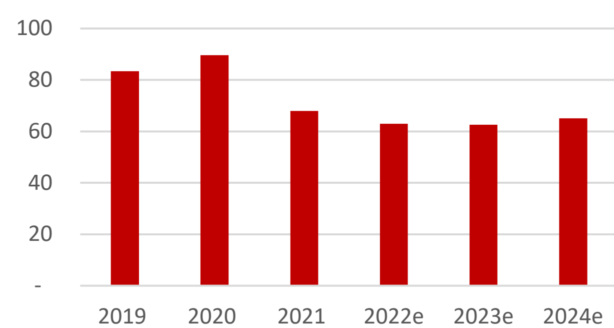
Cost of sales expected to rise but margin is expected to expand on higher domestic sales

Riyadh Cement is expected to see improvement in its net margin per ton from 2022e onwards due to recovery in domestic sales. The company did not export any volume during 2021.

Fig. 21 Cost of sales to rise…



… but margin per ton expected to improve

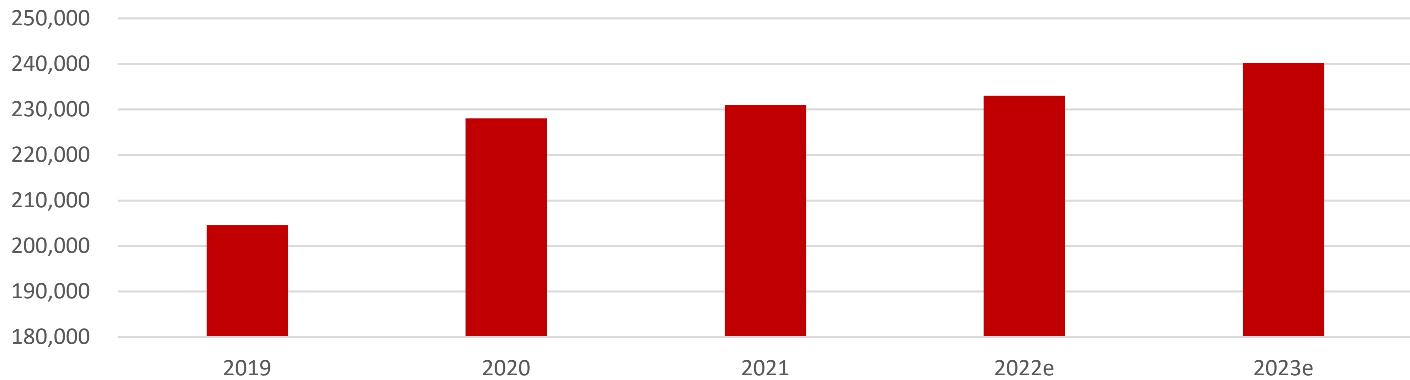


Source: Company Reports, U Capital Research

Operating expenses expected to grow in tandem with sales

The company's operating expenses are expected to grow in tandem with sales. This is expected to boost the net profit of the company over the forecast period.

Fig: 22 Operating profits (SAR'000) expected to improve in tandem with sales over the forecast period

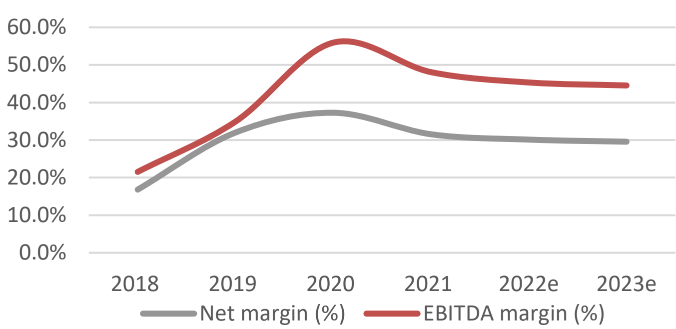


Source: Company Reports, U Capital Research

Net profit margin likely to improve on improving sales

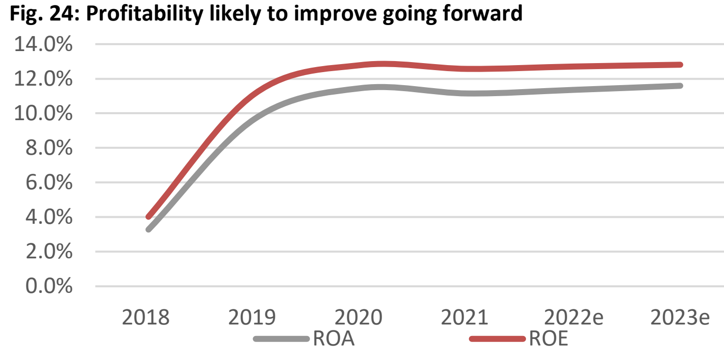
Given the expectation of recovery in cement sales as well as selling prices, we believe that Riyadh Cement will see an expansion in its net profit margin, that will support its profitability metrics.

Fig. 23: Net margin fell in 2021; expected to improve from 2022e



Source: Company Reports, U Capital Research

Fig. 24: Profitability likely to improve going forward



Source: Company Reports, U Capital Research

Strong balance sheet, solid cash flows to take care of dividends

Riyadh Cement has paid off its initial debts and has not resorted to debt of any kind since 2018 to meet its capital expenditure (capex) requirements and has utilized internal funds for this purpose. The company has consistently generated operating cash flows of almost SAR 873mn in the last four years, supported by healthy margins. As a result, its cash balance has grown to SAR 35mn as of FY21-end vs. SAR 19.5mn at FY20-end and SAR 20mn at the end of FY16.

Provision of SAR 10mn created on the balance sheet for alleged violations of the Competition Law in 2018

During November 2021, the Company received a legal notice from the Saudi General Authority for Competition, stating that based on the resolution issued by the General Authority for Competition in October 2021, the Company is liable for a financial penalty amounting to Saudi Riyals 10 million in relation to alleged violations of the Competition Law in 2018. After taking appropriate legal advice, the Company appealed against the decision. If upheld, payment of Saudi Riyals 10 million will be required. Accordingly, the Company has recorded the above as a provision during 2021. The court of appeal is expected to consider this matter during 2022.

SWOT Analysis of Riyadh Cement

Strengths	Weakness
1. Managing and operating cement factories of both types: Production of white cement and the production of ordinary and resistant Portland cement (gray cement). White cement is used in architectural beauty, interior and exterior decorations, floorings, ornamental concrete products such as idols while grey cement is mostly used for construction purposes. 2. Wholesale and retail trade in the company›s products and building materials. 3. Excellent location of the plants to benefit from the expected construction boom in the Riyadh region. 4. Establishing or participating in the establishment of industrial services companies for the purpose of providing maintenance and services to factories inside and outside the Kingdom. 5. Ownership of lands, real estate, and patents, and benefiting from them in achieving their industrial purposes. 6. Debt-free balance sheet.	1. Heavy reliance on local cement sales. 2. Reliance on fossil fuels as a primary fuel for energy production. 3. Reliance on government backed infrastructure projects.
Opportunities	**Threats**
1. Housing demand due to increase in mortgage loans and the government's mega projects under Vision 2030. 2. Geographic diversification. 3. Improving energy savings to improve efficiency. 4. Preserving the environment using modern technologies in energy production. 5. Improving the efficiency of operating systems and recycling systems and using manufacturing exhausts to produce electrical energy as well as reducing emissions especially carbon dioxide. 6. Wean from expensive fossil fuels for energy production and source energy needs from alternative fuels.	1. New entrants. 2. Regulatory changes e.g. increase of VAT in 2020. 3. Fall in oil prices that might adversely affect the implementation of Mega Projects. 4.

FY21 Performance Overview

Despite the difficult challenges and strong competition witnessed by the cement sector markets this year, the company has achieved good gains through:

1. Raising production efficiency and production capacity.
2. Reducing operational costs.
3. Raising the company's market share and opening new markets.

This supported the company in achieving an increase in black cement sales to 3.52mn tons, an increase of 40% over 2020. An increase in white cement sales to 368k tons, an increase of 15% over 2020.
Volumetric sales led to a double-digit growth in revenue: In FY21 Saudi White Cement revenue stood at SAR 671.1mn (+14%YoY) due to an increase in volumes for Black as well White Cement, and despite a fall in realization per ton (-17%YoY).

However, the company's net profit fell by 4%YoY to SAR 211mn for 2021, largely on account of a jump in operating expenses. Net margin dropped to 31.5% in FY21 from 37.3% in FY20.

The company paid off all of its loans for the year 2021, and at the same time, it maintained the continuation of paying its shareholders' annual dividends at 1.75 riyals per share for the year 2021.

Production & Sales Volumes ('000 tons)	2017	2018	2019	2020	2021	YoY 2021/2020
Black Clinker Production	2,134	1,545	2,072	3,332	3,280	-2%
Black Cement Production	2,785	1,961	2,512	2,523	3,519	39%
Black Cement Sales	2,785	1,980	2,499	2,517	3,522	40%
White Clinker Production	281	279	269	267	252	-6%
White Cement Production	239	275	271	319	373	17%
White Cement Sales	247	282	274	321	369	15%

Source: Board Report 2021

Assign BUY rating on the back of sales growth and healthy margins

Riyadh Cement has a very clear-cut business strategy, focusing mostly on organic growth. In our view, the company is well placed to boost its top line going forward, driven by an expected improvement in economic conditions and the projected pipeline of new and continuing construction projects. We believe that the company is strongly positioned to benefit from the construction drive in and around Riyadh, ahead of the implementation of a multi-billion dollars transformation program as a smart business move from the Government. Furthermore, the Central region of KSA is witnessing strong cement sales growth, and Riyadh Cement is in this region. In February 2022, YTD cement dispatches decreased 9.7% YoY to 9.2mn tons. The central region witnessed the highest growth of 6.3% YoY, the northern, southern, eastern, and western regions recorded YoY decline of 22.9%, 19.8%, 17.2% and 9.8%, respectively.

On top of this, the company has a debt-free balance sheet that helps in maintaining its profitability and thereby amplifying returns to shareholders going forward. Overall, we allocate a **BUY** rating on the stock with a target price of **SAR 41.6, implying an upside of 20.3%.**

About Riyadh Cement Company

Riyadh Cement Co. (previously Saudi White Cement Company, RCC (Bloomberg code: SAWCEM AB EQUITY)) is a Saudi joint stock company established in 1997 with a paid-up capital of SAR 1.2 billion. It is the first and leading white cement manufacturer in the Kingdom of Saudi Arabia which started its white cement production in 2001. Its current capacity is 1mn tons of White Clinker per annum which makes it one of the leading white cement manufacturers globally. Riyadh Cement Company (RCC) started its gray cement production in 2007. RCC is one of the largest gray cement companies in the Saudi Arabia with a total installed capacity of above 3.5 million tons of gray clinker per annum. Given the urban resurgence and the economic growth witnessed by the Kingdom of Saudi Arabia in recent years, both the company's plants complement each other perfectly in nation building and have been associated with many landmark projects of the kingdom for over around 2 decades.

Black Cement Factory:

The black cement factory contains two production lines with a production capacity of 11,000 tons per day, equivalent to 3.5 million tons annually.

White Cement Factory:

The white cement factory contains a production line with a production capacity of 1000 tons per day, in addition to one of the black cement lines (double production) with a production capacity of 2,000 tons per day, and thus the company can produce (1,000,000) tons annually.

Products

Black Cement:

1. Ordinary Portland Cement (OPC):

Uses: reinforced concrete, concrete pipe industry, precast concrete structures, and block industry.

2. Sulfate Resistant Portland Cement (SRC):

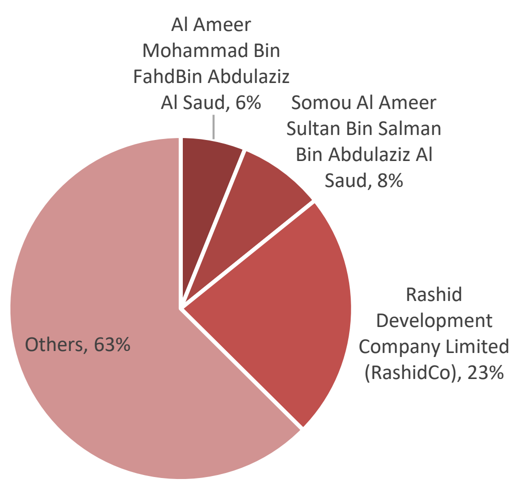
Uses: basements and coastal structures, sewage systems, and the construction of dams and bridges.
3. Finished Portland Cement (FC):
Uses: Plastering and finishing works, foam concrete (floor lining before paving).

White cement:

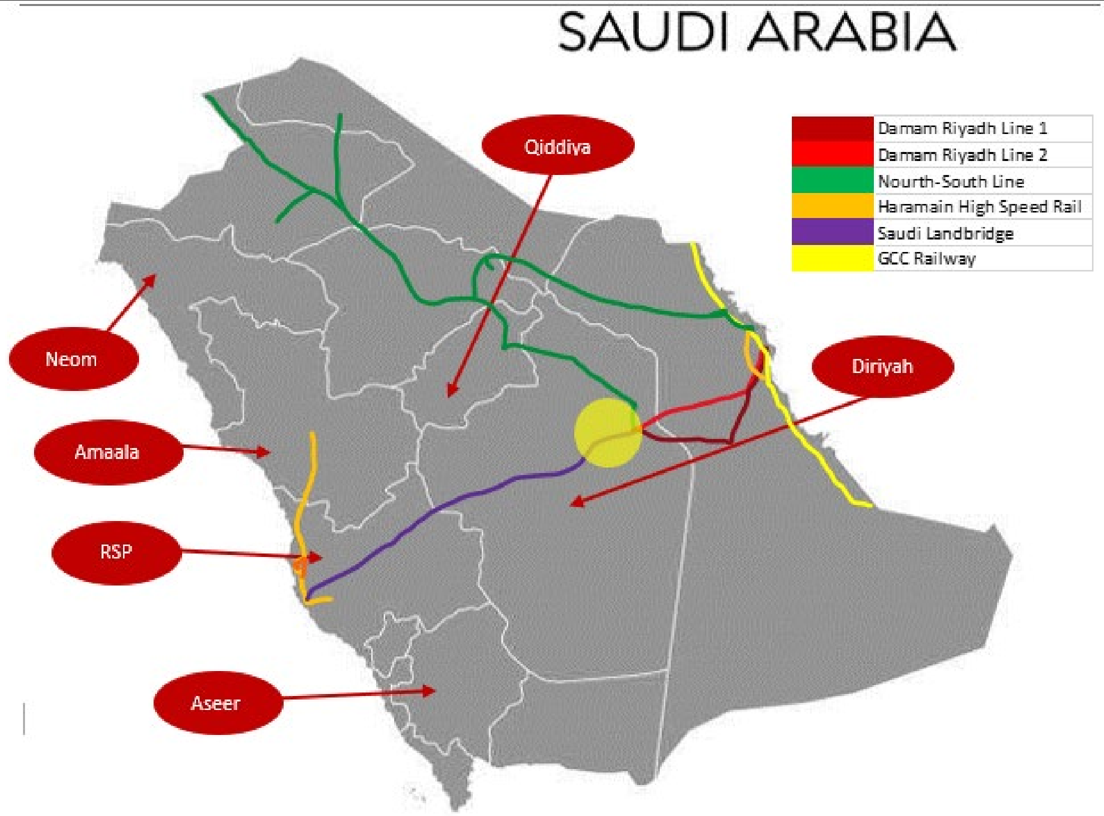
1. White Portland Cement Type I (CEMI 52.5N):
Uses: Decoration, paving and colored concrete, tiles and interlocks, artificial stone, fiberglass reinforced concrete (GRC).
2. White Portland Cement Type II (CEMII 42.5N):
Uses: paving, marble installation fillings, colored plaster, and profile painting on external facades.

The company became listed on the parallel market "NOMU" on September 2, 2020. On December 28, 2020, the General Assembly approved the change of the Company's name to be "Riyadh Cement Company", the legal formalities of this decision have been completed by the Company's management during January 2021. The registered address of the Company is P.O. Box 17775, Riyadh 11494, Kingdom of Saudi Arabia. All the Company's operations are related to one operating segment which is cement manufacturing and are substantially sold to local customers. The authorized, issued capital of the Company is Saudi Riyals 1,200,000,000 divided into 120 million shares of Saudi Riyals 10 each.

Fig. 45: Riyadh Cement: Shareholding Structure

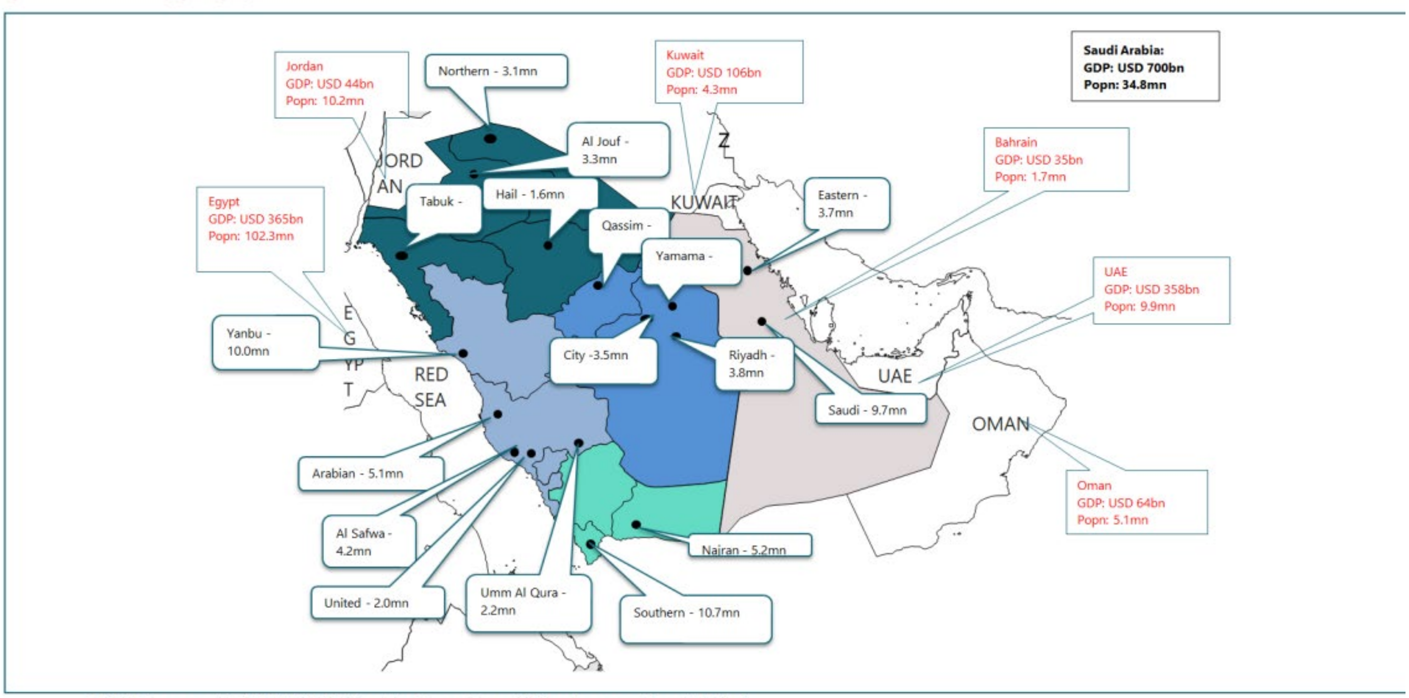


Source: Tadawul



Source: U Capital Research, various news media. Yellow denotes Riyadh area, where Riyadh Cement Company is located.

CEMENT PLANT LOCATIONS



Source | GASTAT, Company website, SFC, IMF I GDP & Population for countries are 2020 numbers sourced from World Bank.
Notation for companies includes cement company name along with plant capacity in tons.
This slide is for information purposes only with data collated from above sources.

Source: Banque Saudi Fransi, Saudi Arabia Cement Chartbook March 2022

Key financials

In SAR mn, except stated otherwise	FY19	FY20	FY21	FY22e	FY23e	FY23e
Income Statement						
Sales	594	590	671	712	748	782
Cost of sales	(364)	(336)	(407)	(443)	(470)	(491)
Gross profit	**230**	**254**	**264**	**269**	**278**	**291**
Selling and marketing expenses	(3)	(3)	(3)	(3)	(3)	(4)
General and administrative expenses	(21)	(20)	(34)	(35)	(36)	(38)
Other gains	0	1	4	2	2	2
Operating profit	**205**	**228**	**231**	**233**	**240**	**251**
Finance costs	(10)	(2)	(1)	(0)	(0)	(0)
Income before zakat and income tax	**195**	**226**	**230**	**233**	**240**	**251**
Income tax	(0)	(1)	(18)	(1)	(2)	(6)
Net income for equity shareholders	**190**	**220**	**212**	**215**	**221**	**231**
Balance Sheet						
Inventories	255	297	282	285	288	291
Trade and other receivables	119	145	207	209	211	213
Cash and bank balances	30	20	36	49	37	26
Property and equipment	1,468	1,408	1,345	1,318	1,364	1,419
Right-of-use assets	3	3	3	3	3	4
Total assets	**1,934**	**1,905**	**1,892**	**1,886**	**1,929**	**1,982**
Loans and borrowings	42	31	-	-	-	-
Trade and other payables	27	104	35	35	35	36
Lease liabilities	4	4	4	4	4	4
Total liabilities	**192**	**208**	**220**	**181**	**182**	**184**
Share capital	1,200	1,200	1,200	1,200	1,200	1,200
Retained earnings	179	137	111	146	187	238
Equity Attributable to Shareholders	**1,743**	**1,697**	**1,671**	**1,706**	**1,747**	**1,798**
Cash Flow Statement						
Net cash generated from operating activities	437	72	207	197	213	240
Net cash generated from investing activities	(1,538)	-	(67)	(27)	46	(75)
Net cash (used in) provided by financing activities	(1,989)	(72)	(267)	(210)	(179)	(326)
Cash and cash equivalents at the end of the period	**30**	**20**	**36**	**49**	**37**	**26**
Key Ratios						
Gross margin (%)	38.7%	43.0%	39.4%	37.8%	37.2%	37.2%
EBITDA margin (%)	34.9%	55.9%	48.1%	45.3%	44.5%	44.5%
Operating margin (%)	34.4%	38.6%	34.4%	32.7%	32.1%	32.1%
Net margin (%)	32.0%	37.3%	31.5%	30.1%	29.6%	29.6%
ROA	9.7%	11.5%	11.1%	11.4%	11.6%	11.6%
ROE	11.1%	12.8%	12.6%	12.7%	12.8%	12.8%
Current Ratio (x)	2.7x	2.9x	3.5x	3.0x	3.9x	3.9x
Capex/Sales	-11.3%	-10.1%	-5.4%	-3.8%	6.2%	6.2%
Debt-Equity Ratio	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
EPS	1.6	1.8	1.8	1.8	1.8	1.8
BVPS	14.5	14.1	14.5	13.9	14.2	14.2
DPS	0.5	1.3	1.5	1.5	1.5	1.5
Dividend Payout Ratio	31.6%	68.2%	85.0%	83.9%	81.4%	81.4%
Dividend Yield (%)	-	4.0%	4.5%	4.3%	4.3%	4.3%
P/E (x)	-	17.0x	18.7x	19.3x	18.7x	18.7x
P/BV (x)	-	2.2x	2.3x	2.5x	2.4x	2.4x
EV/EBITDA (x)	-	11.5x	12.5x	13.1x	12.6x	12.6x
Price as at period end*	-	31.2	33.0	34.6	34.6	34.6

Source: Company Reports, U Capital Research

Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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