الراجحي المالية
Al Rajhi Capital

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Saudi Cement Sector Update

As the demand scenario improves, we expect prices to strengthen

- *Cement sector performance has shown signs of recovery in Q3 2022, with cement volumes increasing by 9.8% y-o-y, compared to a fall of 8.5% y-o-y for M6 2022. Consistent offtake of new residential loans, which has averaged more than SAR10 bn for YTD Sep-22, along with the softening of construction material prices has aided the offtake of cement volumes in the Kingdom. Going forward, we expect offtake for mortgages to remain strong, with new residential mortgages averaging SAR10bn per month in 2022, and SAR7bn per month in 2023, with the overall residential mortgage growing at a CAGR of 18% between 2021 and 2023. This in turn will aid in the recovery of construction, especially in the Central region. Based on the government budget figures, as per our assessment, the Government's 2023 budgeted revenues are likely based on Brent of ~US$76/bbl, (Bloomberg consensus estimate of Brent prices is USD97/bbl for 2023 and USD88/bbl, for 2024) which will aid in strong government spending. In line with this 2023e spending budget has been raised by 18%. We also expect an acceleration in the execution of Giga projects to aid the recovery in the construction segment. Given that cement accounts for between 5-15% of construction spending and that it occurs in the early stages of construction, we expect the cement volumes to continue to remain strong. However, increasing inflation and the resultant increase in interest rate could cap some of the gains in the short term, though we remain positive on the long-term outlook of the industry.*
- *Since Q1 2022, cement prices in the Kingdom have been recovering and we expect this trend to continue in Q4 2022 and 2023, aided by an improving demand scenario. As of Sep-22, the Central region had a clinker inventory of 6.5mn tons, c.6 months of clinker production (LTM' Sep-22), lower than the industry average of c.7 months. The inventory levels have been consistently coming down compared to the levels of 2019 (10.7 mn tons), 2020 (8.7 mn tons), and 2021 (7.4 mn tons). We expect the inventory levels to come down further as the demand scenario improves. Yamama Cement will increase its current capacity by 50%, by transferring its old line to the new factory, at a cost of SAR830mn. The project is expected to commence commercial production in 2026, and we do not expect an immediate impact on cement prices. Yamama Cement has completed the construction of its new factory and the same is expected to commence commercial production in November 2022. Post this, we expect the company will start charging depreciation, which will increase its cost of sales. We feel that the market share of companies has reached suitable levels, which will lend support to cement prices. Overall, we expect cement prices to continue to improve and average c.SAR180 per ton for 2023 and report stable growth post that.*
- *We value Yamama Cement based on a weighted average mix of DCF (50%) and P/E (50%). The DCF target price is based on a 2.0% terminal growth and WACC of 9.8% and comes to SAR34/share. P/E is based on a multiple of 16.0x and comes to SAR34/share. Overall, we have increased our target price for the company to SAR34/share from SAR30 per share, an upside of c.19%, which implies an "Overweight" rating.*
- *We value Qassim Cement based on a weighted average mix of DCF (50%) and dividend capitalisation (50%). The DCF target price is based on a 2.0% terminal growth and WACC of 9.7% and comes to SAR70/share. Dividend capitalisation is based on a fair value yield of 5% and also comes to SAR70/share. Overall, we have reduced our TP to SAR70/share, from the earlier TP of SAR78/share a downside of c.4%, which implies a "Neutral" rating.*
- *We value Najran Cement based on a weighted average mix of DCF (50%) and P/E (50%). The DCF target price is based on a 2.0% terminal growth and WACC of 9.7% and comes to SAR18/share. P/E is based on a multiple of 16.0x and comes to SAR13/share. Overall, we have maintained our TP at SAR15/share, an upside of c.22%, which implies an "Overweight" rating.*
- *For our estimates, we have assumed energy prices will remain stable.*

Figure 1: Rating Summary

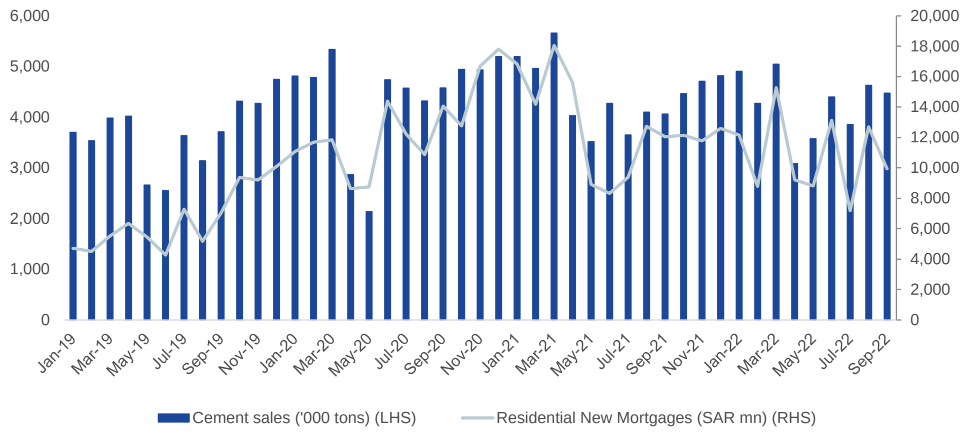
Companies	Old Tp SAR/sh	New Tp SAR/sh	Revision in TP %	CMP	Up/down to CMP %	Rating
Yamama Cement	30	34	13.3%	29	18.7%	Overweight
Qassim Cement	78	70	-10.3%	73	-4.1%	Neutral
Najran Cement	15	15	0.0%	12	21.8%	Overweight

Source: Al Rajhi Capital

Cement volumes to recover, though the growth could be limited:

Cement volume from Jan-Jun 2022, fell by 8.5% y-o-y, though the same has recovered in Q3 2022, growing by 9.8% y-o-y during the period. Recovery in the construction activity, aided by consistent offtake of mortgage loans, with new mortgage loans averaging c.SAR11 bn YTD (Jan-Sep 2022), and a cooldown in commodity prices, especially construction materials, have aided the recovery of growth in cement volumes. We expect new residential mortgages to average SAR10bn per month in 2022, and SAR7bn per month in 2023, with the overall residential mortgage growing at a CAGR of 18% between 2021 and 2023. Aided by this, we expect construction spending to improve, especially in the Central region. Further, based on the government budget figures, as per our assessment, the Government's 2023 budgeted revenues are likely based on Brent of ~US$76/bbl, (Bloomberg consensus estimate of Brent prices is USD97/bbl for 2023 and USD88/bbl, for 2024) which will aid in strong government spending. In line with this 2023e spending budget has been raised by 18%. We also expect an acceleration in the execution of Giga projects to aid the recovery in the construction segment. Given that cement accounts for between 5-15% of construction spending and that it occurs in the early stages of construction, we expect this to have a positive impact on cement sales. However, any growth in the short term is likely to be capped by the increasing global inflation, and the resultant increase in interest rates. Overall, we expect the momentum in cement offtake to continue in Q4 2022, though any upside could be capped, even as we continue to remain positive on the long-term demand outlook for the industry.

Figure 2. Trend in cement volume and new mortgages



Source: SAMA, Yamama Cement and Al Rajhi Capital

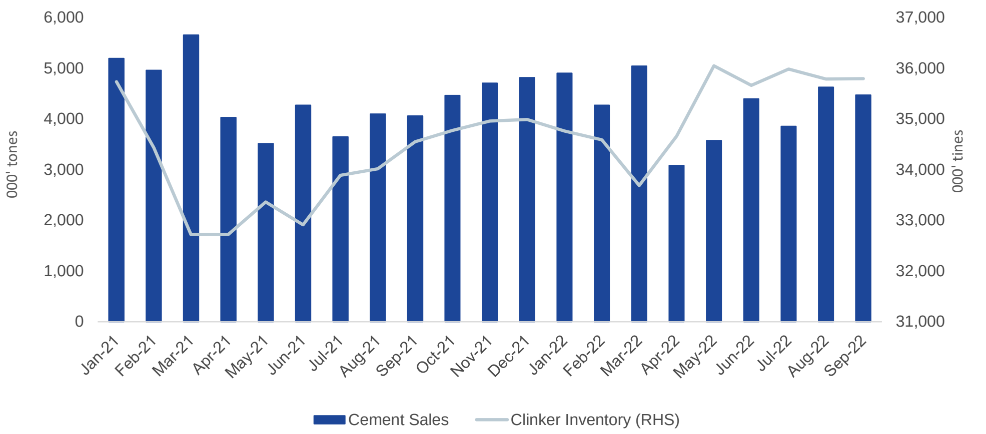
Cement prices to improve:

On the back of lower cement offtake, and an increase in competition, cement prices in the industry came under pressure in Q1 2022. However, the prices for most of the companies in the industry have improved from these levels, and going forward we expect the price to further improve in Q4 2022 and 2023.

As of Sep-22, the Central Region had a clinker inventory of 6.5mn tons, c.6 months of clinker production (LTM' Sep-22), lower than the industry average of c.7 months, and also lower than 2021 levels of 7.4 mn tons. It has to be noted that the clinker levels in the region have consistently fallen in the regions, from 10.7 mn tons in 2019 and 8.7 mn tons in 2020. These levels are likely to come down further as the demand scenario improves.

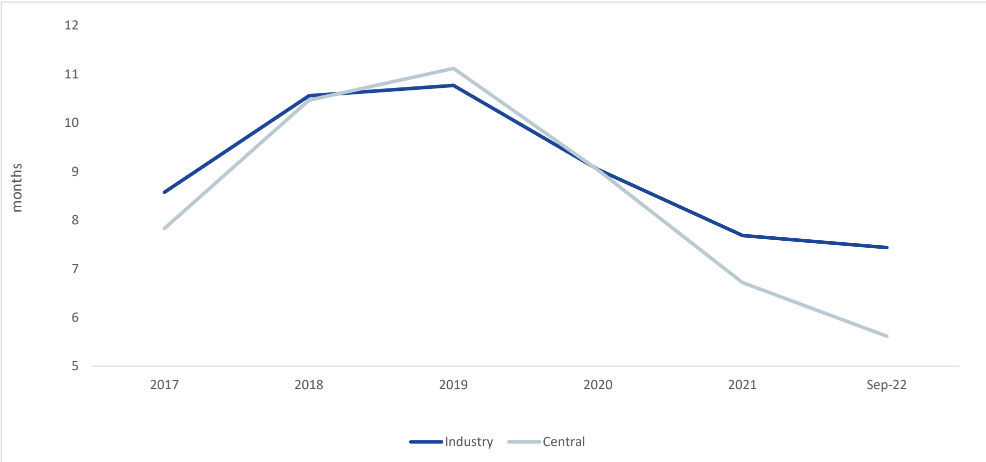
Yamama Cement has reported that it will transfer its seventh production line from its old factory to the new one, at a total Capex of SAR830 mn to be financed through a combination of debt and own funds. The transfer is expected to be completed in SH2025, with commercial production commencing in 2026; we expect the capacity of the company will increase by 50%. The impact of this capacity addition will depend on the market scenario in 2026, though we expect the production will increase in line with the increase in the overall demand of the market. Yamama Cement has completed the construction of its new factory and the same is expected to commence commercial production in November 2022. Post this, we expect the company will start charging depreciation, which will increase its cost of sales. We feel that the market share of companies has reached suitable levels, which will support prices. Going forward, we expect the cement prices to improve in Q4 2022 and average c.SAR180 per ton for 2023.

Figure 3. Trend in cement volume and Inventory



Source: Yamama Cement and Al Rajhi Capital

Figure 4. Clinker inventory in months of clinker production



Source: Yamama Cement and Al Rajhi Capital

Valuation:

- We value Yamama Cement based on a weighted average mix of DCF (50%) and P/E (50%). The DCF target price is based on a 2.0% terminal growth and WACC of 9.8% and comes to SAR34/share. P/E is based on a multiple of 16.0x and comes to SAR34/share. Overall, we have increased our target price for the company to SAR34/share from SAR30 per share, an upside of c.19%, which implies an "Overweight" rating.

- We value Qassim Cement based on a weighted average mix of DCF (50%) and dividend capitalisation (50%). The DCF target price is based on a 2.0% terminal growth and WACC of 9.7% and comes to SAR70/share. Dividend capitalisation is based on a fair value yield of 5% and also comes to SAR70/share. Overall, we have reduced our TP to SAR70/share, from the earlier TP of SAR78/share a downside of c.4%, which implies a "Neutral" rating.

- We value Najran Cement based on a weighted average mix of DCF (50%) and P/E (50%). The DCF target price is based on a 2.0% terminal growth and WACC of 9.7% and comes to SAR18/share. P/E is based on a multiple of 16.0x and comes to SAR13/share. Overall, we have maintained our TP at SAR15/share, an upside of c.22%, which implies an "Overweight" rating.

- For our estimates, we have assumed energy prices will remain stable.

Figure 5 Income Statement – Yamama Cement

(SARmn)	2022E	2023E	2024E
Revenue	1,017	1,305	1,385
Revenue growth	38%	28%	6%
Gross profit	450	581	645
Gross margin	44%	45%	47%
EBIT	373	502	563
EBIT margin	37%	38%	41%
Net profit	390	464	519
Net margin	38%	36%	37%
EPS	1.93	2.29	2.56
DPS	0.00	0.00	0.50
Payout ratio	0%	0%	20%
EV/EBITDA	16x	8x	7x
P/E	15x	13x	11x
RoE	8%	9%	9%

Source: Company data, Al Rajhi Capital

Figure 6 Income Statement – Qassim Cement

(SARmn)	2022E	2023E	2024E
Revenue	679	828	895
Revenue growth	-6%	22%	8%
Gross profit	192	325	376
Gross margin	28%	39%	42%
EBITDA	237	363	408
EBITDA margin	35%	44%	46%
Net profit	134	229	267
Net margin	20%	28%	30%
EPS	1.49	2.54	2.97
DPS	2.25	3.50	3.75
Payout ratio	151%	138%	126%
EV/EBITDA	23.3x	15.3x	13.6x
P/E	49.0x	28.7x	24.6x
RoE	8.0%	14.5%	17.7%

Source: Company data, Al Rajhi Capital

Figure 7 Income Statement – Najran Cement

(SARmn)	2022E	2023E	2024E
Revenue	505	581	614
Revenue growth	-13%	15%	6%
Gross profit	152	219	244
Gross margin	30%	38%	40%
EBITDA	174	237	259
EBITDA margin	35%	41%	42%
Net profit	89	151	174
Net margin	18%	26%	28%
EPS	0.53	0.89	1.02
DPS	0.50	0.70	0.75
Payout ratio	95%	79%	73%
EV/EBITDA	12.7x	9.0x	7.9x
P/E	23.5x	13.9x	12.1x
RoE	4.5%	7.5%	8.5%

Source: Company data, Al Rajhi Capital

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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.

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