Al Yamamah Steel Industries Co
Metals – Industrial
YAMAMAH:AB: Saudi Arabia
23 June 2021

الراجحي المالية
Al Rajhi Capital

US$0.637bn	39%	US$16.30mn
Market cap	Free float	Avg. daily volume

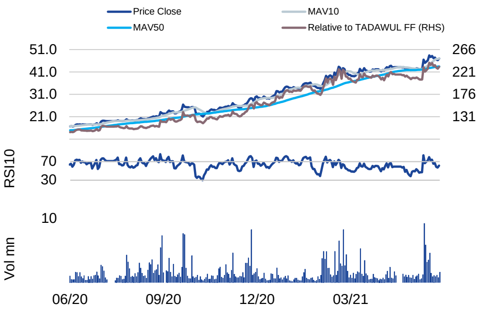
Target price	65.00	38% over current
Current price	47.00	as at 22/06/2021

Research Department
Pratik Khandelwal,
Tel +966 11 836 5486, pratikK@alrajhi-capital.com

Existing rating

Underweight	Neutral	**Overweight**

Performance



Source: Bloomberg

Earnings

(SARmn)	2020A	2021E	2022E
Revenue	1,867	1,844	2,157
Revenue growth	95%	-1%	17%
Gross profit	202	360	452
Gross margin	11%	20%	21%
EBITDA	154	313	406
EBITDA margin	8%	17%	19%
Net profit	51	183	244
Net margin	3%	10%	11%
EPS	1.00	3.60	4.81
DPS	1.00	0.75	3.37
Payout ratio	100%	21%	70%
RoE	7.9%	23.2%	28.4%

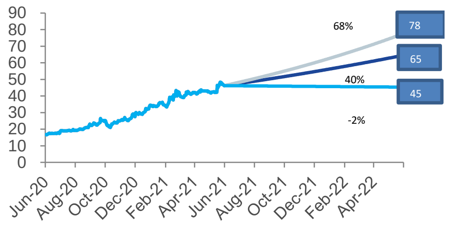
Source: Company data, Al Rajhi Capital

Valuation

Valuations	2020A*	2021E	2022E
P/E	18x	13x	10x
EV/EBITDA	10x	9x	7x
P/B	1x	3x	3x

*202A based on average CMP
Source: Company data, Al Rajhi Capital

Bull, Base and Bear case target prices



Source: Company data, Al Rajhi Capital

Al Yamamah Steel Industries Co
Initiating coverage with a TP of SAR65/sh

Al Yamamah Steel is a leading steel manufacturing company with a market share of ~35% in tubes and ~6% in the rebar segment. The company displayed a resilient performance in FY 2020 mainly driven by its strong capabilities to meet the market demand during the pandemic. The company's earnings bottomed out in FY 2019 and we saw a steep recovery in revenue driven by growth in volumes. We expect the demand to remain strong in the near term as well as medium-term due to overall construction sector growth. In the electricity segment, the company has recently entered into some medium-term contracts, which gives us strong revenue visibility for this sector. The company is planning to raise its tube capacity by 30% from 276,000 tons p.a to 360,000 tons p.a. The company is also in the processes of constructing a wind power tower plant with a capacity of 40,000MT (construction in FY 2021 and FY 2022) which would support the projects. Al Yamamah steel is a pure-play on Saudi Vision 2030 as the company's business aligns with the government's focus on the construction sector (megaprojects and mortgage) and developing renewable sources of energy. We are extremely bullish on the company as we see an increase in demand for the company's products, which would improve the capacity utilization and overall margins on the back of high operating leverage. The majority of the planned capex will be through internal accruals and we expect the return on capital employed to rise to 23% by FY 2024e. We initiate coverage on Al Yamamah steel with a tp of SAR65/sh arising with an equal weight given to DCF, EV/EBITDA, and PE-based relative valuation.

Improvement in capacity utilization to improve margins: We estimate the company to operate at an average capacity utilization of c.55% in the construction segment and c.50% in the electricity segment for 2021. We expect capacity utilization to improve over the next three years, which is likely to aid in the improvement in margins, at the back of operating leverage. Overall, we expect gross margins of Yamamah to improve from 11% in 2020 to c.21% by FY22.

Product prices to remain strong driven by global commodity price rise: In 2020, the revenue growth was driven by growth in volume, as the company's product was available during the pandemic. The company has been able to pass on the raw material price increase to its customers as there was good demand compared to supply. The overall increase in commodity prices has helped the company to increase its mark-up leading to a gross margin expansion over the last two quarters. As per our ground research and analysis, we expect the prices and demand to remain strong in the near term led by rising mortgage construction as well as off-take of government projects in medium term.

Valuation: We value Yamamah using an equal weight of DCF and relative valuation methodologies (EV/EBITDA and P/E). Our DCF based target price based on 2.0% terminal growth and 8.6% cost of capital comes to SAR71/sh, and P/E-based relative valuation based on 13.5x multiple gives us a target price of SAR58/sh. The EV/EBITDA based on a multiple of 10.8x comes to SAR66/sh thus, the target price stands at SAR65/sh which implies an upside of 38% from the current market price of SAR47/sh". The company is trading at 13x 2021e eps which in our view is cheap. Currently the company is trading with a dividend yield of c.2%; given the expected improvement in the financial performance, we also expect the company's dividend flow to increase by FY22. We initiate coverage on Al Yamamah steel with *"Overweight"* rating.

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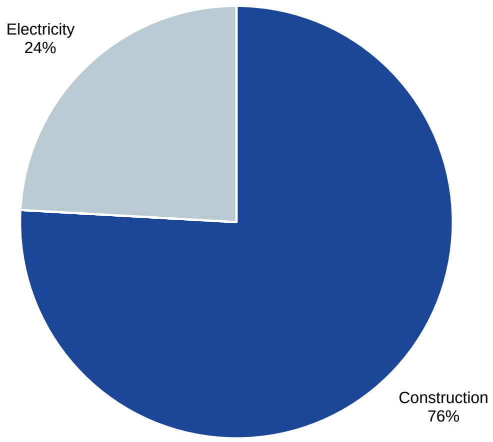
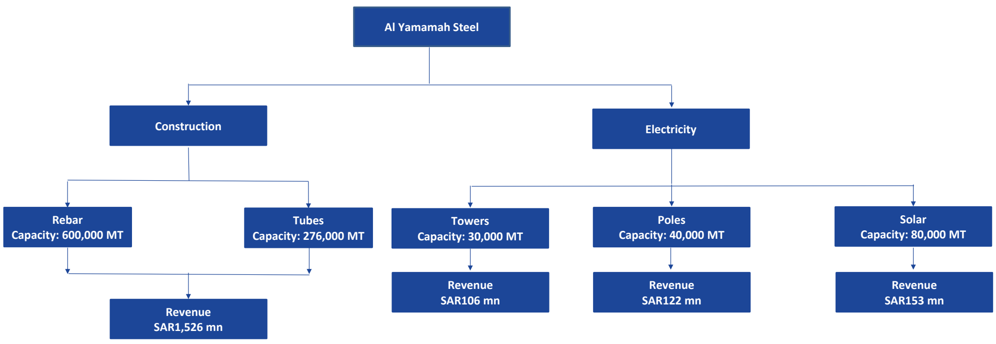
Company Overview: Al Yamamah Steel is a leading steel manufacturing company, with a diversified product profile. Its product portfolio ranges from tubes, pipes, rebar (reinforcing steel bars), and hollow shapes made from iron, manufacturing of metal structures and their parts for bridges and towers, manufacturing and installation of prefabricated steel structures for industrial facilities and manufacturing poles and their parts. The company mainly caters to the requirements of the construction industry. As of FY 2020, its market share in the tube sector was 35% and rebar was 6%. Its two main segments are construction, which accounts for ~76% of the total revenue, and the electricity segment, which comprises ~24% of the top line. In the construction segment, the company manufactures reinforcing steel bars (rebar) and tubes with a total capacity of 876 k tons p.a. In 2020, the capacity utilization for rebar was 80% and tubes 95%. In the electricity segment, it manufactures towers, poles, and products catering to the requirements of solar power systems. The total capacity of electricity segment is 150k tons p.a.

Figure 1. Revenue breakup



Source: Company data, Al Rajhi Capital

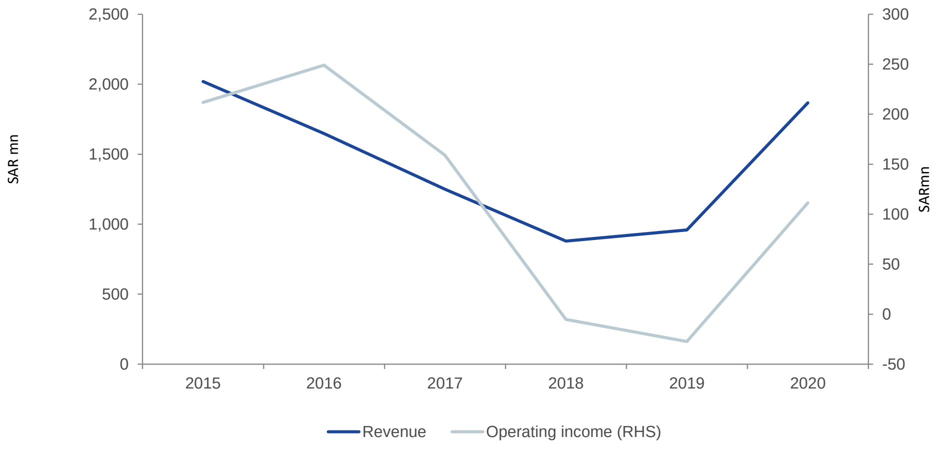
Figure 2. Business overview



Source: Company data, Al Rajhi Capital

Key Financials: Total revenue of Yamamah on an average fell 2% between FY15-20 broadly impacted by 3% average fall in construction revenue, while revenue from the electricity sector increased by 9% for the same period. However, FY 2020 was a total turnaround year for the company where the revenue increased 95% y-o-y, driven by volume growth. We expect the demand to remain robust led by ongoing mortgage related construction activities. Added to this, we also expect the execution of mega projects to pick up pace by the end of 2021e and the beginning of 2022e. Given this, we expect the company to register an average revenue growth of 9% between FY20-23.

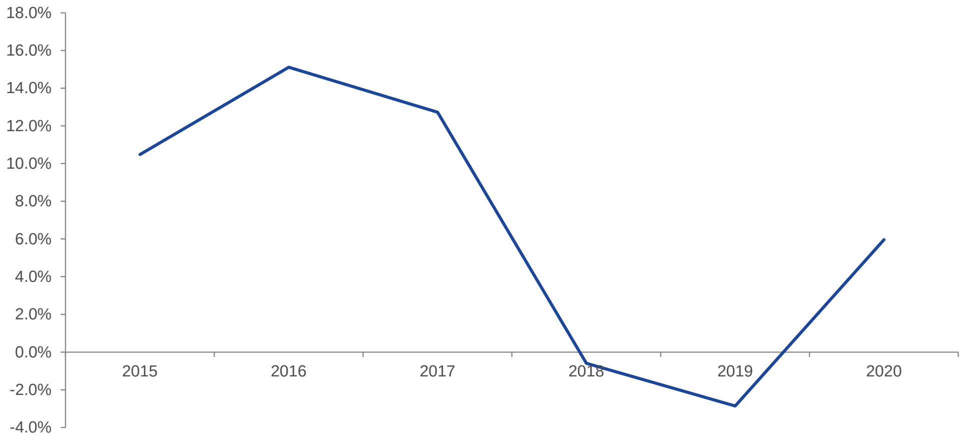
Figure 3. Trends in revenue and operating profits



Source: Company data, Al Rajhi Capital

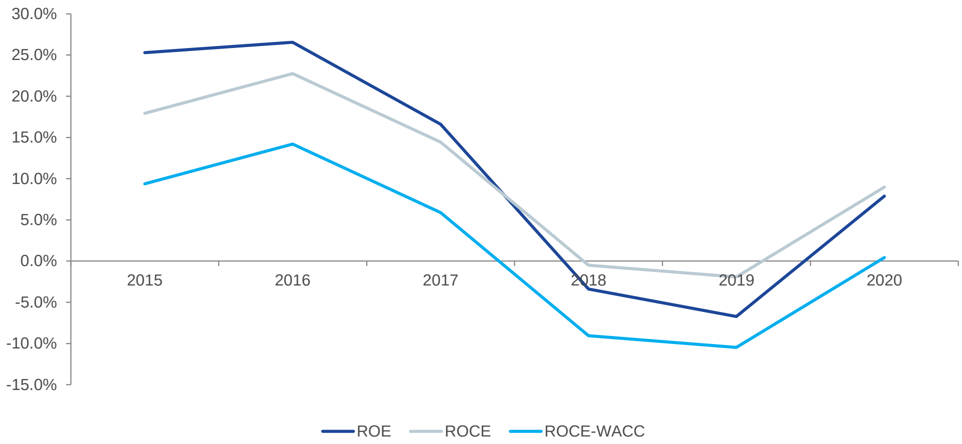
Operating profits (EBIT) fell by an average of more than 10% between FY15-20; lower revenue and the resultant fall in operating scale was the main reason for this. However, profitability has recovered significantly in FY20 and FY21, with FY20 operating income increasing to SAR111 mn, compared to an operating loss of SAR27 mn in the previous year. Operating profits in 1H21 more than doubled, despite lower revenue, aided by better management of raw material inventory. We expect this trend to continue, as we expect operating profits to increase on an average by c.55% for the next three years. As per our estimates, the construction segment is currently operating at a capacity utilization of 55-60%, while the electricity segment is operating at c.50%. Given this, we see sufficient upside in improvement in operating leverage which in turn would lead to margin expansion.

Figure 4. Trends in operating margins



Source: Company data, Al Rajhi Capital

Figure 5. Trends in profitability ratios



Source: Company data, Al Rajhi Capital

Figure 6. Income Statement

For the period ending September	2020	2021E	2022E	2023E
Sales	1,867	1,844	2,157	2,433
Revenue growth %	*95%*	*-1%*	*17%*	*13%*
Cost of Sales	(1,666)	(1,484)	(1,705)	(1,897)
Gross Income	**202**	**360**	**452**	**535**
Gross margins %	*11%*	*20%*	*21%*	*22%*
Gross profit growth %	*504%*	*78%*	*26%*	*19%*
Operating Expenses	(90)	(92)	(100)	(106)
Operating Income	**111**	**267**	**352**	**429**
Operating margins %	*6%*	*15%*	*16%*	*18%*
Operating income growth %	*-507%*	*140%*	*32%*	*22%*
Investment & Others	0	0	0	0
Financing Expense	(22)	(15)	(14)	(14)
Profit before tax & Unusual Items	**90**	**253**	**338**	**415**
Zakat & Tax	(14)	(38)	(51)	(62)
Net Profit Before minority interest	**76**	**215**	**287**	**353**
Net profit margins %	*4%*	*12%*	*13%*	*15%*
Net income growth	*-244%*	*183%*	*33%*	*23%*
EPS (SAR)	**1.00**	**3.60**	**4.81**	**5.91**

Source: Company data, Al Rajhi Capital

Figure 7. Balance Sheet

Balance Sheet	2020	2021E	2022E	2023E
ASSETS				
Cash & Cash Equivalents	18	233	108	31
Receivables, Net	336	331	388	437
Inventory	529	471	541	602
Other	27	27	27	27
Total Current Assets	**910**	**1,062**	**1,064**	**1,097**
Fixed Assets	452	461	572	677
Right-of-use asset	29	29	29	29
Intangibles	7	7	7	7
Other	0	0	0	0
Total Non-Current Assets	**487**	**497**	**608**	**712**
Total Assets	**1,397**	**1,559**	**1,671**	**1,810**
LIABILITIES				
Trade Payables	44	39	45	50
Short-term Debt	407	407	407	400
Short-term lease liabilities	2	2	2	2
Other	67	67	67	67
Total Current liabilities	**521**	**516**	**522**	**520**
Long-Term Debt	23	12	2	0
Long-term lease liabilities	26	26	26	26
Other	46	46	46	46
Total Non-Current Liabilities	**94**	**84**	**74**	**72**
Total Liabilities	**615**	**601**	**597**	**592**
Capital	508	508	508	508
Statutory reserve	68	68	68	68
Retained earnings	66	211	284	374
Change in Fair Value	0	0	0	0
Total Shareholders' Equity	**643**	**787**	**861**	**951**
Minority Interest	139	171	214	267
Total Shareholders' Equity incl. MI	**781**	**959**	**1,075**	**1,218**
Total liabilites and equity	**1,397**	**1,559**	**1,671**	**1,810**

Source: Company data, Al Rajhi Capital

Figure 8. Cash Flow

Cash Flow Statement	2020	2021E	2022E	2023E
Cash Flows from Operating Activities	328	318	221	310
Cash Flows from Investing Activities	(28)	(55)	(165)	(167)
Cash Flows from Financing Activities	(310)	(48)	(181)	(220)
Net change cash & cash equivalents	(11)	215	(125)	(77)
Cash & cash equiv at period end	18	233	108	31

Source: Company data, Al Rajhi Capital

Valuation Summary:

Figure 9. DCF Summary

DCF Method (SAR mn)		FY21E	FY22E	FY23E	FY24E	FY25E
Operating profit		267	352	429	403	361
Growth(%)			*31.6%*	*21.9%*	*-6.0%*	*-10.5%*
Tax rate		*15.0%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*
Post-tax operating profit (NOPAT)		**227**	**299**	**365**	**343**	**307**
Add: Depreciation & amortization		46	54	62	66	70
Add: Change in working capital		57	(120)	(106)	(21)	(6)
Less: Capex		(55)	(165)	(167)	(74)	(73)
Free Cash Flow to Firm		**275**	**68**	**155**	**314**	**297**
FCF growth			*-75.4%*	*128.7%*	*103.0%*	*-5.4%*
Discount factor		*0.98*	*0.90*	*0.83*	*0.76*	*0.70*
PV of Free Cash Flows		269	61	128	240	209
Sum of present values of FCFs	**908**					
Free cash flow (t+1)	303					
Terminal value	**4,628**					
Present value of terminal value	**3,260**					
EV	**4,168**					
Less: Net debt	(440)					
Less: Minority	(139)					
Equity value	**3,589**					
Fair value per share (SAR)	**71**					
Shares O/s	51					
Upside/Downside	50.3%					
CMP	47					

Source: Company data, Al Rajhi Capital

Investment Thesis:

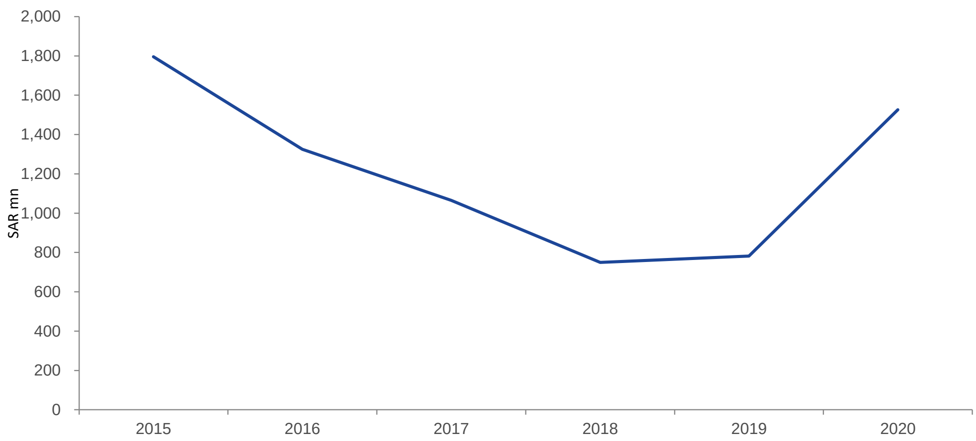
Recent contracts with L&T and Dubai solar power park to provide sustainable revenue growth: The Company recently entered into a contract with L&T Saudi Arabia to supply steel towers. This contract is for a particular project to construct 380KV ultra-high voltage line from Rahfa station to Qaisumah station, the total value of this contract is SAR98.83mn and the period of supply is from May 2021 to July 2022. We expect to see the impact of this contract from the September 2021 quarter.

In March 2019, the company entered into a four-year contract with Europea de Construcciones Metalicas. S.A (Spanish company) to supply the solar steel structure to Dubai solar park project. The financial impact of this contract is reflected from the quarter ended September 2019 (will continue till the end of 26 months). This contract was one of the reasons for the relatively resilient performance of the electricity segment in FY 2020.

Establishing solar power plants and renewable sources of energy are some of the key focus of Saudi Vision 2030 and we believe the company has the required technical expertise and capabilities to be a part of this drive. The company is also setting up a wind tower to meet the energy requirements of the new projects. Therefore, existing projects along with potential long-term projects provide strong demand visibility for a long term.

Construction revenue to continue its winning streak: The construction segment is the largest segment for Yamamah Steel, accounting for ~76% of revenue in 1H21. In this segment, the company operates with a capacity to manufacture 600 k tons of rebar p.a. and 276 k tons of tubes p.a. Average utilization in this segment, increased to c.80% in FY20, after remaining lacklustre at c.35% in the past two years. As per our estimates, Rebar operated at c.80% utilization, while tubes operated at c.95% in FY20. Strong demand, at the back of offtake from housing demand, aided the improvement in utilization during the year. We expect the demand to remain strong as the mortgage and other GIGA projects progress in the coming years. In line with the positive demand outlook, Yamamah Steel is looking to increase its pipes and tubes capacity from the current 276 k tons p.a. to 360 k tons, at a project of cost of SAR33 mn to be financed mainly through internal accruals. We expect this capacity to become operational in the second quarter of FY22. Overall, we expect the revenue of the construction segment to grow at an average rate of c.7-10% for the next three years. This should further improve the company's ROIC and ROCE. We expect the company's ROCE to reach 26% by FY 2023e.

Figure 10. Trend in construction revenue



Source: Company data, Al Rajhi Capital

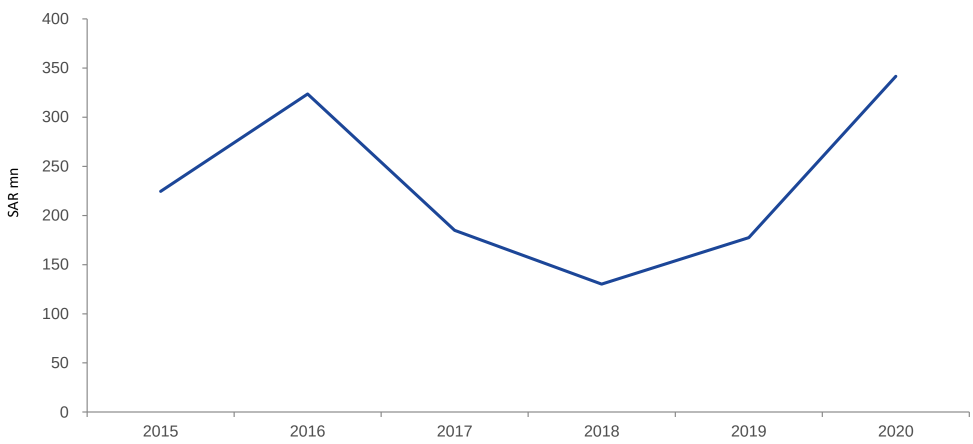
Margin expansion to drive profitability and return ratios: In line with the fall in revenue, the profitability of the construction segment too came under pressure, as gross margins diluted from 17.3% in FY17 to 2.8% in FY19, though it recovered to 12.7% in FY20. Despite lower revenue, gross margins have improved further in 1H21 to 24.8%, aided by higher product prices and favourable management of raw material inventory. Going forward, we expect this trend to continue, as we expect product prices to remain elevated for the next two years, aided by a robust demand scenario. With volume growth improving, we also expect margins to expand by an improved scale of operations. Overall, we expect the gross profit of the construction segment to grow between 35-40% for the next three years.

Figure 11. Construction profitability

Source: Company data, Al Rajhi Capital

Electricity segment to recover due to rising infrastructure spending: The electricity segment accounts for 24% of revenue in 1H21. In this segment, the company has a capacity to manufacture 30k tons of tower, 40 k tons of poles, and 80 k tons of solar. We estimate the average utilization in this segment at c.50% in FY20 and we expect the same to improve in the medium term. Increasing housing demand, the higher outlay for infrastructure megaprojects, and increasing demand for alternate energy will likely aid growth and utilization in this segment.

Figure 12. The trend in electricity revenue



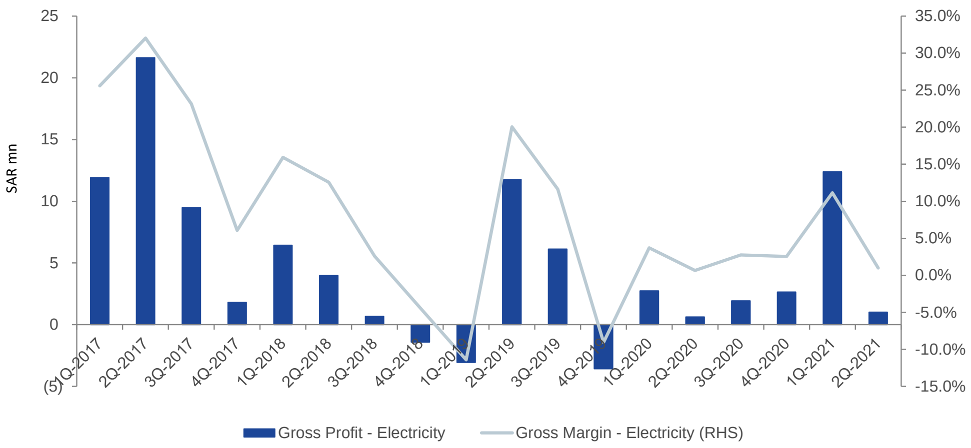
Source: Company data, Al Rajhi Capital

With a view to increase its presence and support Saudi Vision 2030 the company is increasing its capacity to strengthen its renewable energy portfolio. It is looking to invest SAR293 mn to construct a wind tower with a capacity to generate 40k tons of wind energy. The work on this project commenced on March 1, 2021, and expected to complete by the end of FY22. We expect the growth in housing projects to result in latent demand for electricity products. Also, in line with the vision 2030 and the subsequent investments in the mega projects, is likely to result in investment in augmenting the existing power infrastructure. Added to this and given the emphasis on renewable sources of energy, Yamamah Steel's offerings in solar power are likely to aid in strong revenue growth.

Revenue of the electricity segment has been strong in the past five years (FY15-FY20), with the revenue of the company increasing at an average rate of 9%, during the period. 2020, proved to be a strong year for the company, with the revenue growing by 92% y-o-y, after remaining lacklustre between 2017 and 2019. This trend has largely continued in 1H21, with revenue growing 27% y-o-y. Aided by a strong demand scenario, at the back of strong growth in housing and a pickup in demand in the mega projects, we expect the revenue from electricity segment to grow by 15-20% for the next three years.

Profitability of electricity segment to improve driven by improving capacity utilization: Gross margins of the electricity segment have been volatile in the past three years and have fallen from 7.4% in 2018 to 2.3% in 2020. However, the margins improved in 1H21 to 6.3%, though it continues to remain volatile. Aided by higher revenue and improved scale of operation and an overall improvement in the demand scenario, we expect gross margins of the segment to improve in the medium term. Overall, we expect the gross profit of the electricity segment to increase by c.65% for the next three years.

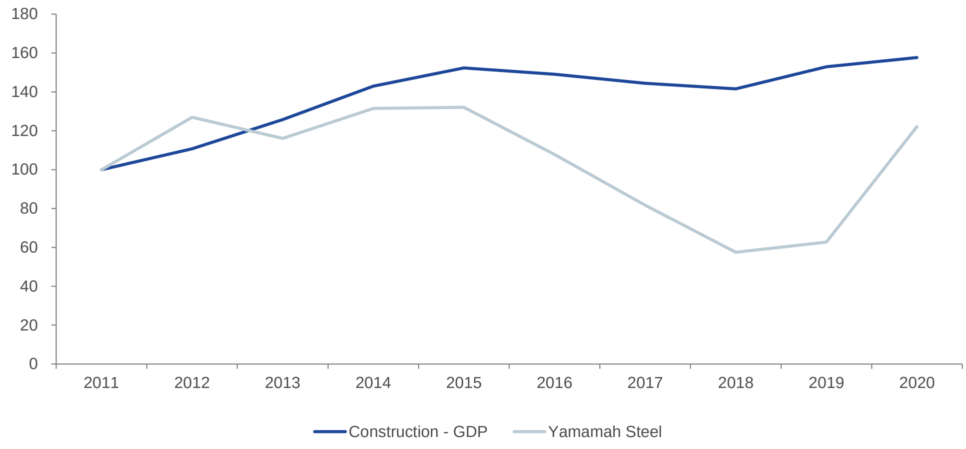
Figure 13. Electricity profitability



Source: Company data, Al Rajhi Capital

Company to benefit from the uptrend in construction spending:

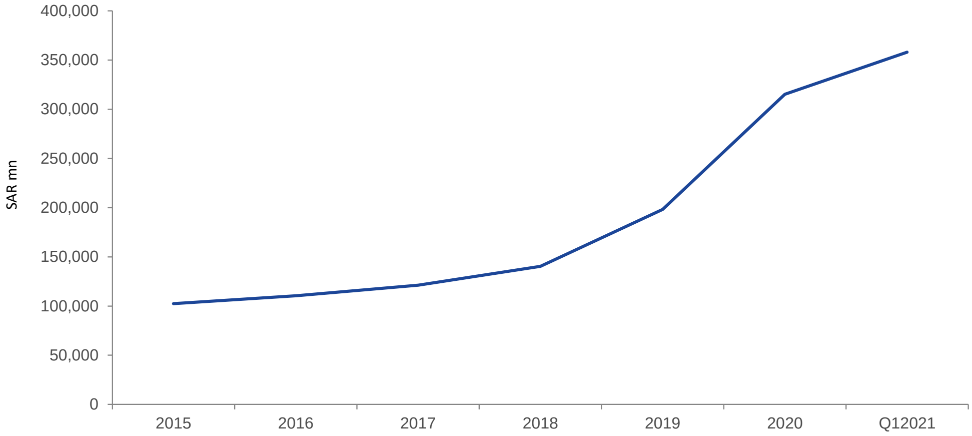
Figure 14. Yamamah revenue trace construction GDP (Indexed to 100)



Source: Company data, Al Rajhi Capital

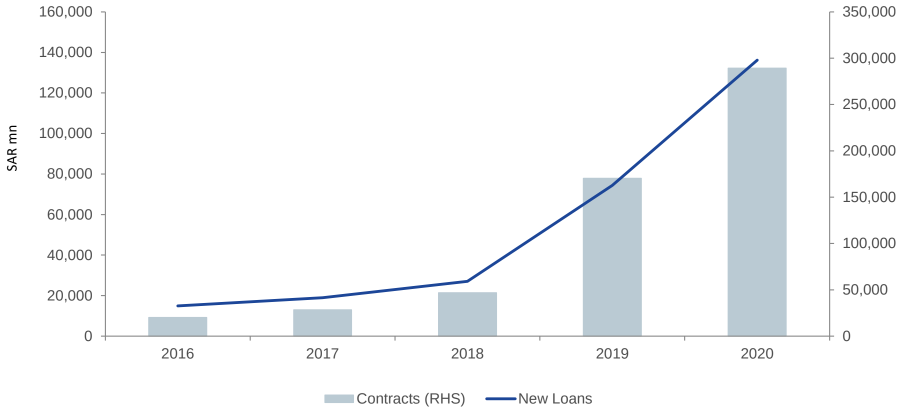
Total revenue of Yamamah Steel since 2015 has come under pressure and has fallen from 2015 levels of SAR2.0 bn to SAR1.9 bn in 2020, an average fall of c.2% p.a. A predominant portion of the company's revenue is correlated to the overall construction activity in the kingdom. Lower construction activity, at the back of lower oil prices, has had a negative impact on the revenue of Yamamah Steel. Construction GDP, between 2015 to 2020, grew at an average of 1% p.a. In what could be seen as signs of recovery, construction GDP registered an 8% y-o-y growth in 2019, compared to a corresponding growth of 9% in Yamamah Steel's revenue in FY19. In 2020, on the other hand, construction GDP increased by 3%, despite the impact of Covid, while the company registered a growth of 95% in revenue in FY20. The recovery trend in construction activity is likely driven by the mortgage. We expect this trend to continue in the short to medium term. In long term, we are optimistic on-demand scenario from several government projects.

Figure 15. Real estate loan grows exponentially



Source: Company data, Al Rajhi Capital

Figure 16. Growth in new real estate loans and number of contracts



Source: Company data, Al Rajhi Capital

Construction segment growth to be aided by mortgage: Between 2015-20, real estate loans provided to retail clients by banks have grown at an average rate of 25% p.a., while as of 31-Mar-21, the loan growth was 14% q-o-q and 59% y-o-y. We expect this growth momentum in mortgages to continue, as cumulative new mortgage loans for 2020 grew by 83% y-o-y, while the number of contracts grew 70% y-o-y. The average time taken to complete a housing project is between 3-4 years and given the strong growth in new loans, we expect the momentum in housing growth to continue which in turn will drive the demand for rebar and steel tubes.

Structural steel accounts for around 10% of the total building cost. Given this, we expect steel for construction will be strong in the medium term. In this scenario, the company has a 35% market share in tubes and a 6% market share in the rebar segment. We also expect the market share of Al Yamamah steel to improve, as we expect the manufacturing to shift towards the organized sector.

Electric transmission tower and pole demand to grow with rising construction activities: The demand for transmission tower and electric poles is poised to grow as the mega projects get executed. The transmission tower and poles are a few of the necessities, which should be commissioned during the middle to end stages of construction activities. Given this, we expect the segment to grow as the construction activities in these mega projects pick up.

Valuation: We value Yamamah using an equal weight of DCF and relative valuation methodologies (EV/EBITDA and P/E). Our DCF based target price based on 2.0% terminal growth and 8.6% cost of capital comes to SAR71/sh, and P/E-based relative valuation based on 13.5x multiple gives us a target price of SAR58/sh. The EV/EBITDA based on a multiple of 10.8x comes to SAR66/sh thus, the target price stands at SAR65/sh which implies an upside of 38% from the current market price of SAR47/sh". The company is trading at 13x 2021e eps which in our view is cheap. Currently the company is trading with a dividend yield of c.2%; given the expected improvement in the financial performance, we also expect the company's dividend flow to increase by FY22. We initiate coverage on Al Yamamah steel with *"Overweight"* rating.

Key Risks:

1) Fall in oil prices, resulting in lower government spending and a fall in construction activity

2) Fall in average realization, resulting in lower revenue and lower profitability

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

4) Mortgage industry is labour intensive and any shortage in labour, due to Covid related traveling restrictions, could result in delay in projects, impacting company's revenue

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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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Contact us

Mazen AlSudairi
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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