



US\$1.308bn Market cap
77% Free float
US\$9.14mn Avg. daily volume

Target price **69.00** 12.6% over current
 Current price **61.30** as at 28/7/2021

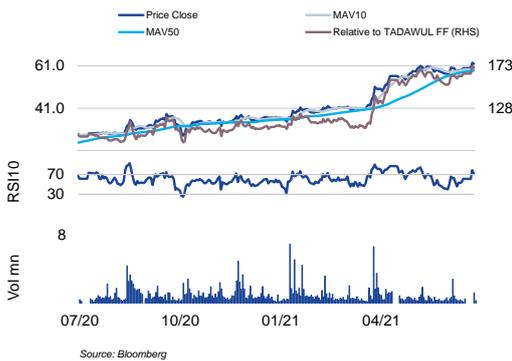
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Existing rating

Underweight **Neutral** **Overweight**

Performance



Earnings

SAR(Mn)	2020A	2021E	2022E
Revenue	1,516	1,668	1,875
Revenue growth	23%	10%	12%
Gross Profit	392	586	685
Gross Margin %	26%	35%	37%
Operating Income	127	316	409
Operating margin %	8%	19%	22%
Net income	78	293	384
Net margins	5%	18%	20%
EPS	0.97	3.66	4.80
DPS	0.00	1.10	1.44
Payout	0%	30%	30%
P/E	63.1x	16.7x	12.8x
EV/EBITDA	21.9x	12.2x	9.7x

Source: Company data, Al Rajhi Capital

Saudi Ceramic

Margin accretion sustainable; Raise TP to 69/sh

Saudi Ceramic Q2 2021 revenue came in at SAR356mn (-7% y-o-y) lower than our estimate of SAR418mn. Lower construction activity due to Ramadan and higher base in Q2 2020, due to pre-Vat buying, affected top-line. However, gross profit increased 33.7% y-o-y to SAR137mn due to 1166bps gross margin expansion (26.8% in Q2 2020 and 33.5% in Q1 2021). Margin accretion was aided by an increase in tiles and water heater prices and improving capacity utilization of sanitary ware segment. Operating efficiencies, lower provisions, and lower finance cost, on the back of debt reduction, resulted in a more than 9x growth in net income to SAR63mn; this was better than our estimate of SAR60mn. We remain bullish on Saudi Ceramics as we expect demand to remain robust. Limited competition from exported tiles provides pricing power to the company, which in turn will further enhance the gross margins and the overall ROCE. We also expect finance cost to remain low, aided by recent debt restructuring; this will boost both profitability and dividend pay-out. Overall, we expect ROCE to improve to around 13-16% for 2021 and 2022, compared to the ROCE of c.10% in 2015. Thus, post-Q2 2021 earnings we increase our target price from SAR56/sh to SAR69/sh and maintain our “overweight rating”.

Figure 1 Earnings Summary

SAR(mn)	Q2 2021	Q1 2021	Q2 2020	% chg y-o-y	% chg q-o-q	ARC est
Revenue	356	440	382	-7%	-19%	418
Gross Profit	137	147	102	34%	-7%	138
Gross Margin	38%	33%	27%	NM	NM	33%
Net income	63	71	7	865%	-10%	60
Net Margin	18%	16%	2%	NM	NM	14%

Source: Company data, Al Rajhi Capital

Key growth drivers:

- 1) Strong revenue visibility, at the back of growth in mortgages and our expectation of an improvement in execution of PIF backed giga projects
- 2) Government’s local content norm to further strengthen Saudi Ceramic’s market position
- 3) Improving pricing scenario, as the inventory of cheaper imported products fall, thus providing pricing power to Saudi Ceramics
- 4) Debt restructuring to lower finance cost and enhance profitability, aiding in an improvement in dividend pay-out

Valuation: We use a 50% DCF and 50% relative valuation using P/E of 18.5x to value Saudi Ceramic. Our DCF based target price (based on 9.9% WACC and terminal growth of 2%) is SAR74/sh and the relative valuation-based target price, based on 18.5x P/E, is SAR65/sh, resulting in a weighted average target price of SAR69/sh, which implies 12.6% upside from CMP of SAR61.30/sh.



Downside Risks: There are a few downside risks to our valuation and assumptions, as below:

- 1) Lower oil prices, resulting in a fall in government spending and a resultant fall in the offtake of the Saudi Ceramic's products
- 2) Increase in Covid cases, resulting in fresh restrictions, could have a negative impact on the company's revenue and profitability
- 3) Increased competition from local GCC players



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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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