

KSA CEMENT SECTOR



SIGNS OF DEMAND NORMALISATION

Sales in May 2014 increased 3.1% YoY, the first increase since the end of the amnesty period for expats in November 2013. We believe this is a sign of demand beginning to normalise, with full recovery expected in 4Q14. Demand slowdown and increased costs from imports will have a negative impact on earnings growth this year. On an adjusted basis, we believe the YoY earnings growth for covered companies will be 1.1% in 2014E. The sector currently trades at a 2014E P/E of 16.0x vs. a historical average of 13.0x.

This is an extract of our published report, the full version of which can be found on the ncbc.com website.

- Growth in May 2014 sales concurs signs of demand normalisation**
 Sales in May 2014 grew by 3.1% YoY, recording the first growth in seven months. The average YoY decline in sales since November 2013, stood at 7.9%. The recent growth supports our view of demand normalizing in 3Q14, with expectations of full demand recovery in 4Q14. For companies in the Central region, demand from the Riyadh Metro project will play a pivotal role in 4Q14.
- Large players maintain prices amidst discounts by remote companies**
 Despite the transportation cost, we believe that several companies in low demand areas are offering discounts to sell in the Western and Central regions. However, companies in high demand regions, such as Yamama Cement, have not offered any discounts which in turn impacted sales. We believe that demand from major projects, such as the Riyadh metro, will help in fully normalizing demand and mitigating discounts as of 4Q14.
- Margin pressure from imports; expectations of this easing in 2015E**
 Imports for the sector stood at 6.8mn tons, as of May 2014. According to management of cement companies, it will be unlikely for imports to be suspended below 10mn tons. However, imports of 47,000 tons in May 2014 were the lowest since June 2013. These imports increased costs and pressured margins. This was evident in 1Q14 results, where average gross margins of covered companies declined to 52%, from 58% in 1Q13. We expect average margins to stand at 52% for 2014E, with this pressure expected to ease in 2015E as margins increase to 55%.
- Remain neutral on the sector; Yanbu Cement top-pick**
 We remain neutral on the sector given that demand has not fully normalized yet, while imports have caused margin pressure. The 2014E P/E for the sector has expanded to 16.0x vs. 14.4x at the time of our last update. This multiple expansion has caused our valuations to increase across all covered stocks. Our top pick is Yanbu Cement, given its favorable location, high dividend yield and low payout ratio (77% vs. 89% for sector) which indicates the possibility of increasing dividends. Yanbu Cement is trading at 2014E P/E of 13.4x, compared to the sector average of 16.0x.

Exhibit 1: Saudi cement companies – Valuation matrix

	Rating	PT (SR)	MCAp \$mn	Stock perf (%)		P/E (x)	EV/ EBITDA '14	P/BV (x)	EV/ton (\$)	DY (%)	ROE (%)
				May	YTD						
Southern Cem (SPCC)	N	122.7	4,304	2.9	4.4	16.4	14.8	6.1	589	6.1	36.4
Yamamah Cem (YSCC)	N	59.4	3,555	5.8	14.8	17.3	15.4	3.3	613	4.6	19.4
Saudi Cem (SCC)	N	103.6	4,599	0.5	10.9	14.2	11.4	5.1	510	6.2	37.1
Qassim Cem (QCC)	N	92.3	2,244	0.0	4.3	13.8	12.8	4.1	589	6.7	30.2
Yanbu Cem (YCC)	N	78.2	3,081	5.0	9.8	13.4	10.6	3.3	464	6.1	25.4
Eastern Cem (EPCC)	N	56.0	1,374	1.2	0.6	12.4	13.6	2.1	457	5.8	17.7

Source: NCBC Research, Bloomberg, All prices as of June 16, 2014, * On a TTM basis
 N: Neutral, UW: Underweight, OW: Overweight, NC: Not Covered

Mohamed Tomalieh +966 12 690 7635
m.tomalieh@ncbc.com

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Kindly send all mailing list requests to research@ncbc.com

NCBC Research website

<http://research.ncbc.com>

Brokerage website

www.alahlitadawul.com
www.alahlbrokerage.com

Corporate website

www.ncbc.com

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