

OMANI CEMENT SECTOR

Play it Safe



October 5, 2011

Key Data

	Currency	Mkt. Cap (Millions)	52-week High / Low	YTD Return	12-month Return
Oman C	OMR	151	0.683 / 0.450	-29.1%	-28.1%
Raysut C	OMR	200	1.285 / 0.904	-18.2%	-14.3%

*As of October 4, 2011. Sources: Reuters and NBK Capital

Rebased Performance



Sources: Reuters and NBK Capital

Valuation

	Currency	Price*	Fair Value	Upside / Downside	Recommendation
Oman C	OMR	0.455	0.648	42%	Buy
Raysut C	OMR	1.002	0.893	-11%	Reduce

Sources: Company financial statements, Reuters, and NBK Capital

Forecasts

	FY2011F				
	P/E	EV/EBITDA	Rev. Growth	EBITDA Growth	Dividend Yield
Oman C	8.9	7.0	-8.5%	-15.5%	5.6%
Raysut C	13.5	9.4	25.4%	-1.2%	7.4%

Sources: Company financial statements and NBK Capital

Highlights

- The Omani cement market is in a paradoxical situation. The long-term growth prospects are excellent, with government and private spending expected to boost construction activity significantly in coming years. However, the market has fallen prey to the disturbances experienced in the UAE: massive over-capacity there, with no prospects of imminent recovery, has led UAE players to aggressively dump cement in Oman. We believe this situation will continue for the foreseeable future.
- The two Omani cement players have reacted radically differently. Oman Cement has increased its clinker capacity, ending its dependence on clinker imports and potentially boosting its margins. The company has at least regained some pricing power. Raysut Cement has bought Pioneer Cement in the UAE, attempting to fight fire with fire in Oman's Northern Region, whilst keeping its export capacity intact.
- We expect pricing pressure to continue well into FY2012, although this will stabilize starting FY2013, as UAE players are close to cash break-even. We expect Oman Cement to become more aggressive on pricing, to protect its market share, whilst the new clinker production line will allow it to maintain its margins. Raysut Cement's margins will be diluted sharply by the Pioneer acquisition, at both operating and net levels. Visibility on the company's export sales is very low given its target markets.
- Overall, we continue to prefer Oman Cement over Raysut Cement. Visibility on the activity, and therefore future dividends, is much better at Oman Cement. Raysut Cement's high-risk strategy could pay out handsomely in the distant future, but medium term uncertainties are too many. Buy Oman Cement, Reduce Raysut Cement.

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THE OMANI CEMENT MARKET

Underlying fundamentals still strong...

The underlying fundamentals of the cement market in Oman remain strong. The government plans to increase infrastructure spending, and private sector spending is expected to grow as well, mainly in the tourism sector.

Figure 1 Upcoming Infrastructure Projects in Oman

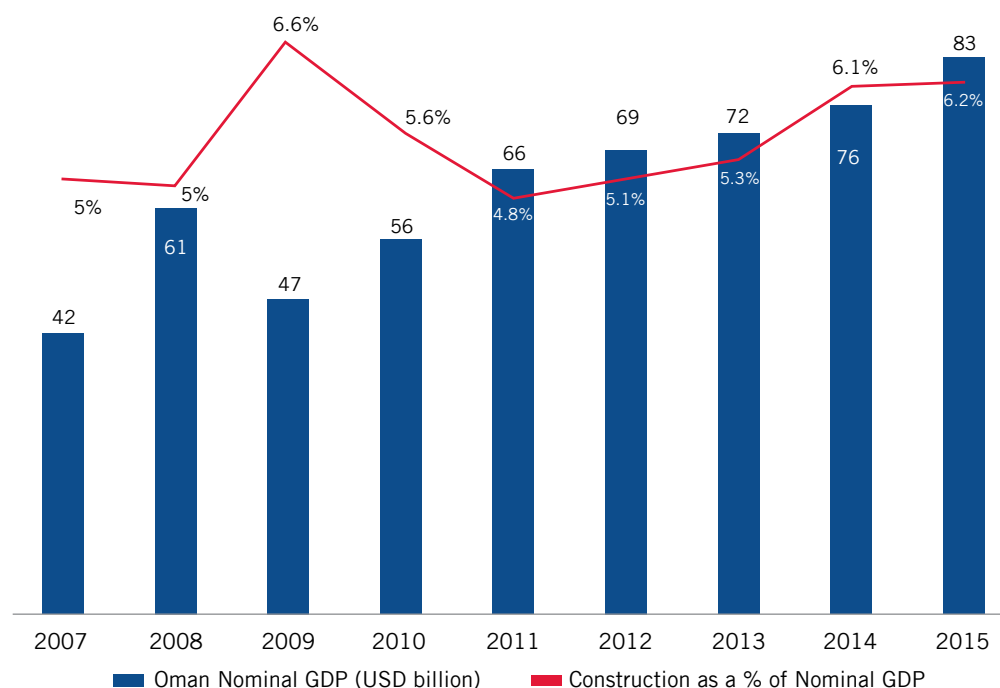
	Contract Value USD million
Airports	
Oman MOTC - Muscat International Airport Expansion - Phase 1 (Package MC3)	1,800
Oman MOTC - Muscat International Airport Expansion - Phase 1 (Package MC1)	1,170
Oman MOTC - Muscat International Airport Expansion - Phase 1 (Package MC2)	147
Oman MOTC - Salalah International Airport	765
Oman MOTC - Ras Al Hadd Airport- Phase 2	365
Oman MOTC - Ras Al Hadd Airport- Phase 3	250
Oman MOTC - Sohar Airport	300
Oman MOTC - Sohar Airport- Package 1	72
Oman MOTC - Sohar Airport- Package 2	98
Oman MOTC - Al Duqm Airport - Package 1	75
Oman MOTC - Al Duqm Airport - Package 2	115
Ports	
Oman MOTC - Duqm Port - Marine Works	1,356
Oman MNE - Duqm Port - Ship Repair Yard and Dry Dock Complex	442
Sohar Industrial Port Company- Deepwater Bulk Jetty	250
Oma MOTC - Salalah Port Expansion - General Cargo and Liquid Terminal	130
Oman MOTC- Al Hallaniyat Harbour	100
Roads and Bridges	
Oman MNE - Masirah Island Causeway	1,500
Oman Supreme Committee for Town Planning - Batinah Coastal Road	720
Oman MOTC- Batinah Expressway	650
Oman MOTC- Bibid to Sur Road Dualisation	623
Oman MOTC- Nizwa to Ibri- Phase 2	190
Oman MOTC- Hasik to Shuwaymiah Highway	178
Oman MOTC- Duqm Port- Roadworks and Infrastructure Facilities	175
Oman MOTC- Izz to Adam Road	170
Oman MOTC- Salalah to Thumrait Road Dualisation	130
Oman MOTC- Ubaylah to Fayyad Road	80
Oman MOTC- Adam to Thumrait Road Dualisation	52
Oman MOTC- Haima to Al Sahmah Road	17
Oman MOTC- Wadi Al Qahfi Road	5
Oman MRMWR- Al Suwaiq Dual Carriageway	3

Source: Zawya, NBK Capital Research.

It should be noted that the main infrastructure projects are planned in the Northern regions of Oman, mainly around the capital Muscat. Projects in the Central Region (mainly centered on the Duqm airport and port facilities) and Western Region account for about 37% of the total. Oman Cement operates entirely in the Northern Region, and would therefore be expected to be the main beneficiary of this government spending. However, the Northern Region is also the one most exposed to disruptions from the UAE.

All in all, demand for cement in Oman is expected to remain robust in coming years. The Global Cement Report expects demand to grow by 46.3% to 4.74mt in FY2011, and by 25.3% to 5.94mt in FY2012.

Figure 2 Oman GDP and Construction Sector



Source: IMF, BMI, NBK Capital Research

... the UAE a spanner in the works

Since the collapse of the UAE real estate sector in FY2008-2009, the Omani cement market has been aggressively targeted by the UAE cement producers.

The situation is simple:

- The UAE's total cement production capacity stands at 40mt p.a. according to the Global Cement Report, whilst FY2010 consumption is reckoned to have stood at just 12mt. Clinker capacity stands at 27.2mt. Overcapacity is therefore enormous.
- Oman represents almost the only market where the UAE players can export. The Saudi market is closed to imports, whilst transport and import costs mean that UAE cement is not price competitive currently in Qatar (although current UAE prices makes this a borderline statement, see our recent upgrade on Qatar National Cement, dated September 7, 2011, for details).

The current situation reflects this. Current ordinary Portland cement (OPC) prices in the UAE are around AED 180-190/ton (although prices as low as AED 170/ton have recently been seen). This is equivalent to OMR 19/ton. Transport costs to the Northern Region of Oman amount to OMR 4/ton approximately, meaning UAE players can sell cement in that region for OMR 23/ton. The Central and Western regions of Oman (home base of Raysut Cement) are sheltered, as transport costs by road or sea are substantially higher (to the tune of OMR 7/8 per ton for road, and about OMR 4/ton for sea, where additional port capacity problems exist).

Pricing pressure in the Northern region from UAE players has thus been relentless. Prices had reached highs of around OMR 30/ton in FY2008-9. Current realization prices for Omani players in the Northern region are hovering around the OMR 24/ton benchmark (domestic players enjoy a small degree of protection on State-backed, large projects, where they are the suppliers of choice). In the Central and Western Regions, prices are holding up closer to OMR 27/ton.

We do not forecast a major change in this situation in the short term. On the one hand, we do not expect a major recovery in the UAE construction segment in the near term. Additional infrastructure

spending (e.g. the UAE Rail Link) will more than likely be offset by lower construction spending in Dubai and indeed Abu Dhabi (where anecdotal evidence suggests the government has seriously clamped down on all non-essential spending). In any case, given the massive supply overhang, the scope of the recovery in construction spending needed for prices to recover would in our view be far above what is currently foreseeable.

On the other hand, most UAE operators are currently running at or close to cash break-even, putting a floor to prices. Only a potential drop in energy prices (South African coking coal is the preferred fuel) could engineer further pricing pressure.

In the longer run, it should be expected that marginal players will disappear and the market will rationalize, as the current situation is clearly not tenable. However, there is little visibility on when this will actually happen.

Reactions of the Omani players

The two Omani cement producers have adopted radically different strategies to cope with the disruptions from the UAE, a function of their different exposure.

Oman Cement, as the main producer in the Northern Region, is the most affected. The company has chosen to counter-act the threat by investing in its production capacity, mainly:

- By doubling its clinker capacity from 1.2mt to 2.4mt p.a. The new capacity has started up in 2Q2011, and is expected to contribute fully from 2H2011;
- By de-bottlenecking its existing clinker and cement capacities.

On the face of it, raising capacity in an over-supplied market may seem like a strange move. However, it should be remembered that Oman Cement's cement production capacity already stood at 2.54mt in past years, with the company having to import clinker. Doubling the clinker capacity will negate the need for imported clinker, which will give the company scope to increase profitability by significantly reducing cost per ton. Accordingly, the company will, if needed, be able to absorb pricing pressure without deteriorating its margins, allowing it much better pricing power. Indeed, our forecasts show Oman Cement maintaining an EBITDA margin in excess of 40% despite continued expected pricing pressure in FY2012 and FY2013.

Raysut Cement is less exposed to the UAE players, as its base in the Western Region is sheltered. The company has therefore chosen to acquire a UAE player, Pioneer Cement. This will allow it to use the acquired UAE capacity in the Northern Region, whilst controlling a potential competitor. At the same time, the company can maintain high prices in the Western Region and direct a larger part of its capacity towards export markets.

We view this strategy as ultimately quite risky, at least in the medium term:

- Pioneer Cement has significantly lower margins than Raysut Cement has historically been able to achieve: we expect FY2011 EBITDA margin of 13% (excluding inventory adjustments) for Pioneer, whilst Raysut Cement's stand-alone EBITDA margin had amounted to 41.6%;
- This margin dilution is compounded at the net level, as the acquisition was entirely debt financed. This has also raised Raysut Cement's overall risk profile significantly;
- Admittedly, at USD 125/ton, the acquisition of Pioneer was cheap; however, this should in our view be set against the company's low profitability, as well as the strongly deteriorated fundamentals of the UAE market. Indeed, Reuters consensus figures show that the UAE cement sector is currently trading on a median EV/ton of just USD 78 (please see below);
- Finally, we would draw attention to the fact that Raysut Cement's main exports markets are Yemen (almost 50% of exports) and selected East African markets, amongst which are Sudan, Ethiopia and Somalia. Whilst most, if not all, of the above countries will at one point in time require massive reconstruction, they are currently very unstable, with very little visibility as to when (or, in the case of Somalia, if) the situation will improve.

2Q2011 RESULTS

The chosen strategy of Oman's cement producers started showing through in 2Q2011

Oman Cement

Oman Cement's results were a bit of a mixed bunch.

Clinker production rose to 400kt from 277kt in 1Q2011, as the additional clinker capacity started kicking in. As a consequence, clinker imports dropped from 215kt in 1Q2011 to just 27kt in 2Q2011.

Cement production dropped slightly from 491kt in 1Q2011 to 460kt in 2Q2011. The company however maintained its market share in Oman, a feat all the more remarkable as Oman Cement managed to maintain its realization price unchanged QoQ, at OMR 26.3/ton. Total revenues therefore stood at OMR 12.5 million, a drop of 5.5% both YoY and QoQ. Net revenues (after discounts), however, decreased to OMR 12 million, a drop of 7% on a QoQ basis and 9.1% on a YoY basis, indicative of the pricing pressure brought on by the UAE players.

As a result of the drop in imported clinker, 2Q2011 EBITDA increased on a QoQ basis, from OMR 4.9 million (margin 38.4%) in 1Q2011 to OMR 5.1 million (margin 42.7%) in 2Q2011. This was in line with our expectations. However, the EBITDA margin dropped on a YoY basis, from 47.8% to 42.7%, mainly as a result of a 35% rise in SG&A, in large part due to the salary increases granted in Oman at the start of the Arab Spring.

PBT stood at OMR 3.6 million, down from OMR 4.7 million in 1Q2011, as a result of both the higher SG&A spend and higher net financial costs, due to the capital expenditure on the new clinker capacity. Again, this is in line with expected FY2011 trends.

Cash flow from operations for 1H2011 stood at OMR 10.1 million, down sharply from 1H2010 (OMR 17.3 million). Free cash flow stood at OMR 8.35 million, as against OMR 7.86 million in 1H2010, as the investment in the new clinker capacity is almost completed. Net cash stood at OMR 29 million (including non-current bank deposits, and AFS investments as cash), as against OMR 39.2 million in 1H2010, as a result of the increased capital expenditure. Oman Cement has since announced it has secured a further loan of OMR 11.47 million from Bank Sohar, to finance further re-bottlenecking and environmental capital expenditure.

Raysut Cement

Raysut Cement's 2Q2011 results made for slightly more difficult reading.

Domestic cement production stood at 369kt as against 390kt in 1Q2011, a drop of 5.4%. Export volumes however dropped strongly to 133kt from 180kt in 1Q2011 (-26.2%).

Domestic pricing dropped slightly from OMR 27.2/ton to OMR 27/ton. This remains higher than realizations at Oman Cement due to the protected nature of Raysut Cement's home markets in the Central and Western regions, and was slightly higher than our expectations. Export prices rose strongly from OMR 23.8/ton in 1Q2011 to OMR 38.1/ton in 2Q2011. Quarterly export prices have been consistently very volatile.

Total revenues for the parent company stood at OMR 14.9 million, almost unchanged from 1Q2011's OMR 15 million. Unsurprisingly, domestic revenues dropped 6.5%, whilst export revenues rose sharply.

Parent company EBITDA margin stood at 36.3% in 2Q2011, as against 41.2% in 1Q2011. This was entirely due to the drop in gross margin, from 42.5% in 1Q2011 to 38% in 2Q2011, mainly on the back of higher energy costs and increased imports.

Pioneer cement produced 360kt of cement in 2Q2011, a sharp rise of 37.5% over 1Q2011 (262kt). Clinker production stood at 290kt in 2Q2011, down from 329kt in 1Q2011 (-12%).

Total cement sales volumes rose in 2Q2011 to 365kt from a level of 262.5kt in 1Q2011, up 39%, including a 15.5% rise in domestic (UAE) sales and a 57% rise in export sales to Oman. Having acquired Pioneer in December 2010, Raysut Cement started implementing its strategy more aggressively in 2Q2011.

Pioneer Cement's revenues in 2Q2011 stood at OMR 8.2 million as against OMR 5.31 million in 1Q2011, a rise of 54%, mainly on the back of higher volumes (the company also sold 110kt of clinker in 2Q2011, as against none in 1Q2011).

Pioneer Cement's EBITDA margin dropped sharply in 2Q2011, to 13.2% from 24.8% in 1Q2011. However, it should be remembered that the figure for 1Q2011 included a massive, positive inventory adjustment, excluding which the EBITDA margin for Pioneer would have stood essentially at break-even. The level of EBITDA margin achieved for 2Q2011 was in line with our expectations for Pioneer.

Thus, at the consolidated level for Raysut Cement, revenues stood at OMR 23.2 million. EBITDA stood at OMR 6.5 million, for a margin of 28%, of course strongly down from 2Q2010 (44%), due entirely to the consolidation of Pioneer. Consolidated PBT stood at OMR 3.9 million, down sharply from 2Q2010's OMR 6.8 million, as a result of the drop in EBITDA, but more importantly, of the steep rise in net interest cost following the acquisition of Pioneer.

The 1H2011 cash flow from operations dropped to OMR 12 million as against OMR 16.6 million in 1H2010, whilst free cash flow dropped to OMR 9.9 million from OMR 12.4 million in 1H2010. Net debt stood at OMR 68 million (again accounting for AFS investments as cash) at June 30, 2011, as against a net cash position of OMR 10.3 million at June 30, 2010.

ESTIMATES

Oman Cement

The key factors for Oman Cement are clinker production and cement pricing.

We are assuming a capacity utilization rate of 58.6% for the new clinker line in FY2011, with 85% capacity utilization for the existing clinker line. From FY2012 onwards, we are assuming capacity utilization of 97.5% (essentially full capacity) for the first line, with the second line capacity utilization rising to 90% by FY2014. The latter is conservative. Crucially, this means we are assuming no clinker imports from 3Q2011 (they were negligible in 2Q2011), which should boost margins, all else being equal.

We are however assuming further pricing pressure, although this will ease in our view after FY2012. We have penciled in an average realization price of OMR 25.7/ton in FY2011, implying a small drop in 2H2011. We expect a further drop to OMR 23.8/ton in FY2012. Essentially, we are assuming that Oman Cement defends its market share from the UAE producers, with the new clinker production line allowing it to maintain EBITDA margins at high levels (average of 43.5% over our forecasting period). We are assuming a 5-year 5.9% CAGR in cement volume sales, driven by the domestic market (exports are negligible at Oman Cement).

We are assuming a dividend payout ratio of 50% in FY2011, rising to 75% by FY2013, as the company will by then have completed its capital expenditure program. The dividend pay-out ratio stood at 49% in FY2010.

The company should be strongly cash flow generative from FY2013 onwards, after the completion of its capex program (we expect capex of OMR 10 million in FY2012).

Raysut Cement

For Raysut Cement, the key factors are Pioneer Cement, domestic pricing levels and export sales.

For Pioneer Cement, we have taken what we consider to be conservative assumptions. We expect FY2011 production levels of 1.2mt of cement, in line with 1H2011 achievements, and expect an EBITDA margin of 13%, in line with the level achieved in 2Q2011 and with company guidance.

We are not assuming any top line growth for Pioneer Cement over our forecast horizon. This may seem conservative as Pioneer's nominal cement production capacity is 1.7mt (clinker capacity of 1.25mt). However, we do not expect any significant recovery in the UAE market, with construction continuing its slowdown in Dubai, and Abu Dhabi remaining quite prudent in its spending. Moreover, we expect that the UAE players' market share in Oman is close to peaking; with Oman Cement's increased pricing power, and the degree of protection Omani players enjoy from the State, we expect the UAE players' share to stabilize. We do not forecast any improvement in UAE pricing.

We are however penciling in a rise in Pioneer's EBITDA margin to 16% by FY2014, in line with company guidance, and achievable by better efficiencies within the Raysut Cement group.

As far as domestic cement prices go, we are assuming a FY2011 realization of OMR 27/ton, slightly higher than for Oman Cement and unchanged from 1H2011. We assume prices will drop further to OMR 25.8/ton in FY2012, and stabilize from there onwards.

Visibility remains extremely low on exports, both for volumes and pricing. We do not expect that export prices achieved in 2Q2011 are sustainable, and would expect a sharp drop in 2H2011. Yemen, Raysut Cement's main export market, has plunged back into turmoil in 3Q2011, whilst visibility on East African export markets remains extremely low. We expect export prices to stabilize at OMR 22/ton from FY2012 onwards.

We expect a 5-year CAGR for cement volumes of 7.3% for the domestic market and 4.7% for the export market. We are assuming Raysut Cement will grow slightly faster than Oman Cement domestically, as work in the Duqm region should benefit mainly Raysut (geographical proximity). As noted above, visibility on export sales remains very low: Raysut Cement mainly exports to countries in severe need of reconstruction and/or infrastructure spending, but their political instability makes forecasting a very delicate exercise.

Based on the dividend for FY2010, Raysut Cement currently yields 10%. However, we do not expect the company to be able to maintain its dividend payment unchanged, due to the integration of Pioneer (with the double whammy of operating margin dilution and the steep rise in interest cost). Although we have (optimistically perhaps) maintained a dividend payout ratio of 100% for the foreseeable future, the expected sharp drop in earnings will lead to a cut in the dividend.

VALUATION

We are valuing the Omani Cement companies through DCF and a comparative valuation, with a weighting of 80-20 in both cases.

Figure 3 Comparative Valuation Table

Company Name	Country	Capacity ('000 Tons)	Valuation								
			PE (x)	PE (x)	PE (x)	EV / ttm EBITDA	EV / 2011 EBITDA	EV / 2012 EBITDA	EV / Ton	Dividend Yield	Dividend Yield
			TTM	2011 EPS	2012 EPS	(x)	(x)	(x)	(USD)	2010 payout	2011 payout
Southern Province Cement Co.	KSA	6,000	13.6	12.8	12.4	10.8	10.1	9.8	429.2	7%	7%
Yamama Cement Co.	KSA	6,300	12.0	12.2	11.8	9.4	9.5	9.5	357.3	6%	6%
Saudi Cement Co.	KSA	9,030	13.4	12.7	11.8	11.2	10.7	10.1	312.6	6%	5%
Qassim Cement	KSA	3,300	12.0	11.9	11.6	9.9	10.1	10.4	492.9	7%	7%
Yanbu Cement Co.	KSA	4,200	13.6	13.8	12.4	12.4	12.5	10.7	441.0	3%	4%
Eastern Province Cement Co.	KSA	3,500	12.5	12.1	11.1	8.9	8.9	8.4	299.8	7%	6%
Arabian Cement Co.	KSA	5,000	10.2	8.7	7.9	9.3	7.9	7.8	243.4	2%	
Tabuk Cement	KSA	1,300	15.4	14.2	13.5	8.8	8.9	8.8	330.0	6%	6%
KSA Average			12.8	12.3	11.6	10.1	9.8	9.4	363.3	5.8%	
KSA Average (excluding outliers)			12.8	12.3	11.8	10.2	9.9	9.5	361.7	6.2%	
KSA Weighted Average			12.8	12.4	11.7	10.4	10.1	9.7		6.1%	
Median			12.9	12.4	11.8	9.7	9.8	9.6	343.7	6.4%	
Gulf Cement Co.	UAE	2,700	26.1	50.2	17.1	(57.1)	10.4	6.5	74.4	10.1%	
Fujairah Cement Industries Co.	UAE	2,100	nfm	76.1		14.0	nfm		131.1	0.0%	
Union Cement Co.	UAE	4,200	nfm	nfm		12.2	6.5	3.6	40.7	8.0%	
Sharjah Cement Co.	UAE	4,600	24.9	nfm		10.4	nfm		33.9	8.8%	
RAK Cement	UAE	1,100	nfm	11.8		22.3	7.2	5.7	90.9	0.0%	
UAE Average			25.5	46.0	17.1	0.4	8.0	5.3	74.2	5.4%	
UAE Average (excluding outliers)						16.2			68.7	8.4%	
UAE Weighted Average			11.2	17.6	5.4	-8.0	6.1	3.9		6.3%	
Median			25.5	50.2	17.1	12.2	7.2	5.7	74.4	8.0%	
Raysut Cement	Oman	3,972	12.5	13.5	12.9	17.8	10.2	9.8	178.3	10.0%	6.9%
Oman Cement	Oman	2,554	10.9	8.8	9.2	6.7	6.6	6.2	134.4	6.4%	4.7%
Oman Average			11.7	11.1	11.0	12.2	8.4	8.0	156.4	8.2%	
Oman Weighted Average			11.8	11.5	11.3	13.1	8.7	8.3		8.5%	
Qatar National Cement	Qatar	4,400	12.6	13.8	10.8	10.1	11.5	9.4	344.9	7.0%	3.8%
Kuwait Cement Co.	Kuwait	2,400	24.8	nfm		23.0	nfm		612.2	1.6%	
GCC Average			15.3	19.5	11.9	8.2	9.4	8.3	267.5	5.8%	
GCC Average (excluding outliers)			14.5	15.9	11.7	12.7	9.5	8.5	260.1	6.3%	
GCC Weighted Average			13.5	11.9	10.6	10.6	9.3	8.7		6.0%	
Median			13.0	12.8	11.8	10.4	9.8	9.1	299.8	6.5%	

Source: Reuters, NBK Capital Research.

Both Omani players are trading at a steep discount to GCC peers on an EV/ton basis (excluding the UAE players who are even further in the doldrums). However, we would not read too much into this given the current competitive landscape in Oman. We would actually argue that Oman Cement would deserve to trade at a premium to Raysut Cement, given the latter's direct exposure to the UAE, and the lack of visibility over its sizeable export sales.

Oman Cement

Our valuation of Oman Cement is as follows.

Figure 4 Oman Cement Valuation

Valuation Method	Value (RO)	Weight
Discounted cash flow	0.629	80%
Peer comparison	0.727	20%
Weighted average fair value	0.648	100%

Source: NBK Capital Research

Our DCF assumptions are as follows.

Figure 5 Oman Cement DCF

Figures in RO Thousands*	Forecast					
Fiscal Year Ends December	2011	2012	2013	2014	2015	2016
Net Operating Profit After Tax	18,466	14,878	17,081	17,166	17,781	17,579
Add: Depreciation and Amortization	3,580	4,306	4,436	4,514	4,566	4,618
Gross Cash Flow	22,045	19,185	21,518	21,680	22,347	22,197
(Increase)/ Decrease in Working Capital	36	(1,066)	(753)	(170)	(566)	(107)
(Incr.)/ Decrease in Operating Fixed Assets	(3,684)	(10,000)	(5,000)	(3,000)	(2,000)	(2,000)
Free Cash Flow from Operations	18,397	8,119	15,765	18,511	19,781	20,090
Terminal Value						160,035
Value of Operations in 12 Months	160,391					
Add: Excess Cash	46,154					
Add: Value of Long-Term Investments	13,000					
Less: Total Debt	(11,458)					
Value of Equity in 12 Months	208,086					
Per Share Value in RO	0.629					

Source: NBK Capital Research

Our Fair Value for Oman Cement thus comes out at OMR 0.648 per share.

Raysut Cement

Our valuation for Raysut Cement is as follows.

Figure 6 Raysut Cement Valuation

Valuation Method	Value (RO)	Weight
Discounted cash flow	0.885	85%
Peer comparison	0.942	15%
Weighted average fair value	0.893	100%

Source: NBK Capital Research

Following the acquisition of Pioneer Cement, we have raised the Risk Level on Raysut Cement to 5. Our cost of equity has thus risen to 14%. We feel this is adequate in view of the lack of visibility on Pioneer Cement, Raysut Cement's export markets, as well as the supplementary gearing resulting from the Pioneer acquisition. Our DCF valuation for Raysut Cement is as follows.

Figure 7 Raysut Cement DCF

Figures in RO Thousand*	Forecast					
Fiscal Year Ends December	2011	2012	2013	2014	2015	2016
Net Operating Profit After Tax	15,637	18,234	21,628	23,623	23,811	24,503
Add: Depreciation and Amortization	7,819	8,124	8,382	8,617	8,825	9,040
Gross Cash Flow	23,456	26,358	30,010	32,240	32,636	33,543
(Increase)/ Decrease in Working Capital	(5,673)	(538)	(798)	(151)	(750)	(825)
(Incr.)/ Decrease in Operating Fixed Assets	(33,694)	(9,975)	(8,647)	(8,020)	(7,304)	(7,473)
Free Cash Flow from Operations	(15,911)	15,845	20,566	24,070	24,582	25,245
Terminal Value						244,521
Value of Operations in 12 Months	238,342					
Add: Excess Cash	-					
Add: Value of Long-Term Investments	4,500					
Add: Value of Other Long-Term Assets	2,500					
Less: Total Debt	(68,417)					
Less: Minority Interest	-					
Value of Equity in 12 Months	176,925					
Per Share Value in RO	0.885					

Source: NBK Capital Research

Our Fair Value for Raysut Cement thus stands at OMR 0.893 per share.

INVESTMENT CONCLUSION

Our preference goes to Oman Cement, which we rate as a Buy. We have a Reduce rating on Raysut Cement.

Essentially, we feel Raysut Cement has undertaken a very risky strategy, against the backdrop of a still very unfavorable market in Oman. We do not foresee any material improvement in the domestic UAE situation and therefore in the fortunes of Pioneer Cement. Visibility on Raysut Cement's exports remains very low, given the destination markets. Meanwhile, Raysut Cement has geared itself considerably, thereby raising its risk profile. Whilst we still expect a yield of 6.5% in FY2011, this is predicated on a payout ratio of 100%, which may prove optimistic.

In contrast, we feel Oman Cement's strategy for coping with the current situation is much more visible. The company can preserve both its market share and margins thanks to its second clinker production line. Though we expect Oman Cement's dividend yield to remain slightly depressed in FY2011, due to the on-going capex program, we expect the share will carry a higher dividend yield than Raysut Cement going forward, with much better visibility on the dividend forecasts.

FINANCIAL STATEMENTS - OMAN CEMENT

Income Statement (RO Thousands)	Historical		Forecast				
Fiscal Year Ends December	2009	2010	2011	2012	2013	2014	2015
Total Revenue	68,284	51,879	47,509	48,892	53,604	55,013	57,347
Cost of Revenue	39,009	25,662	24,785	24,628	26,401	27,443	28,932
Gross Profit	29,275	26,218	22,724	24,264	27,203	27,570	28,415
Selling/General/Admin. Expenses	2,314	2,796	2,713	3,079	3,383	3,573	3,668
Depreciation/Amortization	3,218	3,684	3,580	4,306	4,436	4,514	4,566
Operating Income	23,743	19,737	16,432	16,879	19,384	19,482	20,181
Interest Income (Exp), Net Non-Operating	(21)	(13)	(35)	(731)	(894)	(975)	(975)
Interest/Invest Income - Non-Operating	3,639	8,402	2,758	2,264	2,288	2,295	2,307
Net Income before Taxes	27,363	28,205	19,154	18,412	20,779	20,802	21,512
Provision for Income Taxes	3,131	3,167	2,203	2,209	2,493	2,496	2,581
Net Income after Taxes	24,232	25,038	16,952	16,202	18,285	18,306	18,931
Net Income after minority interest	24,232	25,038	16,952	16,202	18,285	18,306	18,931

Balance Sheet (RO Thousands)	Historical		Forecast				
Fiscal Year Ends December	2009	2010	2011	2012	2013	2014	2015
ASSETS							
Cash and Short-Term Investments	4,407	19,974	46,507	50,043	58,406	64,413	71,732
Total Receivables, Net	5,140	5,589	5,589	5,378	5,896	5,914	6,308
Total Inventory	7,687	9,427	9,427	7,823	8,577	8,802	9,175
Other Current Assets	6,953	5,525	4,500	4,500	4,500	4,500	4,500
Total Current Assets	24,187	40,515	66,023	67,744	77,379	83,629	91,716
Property/Plant/Equipment, Total - Net	91,793	99,502	99,607	105,301	105,864	104,350	101,784
Long-Term Investments	19,108	15,229	13,000	13,000	13,000	13,000	13,000
TOTAL ASSETS	157,438	173,086	178,631	186,045	196,244	200,979	206,499

LIABILITIES & EQUITY

Accounts Payable	4,889	7,708	7,708	4,889	5,360	5,501	5,735
Other Liabilities	3,262	3,410	2,203	2,209	2,493	2,496	2,581
Total Current Liabilities	8,451	12,596	9,911	7,099	7,854	7,998	8,316
Long-Term Debt	3,721	5,871	10,000	12,500	15,000	15,000	15,000
Other Liabilities	1,627	1,637	1,607	1,607	1,607	1,607	1,607
Total Liabilities	17,591	23,761	25,401	25,089	28,344	28,488	28,806
Total Equity	135,938	148,520	153,230	160,956	167,900	172,492	177,693
TOTAL LIABILITIES AND EQUITY	153,529	172,281	178,631	186,045	196,244	200,979	206,499

Cash Flow (RO Thousands)	Historical		Forecast				
Fiscal Year Ends December	2009	2010	2011	2012	2013	2014	2015
Cash from Operating Activities	34,019	27,662	21,863	18,188	21,001	21,581	21,898
Cash from Investing Activities	(32,215)	(17,909)	20,341	(8,044)	(3,024)	(1,018)	(8)
Cash from Financing Activities	(4,109)	(8,947)	(9,621)	(6,607)	(9,614)	(14,556)	(14,571)
Net Change in Cash	(2,304)	807	32,582	3,536	8,363	6,007	7,319

Sources: Company financial statements and NBK Capital

FINANCIAL STATEMENTS - RAYSUT CEMENT

Income Statement (RO Thousand)	Historical		Forecast				
Fiscal Year Ends December	2009	2010	2011	2012	2013	2014	2015
Total Revenue	89,346	64,978	81,493	81,907	87,696	90,730	91,954
Cost of Revenue	56,548	37,361	53,596	52,970	55,003	55,540	56,208
Gross Profit	32,798	27,617	27,896	28,936	32,693	35,190	35,746
Selling/General/Admin. Expenses	583	618	1,197	1,177	1,217	1,211	1,201
Depreciation/Amortization	4,447	4,375	7,819	8,124	8,382	8,617	8,825
Operating Income	27,768	22,623	18,881	19,635	23,094	25,362	25,720
Interest Income (Exp), Net Non-Operating	2,351	425	(2,737)	(2,737)	(3,079)	(3,421)	(3,421)
Net Income before Taxes	32,029	23,533	16,205	16,959	20,115	22,079	22,439
Provision for Income Taxes	3,347	2,811	1,401	1,466	1,739	1,909	1,940
Net Income after Taxes	28,682	20,722	14,804	15,493	18,376	20,170	20,499
Minority Interest	0	0	0	0	0	0	0
Net Income	28,682	20,722	14,804	15,493	18,376	20,170	20,499

Balance Sheet (RO Thousand)	Historical		Forecast				
Fiscal Year Ends December	2009	2010	2011	2012	2013	2014	2015
ASSETS							
Cash and Short-Term Investments	15,821	16,738	49,756	48,142	50,524	53,086	54,279
Total Receivables, Net	8,617	7,304	12,224	12,286	13,154	13,610	13,793
Total Inventory	12,284	12,025	16,299	16,381	16,662	16,331	16,552
Prepaid Expenses	4,530	3,229	3,260	3,276	3,508	3,629	3,678
Other Current Assets	4,527	5,108	5,000	5,000	5,000	5,000	5,000
Total Current Assets	45,779	44,404	86,538	85,085	88,848	91,656	93,302
Property/Plant/Equipment, Total - Net	74,951	79,638	105,513	107,364	107,629	107,032	105,510
TOTAL ASSETS	123,337	191,572	192,051	192,449	196,477	198,688	198,812

LIABILITIES & EQUITY

Accounts Payable	1,625	1,689	5,704	5,733	6,139	6,351	6,437
Payable/Accrued	2,607	2,582	3,000	2,500	2,000	1,500	1,000
Accrued Expenses	2,954	5,015	9,779	9,829	10,524	10,888	11,034
Short-Term Debt	1,324	14,289	34,226	34,226	34,226	34,226	34,226
Other Liabilities	3,298	3,081	1,401	1,466	1,739	1,909	1,940
Total Current Liabilities	11,808	26,656	54,110	53,754	54,627	54,873	54,637
Long-Term Debt	1,367	54,128	34,192	34,192	34,192	34,192	34,192
Deffered Income Tax	3,245	3,244	1,401	1,466	1,739	1,909	1,940
Other Liabilities	181	86	86	86	86	86	86
Total Liabilities	16,601	84,114	89,788	89,498	90,643	91,059	90,854
Total Equity	106,736	107,459	102,263	102,952	105,834	107,629	107,958
TOTAL LIABILITIES AND EQUITY	123,337	191,572	192,051	192,449	196,477	198,688	198,812

Cash Flow (RO Thousand)	Historical		Forecast				
Fiscal Year Ends December	2009	2010	2011	2012	2013	2014	2015
Cash from Operating Activities	25,703	28,985	21,858	25,841	29,502	32,241	31,947
Cash from Investing Activities	(3,494)	(75,690)	33,897	(9,914)	(8,548)	(7,882)	(7,164)
Cash from Financing Activities	(22,145)	45,622	(22,737)	(17,541)	(18,572)	(21,797)	(23,591)
Net Change in Cash	64	(1,083)	33,018	(1,614)	2,382	2,562	1,192

Sources: Company financial statements and NBK Capital

RISK AND RECOMMENDATION GUIDE

RECOMMENDATION			UPSIDE (DOWNSIDE) POTENTIAL	
BUY			MORE THAN 20%	
ACCUMULATE			BETWEEN 5% AND 20%	
HOLD			BETWEEN -10% AND 5%	
REDUCE			BETWEEN -25% AND -10%	
SELL			LESS THAN -25%	
RISK LEVEL				
LOW RISK			HIGH RISK	
1	2	3	4	5

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