



Initiation Coverage

March 16, 2018

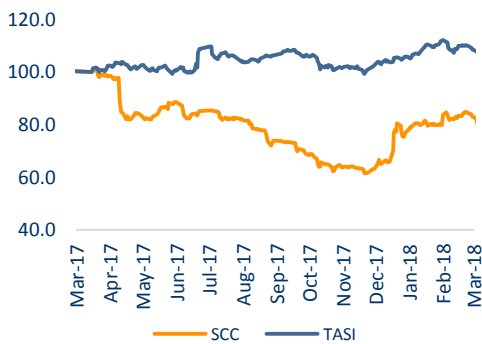
Recommendation	Neutral
Current Price (SAR)	51.8
Target Price (SAR)	52.1
Upside/Downside (%)	0.6%

As of March 13, 2018

Key Data (Source: Bloomberg)

Market Cap (SAR bn)	7.9
52 Wk High (SAR)	62.5
52 Wk Low (SAR)	37.2
Total Outstanding shares (in mn)	153.0
Free Float (%)	89.1%

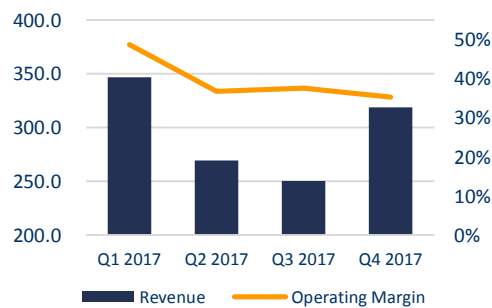
SCC Vs TASI (Rebased)



Price Performance (%)	Absolute	Relative
1m	3.1%	0.2%
6m	17.8%	13.0%
12m	(13.9%)	(26.9%)

Major Shareholders (%)	%
Khaled Abdulrahman Saleh Al Rajhi	8.02
General Retirement Organization	5.62
General Organization for Social Insurance	5.22

Quarterly Sales (SAR mn) and Operating Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 14th March 2018

Saudi Cement Company (SCC) reported upbeat Q4 2017 results, on both revenue and net profits, broadly in-line with market expectations. SCC reported a net profit of SAR107mn (-42% Y/Y, +23% Q/Q), while gross margins fell to 44% in 4Q17 from 56% in 4Q16, weighed down by higher blended costs per ton. SCC restricted its production due to its high inventory levels, resulting in higher costs. For FY 2017, revenue dropped 33.4% YoY to SAR 1,184.5mn, and net income almost halved to SAR 453mn due to higher costs, drop in share of net results of associates, and other income. SCC's capacity utilization declined by 37.6 ppt in 2017 due to production cuts.

Strong market position and an attractive dividend yield are key positives for SCC. The industry is faced with slowdown in demand, excess supply, subsidy removal on HFO fuel and regional instability which will pressurize prices and squeeze margins. Few signs of demand revival visible, following an expansionary 2018 budget, announcement of big-ticket projects (USD 500bn NEOM city), and removal of export tariffs, however, long term sustainability is yet to be achieved. We recommend a neutral rating with a target price of SAR 52.1.

Moderate recovery in demand expected in regional and international markets

SCC is the one of the leading cement player in KSA, with a strong market share of ~11%. SCC is strategically located in the Eastern Region, giving it access to key markets of Jubail which has major ongoing projects composed of 100 industrial plants, desalination plant, roads, railways and oil refinery which will bolster regional cement demand. Internationally, SCC stands to benefit from the waiver of the export fees since February 2018 as they would be able to resume exports to Bahrain (historically 6-7% of its total dispatches). The exports dipped to 1.9% of dispatches in 2017 as Bahrain stopped imports from KSA due to higher prices.

High dividend pay-outs makes SCC a good investment bet

SCC declared a dividend pay-out of SAR 612mn for 2017, implying a high dividend yield of 10.5%, despite a 45.3% YoY decline in free cash flows in 2017. We expect dividend pay-outs to remain attractive (in line with more than 100% of the net income pay-outs over the past four years), in spite of a tough operating environment, which have ensured investor confidence in the company. SCC currently trades at SAR1,014 EV/ton, which is one of the highest in the sector and close to double its regional peer, Eastern Cement (SAR520 EV/ton). Whilst the valuation may look expensive, it is supported by efficient capital utilisation as demonstrated by its superior margins and higher 16%RoE (2018E).

Expansionary budget offers some relief, still uncertainties prevail

We expect moderate recovery in cement demand post the announcement of an increase in capital spending (SAR 205bn in 2018 budget). The volatility in oil prices may pressurize the government finances; therefore we maintain a cautious stance on demand revival. Also, SCC's high inventory levels (highest in the sector at 4.8mn tons) would keep check on realized prices.

Fuel subsidy removal to pressurize margins in near term

The first phase of government subsidy reforms which started in 2016 was partially responsible for the decline in company's margins (SCC's operating margin declined by 12 ppt to 40% in FY 2017). The second phase will commence in 2019 which will increase the prices of HFO fuel used in cement production, and hence impact the operating margins of the company.

Valuation: We valued SCC using the DCF Approach to arrive at a fair value of SAR 52.1 per share. We considered WACC at 9.3%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E
Revenues (SAR bn)	1.2	1.3	1.4	1.4
Operating Profit (SAR bn)	0.5	0.5	0.5	0.5
EPS (SAR)	3.0	3.0	3.1	3.1
Operating Margin (%)	40.0%	37.3%	35.9%	34.8%
D/E (x)	0.2	0.2	0.2	0.2
RoE (%)	15.8%	15.7%	16.0%	16.1%
P/E (x)	16.0	17.0	16.6	16.3
Price/BV (x)	2.5	2.7	2.6	2.6
EV/EBITDA (x)	11.3	12.1	11.0	10.6

Source: Company Financials, FALCOM Research

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Valuation Summary

Explanation of valuation methodology and assumptions

We valued SCC using the DCF Approach to arrive at a fair value of SAR 52.1 per share. We considered WACC at 9.3% with a terminal growth rate of 2.0%. In relative terms, SCC is trading at 1yr forward PE of 15.2x, at a discount of 22.7% to its sector peers and a premium of 5.8% over the Tadawul All Share Index.

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E	
EBIT	474	477	490	498	508	
Taxes	(12)	(12)	(12)	(12)	(12)	
Depreciation, amortization and impairment	208	189	228	229	231	
Changes in working capital	(45)	(54)	(51)	(29)	(22)	
Net capital expenditure	(51)	(51)	(55)	(57)	(60)	
Free Cash Flow to firm	575	549	600	629	645	
Discount Factor		0.9	0.9	0.8	0.7	
PV of free cash flow to firm		512	511	490	460	
Net Present Value (A)					1,974	
Terminal Value					9,008	
PV Terminal Value (B)					6,428	
Assumed Terminal Growth Rate					2.0%	
Discount Rate					9.3%	
Enterprise Value (A+B)	8,402	WACC Assumptions				
Total Cash	120	Risk free rate				2.9%
Total Debt	550	Equity Risk Premium				8.7%
Minority Interest	-	Beta				0.9x
Equity Value in SAR mn	7,972	Cost of equity				10.5%
Number of shares in mn	153	Post tax cost of debt				2.7%
Target Price in SAR per share	52.1	Weight of equity in capital structure				84.0%
CMP in SAR as on March 13th, 2018	51.8	Weight of debt in capital structure				16.0%
Upside/(Downside) to current market price	0.6%	WACC				9.3%

Source: Company Financials, FALCOM ResearchEstimates

Risks

Upside Risks:

- Earlier-than expected execution of big ticket infrastructure projects in the pipeline.
- Prudent inventory management could exert less pressure on prices and margins as expected.

Downside Risks

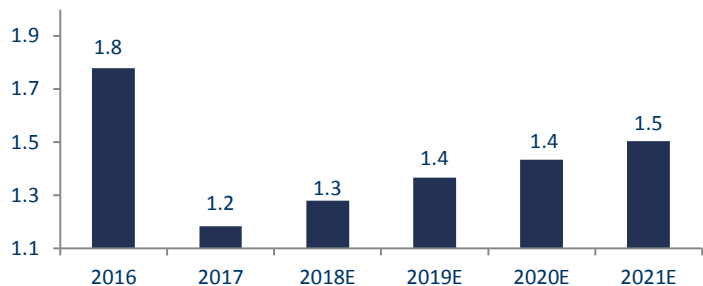
- Deterioration of the geo political tensions in the Middle East and restrictive trade policies could affect sales.
- KSA government granted 37 export licenses to cement companies post lifting the ban on cement exports in 2016. Intense competition in export markets could affect SCC's export sales and margins.

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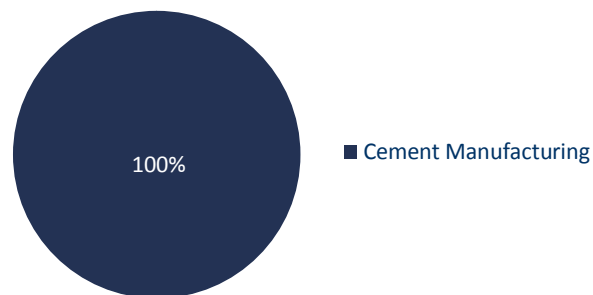
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Key Charts

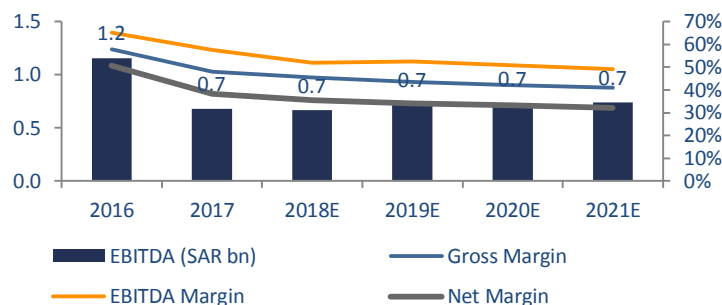
Revenue (SARbn)



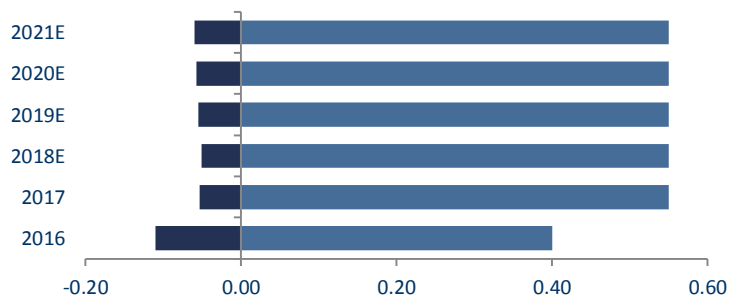
Revenue Split (2017)



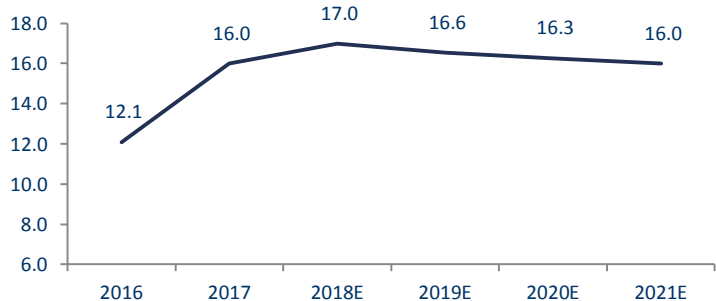
EBITDA & Margins



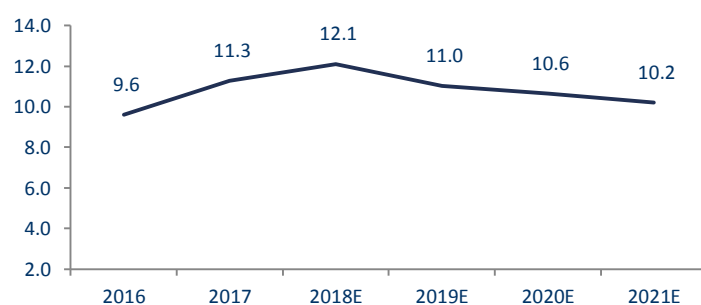
CAPEX and Debt



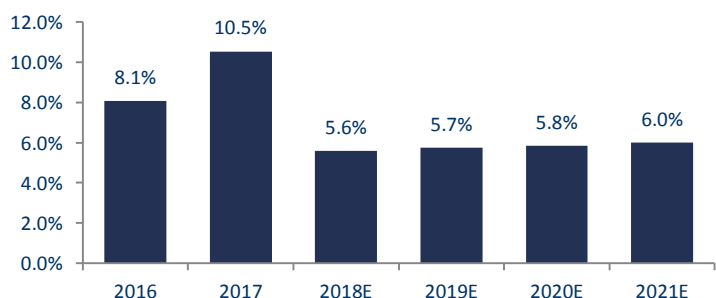
Price to Earnings



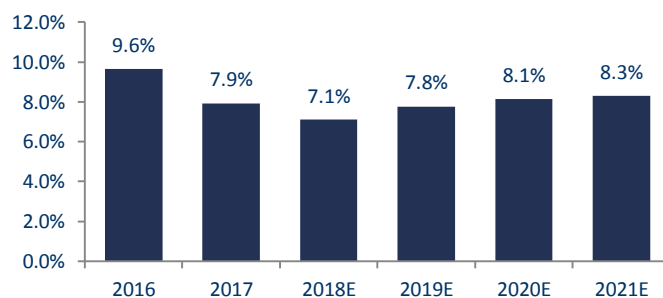
EV/EBITDA



Dividend Yield



Free Cash Flow Yield



Source: FALCOM Research Estimates



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Summary Financials

P&L (SAR mn)	2017	2018E	2019E	2020E
Revenue	1,185	1,279	1,366	1,434
Gross Profit	569	581	596	605
EBITDA	682	666	718	728
EBIT	474	477	490	498
Earnings from Associates	1	1	1	1
Net Interest	(13)	(15)	(15)	(15)
Other	3	3	3	3
PBT	465	467	479	488
Minorities	-	-	-	-
Zakat	(12)	(12)	(12)	(12)
Net Income	453	455	467	476
EPS	3.0	3.0	3.1	3.1
DPS	5.0	2.8	2.9	3.0

BS (SAR mn)	2017	2018E	2019E	2020E
Cash	120	227	373	541
Current Assets (excluding cash)	1,016	1,086	1,153	1,196
Fixed Assets	2,740	2,602	2,429	2,257
Intangibles	-	-	-	-
Investments in associates and JVs	60	59	57	56
Total Assets	3,936	3,975	4,013	4,051
Current Liabilities	429	445	460	474
Short Term Debt	550	550	550	550
Long Term Debt	-	-	-	-
Shareholders Equities	2,878	2,901	2,924	2,948
Total Liabilities	3,936	3,975	4,013	4,051

CF (SAR mn)	2017	2018E	2019E	2020E
Cash Flow from Operating Activities	603	588	642	674
Capex	53	51	55	57
Cash Flow from Investing Activities	(52)	(49)	(52)	(55)
Changes in Debt	150	-	-	-
Dividends	765	432	444	452
Cash Flow from Financing Activities	(615)	(432)	(444)	(452)

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Revenue	(33.4%)	8.0%	6.8%	5.0%
EBITDA	(41.1%)	(2.3%)	7.7%	1.4%
Operating profit	(49.2%)	0.8%	2.6%	1.8%
PBT	(49.7%)	0.4%	2.6%	1.8%
Net Income	(49.7%)	0.4%	2.6%	1.8%

Ratios (%)	2017	2018E	2019E	2020E
Gross Margin	48.0%	45.4%	43.6%	42.2%
EBITDA Margin	57.6%	52.1%	52.5%	50.8%
EBIT Margin	40.0%	37.3%	35.9%	34.8%
Net Margin	38.3%	35.6%	34.2%	33.2%
ROE	15.8%	15.7%	16.0%	16.1%
ROCE	16.0%	16.0%	16.3%	16.5%
ROA	11.5%	11.5%	11.6%	11.7%
Debt/Equity	0.2	0.2	0.2	0.2
Net Debt/EBITDA	0.6	0.5	0.2	0.0
FCF Yield	7.9%	7.1%	7.8%	8.1%
Dividend Yield	10.5%	5.6%	5.7%	5.8%

Valuation	2017	2018E	2019E	2020E
PE	16.0x	17.0x	16.6x	16.3x
PB	2.5x	2.7x	2.6x	2.6x
EV/EBITDA	11.3x	12.1x	11.0x	10.6x
EV/EBIT	16.2x	16.9x	16.2x	15.5x
EV/Sales	6.5x	6.3x	5.8x	5.4x

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Saudi Cement Co.	15.2x	12.1x
Southern Province Cement Co.	19.9x	13.9x
Yanbu Cement Co.	17.8x	10.7x
Arabian Cement	21.9x	8.5x
Yamama Cement Co.	20.7x	10.3x
Qassim Cement Co.	17.5x	9.5x
Eastern Province Cement Co.	19.4x	9.6x
Sector Median	19.7x	9.9x
TASI	14.4x	10.8x

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FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by $\geq 10\%$.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by $\geq 10\%$.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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