ميفك كابيتال
MEFIC Capital

CEMENT SECTOR QUARTERLY REVIEW

September 2018

Quarterly Review of Cement Sector in Saudi Arabia

Tel: +966 11 218 6666 | Fax: +966 11 218 6668 | Toll Free Number: 800-12-63342 | 7758 King Fahad Road-Office 1
Riyadh 4187-12333 Saudi Arabia | www.mefic.com.sa | CMA License Number: 06029-37
CR: 1010237038 | CCR: 184700 @mefic MEFIC MEFIC Capital

Executive Summary

The key highlights of Saudi Cement Sector are:

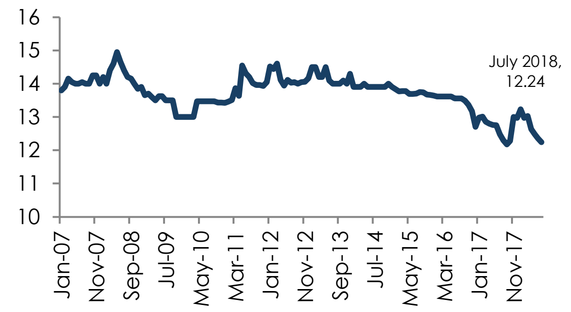
- Cement sales in Saudi Arabia dropped 12.8% YoY to 28.0 million tons during the first eight months of 2018, compared to 32.1 million tons during the same period in 2017.
- Clinker production, on the other hand, fell only 6.1% YoY to 31.6 million tons during the first eight months of 2018, compared to 33.7 million tons during the same period in 2017. This has led to build-up in inventories to record levels across cement producers in KSA, which stood at an all-time high of 39.7 million tons in August 2018.
- Cement prices fell to SAR 12.24 per 50 kg bag in July 2018, the second-lowest monthly figure since January 2007.
- One of the major dampeners of cement demand was lower government spending on infrastructure sector during the first half of 2018, coupled with lower credit exposure to construction activity amid rising interest rates.
- Cement exports slowly started to pick up after the Saudi government scrapped export duties on cement in February 2018, after having reduced it by 50% in July 2017. During the first eight months of 2018, exports volume increased 249% YoY to 568 thousand tons.
- Cement companies from Northern and Eastern region have improved their market share in this year, helped by the start of the initial stages of the NEOM megacity project and scrapping of export duties respectively.
- After a difficult Q1 2018, cement companies continued their subdued performance with even weaker earnings in Q2 2018, posting an aggregate net loss of SAR 54.2 million (-112.2% YoY), with significant decline in operating margins as well.
- We remain cautious on the sector, with weak demand weighing down on cement prices and clinker inventory at all-time high. However, we expect a moderate recovery during the second half of 2018, backed by higher government spending on infrastructure, exports picking up and new construction work starting in USD 500 billion NEOM Mega City project.

Cement Sector Review: Demand—Supply Trends

Cement sales volumes and prices decline in 2018, as inventories rise to all-time high

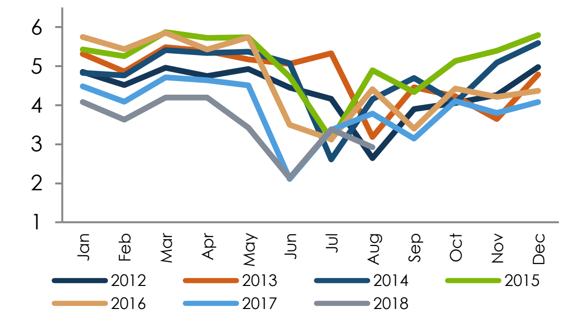
Cement sales in Saudi Arabia dropped 12.8% YoY to 28.0 million tons during the first eight months of 2018, compared to 32.1 million tons during the same period in 2017. As evident from Figure 2, sales volumes in in 2017 were already at a low base compared to the previous five years, and were down 18.2% YoY compared to 39.2 million tons during the same period in 2016.

Figure 1: Cement Prices (SAR, 50kg)



Source: General Authority of Statistics

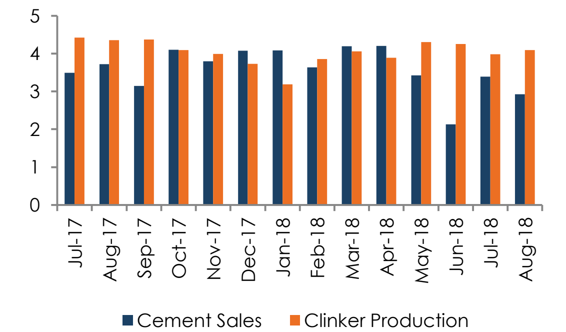
Figure 2: Cement Sales (Mn tons)



Source: Yamama Cement

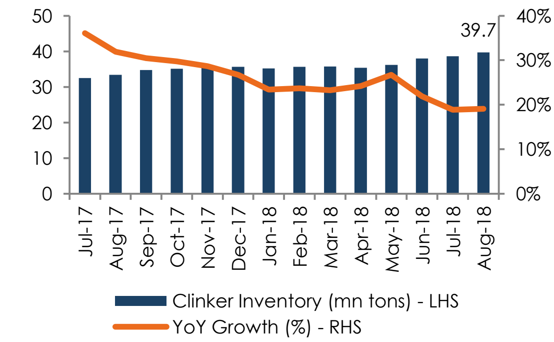
Clinker production, on the other hand, fell only 6.1% YoY to 31.6 million tons during the first eight months of 2018, compared to 33.7 million tons during the same period in 2017. This has led to build-up in inventories to record levels across cement producers in KSA, which stood at an all-time high of 39.7 million tons in August 2018. Due to sales falling amidst weakened demand, and inventories piling up, cement prices fell to SAR 12.24 per 50 kg bag in July 2018, the second-lowest monthly figure since January 2007 (The lowest was reached in September 2017 at SAR 12.18). One silver lining is that inventories are rising at a slower rate in last three months (June, July and August) compared to the start of the year 2018, with YoY growth of 21.9%, 18.9% and 19.1% during June, July and August respectively, compared to the average of 24.2% over the first five months.

Figure 3: Cement Sales vs Clinker Production (mn tons)



Source: Yamama Cement

Figure 4: Monthly Changes in Clinker Inventory (mn tons) vs YoY Growth (%)



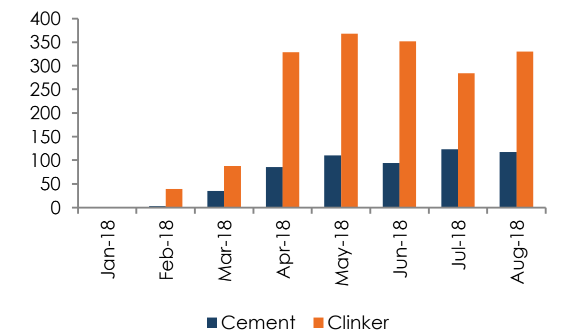
Source: Yamama Cement

Cement exports pick up after removal of export duty

There were no exports of cement from Saudi cement companies during the period of May 2017 to January 2018. Cement exports slowly started to pick up after the Saudi government scrapped export duties on cement in February 2018, after having reduced it by 50% in July 2017. During the first eight months of 2018, exports volume increased 249% YoY to 568 thousand tons.

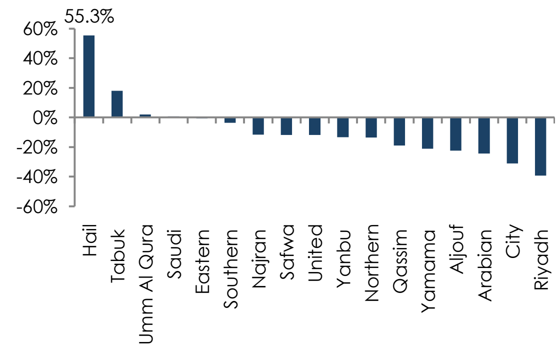
In terms of overall sales, majority of the cement companies saw their volumes decline on YoY basis during first eight months of 2018. Hail Cement posted the highest YoY growth of 55.3% during this period. Other companies which posted growth in volumes were Tabuk, Umm Al Qura and Saudi Cement, which saw volume growth of 18.1%, 1.9% and 0.6% YoY respectively.

Figure 5: Cement and Clinker Exports Volume ('000 tons)



Source: Yamama Cement

Figure 6: 2018 YTD Sales Volume change – Company wise (YoY %)

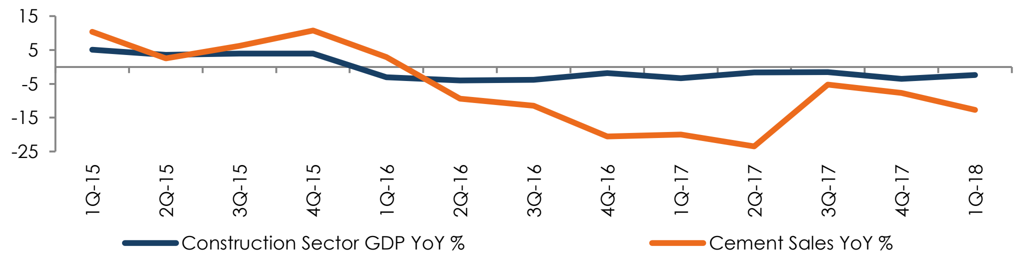


Source: Yamama Cement

Lower infrastructure spending by the government, bank credit weigh down on construction activity

One of the major dampeners of cement demand was government spending on infrastructure sector, which has remained lower so far this year, compared to the spending on other sectors. Infrastructure & Transportation remains one of the most underspent sectors as per H1 2018 budget figures, with only 22% of the total annual budgeted expenditure for the sector utilized so far. With the pace of new construction reducing, and higher interest rates, major banks' credit exposure to Building & Construction sector also decreased 5.1% YoY during the first half of 2018, contributing to lower demand for cement. With construction activity subdued, the total value of real estate transactions from January to July 2018 has declined 32% YoY to SAR 65.8 bn, compared to SAR 97.2 bn during the same period in the previous year. Figure 7 shows the relationship between quarterly GDP growth in construction sector and quarterly cement sales volume growth. It can be seen that both have slipped into negative territory since Q1 2016.

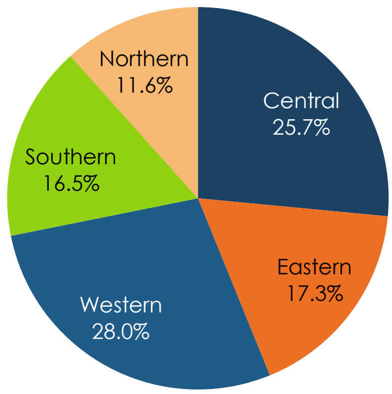
Figure 7: Construction Sector GDP Growth vs. Quarterly Cement Sales Volume (YoY %)



Source: Yamama Cement

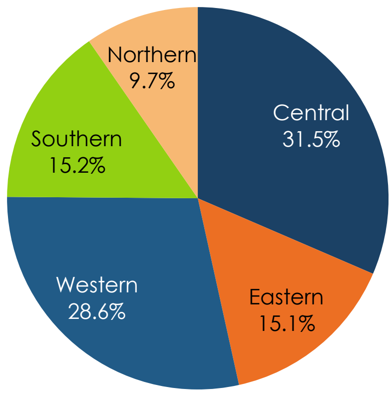
Northern and Eastern regions gain market share

Figure 8: Region-wise Market Share: January—August 2018



Source: Yamama Cement

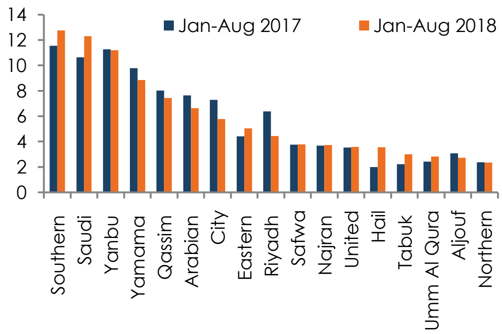
Figure 9: Region-wise Market Share: January—August 2017



Source: Yamama Cement

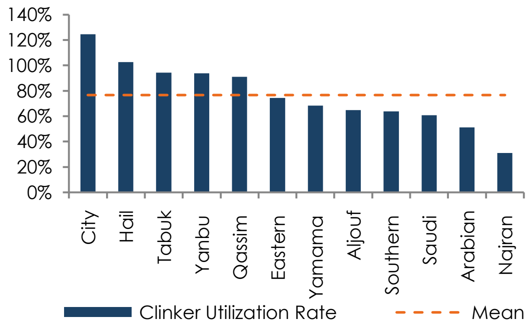
During the first eight months of 2018, cement companies from **Northern** (Tabuk, Northern Cement, Al Jouf & Hail) and **Eastern** (Saudi Cement, Eastern Cement) regions improved their collective market share to 11.6% and 16.5% respectively, from 9.7% and 15.1% during the year-earlier period. Companies in eastern region particularly benefitted from the scrapping of export duties, with export volumes increasing almost threefold over the year-earlier period. Bahrain resumed importing cement from Saudi Arabia during Q2 2018. Bahrain remains one of the most preferred export destinations for Saudi cement companies, as shipping takes only about 36 hours as compared to 5 days for the UAE. On the other hand, northern region benefitted from the start of the initial stages of the NEOM megacity project.

Figure 10: Company wise market share (%)



Source: Yamama Cement

Figure 11: Company wise clinker utilization rates (TTM %)



Source: Yamama Cement, Company Reports

In terms of company-wise market share (See Figure 10), the top three companies were Southern Cement, Saudi Cement and Yanbu Cement, which commanded a market share of 12.8%, 12.3% and 11.2% respectively in the first eight months of 2018.
In terms of operational efficiency (See Figure 11), the average capacity utilization rate across the sector was 77% during the last 12 months (September 2017 to August 2018). City Cement had the highest capacity utilization of 125%, followed by Hail Cement at 103%.

Comparative Performance and Valuations of Key Saudi Cement Companies

Latest (Q2 2018) Earnings Performance: Another subdued quarter

Table 1: Saudi Listed Cement Companies – Quarterly Earnings performance (sorted by YoY Growth)

Company	2Q18 PAT (SAR mn)	YoY %	QoQ %	2Q18 Operating Margin %	2Q17 Operating Margin %	Change in Operating margin (bps)
City Cement	9.9	-20.0	-60.3	17.1	11.6	558
Saudi Cement	58.0	-38.2	-59.2	26.1	36.8	-1068
Eastern Cement	18.8	-46.5	13.8	13.6	17.6	-400
Southern Cement	36.1	-62.0	-64.6	22.4	36.6	-1420
Qassim Cement	18.4	-65.5	-67.9	17.7	36.3	-1854
Yanbu Cement	4.7	-94.2	-88.4	3.8	33.2	-2943
Umm Al Qura	0.2	-97.6	-98.0	17.7	35.9	-1821
Northern Cement	-6.7	-180.3	-557.5	4.6	18.7	-1412
Al Jouf Cement	-13.7	-230.2	-433.5	-44.2	22.0	-6620
Arabian Cement	-57.8	-266.6	-554.1	-48.4	15.8	-6424
Yamama Cement	-36.3	-397.9	-252.1	-26.4	7.8	-3426
Najran Cement	-31.7	-651.2	-211.8	-41.4	5.0	-4640
Hail Cement	-18.0	-776.9	-525.7	-44.5	12.0	-5654
Tabuk Cement	-36.1	-2896.4	-221.3	-50.7	5.9	-5660
Sector	**-54.2**	**-112.2**	**-113.7**	**1.0**	**23.9**	**-2296**

Source: Tadawul, Reuters Eikon, MEFIC Capital; Note: The rows are color-coded as per the company's region:

Western	Eastern	Central	Northern	Southern

After a difficult Q1 2018, cement companies continued their subdued performance with even weaker earnings in Q2 2018, posting an aggregate net loss of SAR 54.2 million (-112.2% YoY). All companies saw significant YoY fall in quarterly earnings, while half of the companies in the sector posting net losses. Operating margins also declined significantly in Q2 2018 as compared to year-earlier period, while six of the companies posted operating losses. City Cement (which has the least YoY fall of 20% in net profit) was the only company which was able to improve its operating margin, to 17.1% from 11.6% during year-earlier period.

Declining sales volumes and prices amid weak demand, high inventory levels and relatively lower capacity utilization rates have all contributed to weak earnings performance. Rise in fuel and electricity costs since the start of the year have also contributed to higher cost of production among other factors, as evident from the significant drop in operating margins. Valuations have been hit by weak operational and earnings performance, as prices of all listed cement stocks in Saudi Arabia have fallen significantly in 2018 so far, with average YTD decline being 25% (See Table 2). Most of the companies are currently trading close to 3-year low EV/EBITDA valuations.

Table 2: Saudi Listed Cement Companies – Price and Valuations (sorted by Market Cap)

Company	Mcap (SAR mn)	P/E (TTM)	EV/EBITDA (TTM)	P/B (TTM)	Price performance % (2018 YTD)
Saudi Cement	6,135	15.5	10.5	2.4	-15.5
Southern Cement	4,718	15.3	9.8	1.5	-30.4
Yanbu Cement	3,248	20.6	6.8	1.0	-39.0
Qassim Cement	2,934	15.1	8.9	1.8	-27.6
Yamama Cement	2,758	27.0	12.5	0.8	-22.7
Arabian Cement	1,926	27.5	6.0	0.7	-43.9
City Cement	1,826	23.4	7.1	0.9	-18.4
Eastern Cement	1,809	31.8	8.0	0.8	-20.3
Northern Cement	1,512	36.6	16.2	0.8	-21.3
Najran Cement	1,304	NA	26.4	0.7	-26.5
Al Jouf Cement	1,284	20.7	18.8	0.8	-10.8
Tabuk Cement	999	NA	18.0	0.9	-20.7
Hail Cement	756	NA	14.5	0.7	-22.0
Umm Al Qura	646	12.8	12.3	1.1	-30.2
Sector	**31,855**	**22.4***	**12.6***	**1.1***	**-24.9***

Source: Tadawul, Reuters Eikon, MEFIC Capital
*Note: Mcap & Valuation data as of September 17, 2018, *- Average of all listed cement companies*

Outlook

We remain cautious on the sector, with weak demand weighing down on cement prices and clinker inventory at all-time high. However, we expect a moderate recovery during the second half of 2018, if the construction activity rebounds backed by higher government spending in H2 2018 on infrastructure sector. Additionally, scrapping of export duties is expected to gradually help cement producers get rid of their excess stock. Moreover, cement companies in the north and the west regions are expected to be benefitted from new construction activity in USD 500 billion NEOM Mega City project.

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