



US\$0.907bn Market cap	63.6% Free float	US\$1.279mn Avg. daily volume
Target price	161.6	18.82% over current
Consensus price	162.3	19.34% over current
Current price	136.0	as at 25/7/2011

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Underweight **Neutral** **Overweight**

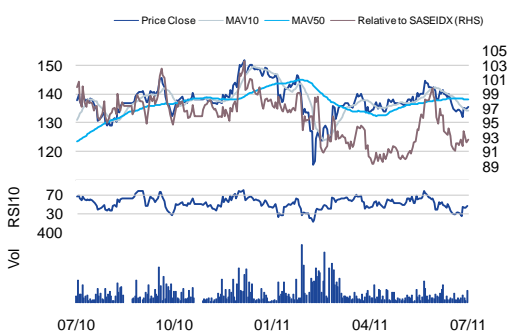
Key themes

Benefiting from robust growth in the Saudi construction market, we believe the ceramics manufacturing industry will continue to grow. Currently, Saudi Ceramics has a strong position in the Saudi market. We believe the strategy of expanding in ceramic tiles will increase the company's growth.

Implications

Saudi Ceramic Company is one of the leading ceramic manufacturing companies in the region. We believe the company will offer good growth in the near future. We also believe the expansions currently taking place coupled with improvements in margins will have a positive impact on the share price.

Performance



Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	1,080	1,222	1,399	1,618
Revenue Growth	12.7%	13.1%	14.5%	15.6%
EBITDA (mn)	318	367	416	477
EBITDA Growth	12.6%	15.5%	13.3%	14.7%
EPS	8.77	9.55	11.24	13.53
EPS Growth	11.2%	8.9%	17.6%	20.4%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Saudi Ceramics

steady growth maintained

Saudi Ceramics announced its Q2 results with strong top and bottom lines growth. Driven by strong tile sales, revenues grew by 15% y-o-y with explicit improvements in EBITDA margin. This fed through to a 13% increase in net profit. As for Q3, due to the seasonality nature of the business (the holy month of Ramadan in Q3), we believe Q3 results will be less interesting compared to the first half of this year. On the back of strong Q2 results, we've marginally revised our near-term forecasts. However, we maintain our target price of SAR161.6, implying 18.8% upside potential. We remain overweight.

Ceramic products driving sales: Saudi Ceramic's revenues grew by 15.4% y-o-y reaching SAR320.6mn, higher than our estimate of 13.7%. Ceramics segment sales grew more than 18% y-o-y while water heaters sales grew by only 4%, below our forecast of 7%. Saudi Ceramics does not disclose detailed breakdown of its segments; however, we suspect that tiles sales was the chief driver of ceramics segment's growth. As for the third quarter of this year, which coincides with the holy month of Ramadan, we expect sales to moderate. We estimate Q3 revenues to decline by 10.9% q-o-q but to grow by 12.1% y-o-y.

Margins of Ceramic tiles stable, heater's struggling: Gross margin of ceramics segment increased by 140bps while net margins remained stable. In contrast, water heaters witnessed a concerning decline in gross margin by 260bps compared to Q2 2010 and by 470 bps compared to Q1 2011, impacting heater's net margin which fell by 260bps y-o-y. We believe the increase in steel prices was the main reason behind this sharp decline. We have accordingly lowered our near term forecasts for water heaters' margins. That said, we believe aggregate margin will improve due to recent expansions in tiles segment (fourth ceramic tile plant), which carries higher margins.

Saudi Ceramics well positioned to grow further: Benefiting from the healthy growth in Saudi residential housing market, ceramics market in the kingdom is still growing. This has attracted GCC ceramic producers such as Ras Al Khaimah Ceramics to enter the market. This should intensify the competition in the Saudi market; however, we believe Saudi Ceramics is well positioned to capture more market share and continue growing. The company enjoys cost advantage over its GCC peers. Its backward integration model coupled with subsidized gas prices result in relatively low production costs and high efficiency. In addition, transportation and tax costs will be another burden on GCC companies.

Valuation and conclusion: In our view, Saudi Ceramics is well positioned to continue growing steadily. We also think that the company will expand its business channel with the government to benefit from the huge government expenditure. Q2 results were strong and supported our view on the company. While we have lowered our forecasts for water heaters segment, we have raised our estimates for ceramics segment. Nevertheless, we remain Overweight and maintain our target price of SAR161.6 which implies 18.8% upside potential. The stock is now trading on a P/E multiple of 14.2x and EV/EBITDA of 11.1. We further note that we expect Saudi Ceramics Company to increase its dividends of this year to SAR4.0 per share (2010 dividends: SAR3.5 per share).



Corporate summary

Saudi Ceramic Company is one of the oldest and leading ceramics producers in the Middle East with a market value of around SAR3.4bn. The company manufactures and markets ceramic products such as ceramic tiles, sanitary ware (bathroom products) and road markers; in addition, the company manufactures water heaters. The company intends to launch production of red bricks by 2012.

Share information

Market cap (SAR/US\$) 3.400bn / 0.907bn
52-week range 115.5 - 151.8
Daily avg volume (US\$) 1.279mn
Shares outstanding 25.00mn
Free float (est) 63.6%

Performance: 1M 3M 12M
Absolute -1.6% 1.1% -1.3%
Relative to index -1.8% 4.3% -6.1%

Major Shareholder:
General Social Insurance 15.9%
Saleh Abdulaziz Al Rajhi 14.3%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	1,080	1,222	1,399	1,618
EBITDA (SARmn)	318	367	416	477
Net Profit (SARmn)	219	239	281	338
EPS (SAR)	8.77	9.55	11.24	13.53
DPS (SAR)	3.50	4.00	4.50	5.55
EPS Growth	11.2%	8.9%	17.6%	20.4%
EV/EBITDA (x)	12.4	11.1	9.6	8.2
P/E (x)	15.5	14.2	12.1	10.0
P/B (x)	3.4	2.9	2.5	2.2
Dividend Yield	2.6%	3.0%	3.3%	4.1%

Source: Company data, Al Rajhi Capital

Figure 1. Saudi Ceramics: Q2 & Q3 results (actual & estimates)

SAR (mn)	2010Q2A	2011Q2E	2011Q2A	Y-Y%	2010Q3A	2011Q3E	Y-Y%
Ceramics revenue	221	254	261	18.3%	202	231	14.3%
Heaters revenue	57	61	59	4.1%	53	55	3.7%
Total revenues	278	316	321	15.4%	255	286	12.1%
Gross profit	99	112	118	19.0%	90	104	15.1%
Gross margin %	35.6%	35.4%	36.7%		35.4%	36.3%	
EBITDA	83	92	101	21.1%	71	82	16.2%
EBITDA margin %	29.9%	29.0%	31.4%		27.7%	28.7%	
Net profit	58	63	65	13.0%	46	53	15.0%
net margin %	20.8%	19.9%	20.4%		18.1%	18.6%	

Source: Company data, Al Rajhi Capital



We expect revenue to reach SAR1.2bn SAR this year

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	958	1,080	1,222	1,399	1,618
Cost of Goods Sold	(605)	(688)	(776)	(883)	(1,015)
Gross Profit	352	392	446	516	602
Government Charges					
S.G. & A. Costs	(156)	(171)	(194)	(213)	(246)
Operating EBIT	197	221	251	303	357
Cash Operating Costs	(675)	(762)	(854)	(983)	(1,141)
EBITDA	282	318	367	416	477
Depreciation and Amortisation	(86)	(97)	(116)	(113)	(121)
Operating Profit	197	221	251	303	357
Net financing income/(costs)	4	5	(5)	(14)	(10)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income					
Other Expenses					
Net Profit Before Taxes	200	226	246	290	347
Taxes	(3)	(6)	(7)	(9)	(9)
Minority Interests					
Net profit available to shareholders	197	219	239	281	338
Dividends	(75)	(88)	(100)	(113)	(139)
Transfer to Capital Reserve					

We expect SCC to maintain its SAR0.5 increase in dividend

	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	25.00	25.00	25.00	25.00	25.00
CFPS (SAR)	11.32	12.65	14.20	15.75	18.35
EPS (SAR)	7.89	8.77	9.55	11.24	13.53
DPS (SAR)	3.00	3.50	4.00	4.50	5.55

Growth in tiles is likely to improve margins

Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth	11.7%	12.7%	13.1%	14.5%	15.6%
Gross Profit Growth	10.0%	11.3%	13.6%	15.8%	16.7%
EBITDA Growth	8.9%	12.6%	15.5%	13.3%	14.7%
Operating Profit Growth	7.6%	12.3%	13.6%	20.8%	17.6%
Net Profit Growth	10.8%	11.2%	8.9%	17.6%	20.4%
EPS Growth	10.8%	11.2%	8.9%	17.6%	20.4%

Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin	36.8%	36.3%	36.5%	36.9%	37.2%
EBITDA margin	29.5%	29.4%	30.1%	29.7%	29.5%
Operating Margin	20.5%	20.5%	20.6%	21.7%	22.0%
Pretax profit margin	20.9%	20.9%	20.2%	20.7%	21.4%
Net profit margin	20.6%	20.3%	19.6%	20.1%	20.9%

Saudi Ceramics is trading on a 2011 PE of 14.2x

Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	15.5%	15.4%	15.3%	16.6%	17.5%
ROIC	14.6%	14.7%	14.4%	15.0%	17.1%
ROE	24.9%	23.6%	22.1%	22.6%	23.5%
Effective Tax Rate	1.5%	2.8%	3.0%	3.0%	2.5%
Capex/Sales	28.0%	16.6%	18.5%	17.9%	16.0%
Dividend Payout Ratio	38.0%	39.9%	41.9%	40.0%	41.0%

Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	17.2	15.5	14.2	12.1	10.0
P/CF (x)	12.0	10.7	9.5	8.6	7.4
P/B (x)	3.9	3.4	2.9	2.5	2.2
EV/Sales (x)	4.0	3.7	3.3	2.8	2.4
EV/EBITDA (x)	13.5	12.4	11.1	9.6	8.2
EV/EBIT (x)	19.4	17.9	16.3	13.1	11.0
EV/IC (x)	2.6	2.3	2.1	2.0	1.8
Dividend Yield	2.2%	2.6%	3.0%	3.3%	4.1%

Source: Company data, Al Rajhi Capital



As a result of recent expansions, Saudi Ceramics' balance sheet is expanding

Gearing measures are at healthy levels

We expect Capex to reach SAR226mn in 2011

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	36	39	45	163	249
Current Receivables	109	100	111	140	210
Inventories	357	425	482	547	582
Other current assets	39	49	57	57	57
Total Current Assets	541	613	695	907	1,099
Fixed Assets	1,176	1,259	1,369	1,507	1,645
Investments	60	52	61	61	61
Goodwill					
Other Intangible Assets	-	-	-	-	-
Total Other Assets	2	2	2	2	2
Total Non-current Assets	1,237	1,313	1,432	1,569	1,708
Total Assets	1,778	1,925	2,127	2,477	2,807
Short Term Debt	289	345	425	425	425
Accounts Payable	126	53	62	70	194
Accrued Expenses	-	-	-	-	-
Dividends Payable	-	-	(100)	(113)	(113)
Other Current Liabilities	66	57	54	54	54
Total Current Liabilities	480	454	441	609	733
Long-Term Debt	406	430	491	491	491
Other LT Payables	0	1	-	-	-
Provisions	33	38	41	41	41
Total Non-current Liabilities	439	468	533	533	533
Minority interests					
Paid-up share capital	250	250	250	250	250
Total Reserves	609	753	904	1,085	1,291
Total Shareholders' Equity	859	1,003	1,154	1,335	1,541
Total Equity	859	1,003	1,154	1,335	1,541
Total Liabilities & Shareholders' Equity	1,778	1,925	2,127	2,477	2,807

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	659	736	871	753	667
Net Debt/EBITDA (x)	2.33	2.31	2.37	1.81	1.40
Net Debt to Equity	76.8%	73.4%	75.5%	56.4%	43.3%
EBITDA Interest Cover (x)	(80.7)	(69.6)	76.4	30.4	49.9
BVPS (SAR)	34.35	40.11	46.16	53.39	61.64

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	200	226	246	290	347
Depreciation & Amortisation	86	97	116	113	121
Decrease in Working Capital	15	(162)	(65)	87	18
Other Operating Cashflow	3	14	(4)	(9)	(9)
Cashflow from Operations	304	175	293	481	477
Capital Expenditure	(268)	(179)	(226)	(250)	(259)
New Investments	2	11	(9)	-	-
Others					
Cashflow from investing activities	(267)	(168)	(235)	(250)	(259)
Net Operating Cashflow	37	7	58	231	218
Dividends paid to ordinary shareholders	(64)	(76)	(188)	(113)	(132)
Proceeds from issue of shares					
Effects of Exchange Rates on Cash					
Other Financing Cashflow	-	-	-	-	-
Cashflow from financing activities	(27)	(4)	(52)	(113)	(132)
Total cash generated	10	3	6	118	86
Cash at beginning of period	25	36	39	45	163
Implied cash at end of year	36	39	45	163	249

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	28.0%	16.6%	18.5%	17.9%	16.0%

Source: Company data, Al Rajhi Capital



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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"**Overweight**": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"**Neutral**": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"**Underweight**": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"**Time horizon**": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"**Fair value**": We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

"**Target price**": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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