# Saudi Ceramic

**Construction and Materials –Industrial**

SCERCO AB: Saudi Arabia

15 November 2011



| US$0.910bn | 63.6% | US$0.781mn |
|---|---|---|
| Market cap | Free float | Avg. daily volume |

| | | |
|---|---|---|
| Target price | 161.5 | 18.10% over current |
| Consensus price | 164.5 | 20.3% over current |
| Current price | 136.75 | as at 14/11/2011 |

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**Underweight** | **Neutral** | **Overweight**

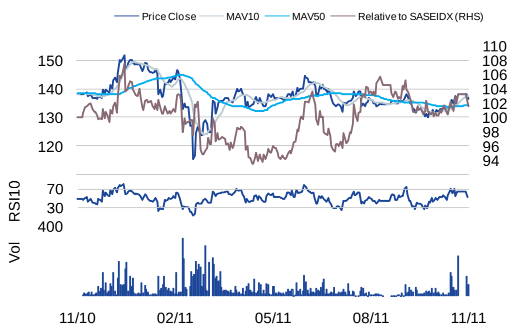
### Key themes

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

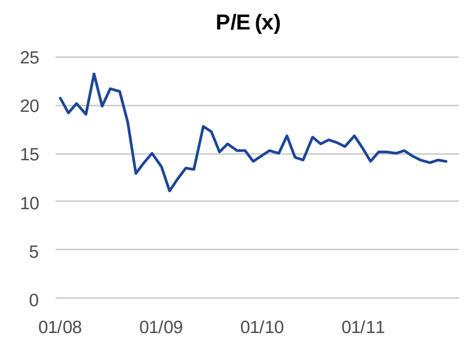



### Earnings

| Period End (SAR) | 12/10A | 12/11E | 12/12E | 12/13E |
|---|---|---|---|---|
| Revenue (mn) | 1,080 | 1,214 | 1,389 | 1,684 |
| Revenue Growth | 12.7% | 12.5% | 14.4% | 21.2% |
| EBITDA (mn) | 318 | 376 | 416 | 484 |
| EBITDA Growth | 12.6% | 18.2% | 10.8% | 16.1% |
| EPS | 8.77 | 9.75 | 11.17 | 13.49 |
| EPS Growth | 11.2% | 11.2% | 14.6% | 20.8% |

**Source:** Company data, Al Rajhi Capital

### Valuation




**Source:** Company data, Al Rajhi Capital

# Saudi Ceramics
# Better margins boosted profits

*Saudi Ceramics announced Q3 results with robust bottom line growth of 17% y-o-y but weak sales growth of 5.9%. We attribute this to weaker Ramadan and summer season than we had expected. On the other hand, the company announced it would double its capacity of sanitary ware plant in 2013. In our view, this announcement coupled with ongoing expansions is encouraging and should ensure continuous growth for the company in the medium to long term. Finally, it is worth noting that the share price has fallen by 8% year to date (TASI down 6% year to date) and now trades at a PE ratio of 12.2x and EV/EBITDA of 9.6x. We remain overweight with a target price of SAR161.5.*

**Revenues below expectation:** Q3 revenues grew by 5.9% y-o-y, below our estimate of 14.5%. We believe that we had underestimated the impact of Ramadan and summer holiday season. That said, we believe sales will pick up in Q4 to grow by almost 14 % y-o-y supported by higher volumes. Although SCC announced commencement of trial production from the second phase of the fourth ceramic tile plant in September (Q3), we don't expect a material impact till Q1 2012 as it normally takes 3-4 months to start commercial production for tile plants.

**Noticeable improvements in margins:** Gross margin of both segments (ceramics and heaters) rose by 3.5pp and 7.5pp y-o-y respectively. These improvements were more than enough to outweigh the slow growth in sales. As a result, aggregate gross profit grew by 19% y-o-y. Further, although SG&A costs/sales increased by almost 3pp y-o-y, it was offset by the hike in gross margin. This resulted in a strong EBIT margin of 20.7% compared to 19% in Q3 2010.

**Other income supported net profit:** Net profit grew by 17.2% reaching SAR54mn; this was close to our estimates of SAR53mn. However, this was supported by high other income which normally includes 1) income from Natural Gas Distribution Company (SCC stake is 15.87%), 2) income from Ceramic Pipe Company (SCC stake is 50%), and 3) Scrap and other materials sales. We suspect that the boost mainly came from the latter. Thus, we don't expect it to be sustainable.

**New projects:** SCC announced that it would build a new plant for sanitary ware (bath room products). This new plant should double its capacity by adding 36,000 tons per annum of sanitary ware products. As a result, total capacity will reach 70,000 tons pa, or between 5.5mn-6mn pieces pa. We believe that this expansion not only will ensure continuous growth for the company, but should act as a catalyst for the share price as well. (See table 1 for SCC project pipe line)

**Conclusion:** We think the expansion in sanitary ware is encouraging and should ensure continuous growth for the company. Looking ahead, we expect SCC to sustain its double digit revenue growth streak and report a 2011 revenue growth of 12.5%. Despite the weak growth in sales, Q3 results were overall satisfactory considering the spectacular improvements in margins; we have accordingly revised our forecasts. We maintain our Overweight rating and target price of SAR161.5, implying 18% upside. SCC stock trades at 2012 EV/EBITDA multiple of 9.6x and offers a dividend yield of 3.3%.

### 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$) | 3.412bn / 0.910bn |
| 52-week range | 115.5 - 151.8 |
| Daily avg volume (US$) | 0.781mn |
| Shares outstanding | 25.00mn |
| Free float (est) | 63.6% |

| Performance: | 1M | 3M | 12M |
|---|---|---|---|
| Absolute | 3.4% | -0.2% | -1.3% |
| Relative to index | 0.9% | -1.8% | 1.6% |

| 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 | 1,214 | 1,389 | 1,684 |
| EBITDA (SARmn) | 318 | 376 | 416 | 484 |
| Net Profit (SARmn) | 219 | 244 | 279 | 337 |
| EPS (SAR) | 8.77 | 9.75 | 11.17 | 13.49 |
| DPS (SAR) | 3.50 | 4.00 | 4.50 | 5.53 |
| EPS Growth | 11.2% | 11.2% | 14.6% | 20.8% |
| EV/EBITDA (x) | 12.5 | 11.0 | 9.6 | 8.3 |
| P/E (x) | 15.6 | 14.0 | 12.2 | 10.1 |
| P/B (x) | 3.4 | 2.9 | 2.6 | 2.2 |
| Dividend Yield | 2.6% | 2.9% | 3.3% | 4.1% |

**Source:** Company data, Al Rajhi Capital

# Saudi Ceramics projects pipeline
## future looks bright

Saudi Ceramics has set ambitious plans to ensure growth in the future. Although the project pipeline might seem optimistic, we believe the Saudi residential market will continue to grow and absorb the increase in supply. Furthermore, as mentioned in previous reports, Saudi Ceramics is gradually widening its channel with the government and hence we believe the company will benefit from the government's mega housing projects. Below we present Saudi Ceramics projects pipeline.

**Figure 1. Saudi Ceramics: Projects pipeline**

| Due | Project | Segment | Description |
|---|---|---|---|
| Q1 2012 | Phase 2 (final phase) of fourth ceramic tile plant | Tiles | In Sep 2011, trial production started. It usually takes 3-4 month to start commercial production for tiles. This phase will add 9 mn sqm pa to make the total tile production 52 mn sqm pa. This phase is expected to generate around SAR150mn in revenues pa when running at full capacity |
| Q3 2012 | Phase 1 of red bricks plant | Red bricks | We expect SCC to start commercial production in Q3 2012. The capacity for phase one is 264 kton and is expected to generate SAR51mn in revenues pa when running at full capacity |
| Q1 2013 | Modification of two production lines in the second tile plant | Tiles | Two old production lines that produce 4 million sqm pa will be modified to produce 12 million sqm pa. By copleting it, SCC tile capacity will reach 60 million sqm pa |
| Q3 2013 * | Phase 2 of red bricks plant | Red bricks | SCC did not announce how many phases will be done to complete the red bricks plant. However, we believe it will be completed in three phases. We assume the second phase will be completed in Q3 2013. We also assume that the second phase will add 216 ktons pa of red bricks when running at full capacity |
| Q3 2013 | Phase 1 of the second sanitary ware plant | Sanitary ware | We expect commercial producrtion to start in Q3 2013. The capacity for phase one is 18 kton pa and expected to generate SAR75mn in revenues pa when running at full capacity |
| Q3 2014 * | Phase 2 (final phase) of the second sanitary ware plant | Sanitary ware | We expect commercial production to start in Q3 2014. The capacity for the second phase is 18 kton pa. By adding this phase, the full capacity of sanitary ware products will reach almost 70 kton pa or between 5.5mn - 6mn pieces pa. |
| Q3 2014 * | Phase 3 (final phase) of the red bricks plant | Red bricks | We expect the third and final phase of the red bricks plant to be completed in Q3 2014. By adding this phase, the full capacity of red bricks will reach 690 kton pa |

* ARC estimates

Source: Company data, Al Rajhi Capital

# Q4: growth continues

Below we summarize sales breakdown and profits for Q3 and Q4 for both years 2011 and 2010 (our estimates vs. actual results).

**Figure 2. Saudi Ceramics: Q3 results vs. our estimates and our expectation for Q4 results**

| (SAR) mn | 2010Q3A | 2011Q3E | 2011Q3A | YOY % chg. | 2010Q4A | 2011Q4E | YOY % chg. |
|---|---|---|---|---|---|---|---|
| Ceramic revenue | 202 | 231 | 217 | 7.4% | 206 | 245 | 18.6% |
| Heaters revenue | 53 | 55 | 53 | 0.2% | 73 | 73 | 0.3% |
| **Total revenue** | **255** | **286** | **270** | **5.9%** | **279** | **318** | **13.9%** |
| | | | | | | | |
| **Gross profit** | **90** | **104** | **107** | 19.1% | **102** | **120** | **17.0%** |
| Gross margin % | 35.4% | 36.4% | 39.9% | | 36.7% | 37.7% | |
| | | | | | | | |
| **EBITDA** | **71** | **82** | **84** | 18.6% | **82** | **96** | **18.1%** |
| EBITDA margin % | 29.9% | 27.7% | 29.3% | | 29.3% | 30.4% | |
| | | | | | | | |
| **Net profit** | **46** | **53** | **54** | 17.2% | **57** | **64** | **13.1%** |
| Net margin % | 18.1% | 18.5% | 20.1% | | 20.4% | 20.2% | |

Source: Company data, Al Rajhi Capital

We expect 2011 revenues to reach SAR1.2bn and net profit to reach SAR244mn

| Income Statement (SARmn) | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
|---|---|---|---|---|---|
| **Revenue** | **958** | **1,080** | **1,214** | **1,389** | **1,684** |
| Cost of Goods Sold | (605) | (688) | (757) | (876) | (1,053) |
| **Gross Profit** | **352** | **392** | **457** | **514** | **631** |
| Government Charges | | | | | |
| S.G. & A. Costs | (156) | (171) | (201) | (211) | (269) |
| **Operating EBIT** | **197** | **221** | **256** | **302** | **362** |
| | | | | | |
| Cash Operating Costs | (675) | (762) | (838) | (973) | (1,200) |
| EBITDA | 282 | 318 | 376 | 416 | 484 |
| Depreciation and Amortisation | (86) | (97) | (120) | (114) | (122) |
| **Operating Profit** | **197** | **221** | **256** | **302** | **362** |
| Net financing income/(costs) | 4 | 5 | (4) | (14) | (16) |
| Forex and Related Gains | | | | | |
| Provisions | - | - | - | - | - |
| Other Income | | | | | |
| Other Expenses | | | | | |
| **Net Profit Before Taxes** | **200** | **226** | **252** | **288** | **346** |
| Taxes | (3) | (6) | (8) | (9) | (9) |
| Minority Interests | | | | | |
| **Net profit available to shareholders** | **197** | **219** | **244** | **279** | **337** |
| Dividends | (75) | (88) | (100) | (113) | (138) |
| Transfer to Capital Reserve | | | | | |

We expect SCC to increase its DPS SAR0.5 every year

| | 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 | 14.56 | 15.74 | 18.37 |
| EPS (SAR) | 7.89 | 8.77 | 9.75 | 11.17 | 13.49 |
| DPS (SAR) | 3.00 | 3.50 | 4.00 | 4.50 | 5.53 |

We expect SCC to continue its double digit revenue growth over the next three years

| Growth | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
|---|---|---|---|---|---|
| Revenue Growth | 11.7% | 12.7% | 12.5% | 14.4% | 21.2% |
| Gross Profit Growth | 10.0% | 11.3% | 16.5% | 12.4% | 22.9% |
| EBITDA Growth | 8.9% | 12.6% | 18.2% | 10.8% | 16.1% |
| Operating Profit Growth | 7.6% | 12.3% | 15.7% | 18.2% | 19.7% |
| Net Profit Growth | 10.8% | 11.2% | 11.2% | 14.6% | 20.8% |
| EPS Growth | 10.8% | 11.2% | 11.2% | 14.6% | 20.8% |

| Margins | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
|---|---|---|---|---|---|
| Gross profit margin | 36.8% | 36.3% | 37.6% | 37.0% | 37.5% |
| EBITDA margin | 29.5% | 29.4% | 31.0% | 30.0% | 28.7% |
| Operating Margin | 20.5% | 20.5% | 21.1% | 21.8% | 21.5% |
| Pretax profit margin | 20.9% | 20.9% | 20.7% | 20.7% | 20.5% |
| Net profit margin | 20.6% | 20.3% | 20.1% | 20.1% | 20.0% |

| Other Ratios | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
|---|---|---|---|---|---|
| ROCE | 15.5% | 15.4% | 14.8% | 15.9% | 17.1% |
| ROIC | 14.6% | 14.7% | 14.7% | 14.7% | 17.3% |
| ROE | 24.9% | 23.6% | 22.5% | 22.4% | 23.4% |
| Effective Tax Rate | 1.5% | 2.8% | 3.2% | 3.0% | 2.5% |
| Capex/Sales | 28.0% | 16.6% | 20.2% | 18.0% | 16.0% |
| Dividend Payout Ratio | 38.0% | 39.9% | 41.0% | 40.3% | 41.0% |

SCC is trading on 2012 PE of 12.2x

| Valuation Measures | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
|---|---|---|---|---|---|
| P/E (x) | 17.3 | 15.6 | 14.0 | 12.2 | 10.1 |
| P/CF (x) | 12.1 | 10.8 | 9.4 | 8.7 | 7.4 |
| P/B (x) | 4.0 | 3.4 | 2.9 | 2.6 | 2.2 |
| EV/Sales (x) | 4.0 | 3.7 | 3.4 | 2.9 | 2.4 |
| EV/EBITDA (x) | 13.6 | 12.5 | 11.0 | 9.6 | 8.3 |
| EV/EBIT (x) | 19.5 | 18.0 | 16.2 | 13.3 | 11.0 |
| EV/IC (x) | 2.6 | 2.4 | 2.1 | 2.0 | 1.8 |
| Dividend Yield | 2.2% | 2.6% | 2.9% | 3.3% | 4.1% |

**Source:** Company data, Al Rajhi Capital

With huge expansions taking place, SCC balance sheet is expanding

| Balance Sheet (SARmn) | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
|---|---|---|---|---|---|
| Cash and Cash Equivalents | 36 | 39 | 45 | 184 | 230 |
| Current Receivables | 109 | 100 | 114 | 139 | 219 |
| Inventories | 357 | 425 | 495 | 542 | 606 |
| Other current assets | 39 | 49 | 69 | 69 | 69 |
| **Total Current Assets** | **541** | **613** | **724** | **933** | **1,124** |
| Fixed Assets | 1,176 | 1,259 | 1,384 | 1,520 | 1,668 |
| Investments | 60 | 52 | 62 | 62 | 62 |
| Goodwill | | | | | |
| Other Intangible Assets | - | - | - | - | - |
| Total Other Assets | 2 | 2 | 2 | 2 | 2 |
| **Total Non-current Assets** | **1,237** | **1,313** | **1,448** | **1,583** | **1,731** |
| **Total Assets** | **1,778** | **1,925** | **2,171** | **2,517** | **2,855** |
| Short Term Debt | 289 | 345 | 379 | 379 | 379 |
| Accounts Payable | 126 | 53 | 64 | 69 | 202 |
| Accrued Expenses | - | - | - | - | - |
| Dividends Payable | - | - | (100) | (113) | (113) |
| Other Current Liabilities | 66 | 57 | 58 | 58 | 58 |
| **Total Current Liabilities** | **480** | **454** | **400** | **566** | **699** |
| Long-Term Debt | 406 | 430 | 567 | 567 | 567 |
| Other LT Payables | 0 | 1 | - | - | - |
| Provisions | 33 | 38 | 45 | 45 | 45 |
| **Total Non-current Liabilities** | **439** | **468** | **613** | **613** | **613** |
| Minority interests | | | | | |
| Paid-up share capital | 250 | 250 | 250 | 250 | 250 |
| Total Reserves | 609 | 753 | 909 | 1,088 | 1,293 |
| **Total Shareholders' Equity** | **859** | **1,003** | **1,159** | **1,338** | **1,543** |
| **Total Equity** | **859** | **1,003** | **1,159** | **1,338** | **1,543** |
| **Total Liabilities & Shareholders' Equity** | **1,778** | **1,925** | **2,171** | **2,517** | **2,855** |

Net debt/EBITDA is slightly high due to huge expansions but financing cost is relatively low

| Ratios | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
|---|---|---|---|---|---|
| Net Debt (SAR) | 659 | 736 | 901 | 762 | 716 |
| Net Debt/EBITDA (x) | 2.33 | 2.31 | 2.40 | 1.83 | 1.48 |
| Net Debt to Equity | 76.8% | 73.4% | 77.8% | 57.0% | 46.4% |
| EBITDA Interest Cover (x) | (80.7) | (69.6) | 93.7 | 29.0 | 30.7 |
| BVPS (SAR) | 34.35 | 40.11 | 46.35 | 53.52 | 61.74 |

| Cashflow Statement (SARmn) | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
|---|---|---|---|---|---|
| **Net Income before Tax & Minority Interest** | **200** | **226** | **252** | **288** | **346** |
| Depreciation & Amortisation | 86 | 97 | 120 | 114 | 122 |
| Decrease in Working Capital | 15 | (162) | (92) | 108 | (12) |
| Other Operating Cashflow | 3 | 14 | 2 | (9) | (9) |
| **Cashflow from Operations** | **304** | **175** | **282** | **501** | **447** |
| Capital Expenditure | (268) | (179) | (245) | (250) | (269) |
| New Investments | 2 | 11 | (9) | - | - |
| Others | | | | | |
| **Cashflow from investing activities** | **(267)** | **(168)** | **(254)** | **(250)** | **(269)** |
| **Net Operating Cashflow** | **37** | **7** | **28** | **251** | **178** |
| 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)** | **(22)** | **(113)** | **(132)** |
| Total cash generated | 10 | 3 | 6 | 139 | 46 |
| Cash at beginning of period | 25 | 36 | 39 | 45 | 184 |
| **Implied cash at end of year** | **36** | **39** | **45** | **184** | **230** |

We expect Capex to be around SAR788mn between 2012 and 2014

| Ratios | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
|---|---|---|---|---|---|
| Capex/Sales | 28.0% | 16.6% | 20.2% | 18.0% | 16.0% |

**Source:** Company data, Al Rajhi Capital

# Disclaimer and additional disclosures for Equity Research

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### 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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