



Rating	NEUTRAL
Target price	SAR157.20 (6.6% upside)
Current price	SAR147.41



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Key themes & implications

A recent stock rally over the past couple of months in the absence of major news flow led us to placing the stock “under review”. After analyzing the detailed financials and taking into consideration the company’s proposed expansion plans, we raise our target price upward while maintaining our Neutral rating.

Share information

Market cap (SAR/US\$)	5.64bn / 1.505bn		
52-week range	106.3 - 152.4		
Daily avg volume (US\$)	5.6mn		
Shares outstanding	37.50mn		
Free float (est)	77%		
Performance	1M	3M	12M
Absolute	9.3%	11.2%	28.4%
Relative to index	-0.6%	1.5%	-2.0%
Major Shareholder:			
General Social Insurance	16.1%		
Saleh Abdulaziz Al Rajhi	6.8%		

Valuation

	12/12A	12/13A	12/14E	12/15E
P/E (x)	22.8	18.2	17.1	13.4
P/B (x)	4.3	3.7	3.2	2.7
EV/EBITDA (x)	15.9	13.1	13.4	10.4
Dividend Yield	1.7%	1.7%	1.7%	2.2%

Source: Company data, Al Rajhi Capital

Performance



Source: Bloomberg, Company data, Al Rajhi Capital

Company summary

Headquartered in Riyadh and founded in 1977, Saudi Ceramic Company is a leading manufacturer and marketer of sanitary ware, ceramic tiles and electric water heaters in KSA.

Saudi Ceramic

Stock rally could sustain

Saudi Ceramic posted a decent set of Q2 results as net profit rose 2.3% y-o-y to SAR84.1mn, in line with our SAR85mn estimate. While the company’s earnings did not throw up any major surprises, the stock price soared in the last couple of months even in the absence of any significant news flow. In fact, the rally occurred despite the fact that the company’s operating profit slipped for the second consecutive quarter to come in at just SAR78.9mn (-12.3% y-o-y). We have revalued the company taking into account the latest financial results. We have also lowered our cost of equity assumption after the government’s decision to allow foreign investors direct access to the Saudi capital markets. Based on our latest estimates and assumptions, we have revised our target price on Saudi Ceramic upwards to SAR157.2 per share, and reiterate our Neutral rating on the company.

Reasonable top-line while margins shrink: Saudi Ceramic reported a Q2 revenue of SAR437.6mn (+2% y-o-y), in line with our estimate of SAR438mn. While the top-line figures were not overly impressive, we still view it as a healthy result, given the slowdown in the construction sector. The company’s margins were dented this quarter weighed down by higher operating costs as the company prepares to roll-out additional production lines in its sanitary-ware and red bricks’ segments.

Expansion plans: We are optimistic about the company’s ability to grow its top-line which will be driven by the gradual recovery in the construction sector as well as the commissioning of new plants in 2014. Saudi Ceramic has adopted an aggressive expansion strategy over the past few years as it increased production capacity of tiles by about 11% in 2013, reaching 60mn square-meters (sqm). The company is expected to further increase this capacity to about 64mn sqm in 2014. Further, we anticipate a ramp-up in production capacity of about 21% in the sanitary-ware segment by the end of 2014. Finally, work is progressing on the first phase of the red bricks factory, which has a production capacity of 264,000 tons, expected to kick off in H2 2014. This segment is expected to contribute a revenue of about SAR50mn to Saudi Ceramic’s top-line. The company’s plans to ramp-up capacity will result in a healthy top-line growth creating further upside from current levels. We anticipate a revenue growth of about 6% in 2014 which is likely to jump to about 20% in 2015 as utilization levels improve in subsequent years.

Period End (SAR)	12/11A	12/12A	12/13A	12/14E	12/15E
Revenue (mn)	1,221	1,447	1,601	1,695	2,037
Revenue Growth	13.1%	18.5%	10.6%	5.9%	20.2%
Gross profit margin	36.5%	33.1%	36.2%	35.3%	35.6%
EBITDA margin	29.8%	26.7%	29.5%	27.7%	29.7%
Net profit margin	19.0%	17.1%	19.3%	19.5%	20.7%
EPS	6.19	6.60	8.25	8.80	11.24
EPS Growth	5.8%	6.7%	25.0%	6.6%	27.7%
ROE	21.6%	20.2%	21.9%	20.3%	22.2%
ROCE	15.2%	13.7%	17.0%	13.4%	15.9%
Capex/Sales	22.6%	19.7%	23.3%	17.4%	15.0%

Source: Company data, Al Rajhi Capital

Disclosures Please refer to the important disclosures at the back of this report. Please note the change in our rating definitions. Our Overweight rating imply an upside of more than 10%(earlier 15%) and Underweight rating imply a downside of more than 10%(earlier 5%) from the current price. Companies with an expected variation of -10% to +10%(earlier -5% to +15%) are assigned a Neutral rating.

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Changes to our estimates and assumptions

Reduction in cost of equity: The government’s recent decision to allow foreigners to invest directly in the Saudi market will lead to increased interest in the market. We had earlier assumed a 1% additional risk premium for the Saudi market due to its limited access to foreign investors. However, with this development, we have reduced this risk premium by 50bps to 0.5% due to the improved integration with global markets.

Risks to our rating

Volatile “other income”: Saudi Ceramic posted an “other income” of SAR14.6mn in 2012 (about 5.7% of its net operating profit) and a loss of SAR749,000 in this segment in 2013. However “other income” stood at SAR13.3mn in the first two quarters of 2014 alone. In fact the bottom-line was salvaged by an unusually high “other income” of SAR9.5mn in Q2, which accounted for about 12% of its net operating profit. If the company’s “other-income” drops-off from this level in future quarters, it runs the risk of a squeeze in its bottom-line which may adversely affect our rating.

Project delays: Any project delays will negatively impact the company’s earnings and may impact our rating on the company as well.

Valuation

We have valued Saudi Ceramic using a weighted combination of DCF (70%) and Relative valuation (30%):

DCF: We have used a WACC of 7.7% (cost of equity: 8.8%) and a debt-equity ratio of 14.3%. Based on our estimates, we have arrived at a revised share price of SAR160.9.

Figure 1 DCF Valuations(in SAR mn except fair value per share)

Valuation as per FCFF	6869
Adjust:	
Associates and non-core assets	-
Net Debt	834
Minorities	-
Equity value	6035
Number of shares	37.5
Fair value per share	160.9

Source: Company data, Al Rajhi Capital

Relative valuation: We have used a P/E multiple of 13.2x its FY15E earnings, which is the valuation that its peers are trading at. Based on our estimated EPS of SAR11.2 for FY2015, we have arrived at a fair value of SAR148.4 for the company.

Figure 2 Blended Valuation Table (in SAR)

Company	Saudi Ceramic
Fair value(DCF)	160.9
Fair value(Relative)	148.4
DCF Weightage	70%
Relative Weightage	30%
Target price	157.2

Source: Company data, Al Rajhi Capital

Conclusion: Q2 2014 was a decent quarter for Saudi Ceramics, with earnings meeting our forecasts while revenue grew marginally. We are optimistic about the company’s long-term prospects given the gradual recovery in the construction sector and its aggressive expansion plans to scale up production capacity over the next couple of years. We have revalued the company to reflect our latest EPS and growth forecasts using a combination of the DCF and relative valuation methods. Based on our revised estimates and assumptions, we have arrived at a fair value of SAR157.2, implying a Neutral rating.



Other Developments

Termination of MoU

Saudi Vitrified Clay Pipe Co.(SVCP) has announced that its memorandum of understanding(MoU) with Ceramic Pipes Co. to fully acquire the company has been terminated. The Council of Competition has rejected the company's request to acquire Ceramic Pipes, citing a possible negative impact on the market due to the buyout. The MoU had expired on June 15, 2014 and was thereafter renewed for a period of three months, post which it was terminated.



Revenue to grow by double-digits in 2015 as new production capacity kicks in

Margins to improve in 2015 as the company realizes economies of scale

P/E ratio to fall in subsequent years as earnings improve

Income Statement (SARmn)	12/11A	12/12A	12/13A	12/14E	12/15E
Revenue	1,221	1,447	1,601	1,695	2,037
Cost of Goods Sold	(775)	(968)	(1,021)	(1,097)	(1,313)
Gross Profit	446	479	579	598	724
Government Charges					
S.G. & A. Costs	(203)	(221)	(248)	(272)	(285)
Operating EBIT	244	258	331	327	439
Cash Operating Costs	(857)	(1,060)	(1,129)	(1,225)	(1,432)
EBITDA	365	387	472	470	604
Depreciation and Amortisation	(121)	(129)	(140)	(144)	(165)
Operating Profit	244	258	331	327	439
Net financing income/(costs)	(4)	(2)	(13)	11	(7)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income					
Other Expenses					
Net Profit Before Taxes	239	256	318	337	432
Taxes	(7)	(9)	(9)	(7)	(11)
Minority Interests					
Net profit available to shareholders	232	248	309	330	422
Dividends	(88)	(94)	(94)	(94)	(126)
Transfer to Capital Reserve					
	12/11A	12/12A	12/13A	12/14E	12/15E
Adjusted Shares Out (mn)	37.50	37.50	37.50	37.50	37.50
CFPS (SAR)	9.41	10.04	12.00	12.63	15.65
EPS (SAR)	6.19	6.60	8.25	8.80	11.24
DPS (SAR)	2.333	2.500	2.500	2.500	3.372
	12/11A	12/12A	12/13A	12/14E	12/15E
Growth					
Revenue Growth	13.1%	18.5%	10.6%	5.9%	20.2%
Gross Profit Growth	13.8%	7.4%	20.8%	3.3%	21.0%
EBITDA Growth	14.7%	6.1%	21.9%	-0.3%	28.5%
Operating Profit Growth	10.4%	5.8%	28.4%	-1.3%	34.4%
Net Profit Growth	5.8%	6.7%	25.0%	6.6%	27.7%
EPS Growth	5.8%	6.7%	25.0%	6.6%	27.7%
	12/11A	12/12A	12/13A	12/14E	12/15E
Margins					
Gross profit margin	36.5%	33.1%	36.2%	35.3%	35.6%
EBITDA margin	29.8%	26.7%	29.5%	27.7%	29.7%
Operating Margin	20.0%	17.8%	20.7%	19.3%	21.6%
Pretax profit margin	19.6%	17.7%	19.9%	19.9%	21.2%
Net profit margin	19.0%	17.1%	19.3%	19.5%	20.7%
	12/11A	12/12A	12/13A	12/14E	12/15E
Other Ratios					
ROCE	15.2%	13.7%	17.0%	13.4%	15.9%
ROIC	14.1%	13.6%	15.5%	14.0%	17.0%
ROE	21.6%	20.2%	21.9%	20.3%	22.2%
Effective Tax Rate	3.1%	3.3%	2.7%	2.2%	2.5%
Capex/Sales	22.6%	19.7%	23.3%	17.4%	15.0%
Dividend Payout Ratio	37.7%	37.9%	30.3%	28.4%	30.0%
	12/11A	12/12A	12/13A	12/14E	12/15E
Valuation Measures					
P/E (x)	24.3	22.8	18.2	17.1	13.4
P/CF (x)	16.0	15.0	12.5	11.9	9.6
P/B (x)	4.9	4.3	3.7	3.2	2.7
EV/Sales (x)	5.0	4.2	3.9	3.7	3.1
EV/EBITDA (x)	16.7	15.9	13.1	13.4	10.4
EV/EBIT (x)	25.0	23.8	18.7	19.2	14.3
EV/IC (x)	3.3	3.0	2.7	2.5	2.2
Dividend Yield	1.6%	1.7%	1.7%	1.7%	2.2%

Source: Company data, Al Rajhi Capital



The company has a solid balance sheet and steady cash-flows

Balance Sheet (SARmn)	12/11A	12/12A	12/13A	12/14E	12/15E
Cash and Cash Equivalents	64	57	31	269	333
Current Receivables	136	132	148	235	269
Inventories	535	598	610	542	672
Other current assets	57	106	123	135	135
Total Current Assets	793	893	912	1,180	1,408
Fixed Assets	1,415	1,572	1,806	1,955	2,095
Investments	61	81	78	74	74
Goodwill	-	-	-	-	-
Other Intangible Assets	-	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	1,476	1,653	1,883	2,030	2,170
Total Assets	2,269	2,546	2,795	3,210	3,578
Short Term Debt	355	333	452	424	424
Accounts Payable	175	201	249	200	240
Accrued Expenses	-	-	-	-	-
Dividends Payable	-	4	-	-	-
Other Current Liabilities	78	55	76	73	73
Total Current Liabilities	620	618	792	697	737
Long-Term Debt	454	570	421	700	700
Other LT Payables	-	-	-	-	-
Provisions	48	52	60	76	76
Total Non-current Liabilities	502	622	482	776	776
Minority interests	-	-	-	-	-
Paid-up share capital	250	375	375	375	375
Total Reserves	897	931	1,146	1,362	1,690
Total Shareholders' Equity	1,147	1,306	1,521	1,737	2,065
Total Equity	1,147	1,306	1,521	1,737	2,065
Total Liabilities & Shareholders' Equity	2,269	2,546	2,795	3,210	3,578
Ratios	12/11A	12/12A	12/13A	12/14E	12/15E
Net Debt (SARmn)	744	846	842	855	791
Net Debt/EBITDA (x)	2.04	2.19	1.79	1.82	1.31
Net Debt to Equity	64.9%	64.8%	55.4%	49.2%	38.3%
EBITDA Interest Cover (x)	83.4	225.2	36.6	(44.4)	90.6
BVPS (SAR)	30.58	34.82	40.56	46.32	55.06
Cashflow Statement (SARmn)	12/11A	12/12A	12/13A	12/14E	12/15E
Net Income before Tax & Minority Interest	239	256	318	337	432
Depreciation & Amortisation	121	129	140	144	165
Decrease in Working Capital	(19)	(101)	(11)	(108)	(124)
Other Operating Cashflow	9	13	30	6	(11)
Cashflow from Operations	350	297	477	378	463
Capital Expenditure	(276)	(286)	(373)	(295)	(306)
New Investments	(9)	(24)	0	0	-
Others	-	-	-	-	-
Cashflow from investing activities	(285)	(310)	(373)	(295)	(306)
Net Operating Cashflow	65	(12)	104	83	157
Dividends paid to ordinary shareholders	(88)	(89)	(95)	(111)	(94)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	-	-	-	-	-
Cashflow from financing activities	(40)	6	(125)	139	(94)
Total cash generated	25	(7)	(21)	223	64
Cash at beginning of period	39	64	57	31	269
Implied cash at end of year	64	57	37	254	333
Ratios	12/11A	12/12A	12/13A	12/14E	12/15E
Capex/Sales	22.6%	19.7%	23.3%	17.4%	15.0%

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 10% 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 10% below the current share price and 10% above the current share price on a 6-9 month time horizon.

"**Underweight**": Our target price is more than 10% 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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