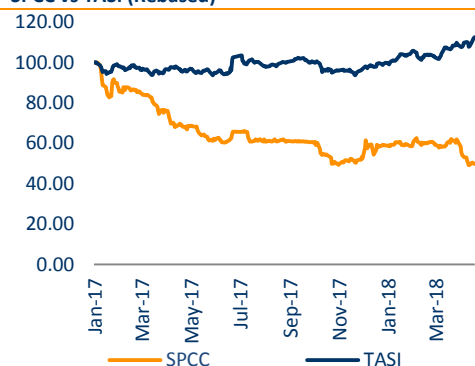



Initiation Coverage
April 23, 2018

Recommendation	Neutral
Current Price (SAR)	40.9
Target Price (SAR)	43.0
Upside/Downside (%)	5.1%

As of April 18, 2018
Key Data (Source: Bloomberg)

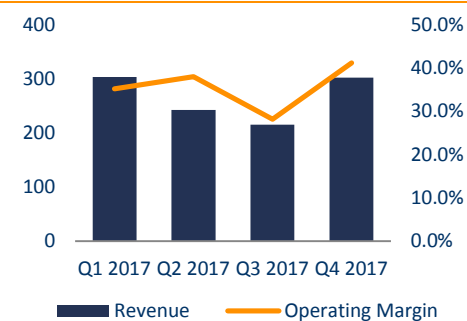
Market Cap (SAR bn)	5.73
52 Wk High (SAR)	57.00
52 Wk Low (SAR)	39.60
Total Outstanding shares (in mn)	140.00
Free Float (%)	41.82%

SPCC vs TASI (Rebased)


Price Performance (%)	Absolute	Relative
1m	-18.5%	-23.9%
6m	-7.8%	-25.1%
12m	-27.9%	-45.3%

Major Shareholders (%)

Public Investment Fund	37.43%
General Org for Social Insurance	15.82%
Abdullah Al Saud	0.54%

Quarterly Sales (SAR mn) and Operating Margin


Source: Bloomberg, Company Financials, FALCOM Research; Data as of 18th April, 2018

In 2017, Southern Province Cement (SPCC) reported a 40.1% YoY decline to SAR 1,064mn in its top line, driven by a decline in sales volume and sales price. The company's operating income was recorded at SAR 384mn (down 56.3%), while the bottom line declined 57.8% YoY to SAR 370mn during the fiscal. In 4Q17, SPCC reported revenue of SAR302mn (-15% Y/Y, +40% Q/Q), gross profit of SAR137mn (-23% Y/Y, +111% Q/Q) and net income was SAR115mn (-24% Y/Y, +101% Q/Q).

Saudi Arabia's cement sector remained subdued in 2017 due to intense competition and sluggish demand. The decline in oil prices had an adverse impact on government finances, which led to a slowdown in construction activity. SPCC was not unscathed from this trend and reported weak results for 2017. However, SPCC retained its position as a market leader and recorded superior margins. Going forward, we expect the company to see a moderate recovery in cement dispatches due to fiscal expansion and removal of export tariffs. However, we expect margin pressures to persist, given aggressive pricing policy of the firm. In the light of these factors, we recommend a "Neutral" stance on the company, with a target price of SAR 43.0 per share.

Aggressive price strategy, detrimental to operating margins

SPCC adopted an aggressive pricing strategy to gain market share in 2017, SPCC's realized price per ton declined 12% y-o-y in Q4 2017 to SAR 203, much above the sector average of 2% decline to SAR 190 per ton. Consequently, SPCC's market share moved up by 56bps y-o-y to 12.4%, while EBIT margins trimmed down -300bps to 41% in 4Q 2017. Whilst the company has recorded an improved performance sequentially in 4Q, it was hardened by four consecutive months of market share loss. We expect the company to maintain this strategy through 2018, thus margins are likely to be remain below historical range. In a bid to regain the recent loss of market share, we expect compressed margins in 2018 (-160bps to 34.5%).

Export tariff removal, likely to fuel international demand

The complete removal export tariffs, effective 1 Feb 2018, signals a significant change for Saudi Arabian cement producers. Although the tariffs were reduced from SAR133/ton to SAR85/ton, the lifting of the cement export ban in 2017 did not inspired trade. Historically, exports from Saudi Arabia have remained below 10% of the total production, but there is potential for these levels to rise to much higher in the medium-term, with Iraq and Yemen as likely target destinations. SPCC is well placed, given its geographic proximity, to explore opportunity in the East Africa market.

Production cuts and competitive prices to keep inventory levels in check

SPCC's current inventory to LTM sales ratio stands at 59%, much below the sector average of 77%. Although the company's production curbs resulted in a decline in cement capacity utilization by 19ppt to 57% in 2017, the effect on inventory levels remained largely positive. We expect SPCC to keep its inventory levels in check by curtailing production and offering competitive prices. In addition, the revival in demand due to the government's strategic reforms would aid in preventing inventory pile-up.

Despite margin pressures, dividend pay-outs likely to be maintained at historical levels

In 2017, FCF contracted by less than half to SAR 343mn primarily due to lower margins, while we expect modest recovery in 2018 to SAR 595mn on improved working capital management. Dividends declared contracted to SAR1.50/share in 2017 from SAR4.75/share in 2016, while we expect dividend payouts to improve in 2018 (65%), but remain below the peak levels of 2015-16 (78%).

Valuation: We valued Southern Province Cement using the DCF Approach to arrive at a fair value of SAR 43.0 per share. We considered WACC at 11.8%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E	2021E
Revenues (SAR bn)	1.1	1.2	1.2	1.3	1.3
Operating Profit (SAR bn)	0.4	0.4	0.4	0.5	0.6
EPS (SAR)	2.7	2.7	2.9	3.4	4.0
Operating Margin (%)	36.1%	34.5%	35.1%	36.9%	40.4%
D/E (x)	0.17	0.17	0.16	0.15	0.14
RoE (%)	11.7%	11.3%	11.9%	13.1%	14.7%
P/E (x)	18.3	16.0	14.6	12.6	10.7
Price/BV (x)	2.1	1.8	1.7	1.7	1.6
EV/EBITDA (x)	12.7	10.3	9.4	8.2	6.9

Source: Company Financials, FALCOM Research



Initiation Coverage

April 23, 2018

Valuation Summary

Explanation of valuation methodology and assumptions

We valued Southern Province Cement using the DCF Approach to arrive at a fair value of SAR 43.0 per share. We considered WACC at 11.8% with a terminal growth rate of 2.0%. In relative terms, SPCC is trading at 1yr forward P/E of 13.2x, at a discount of 21.8% to its sector peers and discount of 9.2% to the Tadawul All Share Index.

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E
EBIT	384	398	417	469	543
Taxes	(5)	(8)	(9)	(10)	(12)
Depreciation, amortization and impairment	187	196	199	202	204
Changes in working capital	(121)	113	57	(6)	(3)
Net capital expenditure	(109)	(104)	(83)	(76)	(67)
Free Cash Flow to firm	337	595	581	578	664
<i>Discount Factor</i>		0.9	0.8	0.7	0.7
PV of free cash flow to firm		550	481	427	439
Net Present Value (A)					1,898
Terminal Value					6,908
PV Terminal Value (B)					4,572
Assumed Terminal Growth Rate					2.0%
Discount Rate					11.8%
Enterprise Value (A+B)	6,470	WACC Assumptions			
Total Cash	98	Risk free rate	2.8%		
Total Debt	548	Equity Risk Premium	9.1%		
Minority Interest	-	Beta	1.1x		
Equity Value in SAR mn	6,019	Cost of equity	12.5%		
Number of shares in mn	140	Post tax cost of debt	2.8%		
Target Price in SAR per share	43.0	Weight of equity in capital structure	92.5%		
CMP in SAR as on April 18th, 2018	40.9	Weight of debt in capital structure	7.5%		
Upside/(Downside) to current market price	5.1%	WACC	11.8%		

Source: Company Financials, FALCOM Research Estimates

Risks

Upside Risks:

- Reversal of market share loss in the upcoming quarters will support premium margins
- Better than expected export sales, will further reduce inventory pressure and improve price realization

Downside Risks

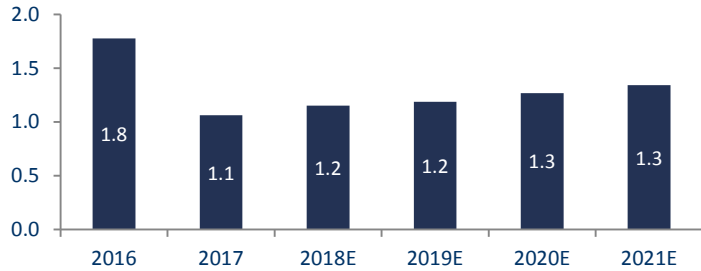
- Deterioration of the geo political tensions in the Middle East and restrictive trade policies could affect sales.
- Delay in execution of the project pipeline surrounding Southern Region will dampen the expectations of recovery in demand

Initiation Coverage

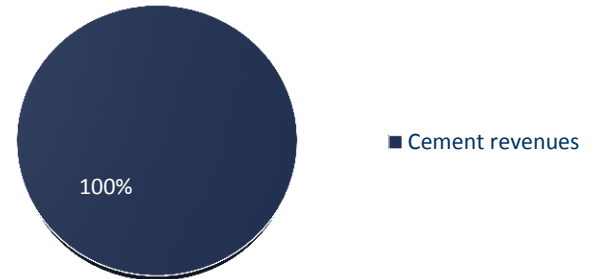
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Key Charts

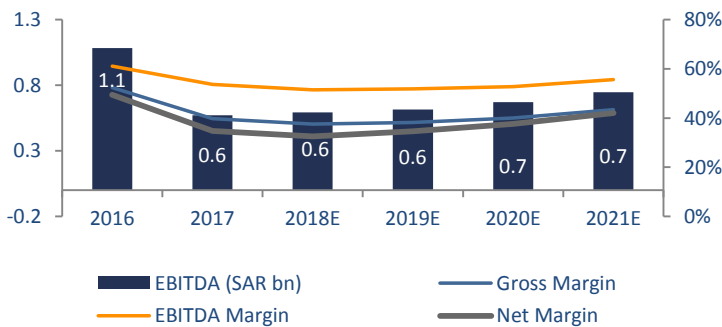
Revenue (SAR bn)



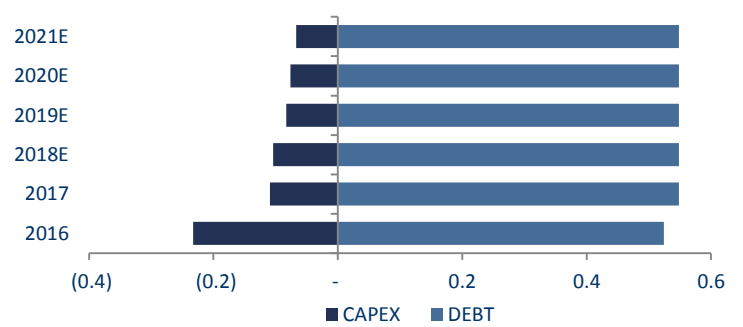
Revenue Split (2017)



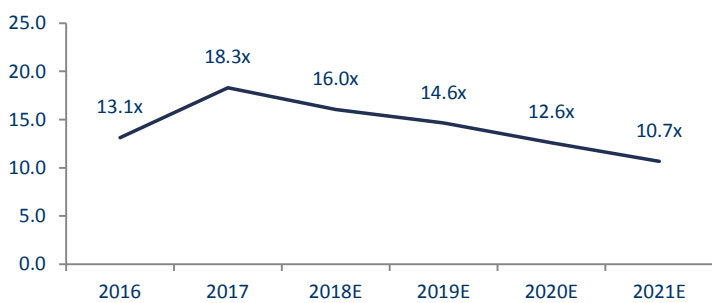
EBITDA & Margins



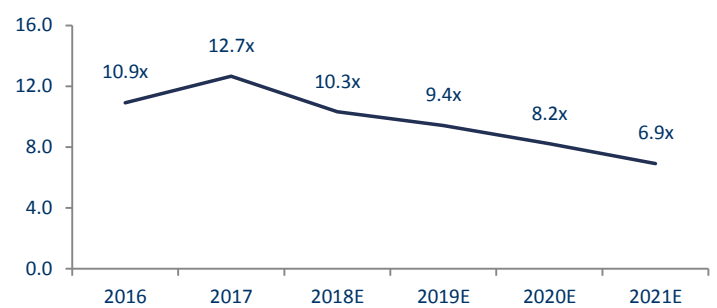
CAPEX and Debt (SAR bn)



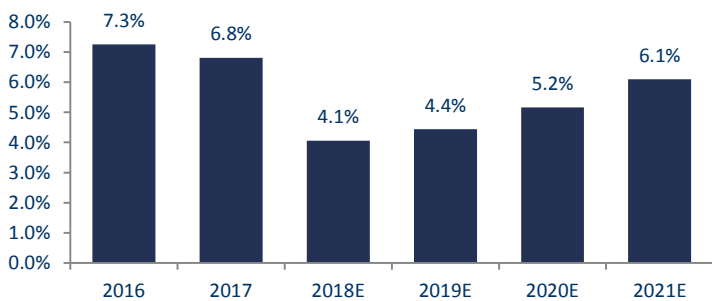
Price to Earnings



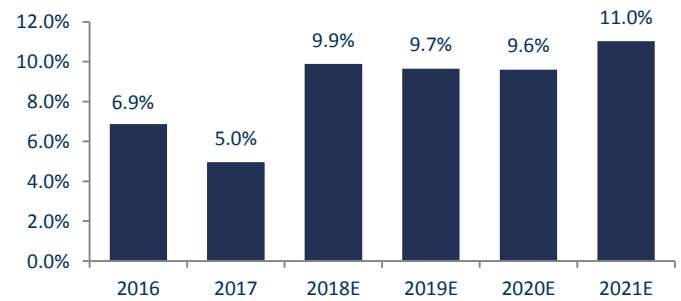
EV/EBITDA



Dividend Yield



Free Cash Flow Yield



Source: FALCOM Research Estimates



Initiation Coverage

April 23, 2018

Summary Financials

P&L (SAR mn)	2017	2018E	2019E	2020E
Revenue	1,064	1,153	1,188	1,270
Gross Profit	424	434	454	508
EBITDA	571	594	616	670
EBIT	384	398	417	469
Net Interest	(9)	(14)	3	19
Other	-	-	-	-
PBT	375	384	420	488
Zakat	5	8	9	10
Minorities	-	-	-	-
Net Income	370	376	411	478
EPS	2.7	2.7	2.9	3.4
DPS	1.5	1.7	1.9	2.2

BS (SAR mn)	2017	2018E	2019E	2020E
Cash and cash equivalents	98	443	768	1,065
Current Assets (excluding cash)	709	600	548	566
Fixed assets	3,344	3,252	3,136	3,010
Intangibles	-	-	-	-
Total Assets	4,157	4,300	4,458	4,646
Current Liabilities	335	339	344	355
Long Term Debt	353	353	353	353
Shareholders Equities	3,172	3,312	3,464	3,642
Total Liabilities & Shareholders' Equity	4,157	4,300	4,458	4,646

CF (SAR mn)	2017	2018E	2019E	2020E
Operating Cash Flow	560	580	619	689
Working Capital Changes	(121)	113	57	(6)
Cash Flow from Operating Activities	439	693	676	683
Capex	(109)	(104)	(83)	(76)
Cash Flow from Investing Activities	(109)	(104)	(83)	(76)
Changes in Debt	24	-	-	-
Dividends	(461)	(244)	(267)	(310)
Cash Flow from Financing Activities	(445)	(244)	(267)	(310)

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Revenue	-40.1%	8.4%	3.0%	6.9%
EBITDA	-47.3%	4.0%	3.7%	8.8%
Operating profit	-56.3%	3.5%	4.8%	12.4%
PBT	-57.7%	2.3%	9.5%	16.2%
Net Income	-57.8%	1.4%	9.5%	16.2%

Ratios (%)	2017	2018E	2019E	2020E
Gross Margin	39.8%	37.6%	38.2%	40.0%
EBITDA Margin	53.7%	51.5%	51.9%	52.8%
EBIT Margin	36.1%	34.5%	35.1%	36.9%
Net Margin	34.8%	32.6%	34.6%	37.6%
ROE	11.7%	11.3%	11.9%	13.1%
ROCE	10.6%	10.6%	10.6%	11.4%
ROA	8.9%	8.7%	9.2%	10.3%
Debt/Equity	0.17	0.17	0.16	0.15
Net Debt/EBITDA	0.79	0.18	(0.36)	(0.77)
FCF Yield	5.0%	9.9%	9.7%	9.6%
Dividend Yield	6.8%	4.1%	4.4%	5.2%

Valuation	2017	2018E	2019E	2020E
PE	18.3x	16.0x	14.6x	12.6x
PB	2.1x	1.8x	1.7x	1.7x
EV/EBITDA	12.7x	10.3x	9.4x	8.2x
EV/EBIT	18.8x	15.4x	13.9x	11.7x
EV/Sales	6.8x	5.3x	4.9x	4.3x

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Yamamah Cement	21.4x	10.1x
Saudi Cement	16.3x	12.6x
Eastern Cement	23.0x	8.6x
Qassim Cement	17.4x	8.7x
Yanbu Cement	16.3x	9.4x
Arabian Cement	11.8x	6.4x
Southern Cement	13.2x	10.3x
Sector Median	16.9x	9.1x
TASI	14.5x	11.6x



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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