Holcim (Liban)

BLOMINVEST BANK S.A.L.

Alert on 2010 Earnings Report

Sector:	Basic Materials & Industrial Products
Country:	Lebanon
Date:	June 17, 2011

Share Price (USD):	17.60
Fair Value (USD):	16.00
Downside:	-9.00%
Recommendation:	Hold

Maintaining a HOLD recommendation with a target share price of USD 16.00 with 2010 earnings meeting our expectations

Revenues

Holcim (Liban)'s revenue has reached a new high of USD 227 million in 2010, growing by 9.8% y-o-y, led by increasing local demand. The size of the Lebanese grey cement market grew to 5.2 million tons in 2010, with HL's market share at 41.7%. Grey cement export sales however remained negligible in 2010 due to the local demand exhausting the company's total capacity and the prices in Syria becoming highly unattractive to local producers. White cement sales volume increased by 14% y-o-y to 64,000 tons as the surge in the local demand largely offset the 8% drop in exports that resulted from Turkish companies' competition on the Syrian market.

Earnings

HL's gross income jumped 22% to $83 million in 2010 led by solid revenue growth. Gross margin from sales improved to 36.5% versus 32.8% in 2009 as sales grew much faster than COGS on improving production efficiency. Similarly, net income also showed a 22% y-o-y increase reaching $ 37.4 million, mainly driven by operating efficiency. The bottom line for 2010 was close to our estimates of $35 million, with the variance mainly caused by an unexpectedly higher gross margin. Net profit margin for 2010 improved to 16.4% from 14.8% for the previous year.

Liquidity

During 2010, HL experienced high levels of liquidity which permitted the company to repay around $29.7 million from its debt outstanding balance, in addition to the projected 50% capital reduction on the nominal value of HL's stock, amounting to $64.7 million or the equivalent of $3.3 per share and which we do not expected to be completed before the end of 2011. Despite significant debt repayment and the distribution of $ 26.1 million in dividends on 2009 profits, HL maintained current and cash ratios at 1.6 and 0.4, respectively. The cement producer further agreed to pay out $30.8 million in dividends during the year on 2010 profits.

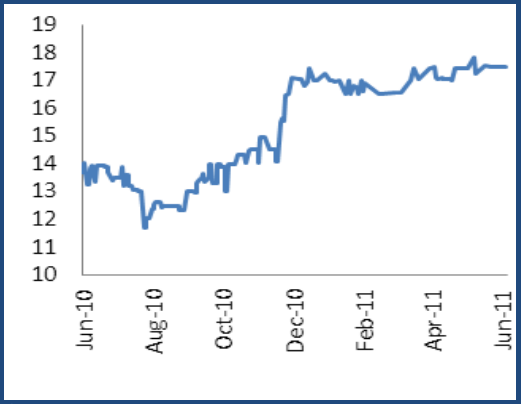
Conclusion

With the real estate market in Lebanon slowing since the beginning of the year, we lower our target price to $16.16 from $17.49 previously and maintain a HOLD recommendation with a discount rate at 16% and a 3.5% terminal growth, revised down from 4% in our initiation. We note that if the company completes the capital reduction, we believe the share price would decline by an amount close to the reduction to hover near $14.

Share Data

Bloomberg Symbol	HOLC LB
Reuters Symbol	HOLC.BY
Market Cap	341,530,700
Number of Shares	19,516,040
Free Float	17.8%
Price-to-Earnings 10	9.14
Price-to-Book 10	1.81

Share Performance



Source: Reuters

1 Month Return	0.29%
3 Month Return	5.68%
6 Month Return	2.94%
12 Month Return	25.00%
52 Week Range	17.83 – 11.70

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Performance and Forecasts

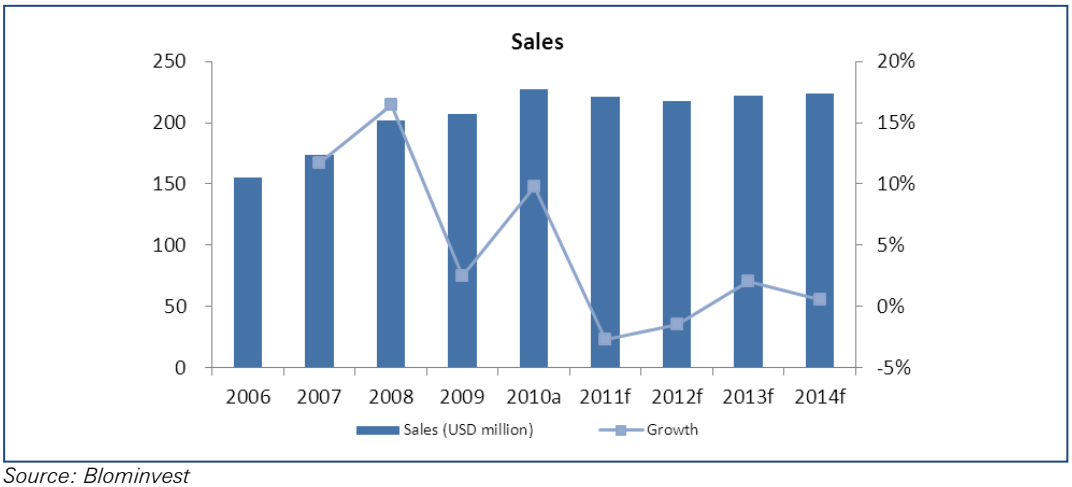
Year	2009	2010	2011e	2012f	2013f	2014f
Revenues (USD millions)	208	227	221	218	222	223
Net Income (USD millions)	30.6	37.4	37.0	38.6	40.5	40.5
EPS (USD)	1.57	1.91	1.90	1.98	2.08	2.08
BVPS (USD)	9.38	9.65	9.98	9.50	9.31	9.13
ROA	10%	12%	13%	14%	15%	15%
ROE	14%	16%	16%	17%	18%	18%

INCOME STATEMENT HIGHLIGHTS

Revenues

Revenues at Holcim Liban (HL) recorded a 9.8% y-o-y growth in 2010 to $228 million after they had edged up by a small 2.5% y-o-y in 2009, led by increasing local sales for all of the company's products amidst flourishing residential construction projects in the country.

Local demand for grey cement reached 5.2 million tons for the year, out of which our target company satisfied 2.17 million tons, or an 8% y-o-y increase in sales volume for the product. White cement sales volume, on the other hand, rose by 14% y-o-y reaching 64,000 tons in 2010 against a capacity stagnating near 100,000 tons.

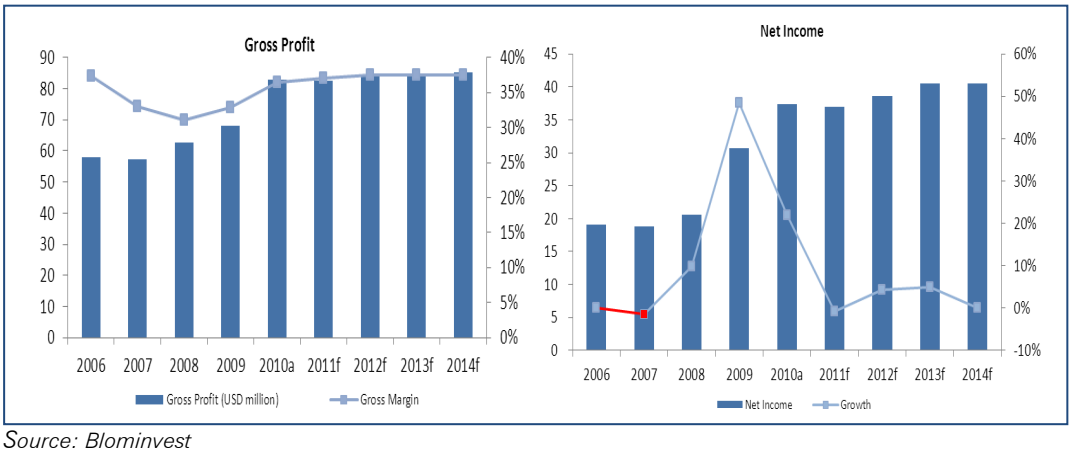


Source: Blominvest

Grey cement export sales remained negligible in 2010, due to the local demand exhausting the company's total capacity and grey cement prices in Syria becoming highly unattractive to local producers, as previously elaborated under our initiation report[1].

White cement export sales, however, witnessed an 8% decline during the year to 38,100 tons, pressured down by increased competition from Turkish producers on the Syrian market.

Finally, ready-to-use concrete sales jumped by 22% y-o-y to 360 million cubic meters on increased production, mainly led by the company launching operations in two new facilities in Halba and Beirut Port.



Source: Blominvest

[1]The initiation report can be found under the research section at www.blominvestbank.com

Earnings and margins

The performance of HL improved during 2010 as gross income jumped by 22% y-o-y to $83 million, led by revenue growth but also due to improved production efficiency. Revenue growth stood at threefold that of cost of sales sending the gross profit margin to 36.5% from 32.8% in 2009. Also, HL's operating margin reached a six-year high of 23% compared with 20% a year earlier, on larger local sales for products enjoying higher margins, although distribution, selling and administrative expenses margin rose from 12.5% to 13.2% during the year.

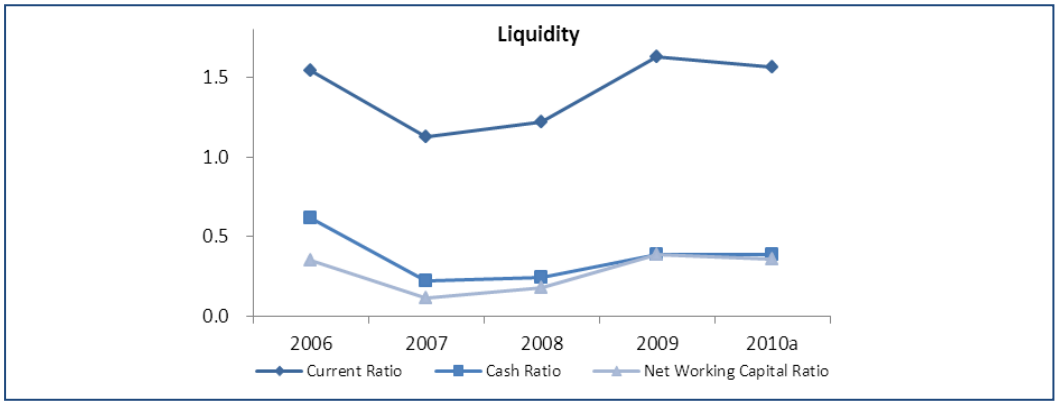
Similar to gross profit, net income also showed 22% y-o-y to $37 million from $31 million on the previous financial reporting period, on improved efficiency but also since finance costs were reduced by around $500 thousand after HL settled around $29.7 million of its outstanding debt. As a result, net profit margin stood at 16.4% in 2010 from 14.8% in 2009, although the company charged a $1.6 million provision for risks and charges on its income statement for pending legal issues with the NSSF

BALANCE SHEET HIGHLIGHTS

Liquidity

In 2010, HL's balance sheet witnessed a $6 million increase in its cash and inventories against a $7 million rise in current liabilities, leading to stagnant current and cash ratios at 1.6% and 0.4%, respectively, while the net working capital ratio slightly decreased to 0.36% from 0.39% in 2009. The current portion of loans and borrowings declined by around $2 million last year as the company repaid part of its outstanding debt owing to increasing retained earnings, but this gain was largely offset by the $8 million growth in the payables and accruals account.

Current Ratio = Current Assets / Current Liabilities
Cash Ratio = Cash / Current Liabilities
Net Working Capital Ratio = (Current Assets – Current Liabilities) / Current Assets



Source: Blominvest

Dividend payment

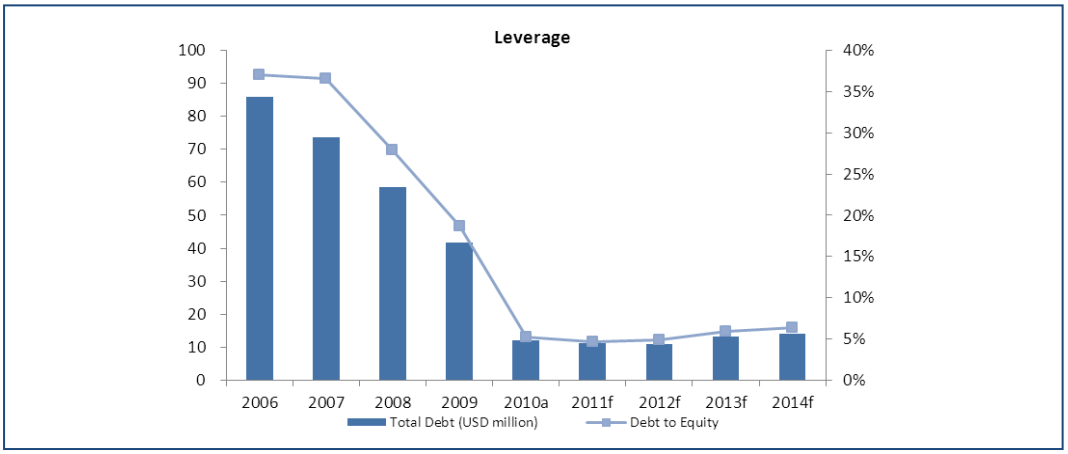
HL distributed $26.1 million in dividends on the profits of 2009 for a dividend yield of around 10.7% on the year-end 2009 closing share price of $12.52 per share. The company will further distribute $1.55 per share in dividends on 2010 earnings due by July 2011 for a total dividend yield of 9.1% on the year-end 2010 closing share price of $17.

Capital reduction

The extraordinary General Assembly held on December 14, 2010 voted for a capital reduction of $64.7 million, to be paid upon the completion of some legal proceedings estimated to persist at least until the end of 2011. The company expects to repay around 50% of the nominal value of its stock, or an equivalent of LL 5,000 ($ 3.3) per share on the 19,516,040 shares which constitute HL's share capital. Were the company to complete the capital reduction as expected, we believe that the share price of HL would decline by an amount close to the reduction to hover near $14.

Financial Leverage

During 2010, HL repaid $27.5 million of the non-current portion of debt which fell to $4 million sending the gearing ratio – which measures a company's long-term debt to equity – down to 2% in 2010 from 14% during the earlier year. Repayment of debt has been mostly enabled by the high levels of liquidity during the year, especially since major capital expenditures were limited to the replacement of the principal filter at the beginning of the year.



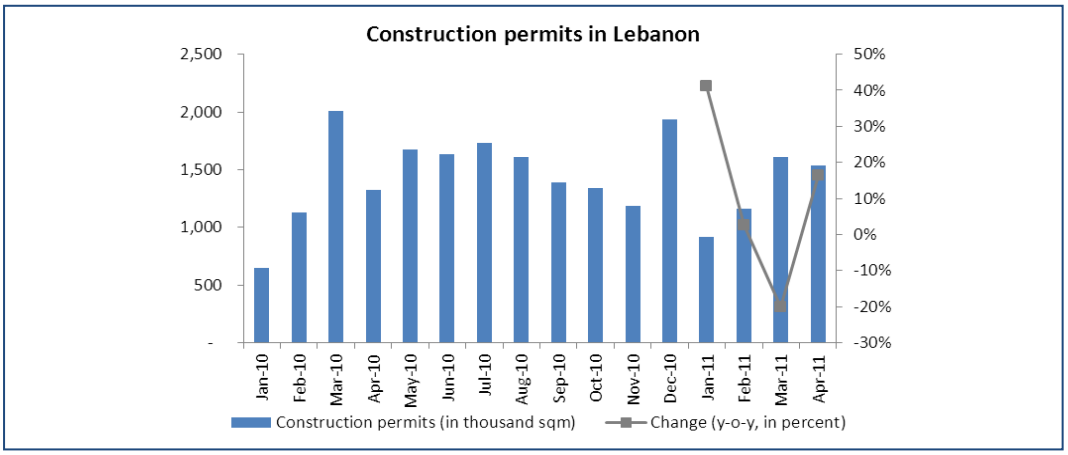
Source: Blominvest

Outlook

The Lebanese real estate market faces a challenging year

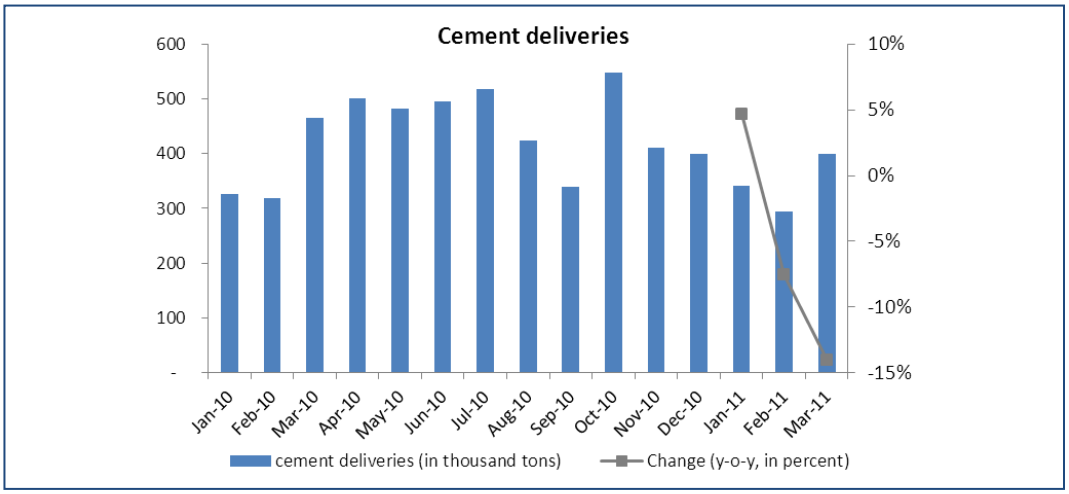
The real estate sector in Lebanon seems to have started the year on a decline compared to the same period of 2010 despite the number of construction permits in terms of square meters posting a 2.15% y-o-y gain. On the demand side, the number of real estate sales transactions during the first quarter of the year fell by 21% y-o-y to 17,373 and sales to foreigners, the pillar of the upper-end residential market, slumped by more than 30% over the same period due to the regional uprisings and the political instability in Lebanon from a lack of a government, despite five months having passed since the nomination of a new Prime Minister, Najib Mikati, at the head of the government.

Although Mikati recently formed a new cabinet, we remain conservative that these developments on the political scene will have much positive effect on the demand for real estate in Lebanon, as foreign investors remain dubious amid the negative developments in the region.



Source: BDL, Blominvest

In comparison, the value of transactions fell only by 14.5% y-o-y, giving evidence that prices remain relatively sticky as real estate developers keep prices high in the face of the slowing demand, reflective of the cost of land that seems to be withstanding the demand's downward trend. On the supply side, cement deliveries declined by 6.7% y-o-y over the first quarter of 2011 to 1,035 thousand tons further enforcing our anticipation for a slowing real estate market.



Source: BDL, Blominvest

Anticipating a decline in HL's top line for 2011

Last year's exceptional results for HL were driven by very high levels of local sales for all of the company's products, a situation that would doubtfully persist in 2011 due to the anticipated slowdown in the Lebanese real estate market. We therefore maintain our expectations that the local market size will decline to 5.05 million from 5.2 million in 2010, and will follow a trend of 1% decline per year beyond 2011 and through 2015.

We increase the price of grey cement to $92 per ton from $88 per ton supported by rising oil prices, while we believe the price of white cement will stagnate near $170 per ton. We anticipate a stabilization of gross margin near 36.5% for 2011 supported by sustained production efficiency. However, slowing sales growth will pressure HL's bottom line expected to experience a negligible growth of 0.2% y-o-y at $37 million.

Finally, we decreased our terminal growth rate to 3.5% from 4%, in line with our expectations for a sluggish revenue expansion.

PROJECTED INCOME STATEMENT

In USD million	2008	2009	2010a	2011f	2012f	2013f	2014f	2015f
Sales of Goods	202	207	227	221	218	222	223	225
Production Cost of Goods Sold	(139)	(139)	(144)	(140)	(137)	(139)	(140)	(139)
Gross Profit	63	68	74	81	81	83	84	85
Distribution & Selling expenses	(21)	(20)	(23)	(22)	(22)	(23)	(23)	(23)
Administrative Expenses	(9)	(6)	(7)	(7)	(7)	(7)	(7)	(7)
Other Income	1	0	0	0	0	0	0	0
Other Expenses	(5)	(4)	(5)	(5)	(5)	(5)	(5)	(5)
Interest Income	1	1	1	1	1	1	1	1
Provision for risks & charges	-	-	(2)	(2)	-	-	-	-
Finance Costs	(5)	(3)	(2)	(1)	(1)	(1)	(1)	(1)
Profit Before Tax	24	37	45	44	46	49	49	50
Income Tax Expense	(4)	(6)	(8)	(7)	(8)	(8)	(8)	(8)
Profit for the Year	21	31	37	37	39	41	41	41

Source: Blominvest

PROJECTED BALANCE SHEET

In USD million	2008	2009	2010a	2011f	2012f	2013f	2014f	2015f
Current Assets								
Cash & Cash Balances	14	18	20	22	24	27	30	31
Inventories	38	40	44	42	40	42	42	40
Accounts Receivables & Prepayments	19	17	17	19	17	19	21	20
Total Current Assets	71	74	82	83	82	88	94	92
Non-Current Assets								
Property, plant & equipment	184	169	157	150	142	135	130	126
Investment Properties	11	11	11	11	11	10	10	10
Goodwill	12	12	12	12	12	12	12	12
Intangible assets	39	35	30	27	25	22	20	18
Other Financial Assets	6	5	5	6	5	6	6	5
Total Non-Current Assets	253	233	216	205	194	185	177	171
Total Assets	324	307	298	288	276	273	271	263
Current Liabilities								
Loans & Borrowings	11	10	8	7	6	6	6	4
Accounts Payable & Accruals	43	29	37	28	26	25	24	25
Taxes Payable	4	6	7	5	6	4	6	4
Provision for Risks & Charges	1	1	1	1	1	1	1	1
Total Current Liabilities	59	46	52	41	38	36	36	34
Non-Current Liabilities								
Loans & Borrowings	48	32	4	4	5	7	8	10
Provision for employees end of service benefits	5	5	5	5	5	5	5	5
Provision for risks & Charges	1	1	3	1	1	1	1	1
Deferred Tax Liability	1	1	1	0	0	1	0	0
Total Non-Current Liabilities	55	38	13	11	12	13	15	16
Shareholders' Equity								
Share Capital	129	129	129	129	129	129	129	129
Statutory Reserve	15	17	21	23	25	27	28	30
Revaluation Reserve	37	37	37	37	37	37	37	37
Retained earnings	24	34	41	42	29	25	21	11
Minority interest	5	5	5	5	5	5	5	5
Total Equity	211	223	233	237	226	224	221	212
Total Liabilities & Equity	324	307	298	288	276	273	271	263

Source: Blominvest

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