



## Alert on H1 2012 Earnings Report

Sector: Basic Materials &amp; Industrial Products

Country: Lebanon

Date: October 31, 2012

Share Price (USD): 15.51

Target Price (USD): 15.21

Downside: 1.93%

Recommendation: Hold

**Maintaining a HOLD recommendation with a target share price of USD 15.21 per share on attractive dividend yield**
**Slowing demand weighs on sales however export opportunity may arise**

Lower local demand dragged Holcim Liban's (HL) revenues down by 7.5% y-o-y in the first half of 2012 to reach \$89.8 million. Revenue growth is expected to mirror the activity in the real estate market with slowing sales growth continuing to pressure HL's bottom line. Domestic sales formed the majority of HL's revenues as the company aims primarily to satisfy the local demand due to selling at higher prices than its previous export market, Syria. Nevertheless, the fall in construction projects in Lebanon could push Holcim to develop an export plan over the medium to long-term, benefiting from the reconstruction phase that will follow in Syria.

**High fuel costs pressure earnings but waste heat recovery to the rescue**

HL's gross income fell by 37.4% y-o-y in H1 2012 to attain \$24.4 million due to the simultaneous increase in productions costs and a steep decline in revenues. Higher energy prices reduced gross margin to 27.2% compared to 40.2% during the first half of 2011. Earnings followed suite, almost halved to \$9.1 million from \$19.9 million during the same period last year with profit margin plunging to 10.1% from 20.5%. On a positive note, HL's investment in Waste Heat Recovery couldn't come at a better time. Starting in 2013, HL will be able to reduce production costs by around \$3 million annually, cutting fuel consumption and lowering HL's profit variability in relation to oil prices.

**Reduction in cash and higher level of debt as part of HL's operating cycle**

As part of Holcim's annual operating cycle, cash and inventories dropped by a respective \$12 million and \$5 million in H1. Consequently, current ratio declined to 1.45 from 1.65 in 2011, while cash and net working capital ratios fell to 0.18 and 0.31 respectively. The current portion of loans and borrowings jumped by \$12.2 million up to June 2012 as HL normally utilizes short-term credit facilities during the first half of the year to help pay for a fuel shipment and its cash dividends. As for its debt to equity ratio, it remained unchanged at 6% in H1 2012 after decreasing considerably in the past two years as the high levels of liquidity allowed the company to repay a portion of its debt.

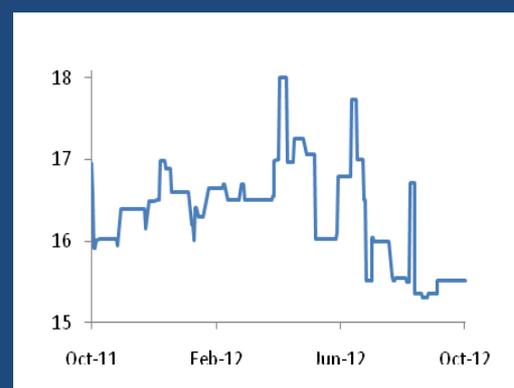
**Price reflects challenging environment with an attractive dividend yield**

Holcim's shares are currently yielding a very attractive 7%-9% in dividends but the challenging regional and local political situation continue to negatively impact share price. As a result, we maintain a HOLD rating with a target price of USD 15.21 per share. The discount rate is kept at 15% as the risk associated with the current turmoil in Syria impacting the Lebanese market is already reflected in our forecasts with Holcim operating below its full capacity in 2012. We maintain the terminal growth rate at 3% after considering the outlook of the company and inflation in Lebanon.

## Share Data

Bloomberg Symbol	HOLC LB
Reuters Symbol	HOLC.BY
Market Cap	302,693,780
Number of Shares	19,516,040
Free Float	17.8%
Price-to-Earnings 12	15.26
Price-to-Book 12	1.95

## Share Performance



Source: Bloomberg

1 Month Return	0.98%
3 Month Return	-0.06%
6 Month Return	-8.76%
12 Month Return	-8.50%
52 Week Range	15.31- 18.00

## Performance and Forecasts

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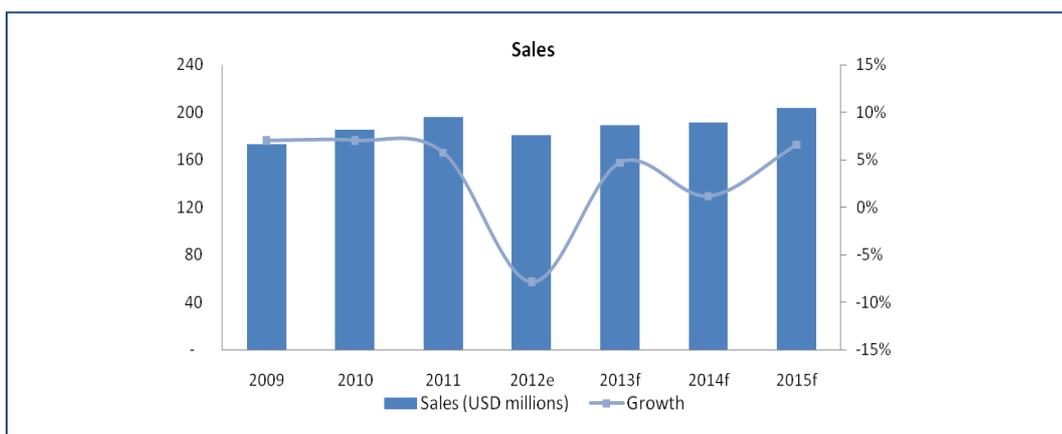
Year	2009	2010	2011	2012e	2013f	2014f
Revenues (USD millions)	173	185	196	180	189	191
Net Income (USD millions)	29.2	33.7	28.3	19.8	26.9	30.0
EPS (USD)	1.50	1.73	1.45	1.02	1.38	1.54
BVPS (USD)	8.88	9.07	8.18	7.94	8.02	8.10
ROA	9.4%	11.5%	9.6%	6.7%	9.3%	10.5%
ROE	13.9%	15.8%	13.1%	9.3%	12.5%	13.8%

Source: Company Financials, Blominvest Estimates

## INCOME STATEMENT HIGHLIGHTS

### Drop in revenues and upsurge in production costs negatively impacted the bottom line

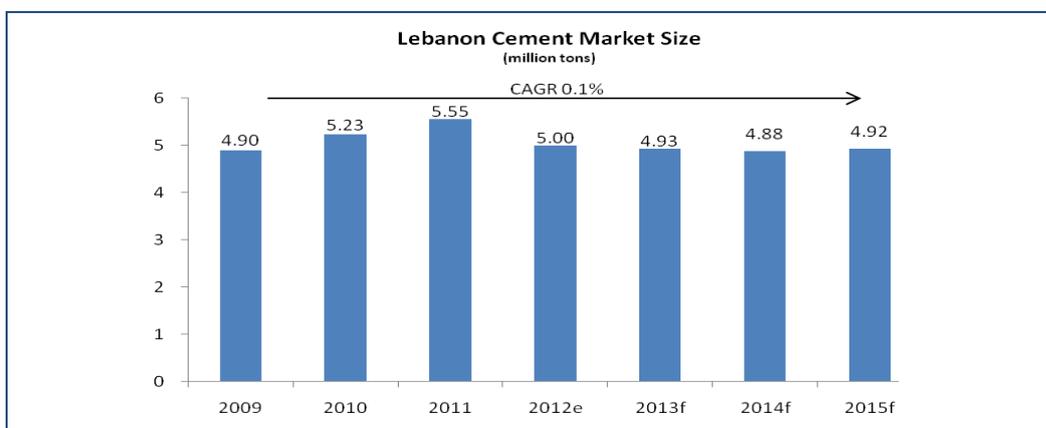
Despite stable cement prices, Holcim Liban’s (HL) revenues reached \$89.8 million during the first half of 2012, decreasing by 7.47% y-o-y, due to lower local demand amid a continued real estate slowdown. The size of the Lebanese cement market declined 2.9% y-o-y to 2.6 million tons in H1 2012, according to Lebanon’s Central Bank (BdL). HL captured a market share of 38.5%, satisfying 1 million ton of the local demand for grey cement up to June 2012 compared to 1.12 million tons a year earlier. We estimate the company’s sales to reach \$180.3 million in 2012, 7.84% lower than \$195.6 million a year earlier mirroring the weakening demand for cement. HL’s subsidiary white cement producer, Societe Libanaise des Ciments Blancs (SLCB), posted revenues of \$7.52 million in H1 2012 as opposed to \$6.87 million registered a year earlier. White cement sales volume recorded a 4.08% y-o-y increase to nearly 51,000 tons in H1 2012, still relatively low when considering its full capacity of around 100,000 tons.



Source: Holcim, Blominvest

### Potential opportunity to re-enter the Syrian market

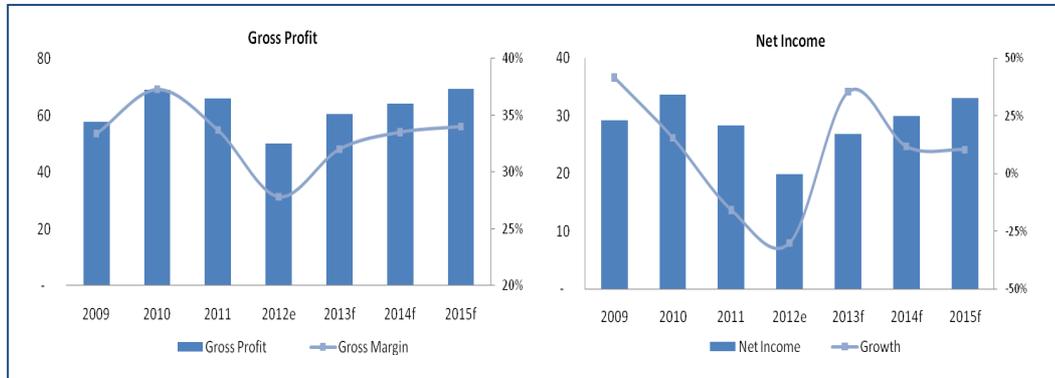
Local sales continue to form the majority of HL’s revenue as the company aims primarily to satisfy the local demand due to selling at better prices than its previous export market, Syria. Grey cement export sales remained nil during the first half of the year. Although higher local cement prices present more profitable opportunities for the company, the fall in construction projects in Lebanon could push Holcim to develop an export plan in order to utilize its full capacity. White cement export sales also plunged in the first half of 2012, impacted by the turmoil in Syria.



Source: BdL, Blominvest

## High energy prices pressure profit margins and net earnings

Holcim Liban's gross income diminished by 37.44% y-o-y during the first half of 2012 to attain \$24.4 million, mainly due to shrinking revenues. It also posted a 54.36% y-o-y plunge in the unconsolidated earnings to \$9.1 million from \$19.9 million. This was mainly attributable to higher production costs and a steep decline in sales figures.



Source: Holcim, Blominvest

The Spike in oil prices during H1 2012 sent production costs 12.65% up y-o-y to \$65.4 million. Profit margin at the cement maker plunged to 10.1% from 20.5% in H1 2011. Additionally, HL's operating margin dropped to 13.3% in H1 2012, with distribution, selling and administrative expenses accounting for 13.86% of sales. For 2012, we expect HL's net income to decline 30% on a yearly basis to reach \$19.8 million with gross margin decreasing to 27.8% in 2012.

## Waste Heat Recovery plan to slash production costs by \$3 million annually

On a positive note, starting 2013, HL will start benefiting from its Waste Heat Recovery Investment that will enable it to burn less fuel oil in its plants. In details, the company has installed turbines to generate electricity by capturing heat from some engines in its plants and transform it to electricity. These turbines are estimated to reduce production costs by around \$3 million per year by cutting fuel consumption and lowering HL's profit variability in relation to oil prices. Moreover, this will result in reduced CO<sub>2</sub> emissions and more environment-friendly operation, a major objective for HL.

## BALANCE SHEET HIGHLIGHTS

### Liquidity

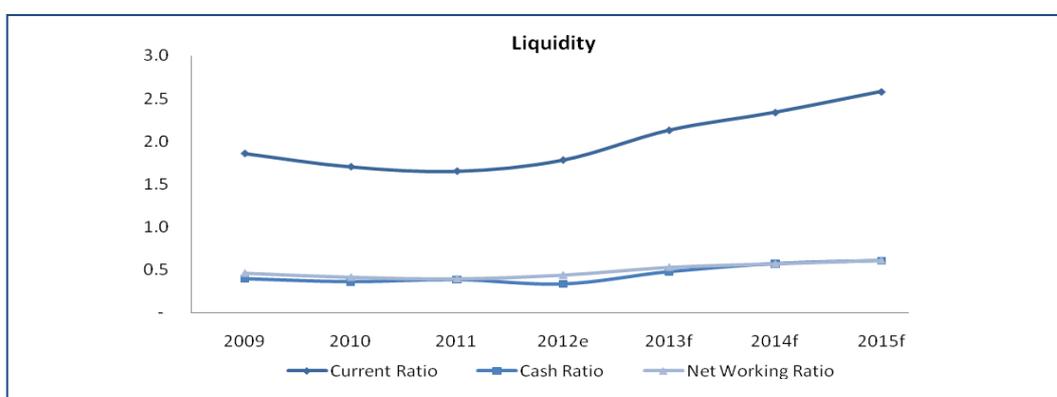
HL's total assets dropped by 5.67% from year start to \$284 million with cash and inventories declining by a respective \$12 million and \$5 million as part of Holcim's annual operating cycle. Current assets retreated 9.77% from December 2011, while current liability rose 2.51% leading to a decline in current ratio to 1.45 from 1.65 in 2011. Cash and net working capital ratios also recorded a decrease to 0.18 and 0.31 against 0.39 in 2011 for both.

HL normally utilizes short-term credit facilities during the first half of the year to help pay for a fuel shipment and its cash dividends. As a result, the current portion of loans and borrowings jumped by \$12.2 million up to June 2012. However, the bank overdraft account, used to pay for \$15 million of fuel shipment and \$25 million in cash dividends, will drop back to zero by year-end.

*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

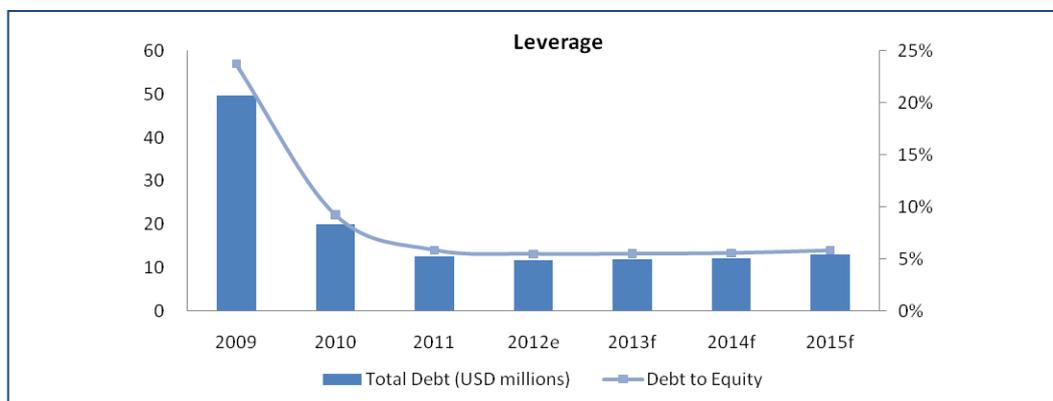
HL distributed \$25 million in cash dividends on 2011 earnings for a gross dividend yield of 7.6% on the year-end 2011 closing share price of \$16.98. In 2010, the company distributed \$30.25 million in dividends on the profits of 2010 for a dividend yield of around 9.1% on the year-end 2010 closing share price of \$17.00 per share. HL's dividend payout ratio remained high at 88.8% in 2011 against 89.8% and 60% recorded in 2010 and 2009 respectively.

	2007	2008	2009	2010	2011
Price / Share	20.75	15.93	12.52	17	16.98
Dividend Paid / Share	0.908	0.698	0.898	1.55	1.29
Dividend Yield	4.4%	4.4%	7.2%	9.1%	7.6%
Earnings/Share	0.96	1.06	1.50	1.73	1.45
Dividend Payout Ratio	94.4%	66.0%	60.0%	89.8%	88.8%

Source: Holcim, Blominvest

## Financial Leverage

HL's debt to equity ratio remained unchanged at 6% in H1 2012 after decreasing considerably in the past two years as the high levels of liquidity allowed the company to repay a portion of its debt. Repayment of debt is expected to continue with no new major capital expenditures plans for the near future.



Source: Blominvest

## VALUATION

### Limited growth prospects with an attractive dividend yield

We maintain a HOLD rating with a target price of USD 15.21 per share using a Discounted Cash Flow method based on a 5-year forecast. The discount rate is kept at 15% as the risk associated with the current turmoil in Syria impacting the Lebanese market is already reflected in our forecasts with Holcim operating below its full capacity in 2012. Additionally, we maintain the terminal growth rate at 3% taking into consideration the outlook of the company and inflation in Lebanon.

We find the revised target price to fairly reflect Holcim's share value, presenting only a 1.93% downside over its recent closing price. When comparing HL to its regional peers, we find that with a P/E ratio of 15.3, the cement producer may be fairly valued compared to its peers which hold an average P/E of 16.4. However, Holcim's shares are currently yielding a very attractive 7%-9% in dividends but the challenging regional and local political situation continue to negatively impact share price.

Revenue forecasts were extended over a five-year period assuming no additions in production capacity. Production costs are expected to decline gradually in the next five years, turning to its historical average of 65% of revenues in 2016. To note that 2012 is an exceptional year as production costs are estimated to reach a peak of 72% of revenues.

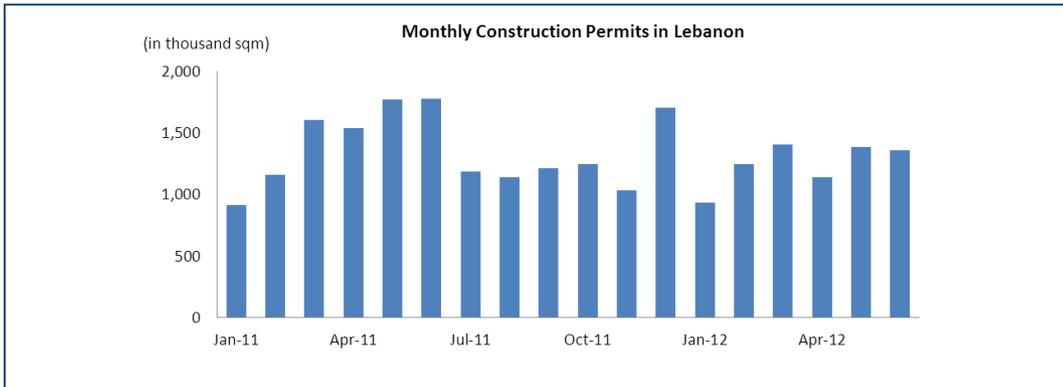
(in USD million)	2012	2013	2014	2015	2016	2017
Net income	19.8	26.9	30.0	33.1	36.2	40.2
Add: Depreciation	13.4	12.9	12.3	11.8	11.2	10.6
Less: CAPEX	(6.0)	(6.0)	(6.0)	(6.0)	(6.0)	(6.0)
Less: Change in Net Working Capital	(8.1)	(5.7)	(2.9)	(9.0)	(1.1)	(6.0)
FCF	19.2	28.0	33.5	30.0	40.2	38.9
Terminal value						334
Discounted FCF	19.2	24.3	25.3	19.7	23.0	19.3
<b>Holcim Value</b>	<b>296.7</b>					
Number of shares (in millions)	19.5					
<b>Target Share Price (in USD)</b>	<b>15.21</b>					

Source: Blominvest

**OUTLOOK**

**A challenging year for the Lebanese cement industry**

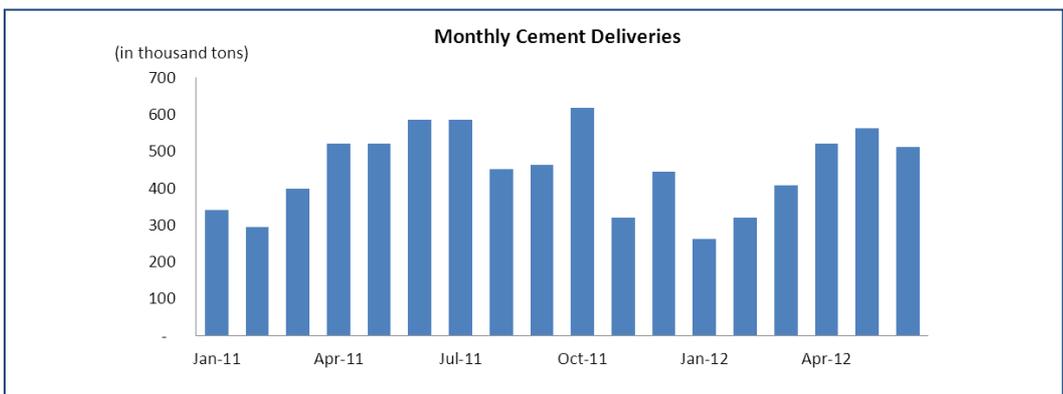
The Lebanese cement industry witnessed a slowdown in the first half of 2012 as the political unrest sweeping most Arab countries and the local political instability affected the economic activity of the country and tamed demand for cement. Indicators point to a downward trend in real estate activity as construction permits, measured by surface, fell 14.72% y-o-y during the first half of the year to reach 7.48 million sqm according to the Order of Engineers in Beirut and North. Average area authorized for construction in the first six months of 2012 stood at 831 sqm per permit compared to 902 sqm per permit a year earlier.



Source: Order of Engineers in Beirut and North

**Property prices proving resilient amid slowdown**

On the demand side, the crisis in Syria continues to impact the Lebanese market with the number of property sales transactions declining by 8% y-o-y up to June 2012 to reach 34,388 transactions, as posted by the Real Estate Directorate of the Ministry of Finance. However, while domestic and regional security setbacks may have had a key role in keeping demand for properties limited in H1 2012, Lebanon’s real estate market continued to rake in good profits for developers targeting the right niches. The value of real estate transactions increased by 7.8% y-o-y to reach \$4,149 million up to June, giving evidence that prices remain relatively sticky as developers keep prices high in the face of the slowing demand. This is also reflective of the price of land that seems to be withstanding the demand’s downward trend. On the supply side, cement deliveries dropped by 2.9% y-o-y in the first six months to 2.6 million tons.



Source: BdL

## Bottom line pressured by high energy prices and shrinkage in demand

Higher energy costs and weak local demand for cement weighed negatively on Holcim's H1 unconsolidated earnings. We expect a sustained slowdown in the Lebanese real estate market with demand for cement cooling down from 5.5 million tons in 2011 to 5 million tons in 2012. In our financial model, we believe the price of grey cement will remain around \$92 per ton, while the price of white cement will stagnate near \$181 per ton. However, as long as the government is imposing high tariffs on cement imports, Lebanese cement producers will continue to enjoy a price advantage. Revenue growth is expected to mirror the activity in the real estate market with slowing sales growth continuing to pressure HL's bottom line.

Amidst the ongoing shrinkage in local demand, Lebanese producers are finding difficulty to export their cement to Syria due to the escalating crisis there. On the positive side, the reconstruction phase that will follow the turmoil in Syria will boost demand, triggering a rebound in its cement industry.

One of the main drivers of the Lebanese cement industry is government infrastructure investments. Since the Government is limited to finance large projects, the public-private partnership scheme is seen as a potential growth driver to the cement market. However, the government didn't manage to end the debate over this partnership, which may partly compensate for the decline of the real estate market with the upgrade of infrastructure. In addition, the Lebanese government failed to pass a budget since 2005, which could have allocated enough funds to infrastructure projects.

## Higher market share and increase in cement prices to make up for slack in demand

While the cement market size in Lebanon may decline in 2013, we are forecasting for HL to capture additional market share by 0.5% annually to reach its target 34% by 2016. This has kept the number of tons sold by HL steady in 2013 and 2014. However, revenues during these years are expected to increase due to an expected rise in cement prices. We assumed a conservative price increase from \$92 in 2012 to \$96 in both 2013 and 2014 based on feedback from local producers.

	2012e	2013f	2014f	2015f	2016f	2017f
Cement Deliveries in Lebanon (in million tons)	5.00	4.93	4.88	4.92	5.02	5.12
Market Size Growth		-1.50%	-1.00%	1.00%	2.00%	2.00%
Holcim Market Share	32.0%	32.5%	33.0%	33.5%	34.0%	34.0%
Demand satisfied by HL (in million tons)	1.60	1.60	1.61	1.65	1.71	1.74
Expected price per ton (in USD)	92	96	96	100	100	104
Price Growth		4.3%	0.0%	4.2%	0.0%	4.0%
* Expected Net Sales from Grey Cement (in USD m)	147	154	154	165	171	181

*\*: This represents the majority of HL's revenue. The rest is derived from white cement and other construction materials which we did not grow in our forecasts.*

## PROJECTED INCOME STATEMENT

<i>In USD Million</i>	H1 2011	H1 2012	%Ch	2011	2012e	%Ch
Sales of Goods	97.1	89.8	-7.5%	195.6	180.3	-7.8%
Production Cost of Goods Sold	(58.1)	(65.4)	12.7%	(129.8)	(130.2)	0.3%
<b>Gross Profit</b>	<b>39.0</b>	<b>24.4</b>	<b>-37.4%</b>	<b>65.9</b>	<b>50.1</b>	<b>-23.9%</b>
Distribution & Selling expenses	(8.8)	(8.0)	-8.7%	(18.9)	(17.5)	-7.5%
Administrative Expenses	(4.5)	(4.4)	-0.6%	(5.8)	(5.4)	-6.8%
Other Income	1.2	1.4	13.2%	1.9	2.0	2.7%
Other Expenses	(2.5)	(1.9)	-22.5%	(6.3)	(5.0)	-20.6%
Interest Income	0.2	0.1	-32.4%	0.3	0.3	-10.9%
Finance Costs	(0.8)	(0.8)	6.7%	(1.5)	(1.2)	-21.2%
<b>Profit Before Tax</b>	<b>23.9</b>	<b>10.7</b>	<b>-55.2%</b>	<b>35.6</b>	<b>23.3</b>	<b>-34.5%</b>
Income Tax Expense	(4.0)	(1.6)	-59.6%	(7.3)	(3.5)	-52.0%
<b>Profit for the Year</b>	<b>19.9</b>	<b>9.1</b>	<b>-54.4%</b>	<b>28.3</b>	<b>19.8</b>	<b>-30.0%</b>

Source: Holcim, Blominvest

<i>In USD million</i>	2009	2010	2011	2012e	2013f	2014f	2015f
Sales of Goods	172.9	185.0	195.6	180.3	188.8	191.0	203.5
Production Cost of Goods Sold	(115.2)	(116.1)	(129.8)	(130.2)	(128.4)	(127.0)	(134.3)
<b>Gross Profit</b>	<b>57.7</b>	<b>69.0</b>	<b>65.9</b>	<b>50.1</b>	<b>60.4</b>	<b>64.0</b>	<b>69.2</b>
Distribution & Selling Expenses	(14.7)	(16.6)	(18.9)	(17.5)	(18.3)	(18.1)	(19.3)
Administrative Expenses	(3.8)	(5.1)	(5.8)	(5.4)	(5.7)	(5.7)	(6.1)
Other Income	2.1	1.5	1.9	2.0	1.0	1.0	1.0
Other Expenses	(3.7)	(6.5)	(6.3)	(5.0)	(5.0)	(5.0)	(5.0)
Interest Income	0.2	0.2	0.3	0.3	0.3	0.3	0.4
Finance Costs	(3.0)	(2.2)	(1.5)	(1.2)	(1.2)	(1.1)	(1.2)
<b>Profit Before Tax</b>	<b>34.7</b>	<b>40.3</b>	<b>35.6</b>	<b>23.3</b>	<b>31.6</b>	<b>35.3</b>	<b>38.9</b>
Income Tax Expense	(5.5)	(6.6)	(7.3)	(3.5)	(4.7)	(5.3)	(5.8)
<b>Profit for the Year</b>	<b>29.2</b>	<b>33.7</b>	<b>28.3</b>	<b>19.8</b>	<b>26.9</b>	<b>30.0</b>	<b>33.1</b>
% growth in NI	41.6%	15.4%	-15.9%	-30.0%	35.4%	11.7%	10.4%
Number of Shares (in millions)	19.5	19.5	19.5	19.5	19.5	19.5	19.5
Earnings per Share (In USD)	1.5	1.7	1.5	1.0	1.38	1.54	1.7

Source: Holcim, Blominvest

## PROJECTED BALANCE SHEET

<i>In USD million</i>	2009	2010	2011	2012e	2013f	2014f	2015f
<b>Current Assets</b>							
Cash & Cash Balances	16	17	24	19	25	30	32
Inventories	36	40	56	58	58	57	63
Accts Receivables & Prepayments	23	23	24	25	23	23	24
<b>Total Current Assets</b>	<b>75</b>	<b>80</b>	<b>103</b>	<b>102</b>	<b>105</b>	<b>110</b>	<b>119</b>
<b>Non-Current Assets</b>							
Property, plant & equipment	155	143	137	131	126	121	116
Investment Properties	11	11	11	11	11	12	12
Goodwill	18	18	18	18	18	18	18
Intangible assets	35	32	27	25	23	21	19
Other Financial Assets	4	4	4	4	4	4	5
<b>Total Non-Current Assets</b>	<b>224</b>	<b>207</b>	<b>197</b>	<b>189</b>	182	176	170
<b>Total Assets</b>	<b>299</b>	<b>288</b>	<b>301</b>	<b>292</b>	<b>287</b>	<b>286</b>	<b>289</b>
<b>Current Liabilities</b>							
Loans & Borrowings	0	0	0	0	0	0	0
Accounts Payable & Accruals	10	8	2	3	3	4	4
Taxes Payable	25	33	55	51	41	37	36
Provision for Risks & Charges	5	7	5	4	5	5	5
<b>Total Current Liabilities</b>	<b>41</b>	<b>47</b>	<b>63</b>	<b>57</b>	49	46	45
<b>Non-Current Liabilities</b>							
Loans & Borrowings	40	12	10	9	9	8	8
Provision for employee benefits	4	4	4	4	5	5	5
Provision for risks & Charges	4	6	8	8	8	8	8
Deferred Tax Liability	1	1	0	0	0	0	0
<b>Total Non-Current Liabilities</b>	<b>49</b>	<b>24</b>	<b>23</b>	<b>22</b>	22	21	21
<b>Shareholders' Equity</b>							
Share Capital	129	129	129	129	129	129	129
Statutory Reserve	17	19	23	25	27	29	31
Revaluation Reserve	34	34	34	34	34	34	34
Retained earnings	30	35	29	24	26	27	29
<b>Total Equity</b>	<b>210</b>	<b>217</b>	<b>215</b>	<b>213</b>	<b>216</b>	<b>219</b>	<b>223</b>
<b>Total Liabilities &amp; Equity</b>	<b>299</b>	<b>288</b>	<b>301</b>	<b>292</b>	<b>287</b>	<b>286</b>	<b>289</b>

Source: Holcim, Blominvest

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