Holcim (Liban)

BLOMINVEST BANK S.A.L.

Update on H1 2013

Sector: Basic Materials & Industrial Products

Country: Lebanon

Date: 25 February, 2014

Share Price (USD): 14.50

Target Price (USD): 14.62

Upside: 0.85%

Recommendation: HOLD

Maintaining a HOLD recommendation with a target share price of USD 14.62 per share to account for revised forecasts

Sales shrink despite growing local demand for cement

Holcim Liban (HL) registered a 1.1% drop in revenues during the first half of 2013 to reach USD 88.8 million. Although the size of the Lebanese grey cement market grew by 2.7% y-o-y to 2.7 million tons, HL captured a lower market share of 39.2% compared to 41.0% a year earlier. Grey cement sales continue to account for the bulk of total sales volume, constituting 95.5% or 995.9 thousand tons. We expect exports to remain almost non-existent in the near-term as high local cement prices present HL with more profitable opportunities. Looking forward, we estimate 2013 sales to be around 2012 level at USD 187.5 million following better results during the second half of the year.

Tighter margins on rising production costs

HL's gross income fell by 2.7% y-o-y in H1 to USD 23.7 million, pressured by lower revenues and higher cost of coal and fuel oil. Earnings followed suit, declining by 10.4% to USD 8.1 million with a lower margin of 9.2% against 10.1% a year earlier, further distressed by higher finance costs and extraordinary expenses. We estimate earnings at USD 17.8 million in 2013, growing at a CAGR of 24.6% in the coming three years on improved efficiency. HL's investment in Waste Heat Recovery (WHR), which started in May 2013, couldn't come at a better time. The company will benefit from enhancing margins through lowering profit variability in relation to oil prices and cutting production costs by USD 2 million per year.

Postponing payments led to a boost in liquidity ratios

Contrary to Holcim's normal cycle, the payments for fuel shipment and $15.4 million in dividends on 2012 earnings were postponed from the first half to July 2013. Consequently, cash doubled to USD 24 million, while the current portion of loans and borrowings fell by USD 14 million as HL normally utilizes short-term credit facilities to help make these delayed payments. This has translated into better liquidity and short-term leverage ratios compared to a year earlier. Additionally, controlled debt levels continue to contribute to HL's financial health as the debt-to-equity ratio was almost unchanged at 4.3% in H1 2013. We expect this ratio to remain stable in the future as the company has not announced any new major capital expenditure plans.

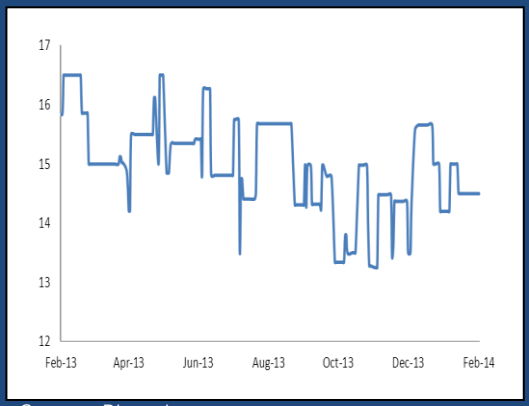
Target price lowered on persistent political tensions

We value Holcim Liban at USD 14.62 per share using a Discounted Cash Flow method based on a 5-year forecast. Holcim shares are yielding a very attractive 5%-7% in dividends but the political unrest sweeping the Arab World accompanied by Lebanon's intensified security incidents continue to act as an obstacle against the desired performance, leading us to issue a HOLD recommendation. HL appears to be slightly undervalued relative to its peers with a P/E ratio of 15.9 compared to 16.5 for the average of the industry in the Middle East. However, we believe this discount is mainly attributable to Lebanon's security and political risks in addition to the continuous spillovers of the 3-Year Syrian war.

Share Data

Bloomberg Symbol	HOLC LB
Reuters Symbol	HOLC.BY
Market Cap	282,982,580
Number of Shares	19,516,040
Free Float	17.8%
Price-to-Earnings 13	15.89
Price-to-Book 13	1.84

Share Performance



Source: Bloomberg

1 Month Return	2.1%
3 Month Return	9.4%
6 Month Return	-7.5%
12 Month Return	-8.5%
52 Week Range	13.25 – 16.50

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Performance and Forecasts

Year	2011	2012	2013e	2014f	2015f
Revenues (USD millions)	195.6	186.8	187.5	188.3	194.0
Net Income (USD millions)	28.3	18.0	17.8	20.8	26.5
EPS (USD)	1.45	0.92	0.91	1.07	1.36
BVPS (USD)	8.18	8.06	8.06	8.10	7.89
ROA	9.6%	6.2%	6.4%	7.5%	9.6%
ROE	13.1%	8.5%	8.6%	10.0%	12.6%

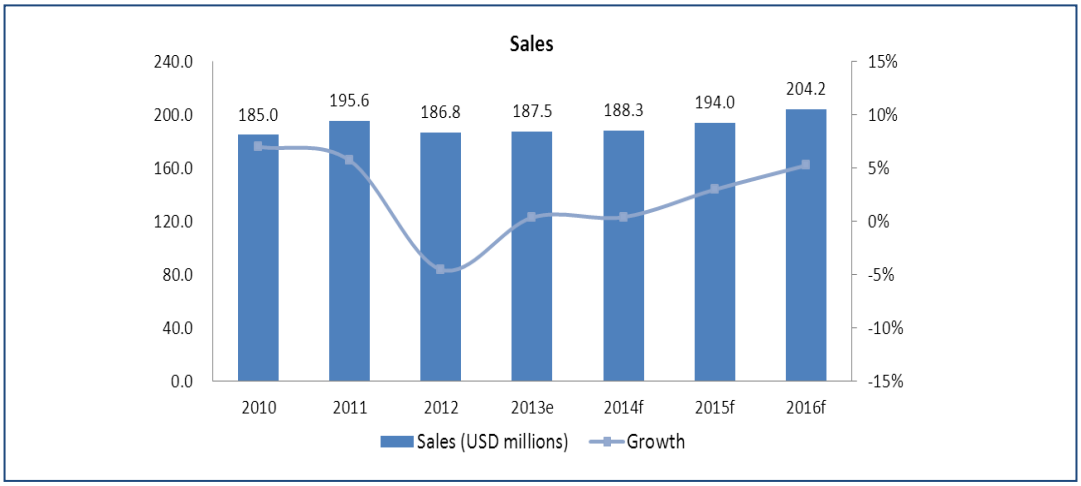
Source: Company Financials, Blominvest Estimates

INCOME STATEMENT HIGHLIGHTS

Holcim's top-line falls on lower grey and white cement sales volume

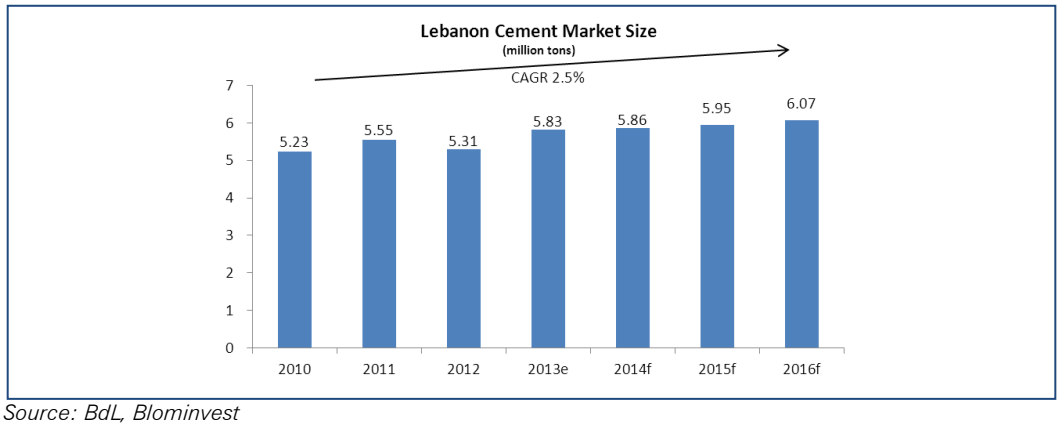
Holcim Liban registered a 1.1% y-o-y drop in revenues during the first half of 2013 to reach USD 88.8 million, led by a 1.7% decline in sales volume to 1.04 million tons. Despite the local political unrest, the size of the Lebanese grey cement market managed to grow by 2.7% y-o-y to 2.7 million tons. However, HL captured a lower market share of 39.2% compared to 41.0% recorded a year earlier. Grey cement sales accounted for the bulk of the company's total sales volume, constituting 95.5% or 995.9 thousand tons. Exports remained almost non-existent with local demand exhausting the company's total capacity. We expect this trend to continue in the near term as high local cement prices present Holcim Liban with more profitable opportunities.

Looking forward, we estimate 2013 sales to be around 2012 level at USD 187.5 million following prospects of recovering results during the second half of the year in line with the expansion of the Lebanese cement market. Similarly, we expect little to no growth during 2014 in the absence of signs for a considerable pick up in local demand for cement as well as potential export to the unstable neighboring Syria. However, Holcim's top-line is estimated to increase at a CAGR of 2.9% in the coming three years, supported by the reconstruction phase that will follow the current social chaos in Syria.



Source: Holcim, Blominvest

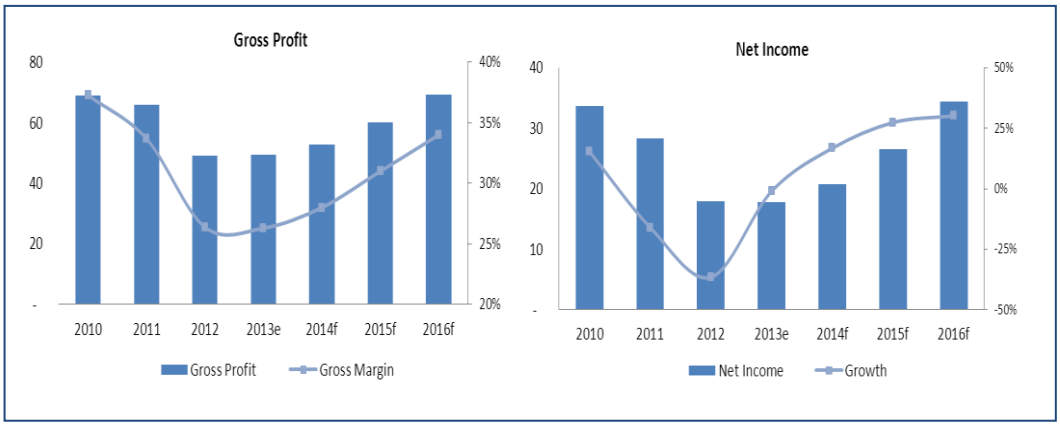
Similarly, revenues at HL's junior sister company, the Societe Libanaise des Ciments Blancs (SLCB), a white cement producer, registered a 5.2% y-o-y decrease during H1 2013 to reach USD 7.1 million. This was mainly led by an 8.7% reduction in white cement sales volume to 46.6 thousand tons. The political turbulence in neighboring Syria continues to deeply affect white cement exports that contracted to 25.7% of total white cement sales after accounting for almost 40% in Syria pre-war years.



Source: BdL, Blominvest

Bottom-line distressed by higher production costs

The performance of Holcim Liban contracted during H1 2013, pressured by lower revenues and higher cost of coal and fuel oil. Production costs rose to 73.3% of sales from 72.8% a year earlier, dragging down HL's gross profit by 2.7% to USD 23.7 million. Earnings followed suit, declining by 10.4% to USD 8.1 million, further distressed by higher finance costs and extraordinary expenses. Hence, the company's net margin tightened to 9.2% as opposed to 10.1% in H1 2012. Looking forward, we estimate 2013 earnings to be around 2012 level at USD 17.8 million, growing at a CAGR of 26.6% in the coming three years on improved efficiency. The Waste Heat Recovery power generation, which started in May 2013, is expected to cut HL's production costs by USD 2 million per year, gradually enhancing the company's margin. HL will benefit from the WHR project by reducing fuel consumption and lowering its profit variability in relation to oil prices.



Source: Holcim, Blominvest

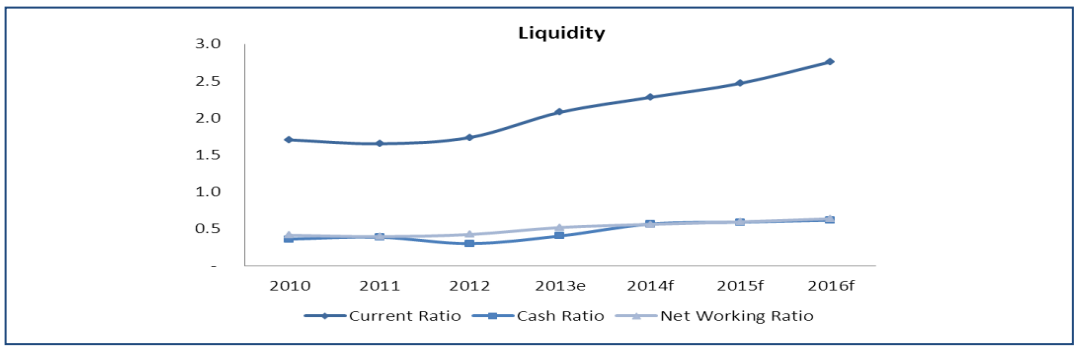
Conversely, SLCB witnessed a 27.8% y-o-y jump in gross profit to USD 2.5 million, boosting gross margin to 34.4% from 25.5% a year earlier following a significant cut in production costs. As well, net profit margin at the white cement maker reached 21.9%, up from 15.3% recorded in H1 2012 with the bottom-line rising by 36.0% to USD 1.6 million.

BALANCE SHEET HIGHLIGHTS

Liquidity

Contrary to Holcim's normal cycle, the payments for fuel shipment and $15.4 million in dividends on 2012 earnings were postponed from the first half to July 2013. As a result, cash doubled to USD 24 million, while the current portion of loans and borrowings fell by USD 14 million as HL usually utilizes short-term credit facilities to help make these delayed payments. This translated into higher liquidity ratios with the current ratio reaching 2.33 compared to 1.45 recorded a year earlier. Likewise, the cash and net working capital ratios increased to 0.57 from a respective 0.18 and 0.31 registered in H1 2012.

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



Source: Holcim, Blominvest

Sustainable dividend payment

HL announced the distribution of $15.4 million in dividends on 2012 earnings for a gross dividend yield of 5% on the year-end 2012 closing share price of $15.75. In 2011, the company distributed $25 million in dividends on the profits of 2011 for a dividend yield of 7.6% on the year-end 2011 closing share price of $16.98 per share. HL's dividend payout ratio remained high at 85.6% in 2012 compared to 88.8% and 89.8% recorded in 2011 and 2010 respectively.

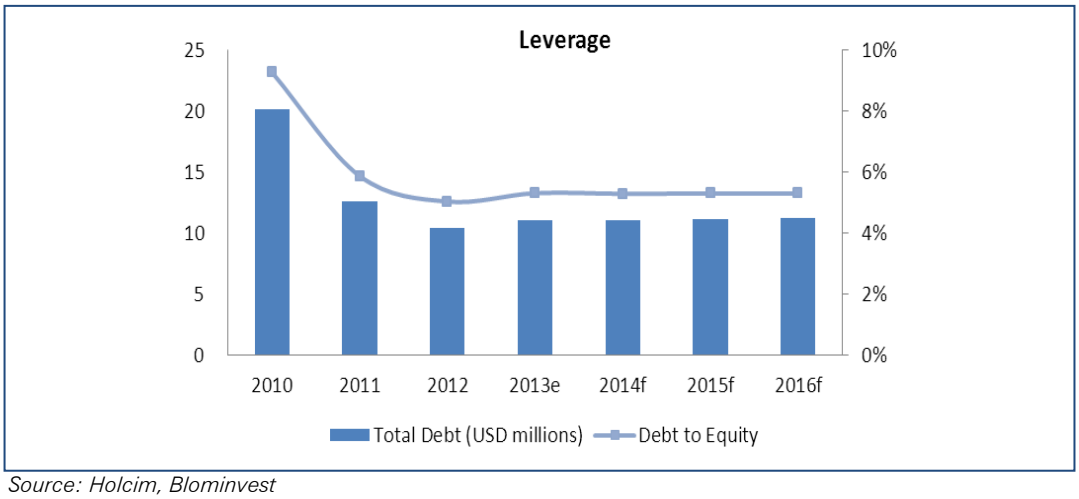
As for Societe Libanaise des Ciments Blancs, it approved the distribution of $2.2 million in dividends to common shareholders on the profits of 2012, which is equivalent to $0.25 per share with a dividend payout ratio of 86.4%.

	2007	2008	2009	2010	2011	2012
Price / Share	20.75	15.93	12.52	17	16.98	15.75
Dividend Paid / Share	0.908	0.698	0.898	1.55	1.29	0.79
Dividend Yield	4.4%	4.4%	7.2%	9.1%	7.6%	5.0%
Earnings/Share	0.96	1.06	1.50	1.73	1.45	0.92
Dividend Payout Ratio	94.4%	66.0%	60.0%	89.8%	88.8%	85.6%

Source: Holcim, Blominvest

Financial Leverage

Controlled debt levels continue to contribute to Holcim Liban's financial health as the long-term debt-to-equity ratio was almost unchanged from a year earlier at 4.3% in H1 2013. We expect the leverage ratio to remain stable in the future as the company has not announced any new major capital expenditure plans.



Source: Holcim, Blominvest

VALUATION

Maintaining a HOLD on sustainable political tensions

We value Holcim Liban at USD 14.62 per share using a Discounted Cash Flow method based on a 5-year forecast. This represents an upside potential of 0.85% over the recent closing price leading us to issue a HOLD recommendation. Holcim shares are currently yielding a very attractive 5%-7% in dividends but the country's shaky economic and political conditions along with the regional political unrest continue to act as an obstacle against the desired performance. Holcim Liban appears to be slightly undervalued relative to its peers with a price-to-earnings ratio of 15.9 against 16.5 for the average of the industry in the Middle East. We believe this discount is mainly attributable to the country's security and political risks in which HL operates on top of the impact of the ongoing political turmoil in neighboring Syria.

The discount rate is kept at 15% as the risk associated with the impact of the Syrian war on Lebanese equities is already reflected in our forecasts. Additionally, we maintain the terminal growth rate at 3% taking into account the outlook of the company and inflation in Lebanon. Revenue forecasts were extended over a five-year period assuming no additions in production capacity. We expect sales to currently remain almost stable, picking up in the medium-term following possible high demand during the reconstruction phase in Syria. Production costs (as a percentage of revenues) are expected to decline gradually in the next five years, turning to its historical average of 65% of revenues in 2017. We estimate 2013 production costs around 2012 level at 73.7% of revenues.

To note that if HL completes the projected 50% capital reduction on the nominal value of the stock, amounting to USD 64.7 million or the equivalent of USD 3.3 per share, the share price would decline by an amount close to the reduction to hover near USD 11.

(in USD million)	2013e	2014f	2015f	2016f	2017f	2018f	Terminal
Net income	17.8	20.8	26.5	34.5	37.9	40.6	
Add: Depreciation	13.2	12.5	11.9	11.3	10.8	10.2	
Less: CAPEX	(6.0)	(6.0)	(6.0)	(6.0)	(6.0)	(6.0)	
Less: Change in Net Working Capital	(8.0)	(1.1)	(6.7)	(8.7)	(6.7)	(2.1)	
Add: Net Borrowing	(0.6)	0.2	0.1	(0.1)	(0.3)	(0.3)	
FCF	16.4	26.4	25.9	31.0	35.7	42.4	
Terminal value							364.0
Discounted FCF	22.5	16.4	23.0	19.6	20.4	20.4	21.1
Holcim Value	**285.4**						
Number of shares (in millions)	19.5						
Target Share Price (in USD)	**14.62**						

Source: Blominvest

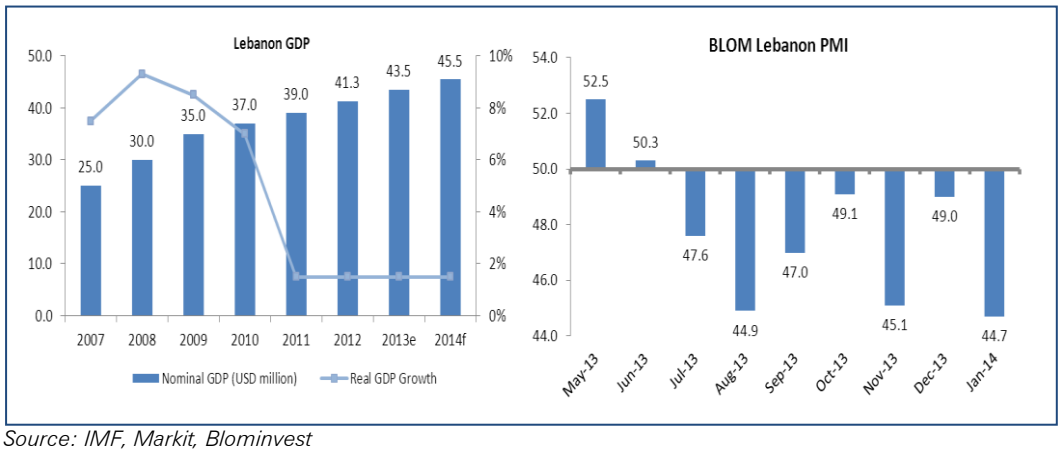
Sensitivity Analysis

Discount Rate	Terminal Growth	Fair Value/Share	Upside
20%	2%	9.67	-33.29%
20%	3%	10.01	-30.93%
20%	4%	10.04	-28.28%
15%	2%	13.83	-4.64%
15%	**3%**	**14.62**	**0.85%**
15%	4%	15.56	7.34%
10%	2%	23.32	60.83%
10%	3%	25.97	79.11%
10%	4%	29.50	103.47%

Source: Blominvest

2013: ECONOMIC OVERVIEW

Lebanon's economic performance remained under stress in 2013 deeply hit by the resignation of Najib Mikati's cabinet at the beginning of the year and the inability to form a new government until February 2014 along with the heightened complications on the Syria front. The BLOM Lebanon PMI (Purchasing Managers' Index) remained below the neutral 50.0 mark since July, revealing a sign of contraction in economic activity as the country's intensified security incidents delayed the nascent recovery. The precarious situation of the country was mirrored by the International Monetary Fund (IMF) downward revision of Lebanon's real GDP growth projection for 2013 to 1.5% from a previous 2.0%.

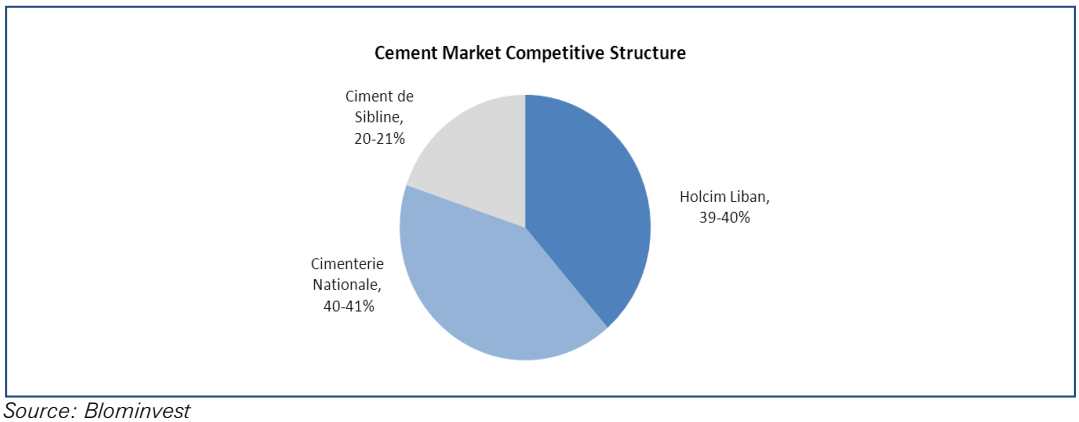


Source: IMF, Markit, Blominvest

The real estate sector, standing at 14% of Lebanon's GDP according to 2011's national accounts, faced numerous challenges in 2013 as dominant developers postponed their investments' agendas amid lower demand from the GCC countries that switched to more secure areas. However, the cement sector, and as opposed to construction and real estate activities, showed an impressive growth over the year, led by high public spending, illegal construction as well as ongoing projects from preceding years.

Cement Market Dynamics

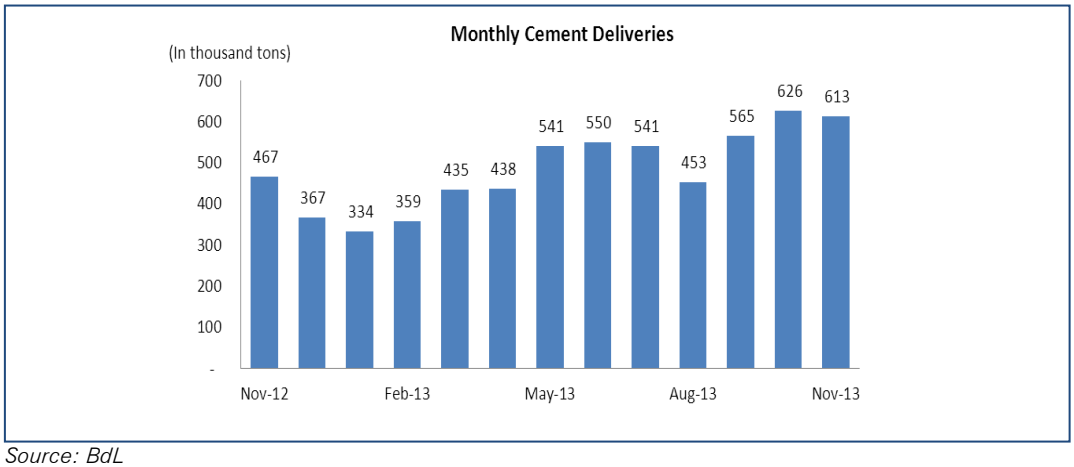
The cement market in Lebanon continues to take the form of an oligopoly, supplied by only three companies with a total production capacity of 6.2 million tons per year. Cimenterie Nationale accounts for 40-41% of the total market size. It offers grey cement only, which is the most common type of cement used domestically and worldwide. Similarly, Holcim Liban makes up 39-40% of cement sales, offering both types of cement, grey and white. Ciment de Sibline comes in the third place, producing only grey cement with a market share of 20-21%. Cimenterie Nationale exports part of its products to Syria, the northern part of Cyprus, Egypt, and southern Europe, while the other two companies mainly focus on satisfying the local demand.



Source: Blominvest

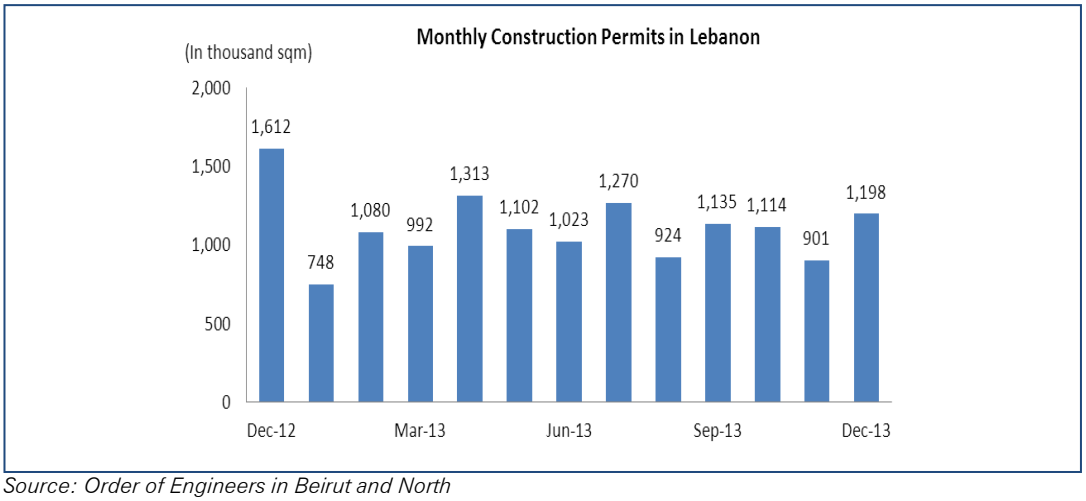
Demand for cement grows contrasting with construction and real estate activities

Most of the demand for cement and construction activity in Lebanon relies on the real estate market which showed a slowdown in 2013, plagued by the continuous spillovers of the 3-Year Syrian war and the domestic instability that intensified by the end of the year. Surprisingly, we recognized an unexpected 10.4% y-o-y growth in the size of the Lebanese cement up to November 2013 after recording a decline of 3.2% during the same period of 2012. The cement industry has been resilient to local and regional events, mainly due to high demand in the public sector with the ongoing expansion project of the Port of Beirut in addition to illegal construction activities and continuing projects from previous years.



Source: BdL

On the other hand, the number of issued construction permits during 2013, which reflects the investors' expectations of real estate activity in the coming 6 months, registered a considerable 8.1% yearly decrease to 16,724 permits as developers scaled down their projects. Moreover, construction area authorized by permit plummeted by 12.8% to 12.82M sqm in 2013 following a 10.8% fall in 2012, implying lower sized projects. However, construction loans went up by 14.7% y-o-y to $9.15B in November 2013 following the stimuli of Banque du Liban and the financial sector to boost demand and consecutively economic growth. Looking forward, we expect the cement market growing at an estimated CAGR of 1.3% throughout the coming three years, supported by high demand for cement from neighboring Syria in the medium term.

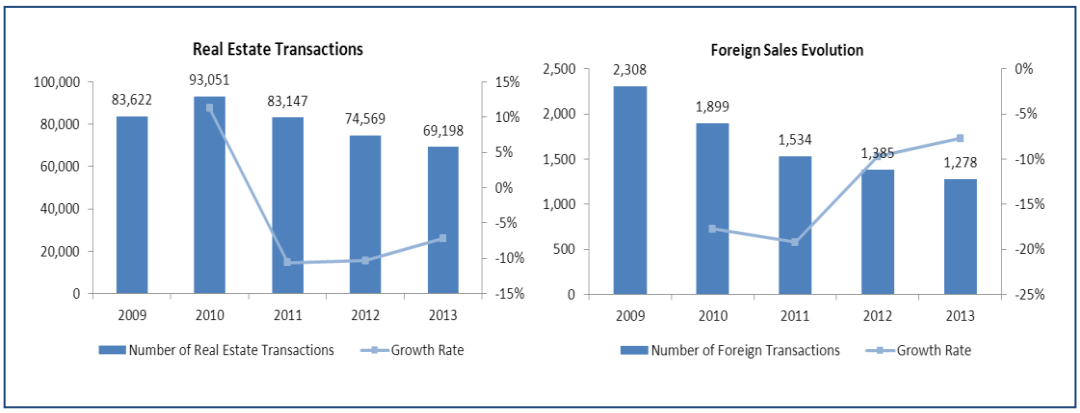


Source: Order of Engineers in Beirut and North

Demand in the Lebanese real estate sector pressured by political unrest

On the demand side, the Lebanese market mimicked local investors' concerns with the real estate market largely affected by the unrest sweeping most Arab countries. Property sales transactions recorded a 7.2% decrease to 69,198 in 2013 compared to 74,569 transactions a year earlier. Total value of property sales transactions retreated by 2.6% y-o-y from $8.94B in 2012 to reach $8.71B by 2013. The number of transactions also edged down, however at a faster pace than transactions' value sending the average value of a real estate transaction higher to $122,841 compared to $119,838 in the year 2012.

Foreign demand had a predictable declining trend in 2013. Sales to foreigners registered a sharp decrease of 9.0% in the volume of sales following repeated warnings form GCC governments calling their citizens to avoid Lebanon due to the high degree of political security instability. Yet, the Syrian crisis has cast a multitude of consequences on the Lebanese real estate sector, as citizens fleeing their country were looking for purchases or rents thus helping to maintain prices.



Source: Cadastre

Stagnant cement prices amid slowing property sector

Cement Prices remained resilient despite the stalling performance in the real estate sector. The price of cement is fixed at an average of $92 per ton - without VAT - for the grey cement, and at an average of $181 per ton - without VAT - for the white cement. On a positive note, the burden of import tariffs by the government, which can reach up to 75% for grey cement, clinker and related products and 25% for white cement, will continue to aid Lebanese cement producers.

Promising prospects for cement activity hand-on-hand with the Syrian crisis settlement

The medium-to-long term prospects of the Lebanese cement industry remain strong. Regardless of what form the settlement in Syria will take next, a reconstruction phase will follow the current social chaos and will entail high demand for cement that will be mostly provided by the neighboring countries such as Lebanon and Jordan. The Cimenterie Nationale initiated studies to establish a new USD 150 million production line in its main facility in Chekka. This line will replace old equipment and increase production capacity in order to meet the expected demand for cement in Syria during the upcoming reconstruction phase and penetrate the North African markets, namely Libya. Likewise, Holcim Liban is currently studying several options in preparation for the construction boom in Syria, while Ciment de Sibline plans to increase its production capacity by 0.15 million tons to reach 1.35 million tons.

The other driver of the cement industry is government infrastructure, which is currently facing low investment levels. This caused infrastructure gaps especially in electricity, water, and road networks. The upcoming need for developing Lebanon's infrastructure, possibly with a public-private partnership, will boost demand for cement, partially compensating any slowdown in the real estate market.

INCOME STATEMENT

In USD million	H1 2011	H1 2012	H1 2013
Sales of Goods	97.1	89.8	88.8
Production Cost of Goods Sold	(58.1)	(65.4)	(65.1)
Gross Profit	**39.0**	**24.4**	**23.7**
Distribution & Selling Expenses	(8.8)	(8.0)	(8.0)
Administrative Expenses	(4.5)	(4.4)	(3.0)
Other Income	1.2	1.4	0.1
Other Expenses	(2.5)	(1.9)	(2.6)
Interest Income	0.2	0.1	0.1
Finance Costs	(0.8)	(0.8)	(0.8)
Profit Before Tax	**23.9**	**10.7**	**9.4**
Income Tax Expense	(4.0)	(1.6)	(1.3)
Profit for the Year	**19.9**	**9.1**	**8.1**
Number of Shares (in millions)	19.5	19.5	19.5
Earnings per Share (In USD)	1.02	0.47	0.42

Source: Holcim

PROJECTED INCOME STATEMENT

In USD million	2010	2011	2012	2013e	2014f	2015f	2016f
Sales of Goods	185.0	195.6	186.8	187.5	188.3	194.0	204.2
Production Cost of Goods Sold	(116.1)	(129.8)	(137.6)	(138.2)	(135.6)	(133.8)	(134.8)
Gross Profit	**69.0**	**65.9**	**49.3**	**49.3**	**52.7**	**60.1**	**69.4**
Distribution & Selling Expenses	(16.6)	(18.9)	(18.3)	(18.4)	(18.3)	(18.8)	(19.4)
Administrative Expenses	(5.1)	(5.8)	(5.7)	(5.6)	(5.6)	(5.8)	(6.1)
Other Income	1.5	1.9	2.1	1.5	1.5	1.5	1.5
Other Expenses	(6.5)	(6.3)	(4.9)	(5.0)	(5.0)	(5.0)	(4.0)
Interest Income	0.2	0.3	0.2	0.2	0.2	0.2	0.2
Finance Costs	(2.2)	(1.5)	(1.5)	(1.1)	(1.1)	(1.1)	(1.1)
Profit Before Tax	**40.3**	**35.6**	**21.2**	**21.0**	**24.5**	**31.2**	**40.6**
Income Tax Expense	(6.6)	(7.3)	(3.2)	(3.1)	(3.7)	(4.7)	(6.1)
Profit for the Year	**33.7**	**28.3**	**18.0**	**17.8**	**20.8**	**26.5**	**34.5**
Number of Shares (in millions)	19.5	19.5	19.5	19.5	19.5	19.5	19.5
Earnings per Share (In USD)	1.73	1.45	0.92	0.91	1.07	1.36	1.77

Source: Holcim, Blominvest

BALANCE SHEET

In USD million	2010	2011	2012	H1 2013
Current Assets				
Cash & Cash Balances	17	24	15	24
Inventories	40	56	50	40
Accts Receivables & Prepayments	23	24	24	34
Total Current Assets	80	103	89	98
Non-Current Assets				
Property, plant & equipment	143	137	136	129
Investment Properties	11	11	10	10
Goodwill	18	18	18	18
Intangible assets	32	27	24	21
Other Financial Assets	4	4	3	3
Total Non-Current Assets	207	197	192	182
Total Assets	288	301	281	280
Current Liabilities				
Bank Overdraft	-	-	4	-
Loans & Borrowings	8	2	1	1
Accounts Payable & Accruals	33	55	43	40
Taxes Payable	7	5	3	2
Provision for Risks & Charges	0	0	0	0
Total Current Liabilities	47	63	51	42
Non-Current Liabilities				
Loans & Borrowings	12	10	10	9
Provision for employee benefits	4	4	6	6
Provision for risks & Charges	6	8	7	7
Deferred Tax Liability	1	0	0	0
Total Non-Current Liabilities	24	23	23	23
Shareholders' Equity				
Share Capital	129	129	129	129
Statutory Reserve	19	23	26	26
Revaluation Reserve	34	34	34	34
Retained earnings	35	29	18	26
Total Equity	217	215	207	215
Total Liabilities & Equity	288	301	281	280

Source: Holcim, Blominvest

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Equity Rating Key

Recommendations are based on the upside (downside) between our 12-month Fair Value estimate and the current Market Price.

Buy: Fair Value higher than Market Price by at least 20%
Accumulate: Fair Value higher than Market Price by 10% to 20%
Hold: Fair Value ranges between -5% to +10% in relation to Market Price
Reduce: Fair Value lower than Market Price by 5% to 15%
Sell: Fair Value lower than Market Price by at least 15%

Risks are based on share price volatility along with qualitative factors such as the nature of the business, the country risk and sensitivity to a single event, single product or single buyer. We've arranged the risk factor into 5 trenches:

- High Risk
- Medium-to-High Risk
- Medium Risk (similar to Market Risk)
- Medium-to-Low Risk
- Low Risk

IMPORTANT DISCLAIMER