Yamama Saudi Cement

BLOMINVEST SAUDI ARABIA

Equity Research – Initiation of Coverage		Share Price (SR):	67.25
Sector:	Basic Materials & Industrial Products	Fair Value (SR):	74.00
Country:	Saudi Arabia	Upside:	10%
Date:	December 17, 2011	Recommendation:	ACCUMULATE
		Risk:	Medium-to-Low

Initiating with an Accumulate Recommendation and a Fair Value of SR 74 per share based on the channels of analysis below

High demand in Saudi Arabia offsets limited exports

The boom in construction activity in Saudi Arabia is set to drive the demand for cement upward through the medium term, led by government efforts to improve the socio-economic environment, with currently $100 billion in infrastructure project pipeline and $80 billion worth of housing projects. Increased public spending on construction projects is also part of the Kingdom's strategy to create an attractive business environment for global investors in the different sectors of the economy. The construction sector shelters Saudi cement producers from the risks of overcapacity in medium term. This risk became further critical with the export restrictions enacted since mid-2008.

Large capacity at Yamama enables capitalization on growing demand

With the largest capacity of 6.3 mtpa among the central region's cement producers and the robust clinker inventory buildup, Yamama holds a first-mover's advantage to capitalize on a sudden hike in the demand for cement in its operating market. Furthermore, the location of its facilities in proximity to the Saudi capital Riyadh, gives it easy access to a large cement consumer hub. As a result, revenues are expected to increase at a CAGR of 10.7% between 2010 and 2015, rising by 15.4% y-o-y in 2011 to SR 1,467M.

Cost efficiency and limited leverage drive Yamama's competitive lead

Yamama has distinguished itself among Saudi peers with superior margins due to the cogeneration of its power supply. The integrated production process and government energy subsidies also contributed to the company's superior profitability, with the gross profit margin standing at 56%, compared with the average of 49% for Saudi peers. Much lower leverage than the country's average supported a senior net profit margin of 52% compared to the 40% average at Saudi peers. The superior operating efficiencies at Yamama are expected to lead a net profit growth of 15% in 2011, higher than that of revenues, to SR 755M.

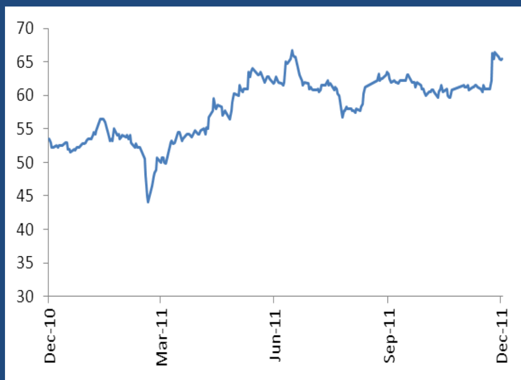
Earnings growth outlook suggests stock is undervalued

We value Yamama at SR 74 per share using a discounted cash flow model with a 12.7% discount rate and a 2,5% terminal growth rate. An Accumulate recommendation is issued taking into consideration the earnings' growth outlook. This is further supported when considering that Yamama is undervalued relative to peers since it trades at a much lower P/E of 13, compared to 15.1 for other Saudi companies.

Share Data

Bloomberg Symbol	YACCO AB
Reuters Symbol	3020.SE
Market Cap (SR)	9,078,750,000
Number of Shares	135,000,000
Free Float	78%
Price to 2010 Earnings	13.81
Price to 2010 Book Value	2.49

Share Performance



Source: Reuters

1 Month Return	10.7%
3 Month Return	8.0%
6 Month Return	33.2%
12 Month Return	28.1%
52 Week Range	44.10 – 67.25

Source: Reuters

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Performance and Forecasts

Year	2010	2011e	2012f	2013f	2014f	2015f
Revenues (SR M)	1,272	1,467	1,680	1,869	2,003	2,114
Net Income (SR M)	657	762	869	954	1,023	1,073
EPS (SR)	4.87	5.64	6.43	7.07	7.58	7.95
BVPS (SR)	27.1	27.0	27.4	27.8	28.0	28.2
ROA (%)	17.9	20.9	23.7	25.6	27.2	28.3
ROE (%)	21.1	24.1	27.9	31.2	33.4	34.9

Source: Blominvest, Yamama Cement

FINANCIALS & VALUATION

Year	2010	2011e	2012f	2013f	2014f	2015f
Profit & Loss Summary						
Revenue (SR M)	1,272	1,467	1,680	1,869	2,003	2,114
Revenue Growth (%)	9.4	14.3	15.4	14.5	11.3	7.1
Gross Profit (SR M)	712	819	932	1,030	1,101	1,157
Gross Margin (%)	56.0	55.8	55.5	55.1	55.0	54.7
Net Profit (SR M)	657	762	869	954	1,023	1,073
Profit Margin (%)	51.7	51.9	51.7	51.0	51.1	50.7
Net Profit Growth (%)	16.9	16.0	14.0	9.8	7.3	4.9
Earnings Per Share (SR)	4.87	5.64	6.43	7.07	7.58	7.95
Price-to-Earnings (Forward P/E)	15.19	13.11	11.50	10.47	9.76	9.31
Balance Sheet Summary (SR M)						
Fixed Assets	2,106	2,001	1,901	1,806	1,715	1,630
Cash & Cash Equivalents	700	763	840	935	1,021	1,099
Trades Receivable	242	293	338	378	401	429
Inventory	132	103	114	123	128	131
Other Assets	473	482	503	510	512	515
Total Assets	3,653	3,642	3,696	3,752	3,777	3,805
Total Liabilities	495	479	640	696	713	720
Book Value Per Share (SR)	27.1	27.0	27.4	27.8	28.0	28.2
Profitability						
ROA (%)	17.9	20.9	23.7	25.6	27.2	28.3
ROE (%)	21.1	24.1	27.9	31.2	33.4	34.9
Liquidity						
Cash / Current Liabilities	2.8	2.8	2.3	2.2	2.3	2.4
Current Assets / Current Liabilities	4.5	4.3	3.6	3.5	3.5	3.7
Net Working Capital / Current Assets	0.8	0.8	0.7	0.7	0.7	0.7

Comparables

	Valuation			Margin Analysis (%)			Profitability (%)	
	P/E	P/Rev	P/BV	Gross	Oper.	Net	ROE	ROA
Yamama	11.5	6.4	2.6	56.0	52.4	51.7	21.1	17.9
Average of Peers	19.4	5.8	2.0	40.7	31.5	30.8	13.4	10.4

Valuation

	2011e	2012f	2013f	2014f	2015f	Term. Val.
Net Income (SR million)	762	869	954	1,023	1,073	
Free Cash Flow to Firm (SR million)	898	830	932	1,047	1,121	11,260
Discounted Cash-flows (SR million)	898	737	734	731	695	6,193
Yamama Cement Value (SR million)						9,988
Number of shares (in millions)						135
Share Value (SR)						**74.00**

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INVESTMENT SUMMARY

We issue an ACCUMULATE recommendation on Yamama Saudi Cement Company after carefully analyzing the following:

Economic Overview

The main drivers of the Saudi economy during the past few years have been government spending and foreign direct investment. Government plans to develop infrastructure and provide housing for the growing population with the Kingdom currently having $100 billion in infrastructure project pipeline and $80 billion worth of housing projects. Foreign direct investment has surged since 2004 from $1.9 billion to $38 billion in 2008 and settled above $28 billion during the past two years. This was the result of government's efforts to build an attractive business environment for global investors.

The cement industry in Saudi Arabia is characterized by a regional segmentation with few leading players within each nearly independent region. This is mainly due to the high transportation cost of cement, to the drivers of demand which vary across the Kingdom's five regions, and to the concentration of oil reserves in certain areas, arising disparity in terms of production costs between local cement producers.

During the first three quarters of the year, the Saudi cement market size has increased by 15% y-o-y to 37 million tons and production at Yamama's facilities rose by 9% y-o-y to 4.5 million tons to take advantage of the 7.4% increase in cement prices locally and which averaged SR 246 per ton during the first half of 2011.

Business Model

Yamama is a Saudi-based grey cement producer with an annual production capacity of 6.3 million tons, the highest of the Central region's players and ranking third among the Kingdom's largest cement producers. This position gives Yamama a first-mover's advantage in case of any sudden hike in the demand for cement in its operating market. In 2010, sales volume at the company reached 5.2 million tons, growing at a CAGR of 10.4% from 2006 to 2010.

Yamama is one the most profitable cement producers in the MENA region with an average gross margin of 58% over the past four years, supported mainly by the government's substantial energy subsidies. Moreover, Yamama uses an integrated production process based on the in-house production of clinker and the cogeneration of power supply in the production method through the use of both electricity and heat.

The Saudi cement producer has established facilities in the Central region, in proximity to Saudi Arabia's vibrant capital Riyadh. The location advantage gave Yamama access to a lucrative market with strong construction activity and abundant limestone and enables the company to take advantage of the 40% y-o-y expected jump in the demand for cement in the central region for 2011, following the housing reforms adopted by King Abdullah.

Growth

Revenues at Yamama are expected to grow by 15.4% y-o-y, reaching SR 1,467 billion in 2011, supported by increased demand amidst flourishing construction activity in the Central region, but also by higher cement prices as Yamama is able to charge a premium without jeopardizing its sales on the back of savings in transportation costs for clients located in Riyadh. We expect the top line to increase at a CAGR of 9.6% between 2011 and 2015 as a result of the robust development in residential units following the government's housing reforms announced earlier during the year.

We estimate Yamama's net income to jump by 16% y-o-y to SR 762 million in 2011, led mostly by the increasing revenues, and the bottom line to grow at a CAGR of 8.9% going forward through 2015.

Profitability

Following the anticipated increase in net income through the medium term, the ROA and ROE ratios at Yamama will substantially improve, rising in 2011 to 20.9% and 24.1% respectively, up from 17.9% and 21.1% the year before.

Yamama's relative high gross margin is expected to slightly decline to 55.8% in 2011, down from 56% in 2010 and average 55.2% over our five-year outlook due to an anticipated minor increase in production costs. The net profit margin trend will maintain its 2010 levels of 52% for the year, before following the trend of the gross margin and slightly decrease to average around 51% through 2015.

Financial Position

Over the past few years, Yamama has consistently maintained very high levels of liquidity, backed mostly by large balances of cash which constituted up to 65% of current assets over the past two years. We expect liquidity ratios to slightly decline over the coming few years underpinned by minor investments capacity increase, before settling near the 2009 levels.

With abundant excess of cash balances, Yamama relies very little on borrowings to finance expansion of its operations and investments in fixed assets. Hence, the company's debt-to-equity ratio stood at 8% last year. We expect the ratio to average 11% through 2015, as the company plans to replace its old production lines with a new one, and slightly increases capacity to meet the anticipated rise in demand over the medium term.

Valuation

We valued Yamama at SR 74 per share using the DCF method with a discount rate of 12.70% and a terminal growth rate of 2.5%. We assumed capacity to expand at a CAGR of 4% through 2015 and the annual utilization rate to average 98%, while we anticipate a 4.4% annual cement price increase over our five-year forecast.

Yamama appears to be significantly undervalued when comparing its price-to-earnings ratio of 13 against both its Saudi and regional peers which hold a P/E of 15.1 and 19.1, respectively. This is further confirmed through a lower price to revenue compared to Saudi cement producers and by our 2011 forecasts, as revenues and earnings are both expected to increase by around 16% this year, further lowering our valuation ratios compared to peers.

Considering Yamama's relative location advantage and high capacity and inventory levels which will allow Yamama to meet an unexpected upsurge in demand, we believe that an upward adjustment in the company's stock price is highly likely in order to bring the company's valuation metrics near the average.

Risks

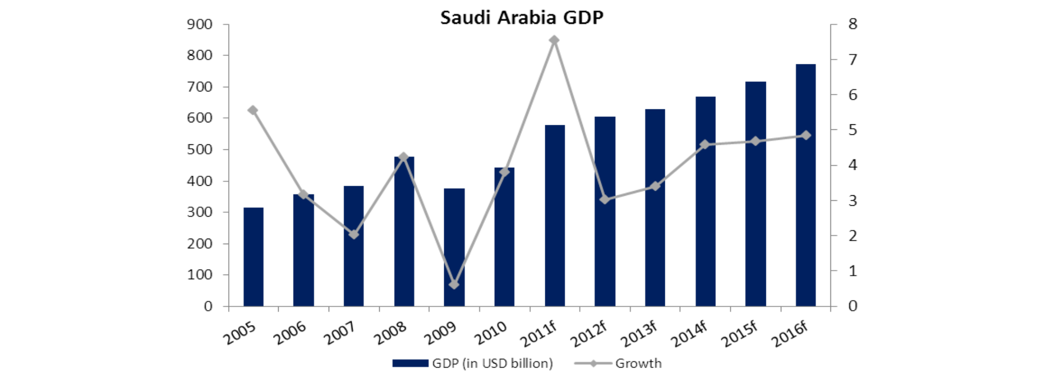
Investing in Yamama entails three major risks which apply to all Saudi cement companies. Firstly, a slowdown in construction activity in the Kingdom in the long term after the government housing reforms projects come to an end would result in high inventory levels at Yamama, a situation that is further aggravated were the cement export restrictions to remain valid in the long term. The excess capacity would end up in obsolete inventory and the cement producers would be forced to significantly cut their prices to SR 195 per ton, the price ceiling if they wished to export the excess output, drastically cutting their margins away. In addition, the long distance between Saudi Arabia's main cities would burden Saudi producers through high transportation costs if the government fails to ease cement export restrictions in the long term, further pressuring margins as producers are forced to supply counterparts instead of exiting their output to nearer export markets. Finally, energy subsidies are a key profitability factor to the Kingdom's cement players. A cut or a lift of governmental support for energy will certainly hurt production efficiency.

ECONOMIC OVERVIEW

Non-oil sectors and Foreign Direct Investment are the main drivers of economic growth

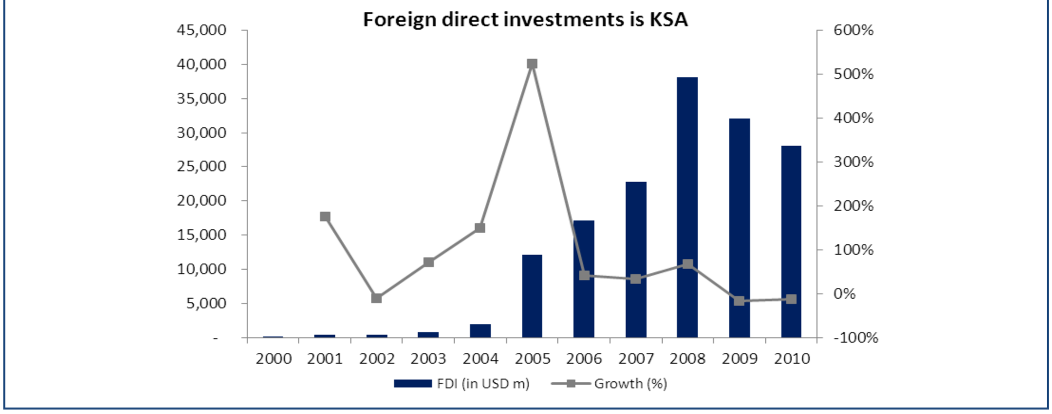
Saudi Arabia's economy has quickly diversified over the past few years, with at least 50% of its Gross Domestic Product (GDP) growth stemming from non-oil sectors after it had been almost-fully reliant on oil revenues prior to 2008.

During 2010, the Kingdom's economy showed signs of recovery from the global recession with GDP expanding at the annualized rate of 3.8% up from a frail 0.6% in 2009, an expansion that is expected to sustain its upward trend in the longer term with GDP forecasted to double by 2025. According to the International Monetary Fund, Saudi Arabia's GDP is projected to jump by 7.5% y-o-y in 2011 bolstered by increased government spending and the country's real non-oil GDP growth expected to reach 7% following the government's long-term development strategy adopted in 2005 to bring improvements in the citizens' quality of life.



Source: IMF, Saudi Arabia Monetary Agency (SAMA), Blominvest

Besides the major contribution of public spending, the government has built an attractive investment environment for global investors in the different sectors of the economy. These include a favorable tax rate for businesses and the absence of capital controls on remittances and repatriation of revenues out of the country, according to the Saudi Arabia Monetary Agency. As a result, foreign direct investment (FDI) has been a catalyst of the Saudi economy's expansion since 2005. Investment inflows to the Kingdom have grown at a CAGR of 56% between 2004 and 2009, peaking at $38 billion in 2008, and settled above $28 billion during the past two years, pressured by the global recession in 2009. In 2010, the United Nations Conference on Trade and Development (UNCTAD) ranked Saudi Arabia at the eighth position among top recipients of FDI globally and at the 17th place in terms of performance rewards.



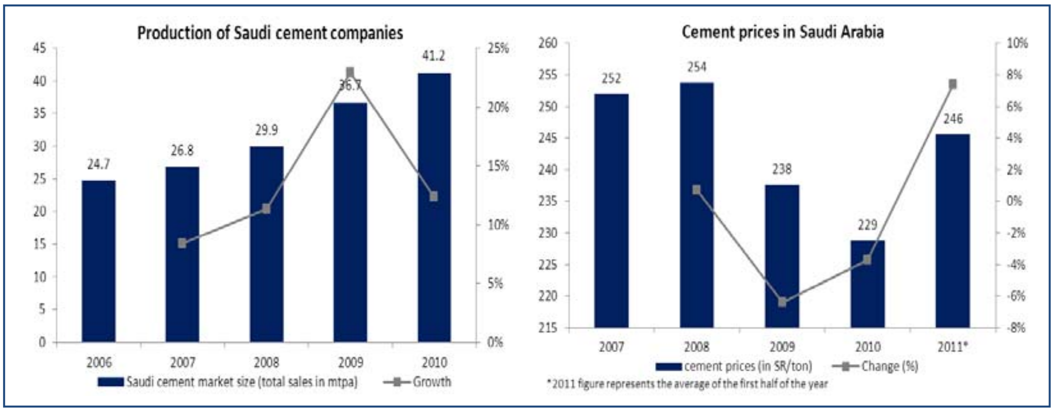
Source: World Bank, Blominvest

Government spending plan on real estate supports medium term positive construction outlook

Saudi Arabia suffers from severe unemployment and a large shortage of supply of housing units as the slow development on these two fronts has been lagging behind the pace of demographic growth. The local residential property market is in need of 1.65 million of housing units by 2015 to meet the demand of the growing Saudi population which stood at 25.4 million in 2009, fourfold its level in the early 1970s. Consequently, King Abdullah announced the allocation of $130 billion in the budget to build 500,000 houses by 2015 for low and middle income Saudis, and another $67 billion in expenditures on unemployment, social welfare and housing benefits which are most likely to translate into increased demand on housing. Currently, the kingdom has $100 billion in infrastructure project pipeline and $80 billion worth of housing projects. The Saudi real estate sector is expected to further grow, boosted by the upcoming enactment of the mortgage law expected in 2012 which will facilitate and enhance the market's sophistication and widen funding options for middle and low-middle income groups further driving the demand for housing upward. Demand for cement will also be boosted by the government plan to develop infrastructure as it declared in December 2008 its intention to spend around $400 billion on infrastructure projects as part of its Ninth Development Plan between 2010 and 2014, following a previous plan covering investments over the period 2005-2009.

Saudi cement market size grows despite price fluctuations

During the first three quarters of the year, the production of cement at Saudi companies' facilities has increased by 15% y-o-y to 37 million tons and by 9% y-o-y at Yamama to 4.5 million tons to take advantage of the 7.4% increase in cement prices locally and which averaged SR 246 per ton during the first half of 2011.



Source: Yamama Cement, Bloomberg, Blominvest

Prior to 2011, the local market grew at a CAGR of 13.6%, to 41.2 million tons per annum (mtpa) in 2010 compared with 24.7 mtpa in 2006. Record growth of 23% y-o-y was registered in 2009, led by government increased spending following the global recession that steered a 6% y-o-y drop in cement prices and a slowdown in FDI.

Highly segmented cement industry led by a few

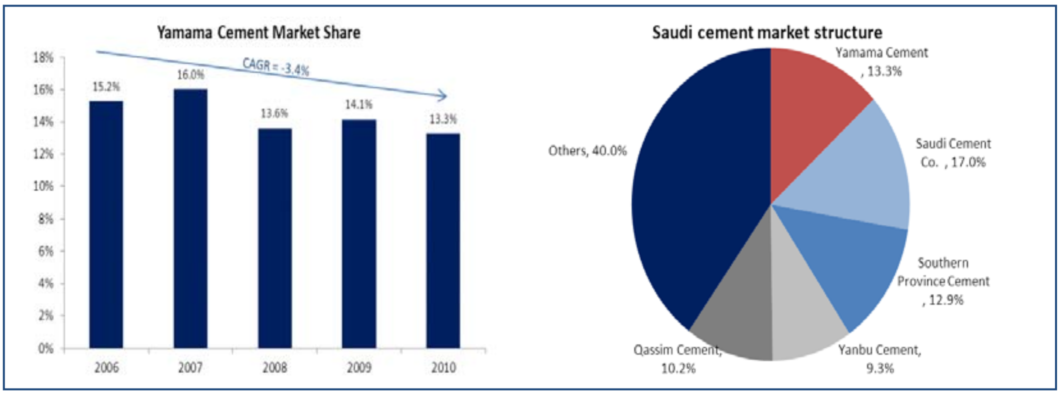
There are 13 cement companies currently competing in Saudi Arabia and holding a collective capacity of 52 mtpa in 2010, with the industry's utilization rate at 79.2% last year. These are distributed mainly in the Western, Eastern and Central regions out of the kingdom's five key regions which also include the Northern and Southern areas[1]. The cement industry in these regions benefits from the abundance of raw materials and the heavy real estate and infrastructure activity, besides their proximity to export markets.

[1] The map of Saudi Arabia is available under appendix I

Region	Main cities	Advantage
Western	Jeddah, Mekka, Al Madina, King Abdullah Economic City	Very strong construction activity Abundant limestone Proximity to export markets through Red sea Abundant natural gas
Eastern	Dammam, Khobar,	Proximity to GCC countries
Central	Jubail, Hofuf Riyadh, Qasim	Abundant limestone Strong construction activity Abundant limestone

Source: Cement MENA Report & Outlook 2010 - Blominvest

The cement industry in Saudi Arabia is highly segmented led by a few companies within each nearly independent region. The dynamics of the industry vary across these regions driven by the demand for cement in each, the concentration of oil reserves in certain areas, and long distances between the major cities. These factors lead to different production and transportation costs among local cement producers and limit the industry's consolidation efforts among regions.



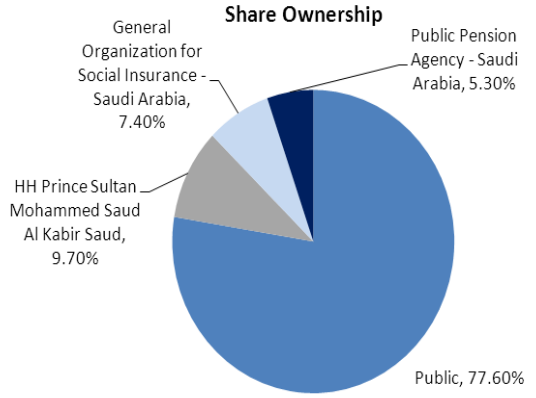
Source: Yamama Cement, Blominvest

Saudi Cement Company, the kingdom's largest cement producer leads the Eastern region with a capacity of 11 mtpa, while Southern Province Cement tops the Southern region with a capacity of 6.2 mtpa, Yamama Cement dominates the Central market with a capacity of 6.3 mtpa and Yanbu Cement holds a capacity of 4.5 mtpa. These four companies hold almost half of the total Saudi cement market share, topped by Saudi Cement which grasps 17% by itself, while Yamama Cement has been losing market share over the past few years to 13.3% in 2010 from a high of 16% back in 2007 on new comers which have been gaining momentum since entering the market in 2008.

COMPANY PROFILE

Yamama Cement Company is the second largest cement producer in Saudi Arabia in terms of market share, with an annual capacity of 6 million tons of clinker and 6.3 million tons of cement. The company was incorporated in 1961 and has production facilities located in Riyadh. It is engaged in the manufacturing and distribution of cement and related products, including clinker, finishing cement, moderate sulfate-resistant cement, ordinary cement and sulfate-resistant cement, in addition to paper bags used for cement packaging.

Ownership



Source: Tadawul, Blominvest

Subsidiaries

- Yemeni Saudi Cement Company: is incorporated in Yemen and in which Yamama cement holds a 20% stake. The cement producer operates a cement plant near the Yemeni city of Aden and has a production capacity of 1.4 million tons of cement per year.
- Cement Product Industry Company: is a privately held cement packaging manufacturer established in Saudi Arabia, and equally held by Arabian Cement Company and Saudi Cement Company, each holding a 33.3% share in the company. The Saudi packaging manufacturer has a total capacity of 280 million bags per year.

Board of Directors

Name	Position
HH Prince Turki Bin Mohammed Bin Abdulazziz Bin Turki Al Saud	Chairman
HH Prince Sultan Mohammed Saudi Al Kabir Al Saud	Vice Chairman
Mubarak Bin Jaber Al Mohaimid	Director representing Public Pension Agency
Jamal Bin Ahmad Al Ajaji	Director representing General Organization for Social Insurance- Saudi Arabia
Rashed Al Mubarak Al Mueaished	Director
Saud Bin Mohammed Al Dablan	Director
Khaled Bin Suleiman Bin Abdulaziz Al Saud	Director
Mubarak Bin Jaber Sahli	Director
Turki Bin Nasser Al Mutawaa	Director
Fahed Bin Thanian Al Thanian	Director
Ibrahim Bin Abdulaziz Al Mehanna	Director
HH Prince Khaled Bin Mohammed Bin Abdulaziz Al Saud	Director

Source: Zawya

Management

Name	Position
HH Prince Sultan Mohammed Saudi Al Kabir Al Saud	Managing Director
Jihad Abdulaziz Al Rasheed	General Manager
Mounir Fahad Al Sahali	Finance and Information Technology Director
Abdullah Ibrahim Al Suwailem	Factory Manager
Walid Suleiman Al Badaa	Production Manager
Abdullah Mohammed Al Noweiser	Materials Manager
Suleiman Mohammed Nasser Al Theeb	Maintenance Manager
Mohammed Nowaf Al Ali	Security and Services Manager
Abdulhakeem Bin Salah Al Arafy	Safety, Health and Environment Technology Manager
Fahad Abdulmohen Al Fadley	Commercial Manager
Manhy Mohsen Al Haydal	Marketing Manager
Mahdi Abdullah Al Ghamdi	Sales Manager
Ali Bin Mohammed Al Garny	Personnel Affairs Manager
Ibrahim Ramian Al Ramian	Administration and Human Resources Manager
Othman Bin Ali Al Hamad	Human Resources Development Manager
Ibrahim Bin Dhefallah Al Mattrafy	Information Technology Manager

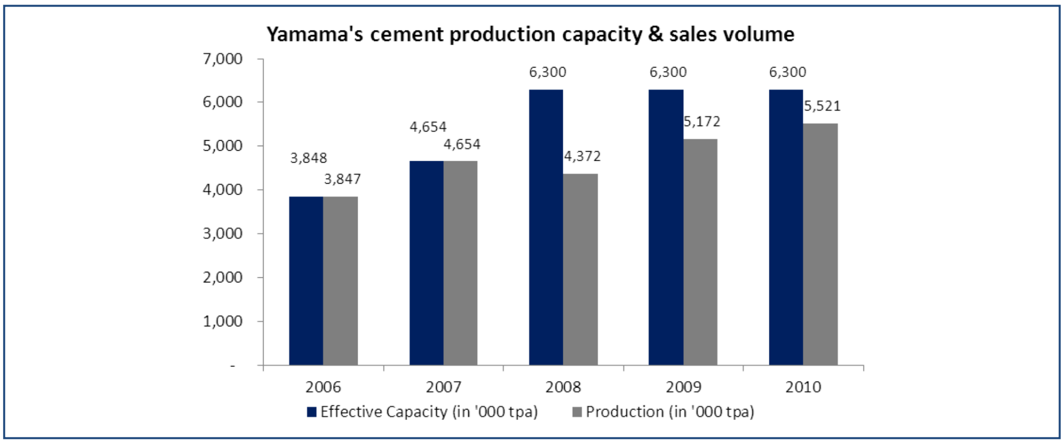
Source: Zawya

BUSINESS MODEL

Revenues at Yamama are generated from sales of grey cement, the production of which is mostly reliant on the capacity of clinker produced at the company's facilities. The integrated production process coupled with the energy subsidies granted by the Saudi government and the premium central location of the company's facilities have enabled Yamama to maintain high levels of profitability.

Revenue growth relies on capacity expansion and stock levels

Yamama's revenue stream solely comes from grey cement sales, which reached 5.5 million tons in volume for 2010, growing at a CAGR of 10% from 2006 to 2010. This has been mostly enabled with the increase in the cement producer's capacity to 6.3 million tons since 2008, up from 3.9 million tons in 2006, to meet the growing Saudi market demand.



Source: Yamama, Blominvest

Yamama's large capacity and high inventory levels play a crucial role in the company's business model. The Saudi company ranks among the Kingdom's three largest cement producers in terms of capacity and tops the central region's players, a position which gives Yamama a first-mover's advantage in case of any sudden hike in the demand for cement in its operating market.

Superior margins achieved through integrated production process along with energy subsidies

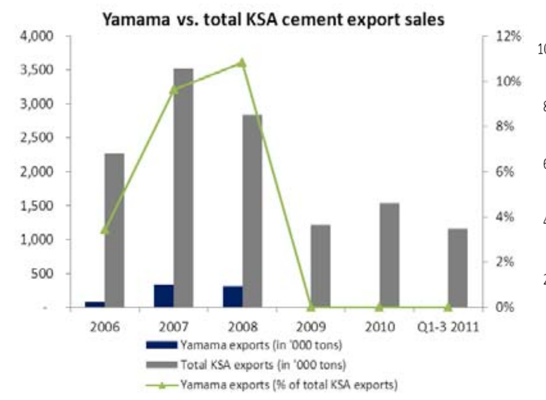
Saudi cement producers have distinguished themselves against other global players with their relatively high margins, an advantage propped by the Saudi government's energy subsidies that currently stand at more than $10 billion per year. Furthermore, the use of integrated production processes based on the internal manufacturing of clinker has resulted in the gross profit margins at Saudi cement companies largely exceeding that of peers operating in other countries.

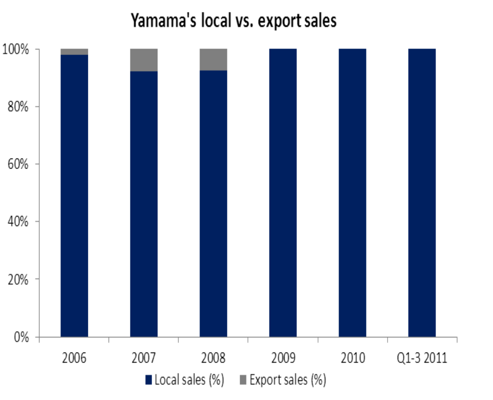
Beyond production efficiencies that have added to the competitive edge of Saudi producers compared to peers in other countries, Yamama uses both electricity and heat in its production process, through the cogeneration of its power supply, which enables the company to further save on costs and rank among the highest profitable of the kingdom's cement players, with a gross profit margin averaging 58% over the past four years.

Strategic location offsets forgone export sales

Having established its facilities in the Central region, in proximity to Saudi Arabia's vibrant capital Riyadh, Yamama has gained access to a lucrative market with strong construction activity and abundant limestone.

This location advantage has enabled Yamama to shield its operations following the export restrictions on Saudi cement producers enacted by the government since June 2008 and which contributed to the 5.4% y-o-y decline in the company's sales volume during that year.





Source: Yamama, Blominvest

In addition, Yamama is well-placed to take advantage of the jump in the demand for cement in the central region for 2011, and the construction boom which will further sustain over the medium term, following the housing reforms adopted by King Abdullah earlier this year.

RISKS

A slowdown in local construction with government maintaining the export restriction on cement

Amidst concerns that the country would suffer from a shortage in the supply of cement for the flourishing local construction projects, Saudi Arabia's government issued a ban on the product's exports to all countries except Bahrain in mid-2008, and limited the weekly outflow of cement to the neighboring state to 25,000 tons, down from 50,000 tons previously. The mandate however, allowed cement exports under the strict conditions that Saudi producers sell a bag of cement at SR195 per ton, a price that would be highly unprofitable to these companies. However, the exports restriction seems to have had limited effect on the profitability of the Saudi producers so far due to the high domestic demand exhausting the total national output.

Although it is most likely that the demand will uphold at high levels over the medium term, led by the government's intentions to further boost the construction sector with the development of housing units, the higher demand would certainly fade over the longer term, were government's spending on construction projects to ease in all Saudi regions and the export constraints to remain valid. In this highly unlikely scenario, coerced to exporting cement at the SR 195 price per ton would eat into the margins of Saudi producers, forcing many to shut operations down.

Long distances and high transportation costs restrict geographical diversification

Saudi Arabia's cement industry is highly segmented between the Kingdom's five regions, each of which is driven by particular dynamics mainly due to a variation in demand across the regions and the geographical distribution of the kingdom's main cities.

The long distances between the major cities are associated with high transportations costs, constraining a company in one region from taking advantage of a sudden hike in another region's demand which cannot be satisfied by the excess capacity of its local producers. This scenario becomes further critical with export restrictions still in effect and forces producers to ship cement to other regions to eliminate excess capacity, despite burdening transportation costs.

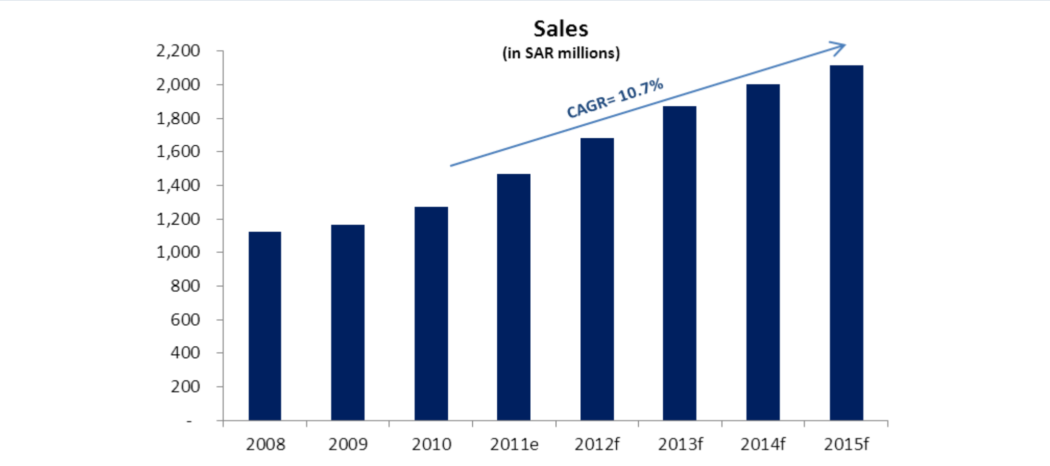
Energy price hike beyond expectations

The profitability of cement makers is highly sensitive to energy costs being the most critical charges in the production of cement. Currently, Saudi producers benefit from ample government subventions which significantly lower the manufacturing costs of the end product, and those companies rely heavily on the continuous flow of these subsidies. Thus, a cut or a lift of governmental support for energy will certainly hurt the margins of Saudi companies.

FINANCIAL ANALYSIS

Revenues

We expect revenues at Yamama to grow at a CAGR of 10.7% between 2010 and 2015, driven by the flourishing construction activity in Saudi Arabia. The stimulus package announced by the government earlier this year will most likely support a robust development for both housing units and infrastructure projects in the Kingdom's main cities and ease any concerns of a manufacturers' oversupply that has been previously prevailing in the industry. With a robust clinker inventory buildup and the largest capacity among the central region's players, Yamama is well-positioned for a first-mover's advantage to capitalize on the expected jump in the demand for cement in the Central region near Riyadh, a large cement consumer hub at the proximity of which Yamama has strategically located its facilities. In this context, revenue growth will reach a peak of 15.4% y-o-y for 2011 sending Yamama's sales to SR 1,467 billion for 2011, supported by increased demand but also by higher cement prices as Yamama is able to charge a premium without jeopardizing its sales on the back of savings in transportation costs for clients located in Riyadh.



Source: Blominvest

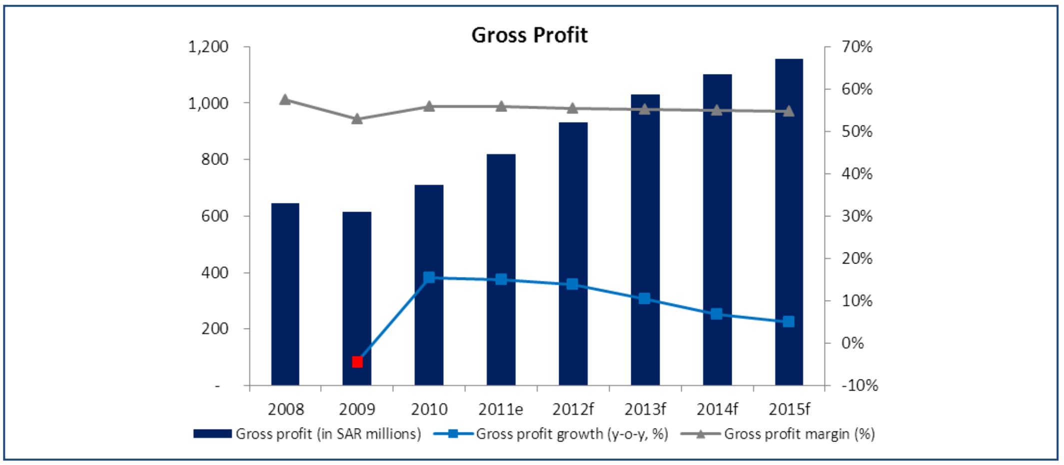
In 2010, Yamama's top line witnessed a 9.4% y-o-y rise to SR 1,272 billion led by a recovery of both demand and prices following the 2009 global recession which saw cancellations and delays of many of the USD 600 billion worth of projects in the Kingdom. However, operating conditions for Saudi cement producers had been challenged during 2008 by the cement export ban in June and which resulted in overcapacity coupled by pressured cement prices, thus sending sales at Yamama down by 5.3% in 2008.

Gross Margins

The gross margin of Saudi cement producers is directly linked to the dynamics of supply and demand prevailing in the different regions across the country, thereby allowing large disparities between the margins of the Saudi cement players. This is especially true due to the difficulty of transportation across the regions and the related high costs.

The gross profit margin at Yamama has been hovering around 55%-56% since 2010 supported by higher prices and the rising demand in the Central region. In 2009, the gross margin at Yamama witnessed a dramatic decline to 53% down from 65% in 2007 pressured by the cement export restrictions and was worsened by the global credit market collapse. Inventory piled up and prices fell sharply on the dampened demand.

However, the integration of its production of clinker and cement as well as the cogeneration of its power supply enabling the use of both electricity and heat in cement manufacturing have enabled Yamama to consistently hold an advantage over its Saudi peers in terms of its production efficiencies despite pressures on prices.

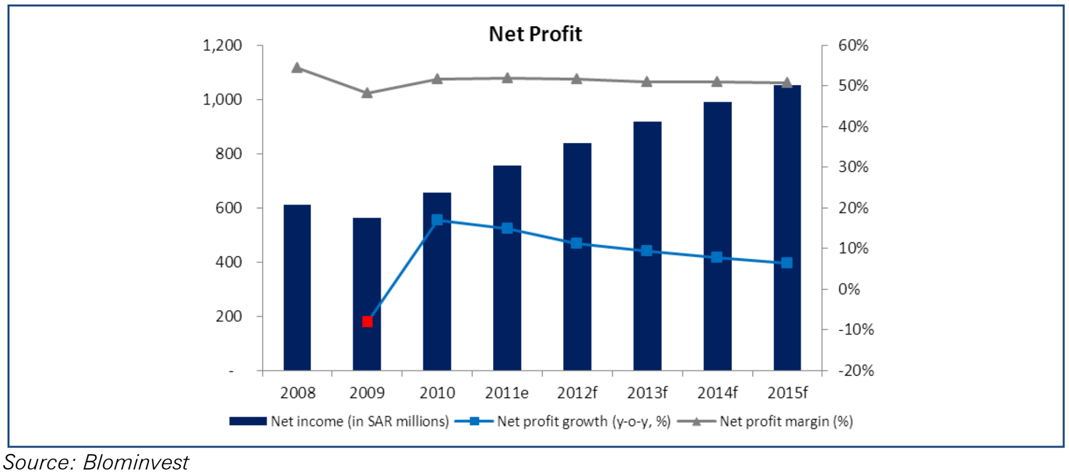


Source: Blominvest

Going forward, we expect the gross profit at Yamama to grow at a slower pace, rising by 15% y-o-y in 2011 to SR 819 million, compared with 15.6% the year before, and the gross margin to slightly decline to 55.8% for the year, down from 56% in 2010 and average 55.2% over our five-year outlook due to an anticipated minor increase in production costs.

Earnings

We estimate Yamama's net income to grow at a CAGR of 10.3% between 2010 and 2015, with a 16% y-o-y jump in 2011 to SR 762 million, led mostly by increasing revenues. The net profit margin at the Saudi cement producer will most likely be near 52%, the level recorded in 2010. Going forward, the company's net profit margin will follow the trend of the gross margin and slightly decline through 2015 to average around 51%.



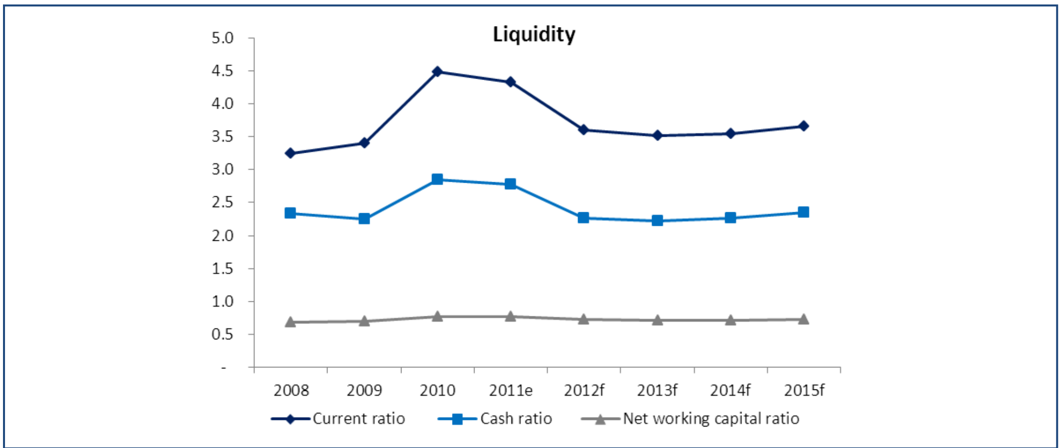
Source: Blominvest

Liquidity

Over the past few years, Yamama has consistently maintained very high levels of liquidity with current assets averaging 3.7 times as much as current liabilities, backed mostly by large balances of cash which constituted up to 65% of current assets over the past two years, down from 72% in 2008. Hence, the company maintained a positive net working capital ratio over the considered period.

We expect liquidity ratios to slightly decline over the coming few years compared to their 2010 levels, underpinned by minor investments capacity increase, before settling near the 2009 levels.

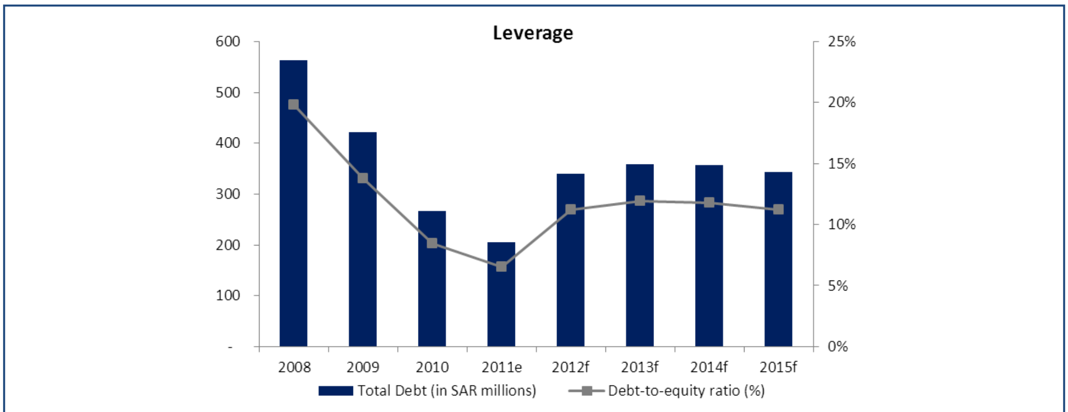
Current Ratio = Current Assets / Current Liabilities
Cash Ratio = Cash / Current Liabilities
Net Working Capital Ratio = (Current Assets – Current Liabilities) / Current Assets



Source: Blominvest

Leverage

Despite competing in a capital-intensive industry, Yamama has been able to rely mostly on its excess cash balances to finance expansion of its operations and investments in fixed assets, with little reliance on borrowing. Hence, the company's debt-to-equity ratio fell from a mere 20% in 2008 to as little as 8% in 2010 and averaged 14% for the period.
Earlier in the year, Yamama has been studying the replacement of five old production lines with a new one. This, coupled with an expected increase in capacity to meet the anticipated rise in demand, will most likely push the leverage of the cement producer upward to an average of 11% through 2015, up from 8% in 2010.



Source: Blominvest

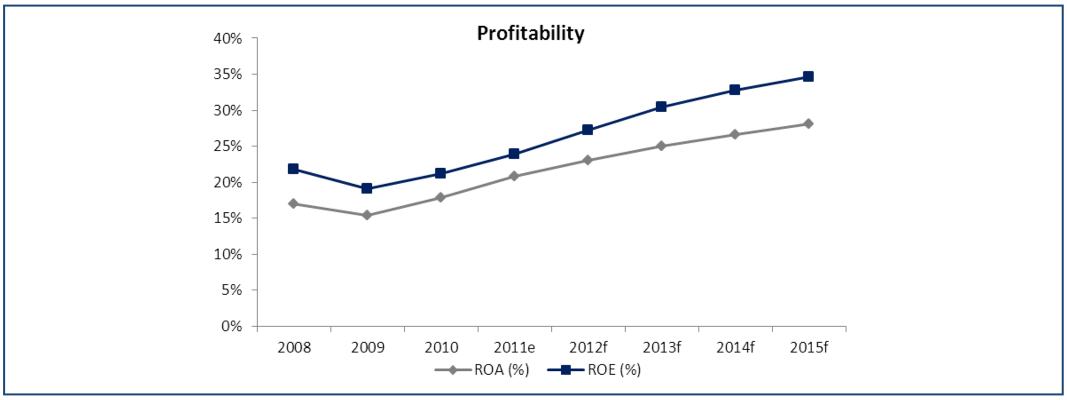
Dividends

Yamama has consistently distributed dividends twice per annum over the past few years with a payout ratio of 80%-90%. Historically, the company paid SR 4 per share, representing a 7.8% yield over the 2010 closing stock price of SR 51.5 and SR 3 per share representing a 6.4% dividend yield over the 2009 closing price of SR 47.2.
With a strong anticipated performance outlook, we expect Yamama to maintain its dividend distribution policy.

Profitability

Yamama's recent limited reliance on leverage to finance day-to-day operations has been of a great advantage to the company's profitability, as low borrowing costs have supported strong margins despite the drop in sales in 2008.

In 2010, the cement producer witnessed more than a 10% hike in its Return on Assets (ROA) and Return on Equity (ROE) to pre-recession levels, reaching 17.9% and 21.1% respectively. We expect a further jump in these ratios, rising in 2011 to 20.9% and 24.1% respectively, supported by strong sales over the foreseeable outlook,



Source: Blominvest

COMPARABLE ANALYSIS

In order to assess the performance of Yamama in comparison to peers, we compare it on four different fronts:

1. Relative Valuation: Demonstrates if the company is overvalued, fairly valued or undervalued compared to its peers.
2. Profitability: Presents the company's Gross, Operating and Net Profit Margins with regard to the average company in the industry and region.
3. Management Effectiveness: Provides insight into how well management is at utilizing assets and equity to generate earnings.
4. Liquidity and Efficiency: Offers a glance at the company's liquidity position in comparison to peers and its inventory turnover compared to the global cables industry.

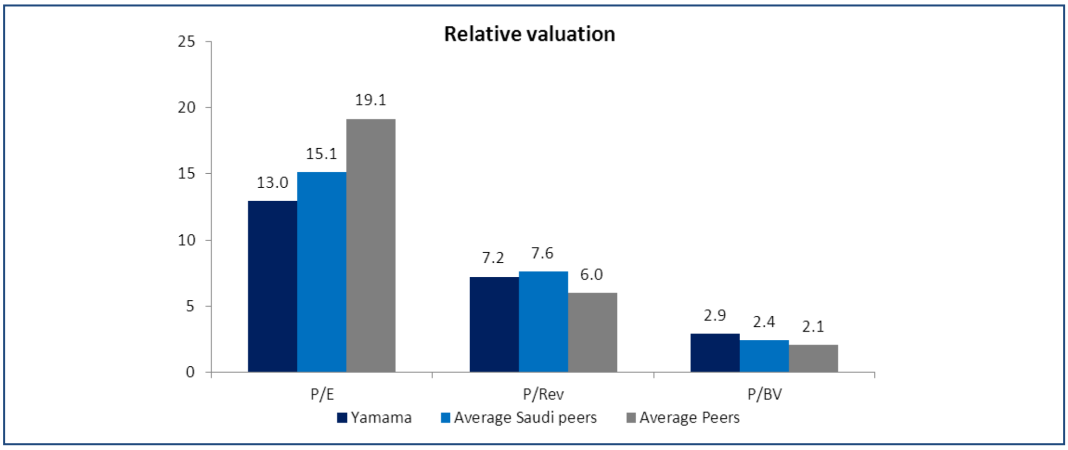
Comparable Firms

We selected a list of 18 cement producers operating in the Middle East and Africa and that are most comparable to Yamama with regards to operations[2]. We drew our sample from companies with a market capitalization that ranges between $500 million and $3 billion with an average of $1.1 billion, versus $2.5 billion for Yamama. We also included all 9 listed Saudi cement companies to serve as a separate benchmark. These have an average market cap of $1.3 billion, ranging from $237 million for National Gypsum Company up to $2.9 billion for Southern Province Cement.

Relative Valuation

Yamama appears to be significantly undervalued when comparing its price-to-earnings ratio of 13 against both its Saudi and regional peers which hold a P/E of 15.1 and 19.1, respectively. This is further confirmed through a lower price to revenue compared to Saudi cement producers, despite the ratio being ahead of the regional average, since we believe that Saudi peers constitute a stronger benchmark given the similar operating and legal environment.

Despite a slightly higher price-to-book value to its peers, we believe Yamama to be undervalued when including our forecast for 2011 results into our analysis. Revenues and earnings are both expected to increase by around 16% y-o-y during the year, further lowering our valuation ratios to 12, 6.2 and 2.6 respectively. Considering Yamama's strong fundamentals, including its facilities' premium location and high capacity and inventory levels which will allow the company to meet an unexpected upsurge in demand, we have no reason to believe that the stock price should trade at a discount to peers. Hence, an upward adjustment in the company's stock price is highly likely in order to bring the company's valuation metrics near the average.

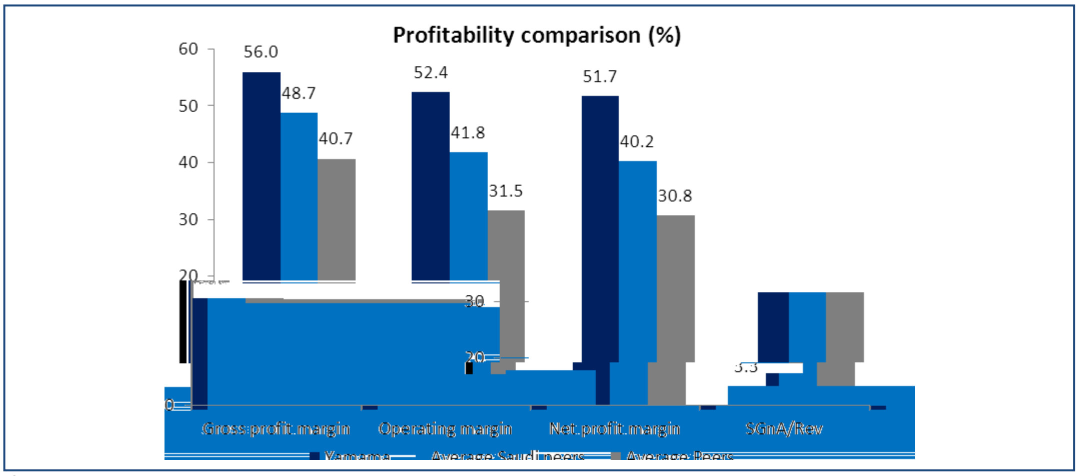


Source: Reuters Knowledge, Blominvest

The complete list of comparable firms is available under appendix II [2]

Profitability Comparison

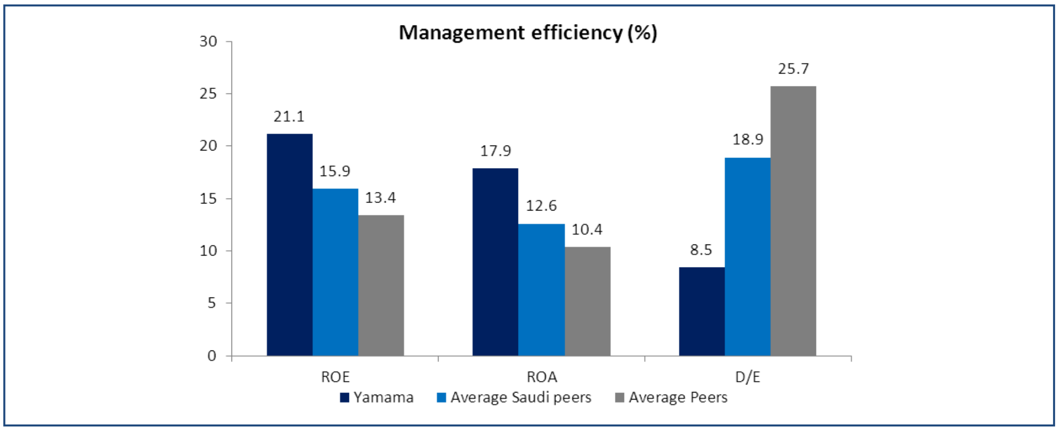
We compared gross margin, operating margin and net income as a percentage of revenues in order to understand how Yamama is managing its expenses compared to peers. Our target company appears to largely outperform both Saudi and regional peers in terms of its production efficiency level, with a gross margin of 56% versus 48.7% and 40.7% for the both benchmarks, respectively. The company's strategy to distinguish itself as a low-cost cement manufacturer has been enabled through the integrated production of both clinker and cement. This allows the company to better manage its cost of sales. Furthermore, the wide spread in production efficiency with regional peers is attributed to heavy governmental energy subsidies and gives Saudi cement producers an edge on the region's manufacturers.



Source: Reuters Knowledge, Blominvest

The wide positive gap in the gross margin relative to peers has allowed Yamama to maintain a leading position in both operational efficiency and net profitability.
a largely tops its peers when comparing its operating margin of 52.4%, to the 41.8% and 31.5% for comparable Saudi and regional cement producers, respectively, a position that is further supported through a lower selling, general and administrative expenses-to-revenue ratio of.
Finally, Yamama exhibits a much higher net profit margin of 51.7% compared to peers, due to limited borrowing costs. This can be attributable to the regional and Saudi peers holding a much higher average debt-to-equity ratio of 26% and 19%, respectively, versus Yamama's 8.5%, hence much lower finance costs.

Management Efficiency

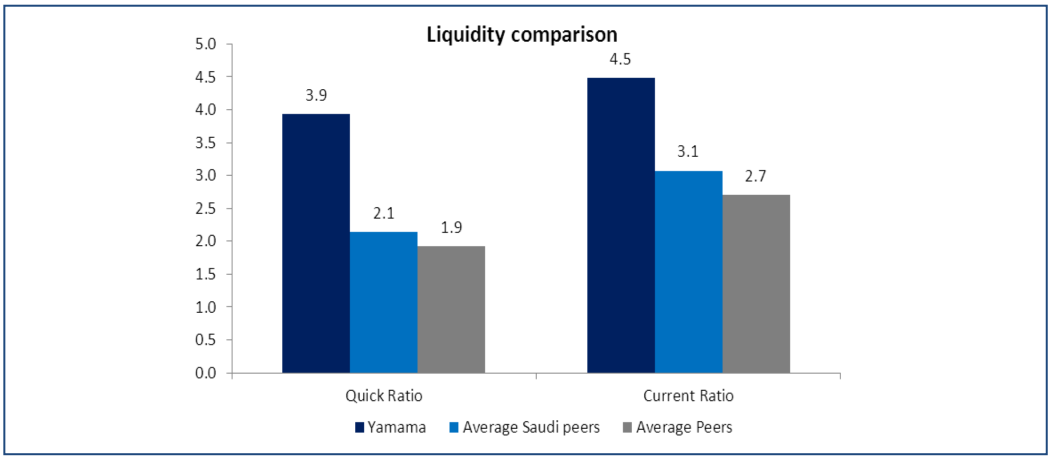


Source: Reuters Knowledge, Blominvest

Yamama's ROE and ROA ratios which stand at 21.1% and 17.9% respectively, confirm that the company outperforms its peers in managing its assets and equity. The significant spread is mainly the result of extremely low finance costs relative to regional peers resulting from large loan settlements since 2008 and a slowdown in borrowings as no major expansionary projects were undertaken at the company since 2007. It is worth noting that capital expenditures over the past few years have been limited to maintenance projects.

Liquidity comparison

Taking a look at the quick and current ratios, Yamama appears to be much more liquid than the average in the market with ratios of 3.9 and 4.5. We believe this is mostly due to the decline in capital investments at the company since 2007, which has allowed the company to maintain large cash balances.



Source: Reuters Knowledge, Blominvest

VALUATION

We value Yamama at SR 74 per share, representing a 10% premium over the current stock price of SR 67.25. In this context, we issue an ACCUMULATE recommendation on the back of the stock's upside potential. Our overweight rating is further supported by Yamama's location advantage and high capacity and inventory levels which gives it the ability to charge a premium on cement prices and be a first mover in case of a sudden increase in demand in the central region.

Assumptions in valuation

Discount Rate

We used a WACC of 12.70% for the purpose of valuing Yamama's equity derived as follows:

WACC = (Weight of Equity * Cost of Equity) + (Weight of Debt * Cost of Debt) * (1 – Tax Rate)

= (0.94 * 13.42%) + (0.06 * 1.95%) * (1 – 3.5%) = 12.71%, rounded down to 12.70%

Yamama's Cost of Equity = Risk-Free Rate + (Beta * Market Risk Premium)

= 1.80% + (0.88 * 13.20%) = 13.42%

- We used a Risk-Free Rate of 1.80% represented by the five year US Treasury bill.
- Yamama's beta over the past 3 years is estimated at 0.88. This is a measure of the share volatility against the TASI Index that represents Saudi Stock exchange.
- A market risk premium of 13.20% is the result of the difference between the expected return of the TASI estimated at 15.00% and the Risk-Free Rate of 1.80%. This represents the premium investors expect to gain for realizing the additional risk of investing in securities.

Terminal Growth Rate

We selected a terminal growth rate of 2.5% for Yamama beyond 2015.

Revenue Growth

Below are the underlying assumptions of our five-year revenue model, supporting a sales growth at a CAGR of 9.6% for the period:

- We expect capacity at Yamama to expand at a CAGR of 4.0% over our five-year outlook, to near 7.4 million tons per annum (mtpa) in 2015 from 6.3 mtpa currently. We assume the first addition to take effect in 2012, following an anticipated jump in demand in the central region, on the back of flourishing construction activity and the implementation of the residential construction plan enacted earlier this year by the Saudi government.
- We forecast capacity utilization rates to hover between 95% and 99% during the medium term as the company accelerates production to meet the rising demand. Also, production volumes will account for 100% of the production according to historical company records.
- We assume a reasonable 4.4% annual growth rate for cement prices, given the current and expected market fundamentals.

	2011e	2012f	2013f	2014f	2015f
Effective Capacity (in '000 tpa)	6,300	6,521	6,977	7,186	7,366
Production (in '000 tpa)	6,011	6,461	6,881	7,122	7,336
Utilization	95.4%	99.1%	98.6%	99.1%	99.6%
Demand satisfied by Yamama (in '000 tpa)	6,011	6,461	6,881	7,122	7,336
Average price per ton (in SR per ton)	244	260	272	281	288
Price growth		6.5%	4.5%	3.5%	2.5%
Expected Revenue (in SRm)	1,467	1,680	1,869	2,003	2,114

Source: Blominvest

Production and operating costs

- Based on the results of the first nine months of 2011, the cost of goods sold as a percentage of revenues stood at 44.4%, marginally above the 2010 level of 44%. In our forecast, we slightly decrease the ratio to 44.2% as cement prices are expected to slightly gain through the last quarter of the year, pushing the gross margin at Yamama upward.
- Selling, general and administrative expenses have slightly risen over the first three quarters of 2011, led by higher selling and distribution expenses as a percentage of costs. We estimate these operating costs to average 1.9% of sales for the current year, up from 1.6% in 2010.

Estimating Net Income

- Finance Expenses were forecasted by applying an average annual 2.5% on interest bearing liabilities.
- A 3.5% Zakat rate is applied in accordance with recent historical trends.

Determining free cash flow and share value

From Net Income, we deduce Free Cash Flow to the Firm (FCFF) by applying the following:

In SR Million	2011e	2012f	2013f	2014f	2015f	Terminal
Net Income to Shareholders	762	869	954	1,023	1,073	
Add: Depreciation	440	504	561	601	634	
Subtract: Capital Expenditures	(250)	(500)	(500)	(500)	(500)	
Subtract: Change in WC	(58)	(50)	(93)	(87)	(96)	
Add: Interest Expense	4	7	11	10	9	
FCFF	898	830	932	1,047	1,121	
FCFF Terminal						11,260
FCFF Discounted	898	737	734	731	695	6,193
Fair Value (in SR M)	9,988					
Number of Shares (M)	135					
Fair Value per Share (SR)	**74.00**					

Source: Blominvest

Sensitivity Analysis

Discount Rate	Terminal Growth	Fair Value/Share	Premium
13.7%	3.0%	69.69	3.6%
13.7%	2.5%	67.62	0.5%
13.4%	2.0%	67.38	0.2%
12.7%	3.0%	76.58	13.9%
12.7%	**2.5%**	**74.00**	**10.0%**
11.7%	2.0%	78.78	17.1%
11.7%	3.0%	85.10	26.5%
11.7%	2.5%	81.77	21.6%
11.7%	2.0%	78.78	17.1%

Source: Blominvest

PROJECTED INCOME STATEMENT

In SR million	2010	2011e	2012f	2013f	2014f	2015f
Sales	1,272	1,467	1,680	1,869	2,003	2,114
Cost of sales	(560)	(649)	(748)	(839)	(901)	(958)
Gross Profit	712	819	932	1,030	1,101	1,157
Selling & distribution expenses	(8)	(15)	(15)	(18)	(19)	(21)
General & admin. expenses	(34)	(40)	(42)	(47)	(50)	(53)
Depreciation charge	(2)	(3)	(3)	(3)	(3)	(3)
End of Service Indemnity charge	(2)	(3)	(3)	(3)	(3)	(4)
Total expenses	(46)	(60)	(63)	(70)	(75)	(80)
Operating income	666	759	869	960	1,026	1,076
Finance costs	(6)	(4)	(7)	(11)	(10)	(9)
Investment income	10	23	25	26	28	30
Other income	12	12	13	13	16	15
Other income (expenses)	16	31	31	29	34	35
Net income before Zakat charge	682	790	900	989	1,060	1,112
Zakat expense	(25)	(28)	(32)	(35)	(37)	(39)
Net profit	657	762	869	954	1,023	1,073

Source: Blominvest, Yamama Cement

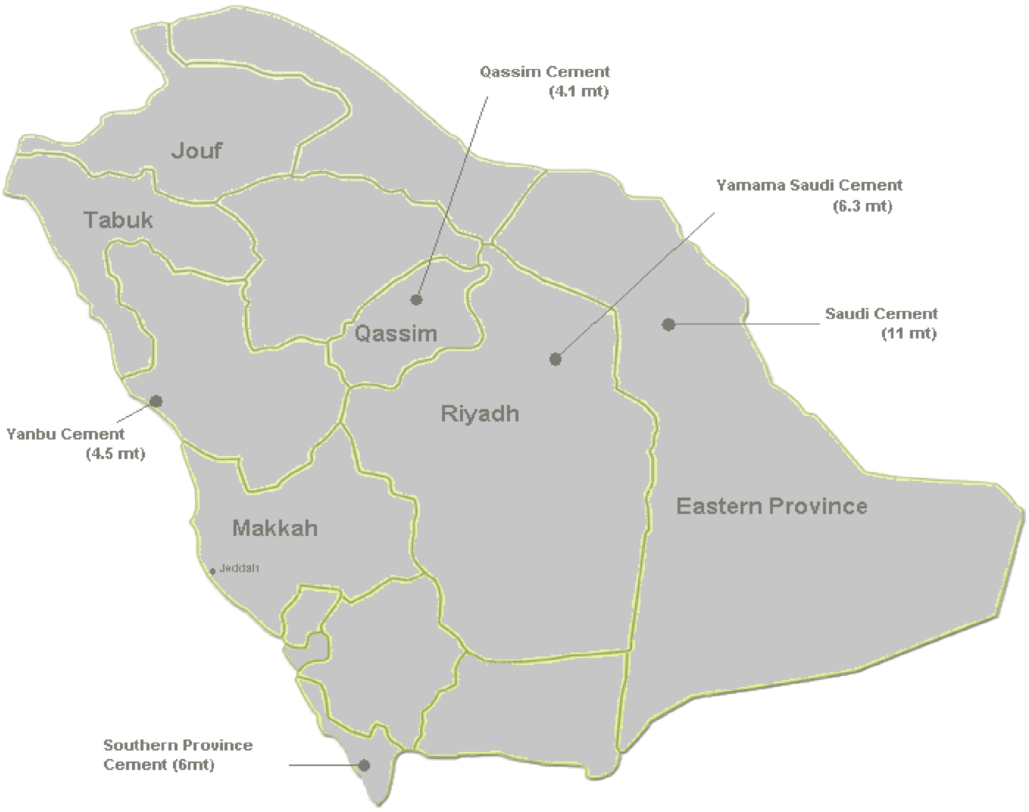
PROJECTED BALANCE SHEET

In SR million	2010	2011e	2012f	2013f	2014f	2015f
Current Assets						
Cash & cash equivalents	700	763	840	935	1,021	1,099
Trade receivables	242	293	338	378	401	429
Due from RP	0	3	4	2	3	4
Other receivables	21	21	29	30	32	35
Inventory	132	103	114	123	128	131
Prepaid expenses	6	6	9	9	10	10
Total current Assets	1,102	1,189	1,334	1,477	1,594	1,708
Non-current assets						
Investments	394	400	400	400	400	400
Loans to subsidiaries	25	25	25	27	28	30
Fixed assets	2,106	2,001	1,901	1,806	1,715	1,630
Projects under progress	7	4	15	20	18	15
Deferred Revenue	19	23	21	22	22	22
Total non-current assets	2,552	2,453	2,362	2,275	2,183	2,096
Total Assets	3,653	3,642	3,696	3,752	3,777	3,805
Current liabilities						
ST portion of LTD	77	66	143	165	180	182
Creditors	61	88	87	99	104	112
Due to RP	7	4	5	7	7	7
Accounts Payable	1	3	4	4	3	4
Other payables	32	40	46	52	54	58
Dividends Payable	41	46	52	57	61	64
Payables to Zakat	26	28	33	37	39	41
Total current liabilities	246	274	370	420	450	468
Long term liabilities						
Long term loans	190	140	201	201	182	164
EOS provision	59	64	69	75	81	88
Total long term liabilities	249	204	270	276	263	252
Total liabilities	495	479	640	696	713	720
Shareholders' equity						
Share capital	1,350	1,350	1,350	1,350	1,350	1,350
Legal Reserve	251	274	304	324	307	322
Additional Reserves	958	1,011	1,061	1,082	1,104	1,126
Retained earnings	550	478	290	249	253	237
Unrealized gains on investments	50	50	50	50	50	50
Total equity	3,159	3,163	3,055	3,056	3,064	3,085

Source: Blominvest, Yamama Cement

APPENDIX

I - Saudi Arabia Map



II - List of Comparable Peers

Company	Country	Mkt Cap (USD M)	Valuation			Profitability				Management Effectiveness			Liquidity	
			P/E	P/Rev	P/BV	Gross margin (%)	Operating margin (%)	Net margin (%)	SGnA/ Rev	ROE	ROA	D/E	Quick Ratio	Current Ratio
Southern Province Cement Company	SAU	2,855.9	13.2	8.2	4.3	54.5	51.3	50.3	2.1	26.6	23.4	0.0	2.4	3.3
Saudi Cement Company	SAU	2,631.5	12.8	6.5	2.9	50.4	44.7	43.2	5.0	20.5	13.8	27.5	0.5	1.2
Yanbu Cement Company	SAU	1,679.9	13.3	7.0	2.5	51.9	49.0	48.6	2.8	17.4	12.6	42.4	0.8	1.3
Qassim Cement Company	SAU	1,643.9	11.9	6.4	3.3	57.5	53.6	51.7	3.9	27.2	23.5	0.0	3.7	5.0
Qatar National Cement Company	QAT	1,483.4	12.9	5.0	2.5	46.7	40.4	42.8	4.9	22.9	18.2	15.0	0.9	2.5
Kuwait Cement Company KSC	KWT	1,146.0	22.5	7.1	2.0	39.5	30.1	29.9	7.4	9.1	5.3	53.9	0.7	1.2
Eastern Province Cement Company	SAU	1,105.3	12.2	5.1	2.0	47.3	42.8	41.9	3.3	16.6	14.7	3.6	3.3	4.9
Arabian Cement Co.	SAU	896.0	9.8	4.5	1.4	42.8	38.7	34.1	5.7	11.0	6.4	57.5	0.8	1.3
Suez Cement Company	EGY	717.6	5.1	0.7	0.6	34.5	24.6	23.7	5.2	17.3	14.8	0.4	1.3	1.8
Konya Cimento Sanayii	TUR	773.2	45.4	6.8	3.9	28.5	13.8	16.7	14.7	10.1	9.1	0.1	7.4	9.1
Nuh Cimento Sanayi	TUR	852.9	24.8	2.1	2.0	13.7	5.4	6.8	8.4	6.6	5.0	15.8	1.7	2.0
Akcansa Cimento Sanayi Ve Ticaret	TUR	700.9	16.3	1.6	1.6	13.7	9.5	7.3	4.2	7.2	5.0	24.2	1.3	1.8
Arkan Building Materials Company	ARE	528.9	49.9	7.9	1.2	44.6	16.5	21.7	27.2	3.4	2.1	58.1	0.7	1.0
Cimsa Cimento Sanayi ve Ticaret	TUR	517.5	7.9	1.4	1.1	26.6	20.6	14.6	6.0	11.5	8.9	13.1	0.8	1.3
Tabuk Cement Company	SAU	511.2	14.7	7.0	1.8	49.3	43.8	44.0	5.3	11.5	9.5	0.0	2.2	2.9
Al Khalij Holding Co QSC	QAT	518.7	23.8	7.1	1.0	43.7	26.9	26.9	14.2	3.8	2.3	74.2	1.3	1.4
Al Jouf Cement Co	SAU	492.2	21.7	17.9	1.5	44.2	18.3	14.3	18.2	1.3	1.1	30.1	4.4	6.0
National Gypsum Company	SAU	237.3	26.7	5.8	1.9	40.8	34.1	34.1	4.1	11.2	8.6	9.5	1.3	1.7
Southern Province Cement Company	SAU	2,855.9	13.2	8.2	4.3	54.5	51.3	50.3	2.1	26.6	23.4	0.0	2.4	3.3
Average Peers		1,071.8	19.1	6.0	2.1	40.6	31.3	30.7	7.9	13.1	10.2	23.6	2.0	2.8
Average Saudi peers		1,339.2	15.1	7.6	2.4	48.7	41.8	40.2	5.6	15.9	12.6	18.9	2.1	3.1
Yamama	SAU	2,447.9	13.0	7.2	2.9	56.0	52.4	51.7	3.3	21.1	17.9	8.5	3.9	4.5

Source: Reuters, 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

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