



US\$0.910bn Market cap	63.6% Free float	US\$3.748mn Avg. daily volume
Target price	161.6	18.39% over current
Consensus price	161.2	-18.14% over current
Current price	136.5	as at 23/5/2011

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Underweight **Neutral** **Overweight**

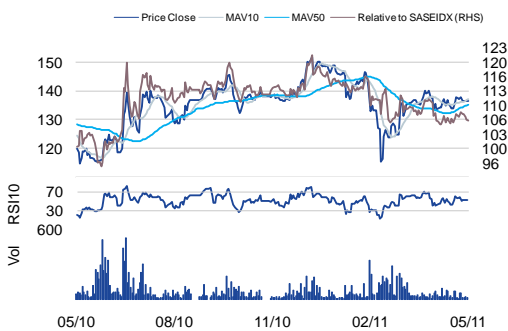
Key themes

We believe the ceramics manufacturing industry will continue to grow. Currently, Saudi Ceramics has a strong position in the Saudi market. We believe the strategy of expanding in ceramic tiles will increase the company's growth.

Implications

Saudi Ceramic Company is one of the leading ceramic manufacturing companies in the region. We believe the company will offer good growth in the near future. We believe the expansions currently taking place coupled with improvements in margins will support the share price.

Performance



Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	1,080	1,218	1,399	1,618
Revenue Growth	12.7%	12.8%	14.9%	15.7%
EBITDA (mn)	318	355	415	480
EBITDA Growth	12.6%	11.7%	16.9%	15.5%
EPS	8.77	9.55	11.39	13.40
EPS Growth	11.2%	8.9%	19.3%	17.6%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Saudi Ceramics outlook remains positive

This report follows our flash view of 19th April. Saudi Ceramics' Q1 results were below our expectation in terms of both revenues and profits. We believe the change in product mix—concentrating on cheaper products that carry lower margins—affected revenues and ultimately profits. Gross margin was affected mainly by water heaters margin which fell by around 1.5% year on year. For the next two years, we do not expect segments' gross margins to improve noticeably. However, the expansion in tiles segment, which bears higher margins, should support the company's aggregate gross margin. On the back of Q1 results, we have trimmed our forecasts and consequently cut our target price by around 7% to SAR161.6. Our new target price still implies 18% upside potential. Therefore, we remain overweight.

Revenues below expectations: Notwithstanding revenues grew 14% year on year, it was below our expectations of 19.7%. We believe the change in product mix as SCC concentrated on cheaper products targeting low end consumers affected the top line. Considering the recent increase in tile production by almost 26%, we think SCC will continue to use this mix as it offers safe strategy at this stage. SCC might consider changing the mix when commercial production for phase II of the fourth ceramic tile plant starts in Q1 2012. We now expect revenues growth of 12.8% and 14.9% for years 2011 and 2012 respectively.

Gross margin: to remain flat: Gross profit increased by 11.3% year on year to reach SAR112mn. However, gross margin at 36.6% was 1% below that in Q1 2010. We believe the decline in gross margin of water heaters affected the overall Q1 margins. Also, the change in production mix also lowered ceramic product margins by 1%. We do not expect both segments margins to improve as SCC is likely to maintain current product mix. However, overall margins will improve as tiles', which carry higher margins, share of revenues is increasing.

Net profit: Saudi Ceramics reported a higher than average interest expense of SAR4.7mn in Q1, on account of a portion of work in progress charged to income statement in this quarter. As a result, interest expense as a percentage of gross debt increased from 1.1% in Q1 2010 to 2.5%. With work in progress currently at SAR96.8mn, we believe that interest costs will return below 2% levels for the remaining quarters of 2011 and net profit will consequently improve.

Capacity set to rise: SCC announced that it will replace two production lines in the second ceramic plant by the end of 2012. A new technology will be used in these two lines which will boost production by 8mn sqm per year. In addition, the proposed lines will use one kiln instead of the two currently used. We believe this approach should increase production efficiency and improve margins on the long run. We further note that Saudi Ceramic is now using subsidised gas prices; but its sustainability remains uncertain. We view the new technology as a smart strategic approach by SCC to reduce the risk of uncertain future gas prices and we will not be surprised to see similar actions taking place in other lines.

Conclusion: Saudi Ceramic has a solid business model with a strong position in the local market. We continue to believe that the fourth ceramic tile plant will be the key growth driver for 2011 and 2012. However, Q1 results were below expectations and certainly not so encouraging. Therefore, we have trimmed our near term forecasts and consequently lowered our target price to SAR161.6. Our new target price implies 18% upside potential. We remain overweight.



Corporate summary	Share information	Valuation
<p>Saudi Ceramic Company is one of the oldest and leading ceramics producers in the Middle East with a market value of around SAR3.4bn. The company manufactures and markets ceramic products such as ceramic tiles, sanitary ware (bathroom products) and road markers; in addition, the company manufactures water heaters. The company intends to launch production of red bricks by 2012.</p>	Market cap (SAR/US\$) 3.412bn / 0.910bn	Period End 12/10A 12/11E 12/12E 12/13E
	52-week range 115.0 - 151.8	Revenue (SARmn) 1,080 1,218 1,399 1,618
	Daily avg volume (US\$) 3.748mn	EBITDA (SARmn) 318 355 415 480
	Shares outstanding 25.00mn	Net Profit (SARmn) 219 239 285 335
	Free float (est) 63.6%	EPS (SAR) 8.77 9.55 11.39 13.40
	Performance: 1M 3M 12M	DPS (SAR) 3.50 4.00 4.50 5.49
	Absolute 2.1% 2.2% 13.5%	EPS Growth 11.2% 8.9% 19.3% 17.6%
	Relative to index 0.4% -4.8% 6.6%	EV/EBITDA (x) 12.5 11.4 9.7 8.4
	Major Shareholder:	P/E (x) 15.6 14.3 12.0 10.2
	General Social Insurance 15.9%	P/B (x) 3.4 3.0 2.6 2.2
Saleh Abdulaziz Al Rajhi 14.3%	Dividend Yield 2.6% 2.9% 3.3% 4.0%	
Source: Bloomberg, Al Rajhi Capital		Source: Company data, Al Rajhi Capital

Figure 1. Saudi Ceramics: Q1 & Q2 results (actual & our forecasts)

SAR (mn)	2010Q1A	2011Q1A	2011Q1E	Y_Y%	2010Q2A	2011Q2E	Change%
Ceramics	203	235	251	15.6%	221	254	15.2%
Heaters	65	72	70	10.1%	57	61	7.0%
Total revenues	268	306	321	14.2%	278	316	13.5%
Gross profit	101	112	123	11.3%	99	112	12.9%
Gross margin %	37.6%	36.6%	38.2%		35.6%	35.4%	
Net profit	58	60	73	2.7%	58	63	9.0%

Source: Company data, Al Rajhi Capital



We expect revenues to increase by 12.7% for this year

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	958	1,080	1,218	1,399	1,618
Cost of Goods Sold	(605)	(688)	(779)	(885)	(1,018)
Gross Profit	352	392	439	514	600
Government Charges					
S.G. & A. Costs	(156)	(171)	(190)	(213)	(246)
Operating EBIT	197	221	249	302	354
Cash Operating Costs	(675)	(762)	(863)	(984)	(1,139)
EBITDA	282	318	355	415	480
Depreciation and Amortisation	(86)	(97)	(106)	(114)	(126)
Operating Profit	197	221	249	302	354
Net financing income/(costs)	4	5	(4)	(9)	(11)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income					
Other Expenses					
Net Profit Before Taxes	200	226	245	292	344
Taxes	(3)	(6)	(7)	(7)	(9)
Minority Interests					
Net profit available to shareholders	197	219	239	285	335
Dividends	(75)	(88)	(100)	(113)	(137)
Transfer to Capital Reserve					

We expect dividend to increase annually by SAR0.5

	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	25.00	25.00	25.00	25.00	25.00
CFPS (SAR)	11.32	12.65	13.78	15.94	18.43
EPS (SAR)	7.89	8.77	9.55	11.39	13.40
DPS (SAR)	3.00	3.50	4.00	4.50	5.49

We expect gross margin to decline this year but improve gradually thereafter

Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth	11.7%	12.7%	12.8%	14.9%	15.7%
Gross Profit Growth	10.0%	11.3%	11.9%	17.1%	16.6%
EBITDA Growth	8.9%	12.6%	11.7%	16.9%	15.5%
Operating Profit Growth	7.6%	12.3%	12.9%	20.9%	17.4%
Net Profit Growth	10.8%	11.2%	8.9%	19.3%	17.6%
EPS Growth	10.8%	11.2%	8.9%	19.3%	17.6%

Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin	36.8%	36.3%	36.1%	36.8%	37.1%
EBITDA margin	29.5%	29.4%	29.2%	29.7%	29.6%
Operating Margin	20.5%	20.5%	20.5%	21.6%	21.9%
Pretax profit margin	20.9%	20.9%	20.1%	20.9%	21.2%
Net profit margin	20.6%	20.3%	19.6%	20.4%	20.7%

Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	15.5%	15.4%	16.0%	17.3%	18.2%
ROIC	14.6%	14.7%	14.4%	15.5%	16.9%
ROE	24.9%	23.6%	22.1%	22.9%	23.2%
Effective Tax Rate	1.5%	2.8%	2.7%	2.5%	2.5%
Capex/Sales	28.0%	16.6%	16.4%	22.9%	17.0%
Dividend Payout Ratio	38.0%	39.9%	41.9%	39.5%	41.0%

Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	17.3	15.6	14.3	12.0	10.2
P/CF (x)	12.1	10.8	9.9	8.6	7.4
P/B (x)	4.0	3.4	3.0	2.6	2.2
EV/Sales (x)	4.0	3.7	3.3	2.9	2.5
EV/EBITDA (x)	13.6	12.5	11.4	9.7	8.4
EV/EBIT (x)	19.5	18.0	16.2	13.4	11.4
EV/IC (x)	2.6	2.4	2.1	2.0	1.8
Dividend Yield	2.2%	2.6%	2.9%	3.3%	4.0%

Source: Company data, Al Rajhi Capital



Saudi Ceramic's balance sheet is expanding as a result of the recent expansions

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	36	39	47	84	90
Current Receivables	109	100	111	154	210
Inventories	357	425	469	533	583
Other current assets	39	49	88	88	88
Total Current Assets	541	613	715	858	971
Fixed Assets	1,176	1,259	1,353	1,559	1,708
Investments	60	52	60	60	60
Goodwill					
Other Intangible Assets	-	-	-	-	-
Total Other Assets	2	2	2	2	2
Total Non-current Assets	1,237	1,313	1,414	1,620	1,770
Total Assets	1,778	1,925	2,130	2,479	2,741
Short Term Debt	289	345	447	447	447
Accounts Payable	126	53	136	140	194
Accrued Expenses	-	-	-	-	-
Dividends Payable	-	-	(100)	(113)	(113)
Other Current Liabilities	66	57	53	53	53
Total Current Liabilities	480	454	536	700	754
Long-Term Debt	406	430	400	400	404
Other LT Payables	0	1	-	-	-
Provisions	33	38	40	40	40
Total Non-current Liabilities	439	468	440	440	444
Minority interests					
Paid-up share capital	250	250	250	250	250
Total Reserves	609	753	904	1,089	1,293
Total Shareholders' Equity	859	1,003	1,154	1,339	1,543
Total Equity	859	1,003	1,154	1,339	1,543
Total Liabilities & Shareholders' Equity	1,778	1,925	2,130	2,479	2,741
Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	659	736	799	763	761
Net Debt/EBITDA (x)	2.33	2.31	2.25	1.84	1.59
Net Debt to Equity	76.8%	73.4%	69.3%	57.0%	49.3%
EBITDA Interest Cover (x)	(80.7)	(69.6)	85.7	43.9	45.7
BVPS (SAR)	34.35	40.11	46.16	53.55	61.70
Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	200	226	245	292	344
Depreciation & Amortisation	86	97	106	114	126
Decrease in Working Capital	15	(162)	(13)	71	(52)
Other Operating Cashflow	3	14	(1)	(7)	(9)
Cashflow from Operations	304	175	337	469	409
Capital Expenditure	(268)	(179)	(199)	(320)	(275)
New Investments	2	11	(8)	-	-
Others					
Cashflow from investing activities	(267)	(168)	(208)	(320)	(275)
Net Operating Cashflow	37	7	130	149	134
Dividends paid to ordinary shareholders	(64)	(76)	(100)	(113)	(131)
Proceeds from issue of shares					
Effects of Exchange Rates on Cash					
Other Financing Cashflow	-	-	-	-	-
Cashflow from financing activities	(27)	(4)	(29)	(113)	(127)
Total cash generated	10	3	101	37	6
Cash at beginning of period	25	36	39	47	84
Implied cash at end of year	36	39	140	84	90
Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	28.0%	16.6%	16.4%	22.9%	17.0%

Source: Company data, Al Rajhi Capital

Capex will increase due to red bricks plant and implementation of new technology in tile plants



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1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"Overweight": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"Neutral": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"Underweight": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"Time horizon": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"Fair value": We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

"Target price": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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