Comparative Energy Costs and Expansionary Fiscal Policies are Fuelling the Saudi Cement Sector

Saudi Cement Sector Review

Contents

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Executive Summary

- Saudi Arabia's continued expansionary policies, large investments in social and physical infrastructure, and subsidized fuel and raw material costs are the main drivers in the cement sector.
- Currently, there are fourteen local cement players, of which eleven are listed on the Saudi Stock Exchange. At the end of 2011, their net income stood at SAR4.2 billion.
- The cement sector is highly regulated with the price of a 50kg bag averaging SAR13.96 in 2011, translating into SAR279 per tonne.
- Market size is estimated to have reached SAR13 billion in 2011.
- Given the construction boom, it is important to differentiate between core and transient demand. The latter's overall growth trajectory is decelerating.
- Inventory amounted to 8.2 million tonnes by the end of 2011, equivalent to 17% of annual demand. Tight stockpiles have contributed to the creation of a secondary 'informal' market.
- Banks' appetite towards the sector is healthy with competitive rates. Yet, a concern for banks lies in funding new projects that are largely geared to meet transient demand.
- SIDF continues to be the main financier of cement companies, disbursing a total of SAR9.7 billion to the sector since inception.
- According to market insights, the cost of cement accounts for a range of 3%-7% of the awarded contract value.
- Cement prices expected to remain elevated over the two years. Average prices are forecasted to fall in the range of SAR258-SAR284/ tonne in 2012, and SAR268-SAR290/ tonne in 2013.
- Demand for cement is expected to rise to 49 million tonnes and 52 million tonnes in 2012 and 2013, respectively.

Introduction

As Saudi Arabia propels forward in diversifying its economy away from oil dependency, it has embarked on numerous infrastructural projects and implemented mechanisms to further encourage foreign direct investment. These key development initiatives have boosted investor confidence in the Kingdom, thereby contributing to the growth of the construction sector, taking shape in the form of residential, industrial, and transportation projects.

On the back of the recent construction spike and primarily large government tenders, the Kingdom's oligopolistic cement sector will continue to grow over the coming two years. Despite the introduction of new production lines from new market entrants, cement prices will likely witness an increase. This is due to a shortage in fuel allocation from Saudi Aramco, and the decline of clinker inventory over the past two years. However, the Ministry of Commerce and Industry (MOCI) will act to mitigate these price increases, as it heavily regulates the cement market.

Market Determinants

The Saudi cement sector is fuelled by strong domestic fundamentals, namely: (1) the government's continued high expenditure on physical and social infrastructure, driven by positive oil price movements, and buoyed by a young demographic structure; (2) relatively low fuel and raw material costs as a result of the subsidized power/ gas, and minimal royalty mining fees, sustaining domestic producers' competitive advantage; and (3) new market entrants, leading to an influx in capacity dispersed geographically in areas of concentrated demand.

(A) Growth in the Economy

Over the past decade, the Saudi economy has more than doubled, as measured by the current size of GDP. By the end of 2011, nominal GDP reached SAR2,163 billion, a 206% increase from the SAR707 billion in 2000. Both the construction and building materials sectors follow the growth trajectory of the country's GDP. As expenditure on mega infrastructure projects is determined by government revenues, the robust 19.48% increase in construction activity can be attributed to oil prices averaging at USD107.8/ bbl in 2011, which created strong demand for building materials including cement.

The government's budget for 2012 continued to focus on capital expenditure with SAR280 billion or 40% of resources being allocated to infrastructure projects. Earlier, in 2010, the Public Investment Fund (PIF) took additional measures to provide funding for industrial projects. It raised the cap on lending from 30% to 40% of project value and extended loan duration from 15 to 20 years.

Saudi Arabia is characterized by an increasingly young population. The most recent population census taken in mid 2010 established that the Kingdom's population stood at 27.1 million, having grown at an inter-census Compounded Annual Growth Rate (CAGR) of 3.15% since 2004. The proportion of young Saudis, identified as those up to the age of 30 years, accounted for approximately 57% of the total population in 2011. This will ultimately translate into greater demand for social infrastructure, as well as housing units for those entering marriageable age. Additionally, the Ninth Development Plan (2010-2014) earmarks SAR111 billion for transportation and communication development, as well as SAR100 billion for expenditure on housing over the plan's five year duration. Furthermore, in March 2011, a royal decree allocated SAR250 billion towards building 500,000 housing units. These factors illustrate that demand for cement is equally driven by the Kingdom's social needs for housing, transportation and other social infrastructure.

(B) Input Costs

The Kingdom's cement producers enjoy lucrative profits due to lower government-regulated fuel prices and cheap access to raw materials. On average, energy costs represent 30%-40% of total production costs, and are the second largest consideration to be factored into the cost structure of producing cement. Fortunately, Saudi Arabia benefits from lucrative gas and oil reserves. Thus, the local price of natural gas is set at USD0.75 MMBtu, significantly lower than international spot market prices that average between USD2.50-USD5.50 MMBtu. Limestone is also heavily subsidized by the government. Together with the substantial volume of projects in the Kingdom, these subsidies give local players significant leverage over imported cement.

(C) Local Players

In 2006, there were only eight cement producers in the Kingdom. High profit margins attracted increased competition within the sector, and as a result, these eight primary players have lost market share to new entrants; namely Riyadh Cement, City Cement, Northern Cement, Al Jouf Cement, Najran Cement, and Hail Cement. The former three remain privately owned, while the latter three were added to the stock market between 3Q10, and 2Q12.

By the end of 2010, The Agency of Petroleum and Mineral Resources, responsible for mining activities in the Kingdom, had awarded a total of twenty six licenses– for varying mining functions such as the extraction of gypsum or limestone ores– to fourteen active cement producers in the Kingdom. Together, they currently have a planned combined cement production capacity of 157 thousand tonnes per day or 50.2 million tonnes annually. Geographically, these plants are spread across Saudi Arabia and located in the Western, Eastern, Northern, Southern or Central regions, (Table 1).

Table 1: Regional Cement Companies

Region	Cement Companies
Western	(Arabian + Yanbu)
Northern	(Northern + Tabuk + Al Jouf + Hail)
Eastern	(Eastern + Saudi)
Southern	(Southern + Najran)
Central	(Qassim + City + Riyadh + Yamama)

Source: SAMA's 47th Annual Report, Yamama Cement

Currently, both Tabuk Cement and City Cement are undergoing expansion plans, with awarded contract values of SAR30 million and SAR135 million, respectively. Hail Cement is also currently underway in building its plant with an awarded contract value of SAR200 million, (Table 2). In 1Q2012, Southern Province Cement completed its planned plant expansion.

Table 2: Cement Companies' Expansion Plans and New Plant in the Execution Phase (SAR mn): 2012-2013

Name	Specification (tonne/day)	Contract Value (SR mn)	Completion Date
Tabuk Cement Company - Plant Expansion	4,000	30	4Q 2012
City Cement Company - Plant Expansion	5,000	135	1Q 2013
Hail Cement Company - New Plant	5,000	200	3Q 2013
Total	**14,000**		

Source: MEED Projects

In total, eleven cement companies are now publicly listed. The market capitalization of the sector stood at SAR60.1 billion at the end of 2011, with net income amounting to SAR4.2 billion.

Regulatory Developments

The Kingdom's cement sector enjoys a supportive regulatory environment alongside subsidies. As part of the WTO 'Safeguard Measures' framework, Saudi Arabia holds pre-emptive rights to invoke 'anti-dumping' punitive tariffs on foreign producers who choose to 'dump' cheap cement into the Kingdom.

The Saudi cement sector is heavily regulated by MOCI. Being a subsidized industry, MOCI has the leverage to interfere in setting the cement prices. In June 2008, MOCI introduced an export ban on cement in an effort to contain local production and meet domestic demand. Earlier that year, local cement producers had exported large volumes for higher profits, creating a shortage of supply in the Kingdom. Consequently, prices increased calling upon MOCI to impose what was intended as a one year ban. This was applied to all countries with the exception of Bahrain, which saw its weekly quota drop by 50% to 25,000 tonnes. However, existing cement producers, on the back of healthy exports, had already commenced with incremental expansion plans– establishing new lines– while new players seized this opportunity to commence production.

In May 2009, the government amended the export ban to include three main conditions. Cement producers were permitted to export a portion of their additional production so long as they (1) sold cement domestically at a price cap of SAR200 per tonne, or alternatively a 50kg bag at SAR10; (2) met all local demand; and (3) maintained an inventory reserve equivalent of 10% of production.

In late April 2011, after a reported increase in local prices of cement to a range of SAR17-SAR20, MOCI intervened once again to set a price cap at SAR14 for a 50kg bag. Consequently, the Council of Saudi Chambers of Commerce and Industry is studying the feasibility of tackling price rises via the direct purchase of products in short supply from manufacturers. Such a proposal will enable them to sell products to consumers at cost price until prices stabilize, weakening informal markets. The Council has also established a national committee under its umbrella to strengthen the Kingdom's cement industry and stabilize local prices. However, in Feb 2012, MOCI re-enforced the export ban, halting all exports of cement and clinker, irrespective of the aforementioned criteria, making an allowance only for Bahrain's weekly quota. In March, MOCI set prices so as not to exceed SAR12 per bag for wholesale and SAR14 for end users at both cement shops and cement selling yards.

The Cement Sector

(A) The Kingdom's Cement

Cement is a man-made powder that, when mixed with water and aggregates, produces concrete. The raw materials for this process begin in a limestone quarry, after which clay and sand are added to limestone and grinded together. The cement-making process can be divided into two basic steps: (1) clinker is made from the aforementioned materials which are aggregated in the kiln at temperatures of 1,450°C and (2) clinker is then ground with other minerals (e.g. gypsum) to produce the powder cement, to be stored in silos. The cement capacity of companies is generally an additional estimated 5% than that of clinker, as gypsum is added to the clinker to produce the final cement powder.

Saudi Arabia readily produces several types of both Portland cement and Blended cement. The former comes in varying forms: Type I, known as Ordinary Portland Cement (OPC); Type II, known as Moderate Sulfate Resistant Cement; and Type V, known as Sulfate Resistant Cement (SRC). Blended cement types include Portland Pozzolana Cement (PPC), as well as oil well cement, which is produced specifically for use by Saudi Aramco within the oil industry. An estimated 70% of the market share is attributed to Type I, with the remainder being split between Type II, Type V and other variants.

Over the years, Saudi cement producers have leveraged their expertise and knowledge of the local market, and there is very little foreign investor involvement. One example of a company that partnered with an international firm is Arabian Cement, (Table 3). However, in August 2011, it announced it would be liquidating its investment with Italcementi Group, on the back of accumulated losses. The company–International City Company for Concrete– was formed to primarily cater to King Abdullah Economic City (KAEC), but after mixed success with construction timelines, the venture suffered financially.

Table 3: Selected Saudi Cement Company Joint Ventures

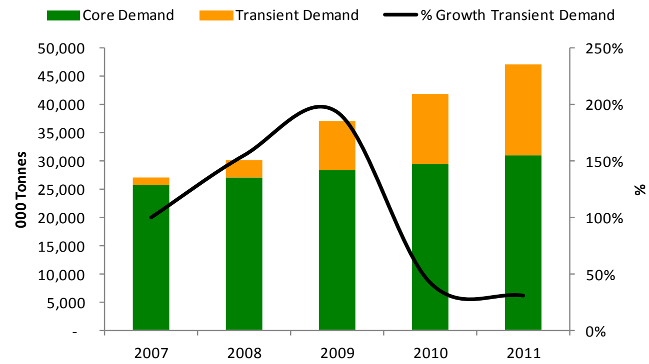
Name	Shareholding Structure	Date Announced	Value (SAR mn)
Al Safwa Cement Company	Lafarge Cement: 50%, Khayyat Group: 50%	2006	1,125
International City Company for Concrete (ICC)	Italcementi Group: 50%, Arabian Cement: 50%	2007	100

Source: Tadawul, Zawya and other newspapers

(B) Market Size

The size of the current cement market can be determined using the Kingdom's construction activity as a proxy. Given the recent spike in construction, it is important to differentiate between core demand and transient demand for cement. Core is identified as the 2002-2006 CAGR demand for cement, which was equivalent to 5%. This period is generally representative of a natural business cycle for the Kingdom, excluding the intermittent construction boom. Transient is that generated from ongoing mega-project construction activity which we have identified as commencing in 2007. Using the 2007-2011 CAGR of 15%, it can be assumed that the differential 10% represents transient demand because this trend is unlikely to continue in the long-term as the pace of new projects is likely to slow in the medium-term. Consequently, while in absolute terms transient demand appears to have increased since 2007, the overall growth trajectory is decelerating, with transient demand decreasing by 30.9% in 2011, (Chart 1).

Chart 1: Core Domestic Sales and Transient Demand (Million Tonnes): 2007-2011



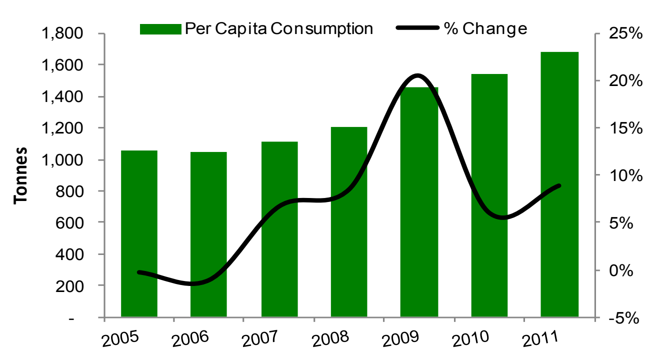
Source: Yamama Cement

By the end of 2011, total local sales amounted to 47 million tonnes, a YoY increase of 12.3%. Of this total, an estimated 16 million tonnes represented transient demand. According to the Central Department of Statistics and Information (CDSI), a 50kg bag of cement in 2011 costs SAR13.96 on average, which translates into SAR279 per tonne. Thus, total revenues are estimated to have reached SAR13 billion.

At the end of 2011, Saudi Cement, the largest producer in the Kingdom, was the market leader in terms of volume of local sales at approximately 7 million tonnes. It was closely followed by Southern Cement and Yamama Cement at 6.7 million tonnes and 6 million tonnes, respectively. At the end of 2010, the eight primary players accounted for 78% of the market share, having lost 6%, in terms of local cement sales, to new entrants. In 2011, the former group maintained their 78% market share.

For the same year, per capita local cement consumption was 1,684 kg. This represents a 60% growth since 2005, when local per capita cement consumption stood at 1,056 kg, (Chart 2).

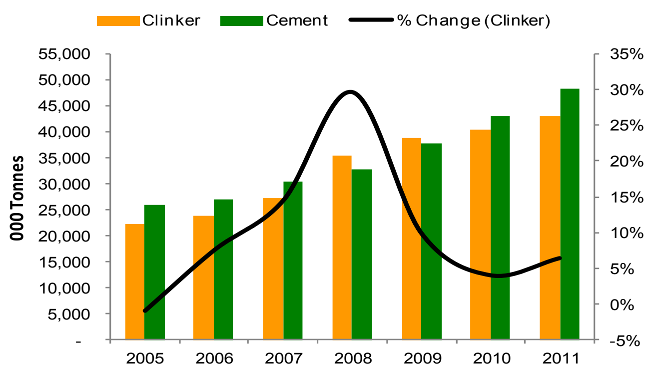
Chart 2: Per Capita Local Cement Consumption (kg): 2005-2011



Source: NCB Estimates

The Saudi cement market has been well supplied by domestic producers. At the end of 2011, the total supply of clinker reached 43 million tonnes, growing at 6.4% YoY. Total cement production amounted to 48.4 million tonnes, growing at approximately 12.6% YoY, (Chart 3). Since 2005, cement production has averaged 7.5% more than clinker production levels.

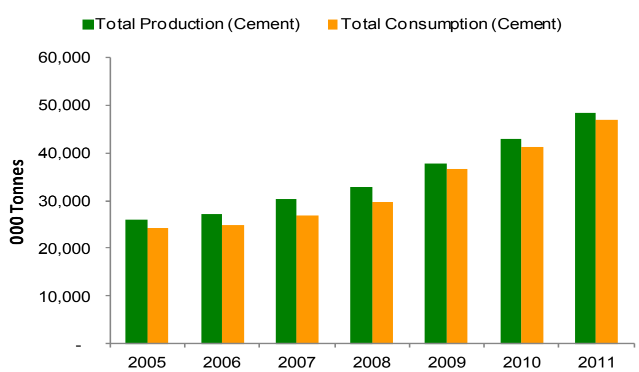
Chart 3: Total Production (Million Tonnes): 2005-2011



Source: Yamama Cement

On the back of increased construction activity, local deliveries as a percentage of production levels, averaged 97% in 2011, (Chart 4). This signifies the tight demand-supply balance that exists in the sector, as there is very little excess capacity.

Chart 4: Total Production and Total Consumption (Million Tonnes): 2005-2011



Source: Yamama Cement

Consumption levels vary across the Kingdom's geographical regions based on pockets of concentrated demand. By the end of 2011, the Central region continued to dominate, with a 33% market share of local deliveries, (Table 4).

Table 4: Regional Local Deliveries (Million Tonnes) and Market Share (%): 2005-2011

Region	Local Deliveries 2010 (mn tonnes)	Share (%)	Local Deliveries 2011 (mn tonnes)	Share (%)
Western	7.1	17%	8.2	18%
Northern	2.8	7%	3.6	8%
Eastern	9.4	23%	9.9	21%
Southern	8.5	21%	9.8	21%
Central	14.3	35%	15.6	33%
	42.0		**47.1**	

Note: Hail Cement is not factored in, as it is planning to commence its operations in 2013.

Source: Yamama Cement

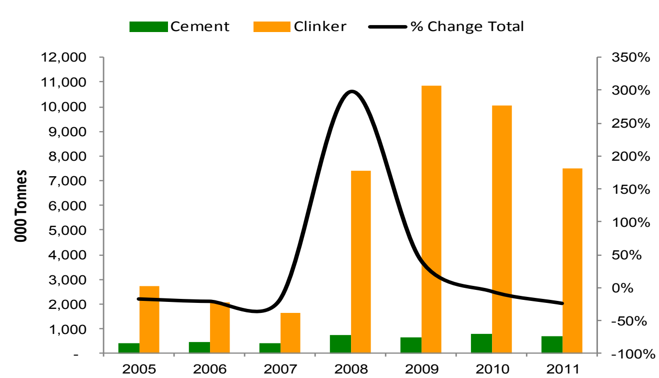
Meanwhile, the Eastern region benefits from its close proximity to natural gas: the main source of fuel used by cement producers. Both Saudi Cement and Eastern Province Cement are positioned in strategic access of cheap energy and export avenues, particularly to other GCC members. However, the conditional export ban and increased competition from other players have put pressure on the operations of these companies.

By the end of 2007, total exports from these two companies amounted to 2.3 million tonnes, or 65% of total exports. Saudi Cement's and Eastern Cement's export ratio to their respective production levels of cement in the same year, was 22% and 32% respectively. By the end of 2011, these two companies accounted for a collectively smaller 36% share of total exports. Saudi Cement's export ratio for cement fell to 7.5%, and Eastern Cement's export ratio fell to 5.5%.

(C) Inventory

At the end of 2011, total company stockpiles amounted to 8.2 million tonnes, equivalent to 17% of annual demand, having continued in a downward trend for the second year in a row, falling by 24% YoY, (Chart 5).

Chart 5: Total Inventory (Million Tonnes): 2005-2011



Source: Yamama Cement

Excess clinker capacity lay with Yamama Cement, Saudi Cement and Southern Cement. Together, they accounted for 58% of total inventory, highlighting the shortage of inventory in the Western region, (Table 5).

Table 5: Total Inventory by Region (Million Tonnes): 2011

Region	Inventory 2011 (mn tonnes)	Share (%)
Western	564	7%
Northern	1,054	13%
Eastern	2,622	32%
Southern	1,608	20%
Central	2,355	29%
	8,203	**100%**

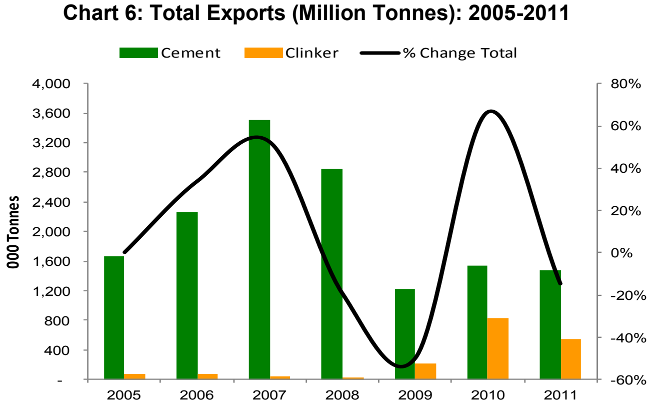
Source: Yamama Cement

Storing cement for long periods of time decreases its quality and strength, so 91% of inventory is made up of clinker. One of the challenges to storing clinker is that the higher usage of clinker inventories will result in a higher cost per tonne. Cement companies also have to comply with MOCI's stipulation of maintaining a 10% reserve of their production levels.

(D) Exports and Imports

By the end of 2008, several months after the implementation of the export ban, total exports for both cement and clinker, amounted to 2.9 million tonnes. This marked an approximate 20% decline from 2007's level of 3.6 million tonnes. By the end of 2009, total exports continued their downward trend, decreasing by 50% to 1.4 million tonnes. This trend did not continue throughout 2010, as end of year total exports reached 2.4 million tonnes, a 66% increase YoY. However, at the end of 2011, exports dipped by an estimated 15%. Both Northern Cement and AlJouf Cement were the only two companies to export clinker, (Chart 6).

Chart 6: Total Exports (Million Tonnes): 2005-2011



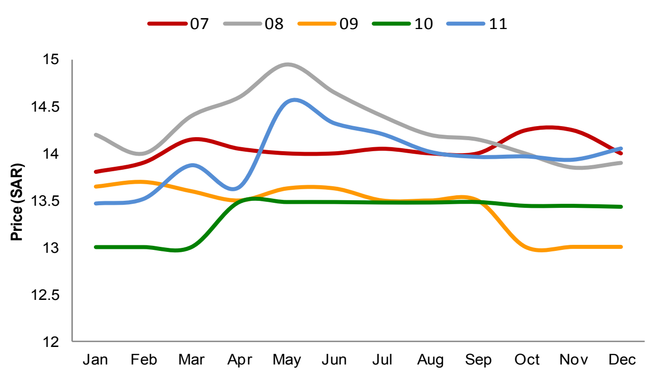
Source: Yamama Cement

As for imports, cement companies import clinker to meet potential shortages in supply within the Kingdom. The three major importing countries are Australia, China and India. In 2005, clinker imports accounted for 592,000 tonnes, with this falling by 83% in 2009 to reach 100,000 tonnes. In 2011, only 35,000 tonnes were imported.

(E) Pricing

As the export ban took effect in 2008, along with the opening up of new manufacturing facilities, cement prices fell. The restriction on exports and the saturation of the cement sector resulted in a decline in several firms' earnings. Others also halted the expansion in additional lines. According to the CDSI, cement prices averaged their lowest at SAR12.69 per 50kg bag or SAR254 per tonne in 2006. However, they recorded their highest in May 2008, at SAR14.95 per 50kg bag, or SAR299 per tonne; a month before the export ban was set. In 2011, prices mimicked the volatility of 2008 by rapidly rising to SAR291 per tonne in May, amidst ongoing concerns of reported fuel shortages. Cement prices closed the year, leveling at SAR279 per tonne in December, (Chart 7). Since 2006, the price of cement as recorded by the CDSI has been growing at a CAGR of 1.9%.

Chart 7: Price of Cement per 50kg Bag (SAR): 2007-2011



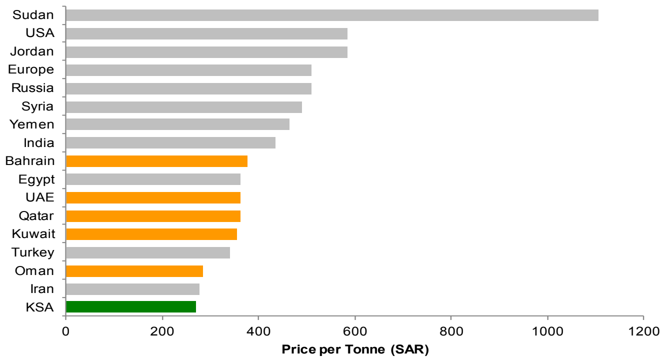
Source: Saudi Central Department of Statistics and Information

In addition to the regulated segment of the cement market, an 'informal' segment exists. This pushes local cement prices upwards to a range of SAR22-SAR25 per 50kg bag when supply is limited, particularly in the Western region. While the exact size of this segment cannot be determined, it represents irregular spikes in cement prices due to the variation in supply between one region of the Kingdom and another.

Storage and transportation costs can account for a considerable amount of the selling price, given cement's bulky packaging nature. This usually amounts to an additional SAR20-SAR40 fee which is charged by the distributor/transport company, resulting in a SAR300/ tonne price for the end consumer. It is worthy to note that several years ago, the government fixed the price at SAR250/ tonne and SAR270/ tonne for Type I and Type

II cement, respectively. In comparison to regional and international markets, Saudi cement remains the most competitive, (Chart 8).

Chart 8: Worldwide Average Cement Prices (SAR): 2010

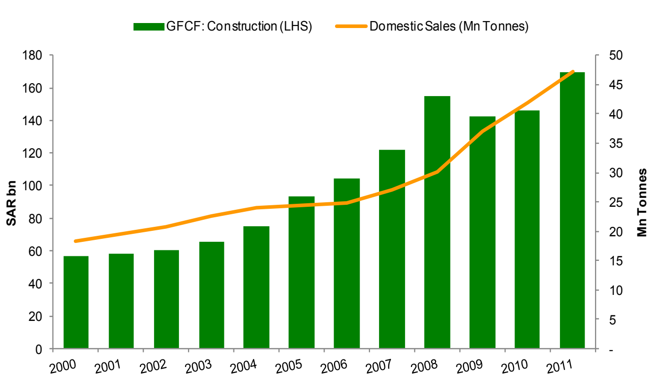


Source: NCB Estimates

(F) Fixed Investment

NCB estimates that total expenditure in the Saudi construction sector, as measured by its components in the country's gross fixed capital formation (GFCF), reached SAR169 billion by the end of 2011. This represented a 200% increase from 2000, and a 16% rise from 2010. The two components are Residential Building Construction (RBC), and Non-Residential Building Construction (NRBC). To further assess private sector participation, we examined the non-oil contribution in each component. While construction GFCF grew at a CAGR of 10.5% from 2000 until 2011, non-oil private sector contribution (RBC, NRBC) grew at an approximate CAGR of 3.6%. Local cement consumption, by comparison, grew at a slower CAGR of 9% over the same period, (Chart 9). This is indicative of a demand-supply mismatch. For the same period, construction GFCF accounted for 9%, on average, of nominal GDP.

Chart 9: Construction GFCF (SAR bn) and Domestic Consumption (Million Tonnes): 2000-2011



Source: Yamama Cement

Examining the relationship between construction GFCF and the SAR value of local cement consumption from 2006-2011, it can be estimated that, on average, the SAR value of local cement consumption accounts for an estimated 6.7% share of construction GFCF. According to market insights, the cost of cement accounts for a range of 3%-7% of the awarded contract value. It is important to note that construction GFCF is not accounting for the total value of contracts awarded, thus the two values are not equivalent.

(G) Financing

There are two main external sources of funding for cement companies: Government loans and Bank loans. State-owned Saudi Industrial Development Fund (SIDF) continues to be a main financier for cement companies. By the end of 2010, total cumulative disbursed funds for the cement sector, since inception, stood at SAR9.7 billion. This is equivalent to 11% of total disbursed funds to date. In 2009, SIDF approved a further SAR784 million for two cement factories; one for construction in Turaif, and the other for expansion in Yanbu. In 2012, a SAR300 million loan was approved to Hail to establish its new plant, (Table 6).

Table 6: SIDF Loans to Selected Cement Companies (SAR mn): 2005-2012

Company	Loan (SAR mn)	Approved (Yr)
Yamama	459.8	2005
Arab	300	2008
Yanbu	150	2009
AlJouf	483.5	2009
Hail	300	2012

Source: Saudi Industrial Development Fund

Bank loans are mainly to provide funding for the day-to-day working capital of manufacturing. These loans are secured by the companies' assets, such as the land and machinery. Historically, interest rates on long-term loans have ranged between 100–150 basis points above SAIBOR. While banks have a healthy appetite for the cement sector, rates are determined based on the company's performance, its financial health, as well as its production lines and existing competition. However, a concern for banks is related to new expansion lines or new factories that mainly address transient demand, which may only last for a few years, while the payback period will span a longer time horizon.

Cement companies can also issue extra shares, availing the option of self-financing for upgrades and/ or expansion plans, and avoiding interest payments on otherwise conventional bank loans. According to industry experts, the financial life cycle of cement companies develops from being a borrower to a financial service seeker. In the latter category, the companies' behavior changes in search for how best to invest surplus cash inflows.

The Sector Outlook

By 2013, we anticipate further growth in the Saudi economy with GDP reaching an estimated SAR2,272 billion, and construction GFCF increasing to SAR209 billion. We project local per capita cement consumption to be 1,730 kg. Oil prices are likely to remain elevated for the coming year, albeit at a lower level of USD95/ bbl strengthening the demand for construction.

On the supply side, we forecast designed clinker capacity to continue at 51 million tonnes in 2012. While capacity was meant to increase by 4.5 million tonnes this year, the shortage in fuel allocation may affect output this year for both Yanbu Cement and Southern Cement. In 2013, we anticipate clinker capacity to rise to the planned 55 million tonnes. As for consumption, we estimate cement demand to rise to 49 million tonnes and 52 million tonnes in 2012 and 2013, respectively.

To validate our demand projections using CAGR, regression analysis was used to forecast on the basis of awarded contract value and the amount of domestic cement sales in value terms, which suggested comparable projections. We used regional projects tracker, MEED Projects, to examine both construction and other sector projects that have a completion date which falls in the range of 1Q 2012 and 4Q 2013. Cement usage is not constrained to use in construction projects only so encompassing all sectors will assist in benchmarking the demand for cement until 2013. Yet, this will still not account for all cement demand such as that generated by individuals building their own houses in the Kingdom.

With an estimated total of SAR472 billion worth of contracts in the Execution and EPC (bid) phases, SAR217 billion represent projects that will be completed within 2012, and SAR255 represent those that will be completed within 2013. On a Kingdom-wide scale, the Western region will command the most construction activity, accounting for an upcoming 39% of projects, followed by the Eastern region at an estimated 26%. An additional 8% of projects will be dispersed Kingdom-wide, (Table 7).

Table 7: Kingdom-wide Contract Values of Upcoming Construction Projects in the Execution and EPC (bid) Phases (SAR mn) and Market Share (%): 2012-2013

Region	Contract Value (SAR mn)	Share (%)
Western	183,701	39%
Eastern	124,084	26%
Central	98,303	21%
Southern	19,016	4%
Northern	8,715	2%
Others	38,104	8%
Total	**471,923**	**100%**

Note: Revised Budget Value (SAR mn) has been used for the EPC (bid) projects.

Source: MEED Projects

As demand from the Western region is poised to grow, existing companies will continue to compete for market share. This region, encompassing Jeddah, Mekkah and Madinah, enjoys major infrastructure projects across a number of sectors. It is the hub for both local (Red Sea) and religious tourism (Hajj pilgrimage) necessitating hospitality services. Based on MEED Projects categorization, transport infrastructure projects will command the largest share until 2013. These encompass expansionary works for King Abdulaziz International Airport, as well as developing the Haramain high-speed rail network with an awarded contract value of SAR42 billion, (Table 8).

Table 8: Western Region's Largest Construction Projects by Category (SAR mn): 2012-2013

Sector	Contract Value (SAR mn)	Share (%)
Infrastructure	62,801	55%
Construction	24,375	21%
Power	22,125	19%
Refining	5,625	5%
Total	**114,926**	**100%**

Source: MEED Projects

In the Eastern region, Saudi Aramco dominates the project market over the forecasted period, at an awarded contract value of SAR21 billion. This is followed by the aluminium project at Ras Al-Khair, which is owned by Maaden, at an estimated SAR9 billion. Of the SAR124 billion worth of awarded contracts in this area, SAR50 billion worth of projects are set to be completed by 4Q 2012.

The Central region's importance as the political and business center of the Kingdom makes it an important target for cement companies. There are currently 114 ongoing projects, the largest of which is owned by Rayadah Investment Company (RIC). Founded in 2007, RIC is the Saudi Public Pension Agency's company for investing in real estate in the Kingdom. In total, it is undertaking 14 projects in the Central region, with a total contract value of SAR27 billion.

In the Southern region, Jizan province is commanding the largest share, at 42% of total contract value. Overall, the construction category accounts for SAR7 billion of the total, with residential construction commanding the bulk, at 82% share. In the North, Prince Abdulaziz Bin Mousaed Economic City is a sizeable project. Its construction commenced in 2006, with a total outlay of SAR30 billion over ten years.

Moving forward, Qatar will prove to be an important export destination for Saudi cement firms following its award of the 2022 World Cup. It is planning on spending an estimated USD70 billion to develop the country's infrastructure. With more favorable export conditions, the Kingdom has the potential for positioning itself as Qatar's lead supplier. We do not anticipate high levels of imports over the upcoming two years.

On the back of the construction re-activation phase in the Kingdom and the narrowing of the demand-supply gap, we expect cement prices to remain elevated over the upcoming two years. Therefore, average prices are forecasted to fall in the range of SAR258-SAR284/ tonne in 2012, and SAR268-SAR290/ tonne in 2013. However, price rises will be limited due to government intervention.

Challenges

The ongoing export ban will serve to constrain growth for Saudi cement producers. In the almost four years since its introduction, neighboring and regional countries have developed their cement markets, becoming substitutes to the Saudi production. This will make it difficult for local producers to retain their high levels of exports should the export ban be removed.

Fuel shortages reported by some cement companies in recent months is an important challenge that the sector faces. According to market insights, it is new fuel allocation that is causing the delay. This has affected the start of new production lines and output, for companies like Yamama Cement, Yanbu Cement and Southern Cement. Consequently, this will put upward pressure on cement prices, due to the increased reliance on inventory, which lowers stockpile levels, and results in a non-optimal utilization of resources.

Conclusion

Saudi cement producers are likely to maintain their competitive advantage over global players in the coming two years. This is backed by sizeable government funding of physical and social infrastructure, the companies' access to subsidized fuel and limestone, and their proximity to respective markets.

By 2013, we forecast designed clinker capacity to reach 55 million tonnes, with cement consumption increasing to 53 million tonnes. We also estimate construction GFCF to increase to SAR209 billion, with a resulting increase in cement prices. These will fluctuate within the range of SAR268-SAR290/ tonne; however MOCI is likely to intervene to maintain a stable price.

The challenges faced by the Kingdom's cement sector include the conditional export ban, which limits growth opportunities within the domestic market. Additionally, fuel shortages reported by some cement companies, and ongoing unresolved discussions with Aramco regarding fuel allocation, will cause delays in clinker production, affecting supply. Consequently, the tight demand-supply balance will continue to serve as another difficulty going forward, with the eight primary players competing to protect market share from new entrants.

Despite the strong appetite and competitive pricing in funding the cement sector, the risk to Saudi banks remains in financing projects that are largely geared towards meeting transient demand.

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